UNITED STATES OF AMERICA
BEFORE FEDERAL TRADE COMMISSION

COMMISSIONERS: **Deborah Platt Majoras, Chairman**
Pamela Jones Harbour
Jon Leibowitz
William E. Kovacic
J. Thomas Rosch

In the Matter of

EQUITABLE RESOURCES, INC.,

DOMINION RESOURCES, INC.,

CONSOLIDATED NATURAL GAS COMPANY,

and

THE PEOPLES NATURAL GAS COMPANY,

Respondents.

Docket No. 9322
PUBLIC

COMPLAINT COUNSEL'S MOTION TO STRIKE
THE AFFIRMATIVE DEFENSE OF STATE ACTION

By this motion Complaint Counsel respectfully move the Commission for an order striking the First Defense of Respondent Equitable Resources, Inc. and the First Affirmative Defense of Respondents Dominion Resources, Inc., Consolidated Natural Gas Company, and The Peoples Natural Gas Company. In these affirmative defenses, Respondents assert that the Commission's enforcement action challenging the acquisition of The Peoples Natural Gas Company by Equitable Resources, Inc. as a violation of Section 7 of the Clayton Act, 15 U.S.C. § 18, and Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45, is precluded by the state action doctrine.

The grounds for this motion, as more fully set forth in the attached brief in support of this motion, is that the Commonwealth of Pennsylvania has not clearly articulated a policy to permit Respondents to effectuate an anticompetitive acquisition and will not actively supervise the post-merger anticompetitive conduct of Equitable Resources, Inc.

Complaint Counsel respectfully request oral argument on this motion.

A proposed order is attached.

Dated: 4-11-07

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In the Matter of

EQUITABLE RESOURCES, INC.

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April 11, 2007

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In the Matter of EQUITABLE RESOURCES, INC., DOMINION RESOURCES, INC., CONSOLIDATED NATURAL GAS COMPANY, and THE PEOPLES NATURAL GAS COMPANY, Respondents.	)))))))))))))))	Docket No. 9322 **PUBLIC**

BRIEF OF COMPLAINT COUNSEL
IN SUPPORT OF ITS MOTION TO STRIKE
THE AFFIRMATIVE DEFENSE OF STATE ACTION

Respondent Equitable Resources, Inc. ("Equitable") plans to acquire The Peoples Natural Gas Company from Dominion Resources, Inc. (collectively, "Dominion"). On March 15, 2007, the Federal Trade Commission filed an administrative complaint alleging that the acquisition of Dominion violates Section 5 of the Federal Trade Commission ("FTC") Act, 15 U.S.C. § 45 (2000), and Section 7 of the Clayton Act, 15 U.S.C. § 18 (2000), by eliminating competition between the only natural gas distribution companies serving certain nonresidential customers in western Pennsylvania.[1] Respondents answered on April 9, 2007, asserting, *inter alia,* that federal antitrust review of their proposed merger is barred by the state action doctrine. Complaint Counsel now move that the Commission strike Respondents' affirmative defense of state action as insufficient as a matter of law. There is no plausible set of facts under which the doctrine would be applicable in this matter.

The state action doctrine provides a narrow defense to federal antitrust review for private parties: (1) carrying out a clearly articulated and affirmatively expressed state policy that displaces competition with regulation; and (2) whose activity in carrying out that policy is actively supervised by the state itself. *California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*, 445 U.S. 97 (1980) (setting forth the two-pronged analysis for private parties claiming state action protection). The doctrine is designed to accommodate conflicting policies of the state and federal governments. It suspends federal antitrust enforcement in deference to state sovereignty in cases where the state has clearly acted to displace competition to pursue other regulatory goals.

Here, however, it is apparent on the face of the statutes that govern natural gas utility mergers in Pennsylvania that there is no such conflict between jurisdictions. State and federal laws equally value competition in utility service, and equally condemn anticompetitive mergers between utility companies. The federal government fosters competition in the Clayton Act and the FTC Act, and the Commonwealth of Pennsylvania fosters competition in the Natural Gas

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[1] If allowed, the proposed merger would end competition between Equitable and Dominion, leaving nonresidential customers in many overlap areas subject to monopoly service. This class of customers includes some of the largest institutions in the Pittsburgh area, including hospitals, schools, churches, and apartment buildings. A price rise to these customers is likely in turn to force an increase in the prices they charge to their own customers.

Choice and Competition Act of 1999, 66 Pa. C.S.A. §§ 2201-2212 (2007). This Pennsylvania law codifies the longstanding policy of the Commonwealth to safeguard competition where it exists between natural gas distributors such as Equitable and Dominion – a policy that Dominion has acknowledged in the past.[2] Far from displacing competition, the Act requires the Pennsylvania Public Utility Commission ("PUC") to examine the competitive effects of a proposed merger between natural gas distributors and explicitly prohibits the approval of any merger found to be anticompetitive. 66 Pa. C.S.A. § 2210. Moreover, the statute clearly indicates that the Pennsylvania legislature, in providing for the review of natural gas mergers, did not intend to "restrict the right of any party to pursue any other remedy available to it." 66 Pa. C.S.A. § 2210(c).

In the absence of divergent policies, and in the absence of any clear intent by the Commonwealth to displace federal merger review, there is no basis for upholding the state action defense. State and federal agencies can properly review the transaction in accordance with their own particular standards and procedures.

Not surprisingly, both Pennsylvania governmental offices that have reviewed the proposed transaction – the Attorney General's Office and the PUC – concluded that state review is not exclusive with regard to the federal antitrust laws and that the state action defense does not apply.[3] After analyzing the Natural Gas Choice and Competition Act, the Chief Counsel to the

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[2] *See* Order Denying Petition of the Office of Trial Staff for the Commencement of an Investigation of Competitive Practices Between Natural Gas Distribution Companies at 8 (Oct. 6, 2005) (Pa. P.U.C. No. P-000052160) (citing Answer of The Peoples Natural Gas Company).

[3] Letter from James A. Donahue, III, Chief Deputy Attorney General, Antitrust (continued...)

PUC concluded that the PUC's review process is not exclusive and does not pre-empt FTC review.[4] The Antitrust Section of the Commonwealth Attorney General's Office agrees with this construction of the Natural Gas Choice and Competition Act. In a letter addressing the Equitable/Dominion acquisition, the Antitrust Section concluded that the Act:

> is not the type of displacement of competition with regulation which would warrant the application of the state action doctrine. Actually, it is the opposite – the displacement of regulation with competition. Federal courts have denied the application of the state action doctrine where the relevant state policy is designed to foster competition. *County of Stanislaus v. Pacific Gas & Electric Co.*, 1994 WL 706711, 22 (E.D. Cal. 1994); *Anheuser-Busch, Inc. v. Goodman*, 745 F. Supp. 1048, 1052 (M.D. Pa. 1990). The goal of the Natural Gas Choice and Competition Act is to promote competition. 66 Pa.C.S.A. § 2204(g); § 2203(2).[5]

In sum, the Commission should strike Respondents' state action defense because Pennsylvania has neither clearly articulated, nor affirmatively expressed, a policy authorizing anticompetitive mergers between natural gas distribution companies (under *Midcal* prong one).

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3 (...continued)
Section, Commonwealth of Pennsylvania, to Bohdan R. Pankiw, Chief Counsel, Pennsylvania Public Utility Commission (Nov. 14, 2006) (hereinafter referred to as "Donahue Letter"); Letter from Bohdan R. Pankiw, Chief Counsel, Pennsylvania Public Utility Commission, to Barbara Adams, General Counsel, Commonwealth of Pennsylvania (Oct. 13, 2006) (hereinafter referred to as "Pankiw Letter").

4 The Chief Counsel, Bohdan R. Pankiw, pointed specifically to § 2210(c) of the Act, which preserves the rights to pursue "other remedies." 66 Pa.C.S.A. § 2210(c). He concluded that "[t]his language tends to undercut the view that the Commission's review of the Dominion acquisition would be exclusive." Pankiw Letter at 2. The PUC formally took a position similar to their Chief Counsel – that its review of a merger did not preclude a subsequent private (or governmental) antitrust action or create a state action defense – in its amicus brief filed in *City of Pittsburgh v. West Penn Power Co.* Amicus Brief Pennsylvania Public Utility Commission Relating to Defendants' Motions to Dismiss Complaint, *City of Pittsburgh v. West Penn Power Co.*, Civ. No. 97-1772 (W.D. Pa. Nov. 18, 1997). The court ultimately found that plaintiff lacked standing, and did not address the state action issue. *City of Pittsburgh v. West Penn Power Co.*, 993 F. Supp. 332 (W.D. Pa. 1997), *aff'd*, 147 F.3d 256 (3rd Cir. 1998).

5 Donahue Letter at 2.

But if the Commission concludes that such a policy has been clearly articulated and affirmatively expressed, it should find that Pennsylvania does not adequately supervise anticompetitive mergers between natural gas distribution companies (under *Midcal* prong two).

I. THE *PARKER* STATE ACTION DOCTRINE SHIELDS ANTICOMPETITIVE CONDUCT FROM FEDERAL ANTITRUST SCRUTINY ONLY WHEN THE CONDUCT IS IN FURTHERANCE OF A CLEARLY ARTICULATED STATE POLICY TO DISPLACE COMPETITION AND WHEN THE CONDUCT IS ACTIVELY SUPERVISED BY THE STATE

Pennsylvania's statutory scheme governing natural gas utility mergers does not meet the rigorous legal standards for state action immunity as articulated by the U.S. Supreme Court, and thus the state action defense must be denied as a matter of law.

A. The Standard of Review

The Commission may strike from any pleading any "insufficient defense." *Cf.* Fed. R. Civ. P. 12(f). A motion to strike can be a useful means of removing "unnecessary clutter" from a case, which may serve to expedite the proceedings. *See Heller Fin., Inc. v. Midwhey Powder Co., Inc.*, 883 F.2d 1286, 1294 (7th Cir. 1989). The Commission should strike an affirmative defense if the Respondents could not prove any set of facts in support of the defense that would defeat the complaint. *See Williams v. Jader Fuel Co., Inc.*, 944 F.2d 1388, 1400 (7th Cir. 1991); *Reis Robotics USA, Inc. v. Concept Industries, Inc.*, 462 F. Supp. 2d 897, 905 (N.D. Ill. 2006).[6]

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[6] The leading antitrust treatise advises that state action issues can often be disposed of on the pleadings. Phillip E. Areeda & Herbert Hovenkamp, I *Antitrust Law* ¶ 222b at 388 (2d ed. 2000):

> Briefly, state authorization is generally interpreted by an objective test that looks at the language of the authorizing statute; if other evidence is needed, it can be gleaned from legislative histories or state judicial decisions. Active supervision, when it is required, is usually examined by looking at the supervisory structure

(continued...)

For purposes of this motion, the Commission should assume that the merger of Equitable and Dominion will result in reduced competition and higher prices for natural gas distribution services. *See Electrical Inspectors, Inc. v. New York Board of Fire Underwriters*, 145 F. Supp. 2d 271, 276 (E.D.N.Y. 2001). Further, in construing the state action doctrine, the Commission should heed to the principle – affirmed by the Supreme Court – that implied exemptions from the antitrust laws are disfavored, and that the *Parker* doctrine must be construed narrowly. *Federal Trade Comm'n v. Ticor Title Ins.*, 504 U.S. 621, 636 (1992).

B. The *Parker* State Action Doctrine

The Supreme Court first articulated the state action doctrine in *Parker v. Brown*, 317 U.S. 341 (1943).[7] This case upheld California's Agricultural Prorate Act against a Sherman Act challenge, upon finding that the legislation clearly intended to restrict competition among agricultural commodities growers. The Court concluded that the Sherman Act did not bar a state, acting through its legislature, from undertaking actions that yield anticompetitive results. The Court based its holding on the recognition that, under a dual system of government, the state is "sovereign, save only as Congress may constitutionally subtract from [its] authority." *Id.* at 351. The Court could discern in the language and legislative history of the Sherman Act no intent to

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6 (...continued)
created in the relevant statutes or state administrative or judicial decisions, although occasionally inquiry will have to be made into the details of agency oversight.

7 "The state-action doctrine is sometimes referred to as 'Parker-immunity.' But as the Fifth Circuit has cautioned, states are not 'immune' from antitrust laws, but rather are exempted from them." *Capital City Cab Service, Inc. v. Susquehanna Area Regional Airport Authority*, 470 F. Supp. 2d 462, 467 n.5 (M.D. Pa. 2006) (*citing Surgical Care Ctr. of Hammond, L.C. v. Hospital Serv. Dist. No. 1*, 171 F.3d 231, 234 (5th Cir. 1999) (*en banc*)).

restrain the activities of "a state or its officers or agents" in those particular circumstances in which the subject activities were "directed by [the state] legislature."[8] *Id.* at 350-51.

The state action doctrine limits the reach of the antitrust laws, and thus safeguards the traditional role of the states in regulating local commerce in the interest of the safety, health, and well-being of local communities. *See Parker*, 317 U.S. at 362. The *Parker* decision did not determine whether or to what extent the defense would apply to the activities of private parties acting pursuant to state law, but did issue the following warning: "[A] state does not give immunity to those who violate the Sherman Act by authorizing them to violate it, or by declaring that their action is lawful." *Id.* at 351. In other words, state sovereignty notwithstanding, there are limits upon the state's authority to empower private parties to act in a manner that would otherwise contravene the federal antitrust laws.

In *Midcal*, a unanimous Supreme Court established a two-prong test to determine when anticompetitive conduct engaged in by private parties is entitled to state action immunity. First, the challenged restraint must be undertaken pursuant to a "clearly articulated and affirmatively expressed" state policy to displace competition in favor of regulation. *Midcal*, 445 U.S. at 105. Second, the anticompetitive conduct must be actively supervised by the state. *Id.*; *accord Ticor*,

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[8] The Supreme Court has determined that a state legislature or state supreme court acting in its legislative capacity is "the sovereign itself," whose conduct is exempt from liability under the Sherman Act without need for further inquiry. *Hoover v. Ronwin*, 466 U.S. 558, 567-68 (1984). In contrast, subordinate political subdivisions, including state regulatory boards, "are not beyond the reach of the antitrust laws by virtue of their status because they are not themselves sovereign." *Town of Hallie v. City of Eau Claire*, 471 U.S. 34, 38 (1985) (a municipality is not the sovereign); *see Southern Motor Carriers Rate Conference v. United States*, 471 U.S. 48, 62-63 (1985) (state Public Service Commission "acting alone" could not shield anticompetitive conduct from antitrust scrutiny); *Goldfarb v. Virginia State Bar*, 421 U.S. 773, 791-92 (1975) (state bar association, a state agency for certain purposes, was not entitled to state action exemption).

504 U.S. at 633 (1992); *South Carolina State Board of Dentistry*, FTC No. 9311, slip op. at 15 (July 30, 2004). These two requirements established in *Midcal* are examined in greater detail below.

C. The "Clear Articulation" Requirement

In applying the clear articulation standard, courts must be careful to distinguish between a legislative intent to *displace* competition, and a legislative intent to *supplement* competition. Only the former can be the basis for the state action defense. "The fact of the matter is that States regulate their economies in many ways not inconsistent with the antitrust laws," *Ticor*, 504 U.S. at 635-36, and without intending thereby to provide an antitrust immunity. *Id.* at 636-37. Proper application of the clear articulation requirement "ensures that antitrust law will not be set aside unless the state does in fact intend to displace competition." *TEC Cogeneration Inc. v. Florida Power & Light Co.*, 76 F.3d 1560, 1568 n. 22 (11th Cir. 1996).[9]

When reviewing state utility regulation, courts often discern a legislative policy to regulate monopoly power where it exists, and at the same time to safeguard competition where, as here, multiple firms operate or are capable of operating. For example, in *Cantor v. Detroit Edison Co.*, 428 U.S. 579 (1976), the state action defense was asserted by an electric utility that distributed free light bulbs to customers. The utility was pervasively regulated by the Michigan

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[9] *See also Columbia Steel Casting Co. v. Portland General Electric Co.*, 111 F.3d 1427, 1436 (9th Cir. 1996) ("The state-action doctrine cloaks anticompetitive conduct with antitrust immunity only if the state's intent to displace competition with regulation is 'clearly articulated and affirmatively expressed as state policy.'") (*quoting Midcal*, 445 U.S. at 105); Phillip E. Areeda & Herbert Hovenkamp, I *Antitrust Law* ¶ 221d at 363 (2d ed. 2000) ("Even strong regard for state policy would require antitrust immunity *only* if that were the state's wish – that is, if the state intended in some sense to displace the antitrust laws from a certain area of activity.") (emphasis in original).

Public Service Commission, and the agency authorized the utility to recover the costs of the light bulbs as part of the company's electricity rates. *Cantor*, 428 U.S. at 581. The *Parker* defense was nevertheless rejected, because the State had not affirmatively articulated a policy to displace competition with regard to the distribution of light bulbs. *Id.* at 598.

Although the legislature need not follow any particular formula in expressing its intent to displace competition, it must be clear that the state contemplates such an outcome. *See Town of Hallie*, 471 U.S. at 43. It follows that general or neutral legislative authorizing language will not be construed to grant authority to undertake anticompetitive action. *Community Communications Co., Inc. v. City of Boulder*, 455 U.S. 40 (1982). For example, state legislatures commonly authorize businesses incorporated under state law to make acquisitions; states do not thereby authorize acquisitions that unreasonably lessen competition. *See Northern Securities Co. v. United States*, 193 U.S. 197, 345-46 (1904).[10] More generally, a state's grant of ordinary corporate powers is not to be construed as authority for that entity to engage in anticompetitive

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[10] In *Northern Securities*, railroads attempting to consummate an anticompetitive merger through a holding company defended on the grounds that the holding company was not prohibited by its charter from acquiring the stock of the railroads. The Court rejected this argument, recognizing that when enacting its corporation laws and authorizing the acquisition of stock, the state did not intend to permit anticompetitive transactions:

> It is proper to say in passing that nothing in the record tends to show that the State of New Jersey had any reason to suspect that those who took advantage of its liberal incorporation laws had in view, when organizing the Securities Company, to destroy competition between two great railway carriers engaged in interstate commerce in distant States of the Union.

193 U.S. at 345.

activity. *First American Title Co. v. DeVaugh*, ___ F.3d ___, 2007-1 Trade Cas. (CCH) ¶ 75,604 (6th Cir. 2007).[11]

An intention to displace competition may be inferred only where the challenged conduct is the kind of program or action that the legislature authorized, and the suppression of competition is the foreseeable result of the legislative authorization. *Town of Hallie*, 471 U.S. at 41-44; *Yeager's Fuel v. Pennsylvania Power & Light*, 22 F.3d 1260, 1266-67 (3d Cir. 1994). In *Southern Motor Carriers*, for example, the Court considered whether the *Parker* doctrine applied to common carrier rate bureaus that engaged in collective rate-making permitted by state public service commissions. *Southern Motor Carriers*, 471 U.S. at 50. The Court found a policy to displace competition because the state statutes in question either explicitly permitted collective rate-making, *id.* at 63, or otherwise plainly contemplated an "inherently anticompetitive rate-setting process." *Id.* at 64. An anticompetitive effect is said to be "foreseeable" when it would "ordinarily or routinely" result from the authorizing legislation. *South Carolina Board of Dentists*, slip op. at 22-23.

Numerous cases have held that if the policy of the authorizing legislation does not contemplate competitive harm – if the legislation is fully consistent with antitrust principles – then a defense under the *Parker* doctrine may not be maintained.[12] And most certainly, where the

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[11] *See also* Phillip E. Areeda & Herbert Hovenkamp, I *Antitrust Law* ¶ 225b4 at 453-55 (2d ed. 2000).

[12] *See, e.g.*, *DeVaugh*, 2007-1 Trade Cas. (CCH) ¶ 75,604 (6th Cir. 2007); *Brentwood Academy v. Tennessee Secondary School Athletic Ass'n*, 442 F.3d 410, 441 (6th Cir. 2006); *Michigan Paytel Joint Venture v. City of Detroit*, 287 F.3d 527, 534 (6th Cir. 2002); *California ex rel. Lockyer v. Mirant Corp.*, 266 F.Supp. 2d 1046, 1056 (N.D. Cal. 2003) ("If the state policy does not conflict with the goal of the federal antitrust laws, there is no need to apply (continued...)

state has expressly disavowed an intention to authorize anticompetitive conduct, the state action exemption is unavailable. An explicit articulation of the state's pro-competition policy was present, for example, in *California CNG, Inc. v. Southern California Gas Co.*, 96 F.3d 1193 (9th Cir. 1996). A California utility provided commercial fleet operators with low-priced natural gas fueling stations at prices that were subsidized by utility ratepayers. State law authorized utilities to operate fueling stations at ratepayer expense, subject to certain conditions. *Id.* at 1197. Among these conditions was that the programs must not "interfere with the development of a competitive market." *Id.* at 1199. The legislation did not confer state action immunity because, given this proviso, there was no clearly articulated state policy to allow anticompetitive conduct. *Id.* at 1203.

In sum, the critical question under prong one of the state action defense is whether the sovereign itself has acted to displace competition. In order to evidence such a decision sufficiently, the state law must articulate a public policy that intrinsically departs from competitive norms. In the absence of a state policy to displace competition, the actions of a regulated private actor – even conduct that is expressly authorized by a state agency – does not constitute state action for purposes of the federal antitrust laws.

D. The "Active Supervision" Requirement

State supervision must be sufficient to ensure that a private party's anticompetitive action is shielded from antitrust liability only when "the State effectively has made [the challenged] conduct its own." *Patrick v. Burget*, 486 U.S. 94, 106 (1988).

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12 (...continued)
the doctrine at all."); *McCaw Personal Communications, Inc. v. Pacific Telesis Group*, 645 F.Supp 1166, 1172 (N.D. Cal. 1986).

> While a state may substitute its own regulatory program in place of the competitive market, principles of federalism and state sovereignty do not empower a state simply to displace the federal antitrust laws and then abandon the market at issue to the unsupervised discretion of non-governmental actors. Accordingly, to qualify for the state action exemption from the antitrust laws, a challenged restraint effectuated by such actors not only must accord with a clearly articulated state policy to displace competition, but also must be actively supervised by the state.

In the Matter of Kentucky Household Goods Carriers Ass'n, (FTC No. 9309) slip op. at 8-9; *see also Midcal*, 445 U.S. at 105.

The standard for active supervision is a rigorous one. To sufficiently supervise, "[a] state official or agency must have ascertained the relevant facts, examined the substantive merits of the private action, and assessed whether the private action comports with the underlying statutory criteria established by the state legislature in a way sufficient to establish the challenged conduct as a product of deliberate state intervention rather than private choice." *In the Matter of Kentucky Household Goods Carriers Ass'n*, slip op. at 10-11. As the Court noted in *Ticor*, "[f]or states which do choose to displace the free market with regulation, our insistence on real compliance with both parts of the *Midcal* test will serve to make clear that the state is responsible for the [anticompetitive conduct] it has sanctioned and undertaken to control." *Ticor*, 504 U.S. at 636.

When the anticompetitive conduct at issue is ongoing, so must be the supervision. "Timeliness in particular is an ongoing concern; if the private conduct is to remain in place for an extended period of time, then periodic state reviews of that private conduct using current economic data are important to ensure that the restraint remains that of the State, and not of the private actors." Analysis of Proposed Consent Order to Aid Public Comment in *Indiana Household Goods and Warehousemen, Inc.*, FTC File No. 021-0115 at 6 (2003), *available at* *http://www.ftc.gov/os/2003/03/indianahouseholdmoversanalysis.pdf.* Periodic state review of private conduct is particularly important when the private conduct is the merger of previously competing businesses. Section 7 of the Clayton Act makes unlawful anticompetitive effects whenever they arise, and liability may extend well beyond consummation. *See, e.g., United States v. E.I. du Pont de Nemours & Co.*, 353 U.S. 586 (1957) (the legality of an acquisition under Section 7 can be determined at "any time when the acquisition threatens to ripen into a prohibited effect"); *United States v. ITT Continental Baking Co.*, 420 U.S. 223, 241 (1975) (the term "acquisition" in Section 7 includes "both the purchase of rights in another company and the retention of those rights" and thus violation continues each day that the acquired assets are retained). Accordingly, the state must actively supervise the potential anticompetitive conduct of the merged firm in the post-merger environment. *See North Carolina ex rel. Edmisten v. P.I.A. Asheville*, 740 F.2d 274, 278 (4th Cir. 1984) (active supervision of a merger is not present where the state statute "in no way attempts to monitor the conduct" of the merged firm).

In its Analysis of Proposed Consent Order to Aid Public Comment in *Indiana Household Goods and Warehousemen, Inc.*, FTC File No. 021-0115 (2003), the Commission evaluated the active supervision requirement in the context of collective rate-setting by household movers in Indiana. *Id.* at 5. While recognizing that there is "no single procedural or substantive standard that the Supreme Court has held a State must adopt," the Commission identified three "specific elements of an active supervision regime that it will consider in determining whether the active supervision prong of state action is met in future cases." *Id.* These criteria are "(1) the development of an adequate factual record, including notice and opportunity to be heard; (2) a written decision on the merits; and (3) a specific assessment – both qualitative and quantitative –

of how the private action comports with the substantive standards established by the state legislature." *Id.*[13]

In sum, active supervision requires the state to examine the challenged conduct to ensure that it comports with the standards of the state's regulatory regime. Where, as in the case of a merger, the potential for anticompetitive harm is ongoing the state must provide ongoing supervision. Only then can the underlying conduct of non-governmental actors accurately be deemed conduct of the state itself that is exempt from liability under the federal antitrust laws.

II. PENNSYLVANIA HAS NOT CLEARLY ARTICULATED A POLICY AUTHORIZING NATURAL GAS DISTRIBUTION COMPANIES TO CONSUMMATE ANTICOMPETITIVE MERGERS

Respondents' state action defense relies on the premise that the Commonwealth of Pennsylvania has clearly articulated a policy authorizing natural gas distribution companies to consummate mergers that eliminate competition to the detriment of consumers. In truth, however, Pennsylvania has long pursued a policy of promoting competition between rival natural gas companies. And in truth, anticompetitive natural gas company mergers are expressly prohibited by state law.

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[13] *See also In the Matter of Kentucky Household Goods Carriers Association, Inc.*, (FTC No. 9309) (2005), in which a unanimous Commission struck down a collective rate-setting scheme adopted by an association of Kentucky movers. Although the conduct was expressly permitted under Kentucky law, and thus met the first prong of *Midcal*, the Commission found the State's supervision inadequate for a variety of reasons. Slip op. at 19-22. These included the failure of the Kentucky Transportation Cabinet to (1) develop and implement a formula or methodology for determining whether the collective rates complied with statutory standards; (2) obtain underlying cost and revenue data from which to make an assessment of the rates; and (3) employ appropriate procedural elements – such as public input, hearings, and written decisions – in making its review. *Id.* at 17-18.

Competition between the merging firms and their predecessors dates back to the original grant of overlapping charters by the state in the late 1800s. In permitting charters with overlapping territories under the Natural Gas Companies Act of 1885,[14] the state expressly rejected the concept of exclusivity, stating that "neither this act nor any other shall be so construed as to . . . give color to any claim of exclusive right . . . ."[15] The original overlapping charters remain in place, and the Pennsylvania Public Utility Commission ("PUC") has long pursued a policy of supporting this competition.[16] Dominion itself has acknowledged this policy, asserting in a recent PUC proceeding that it is and has been the Commonwealth's and the PUC's longstanding policy to approve and encourage free and open competition among natural gas distribution companies that have overlapping service territories.[17]

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14 15 P.S. § 3541 (repealed 1988) (the current Public Utility Code at 66 Pa. C.S.A. § 103(a) grandfathered the nonexclusive charter provisions granted by the Natural Gas Companies Act of 1885).

15 15 P.S. § 3542 (repealed 1988). Thus, "the 1885 act appeared to open the field of natural gas supply to free competition . . . ." *Equitable Gas Co. v. Apollo Gas Co.*, A.L.J. Initial Decision at 50-51, Nos. C-844028; C-844035, (Pa. P.U.C. Aug. 2, 1988)

16 The Public Utility Commission recently acknowledged its policy of "encouraging competition in the gas industry," noting further that:

> The result of this policy encouraging competition in the natural gas industry was the western Pennsylvania gas wars – customer/territorial disputes that erupted among gas distribution companies with contiguous service territories. Western Pennsylvania with its overlapping gas company service territories provided a perfect arena for such competition.

Pennsylvania Public Utility Commission, Report to the General Assembly on Competition in Pennsylvania's Retail Natural Gas Supply Market at 10 (Oct. 2005) (hereinafter cited as "1995 PUC Competition Report").

17 Order Denying Petition of the Office of Trial Staff for the Commencement of an (continued...)

A. The Natural Gas Choice and Competition Act Does Not Evidence a Policy to Authorize Anticompetitive Mergers

Pennsylvania's preference for effective competition between natural gas distributors was affirmed most recently in the Natural Gas Choice and Competition Act.[18] Central to the present motion, the Act prohibits anticompetitive mergers between natural gas utilities. The statute conveys this direction to the Public Utilities Commission in the following language:

> (a) General rule. – In the exercise of authority the commission otherwise may have to approve mergers or consolidations involving **natural gas distribution companies** or natural gas suppliers . . . the commission shall consider:
>
> (1) Whether the proposed merger, consolidation, acquisition or disposition is likely to result in anticompetitive or discriminatory conduct, including the unlawful exercise of market power, which will prevent **retail gas customers** from obtaining the benefits of a properly functioning and effectively competitive **retail natural gas market**.
>
> * * *
>
> (b) Procedure. – . . . If the commission finds, after hearing, that a proposed merger, consolidation, acquisition or disposition is likely to result in anticompetitive or discriminatory conduct, including the unlawful exercise of market power, which will prevent **retail gas customers** from obtaining the benefits of a properly functioning and effectively competitive **retail natural gas market**, the commission shall not approve such proposed merger, consolidation, acquisition or disposition, except upon such terms and conditions as it finds necessary to preserve the benefits of a properly functioning and effectively competitive retail natural gas market.

66 Pa. C.S.A. § 2210 (emphasis added).

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17 (...continued)
Investigation of Competitive Practices Between Natural Gas Distribution Companies at 8 (Oct. 6, 2005) (Pa. P.U.C. No. P-000052160) (citing Answer of The Peoples Natural Gas Company).

18 66 Pa. C.S.A. §§ 2201-2212 (2007).

Here then is the plain meaning of the statute: The PUC is directed to examine mergers involving "natural gas distribution companies." The PUC must evaluate whether the merger is likely to result in "anticompetitive conduct" or the "unlawful exercise of market power." And, if the PUC cannot remedy these consequences, then the PUC "shall not approve such merger."[19]

In the face of this clear legislative instruction, how can Respondents suggest that Pennsylvania policy authorizes anticompetitive mergers between natural gas distribution companies? Respondents will, we expect, ask the Commission to set aside the plain meaning of the statute, and to engage in an esoteric search for a deeper message. The argument starts with the observation that the price paid by a Pennsylvania consumer to obtain natural gas is made up of two components, the price of natural gas supply service and the price of natural gas distribution service.[20] According to Respondents, Section 2210 is concerned only with mergers that harm natural gas supply service competition. Consumers who are victimized by a merger that results in supracompetitive natural gas distribution prices are thus wholly unprotected by this statute.

Respondents' preferred reading of Section 2210 is implausible for several reasons. First, the Legislature instructs the PUC to review the competitive effects of any merger of "natural gas distribution companies." It is most reasonable to suppose that the purpose of this review is to

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[19] Subsection (a)(2) of Section 2210 directs the PUC to consider, in addition to a merger's competitive impact, its effects on the employees and the unions of the merging firms. Arguably, the PUC may block a pro-competitive merger that will harm employees. However, subsection (b) makes clear that the PUC may only approve a merger when it has no adverse competitive effects – without regard to its implications for employees.

[20] Natural gas supply refers to selling the commodity. Natural gas distribution refers to moving the commodity (*e.g.*, to the home or business of the consumer).

consider the effects of such a merger on the natural gas distribution service market, the market in which such firms are primarily active. Second, the term "natural gas supply" – the linchpin of Respondents' argument – does not appear in Section 2210. Instead, the PUC is tasked with protecting the "retail natural gas market." Respondents choose to read the phrase "retail natural gas market" as referring only to the natural gas supply services market. But the term "retail natural gas supply services" is expressly defined in the statute. Had the Pennsylvania Legislature intended that merger review under Section 2210 focus only on supply competition, it easily could have employed the defined phrase ("natural gas supply services") that lay so conveniently at hand. Its choice of a different term – the more inclusive "retail natural gas market" – provides strong evidence that the new term has a different meaning.[21]

Third, and most critically, the protected category of consumers for purposes of Section 2210, the group that is assured of a competitive marketplace, is "retail gas customers." The term "retail gas customer" is defined in Section 2202 of the Natural Gas Choice and Competition Act to mean a "direct purchaser of natural gas supply services *or* natural gas distribution services . . . ."[22] Therefore, in connection with either service – gas supply or gas distribution – anticompetitive mergers are proscribed.

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21 *See Smith v. Pennsylvania DOT*, 740 A.2d 284, 286 (Pa. Commwlth. 1999) (court deemed it important that one statutory section used the general term "person" rather than the more limited term "driver" that was defined earlier in the act); *see also Pietrafesa v. First American Real Estate Information Services*, 2007 U.S. Dist. LEXIS 15785, 18-19 (N.D.N.Y. 2007) (where the term "consumer" is defined in the statute, the use of a different term signifies that a different meaning is intended).

22 66 Pa. C.S.A. § 2202 (emphasis added).

Note that under Respondents' interpretation of the statute, the "retail natural gas market" will consist of consumers of supply services and consumers of distribution services, but sellers of supply services only. This makes no economic sense and no practical sense. There is no reason to conclude that this is what the Legislature intended.[23]

"It is well settled that when the language of a statute is clear and unambiguous, the statute must be interpreted in accordance with its plain and common usage." *Commonwealth v. Burnsworth*, 543 Pa. 18, 24, 669 A.2d 883, 886 (Pa. 1995). Moreover, where the legislature uses different terminology in different parts of a statute, such as referring to an "effectively competitive retail natural gas market" in Section 2210, while referring to "effective competition for natural gas supply services" in Section 2204(g), it provides strong evidence that each term is intended to have a different meaning. *See* 66 Pa.C.S. § 2204(g); 1 Pa.C.S. § 1921(a); *Pantuso Motors, Inc. v. CoreStates Bank, N.A.*, 568 Pa. 601, 608, 798 A.2d 1277, 1282 (Pa. 2002) ("Whenever possible, statutes must be constructed so as to give effect to every word.").[24] The tenet that different words convey different meanings is especially significant where the legislature fails to employ a defined term, such as "natural gas supply services," in a particular section of a statute.

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[23] There is no real mystery in the term "retail natural gas market." This is the market that serves "retail gas customers." "Retail gas customers" purchase services from both "natural gas suppliers" and "natural gas distribution companies." A natural gas merger is therefore prohibited if it has an anticompetitive effect in the provision of either supply services or distribution services. This plain reading of Section 2210 entails none of the anomalies that arise in connection with the tendentious interpretation favored by Respondents.

[24] *See also Hey v. Springfield Water Co.*, 207 Pa. 38, 56 A. 265 (1903) (court deemed it a "very significant fact" that the legislature intended rights in the first paragraph of a statute to be exercised only by corporations "now in existence," whereas the next paragraph omitted the restrictive words and gave different powers to "any corporation").

In the Initial Decision in this case, the PUC's Administrative Law Judge ("ALJ") properly treated Section 2210 as central to his analysis of the merger – and read it to require an assessment of the effects of the proposed merger upon distribution competition. The ALJ recited the provisions of Section 2210 at the start of the opinion along with the other relevant legal standards for decision,[25] and again when substantively evaluating the transaction: "When evaluating the consolidation of two natural gas distribution companies, the Commission must consider whether the proposed consolidation is likely to result in anticompetitive or discriminatory conduct, which will prevent retail gas customers from obtaining the benefits of a properly functioning and effectively competitive retail natural gas market. 66 Pa. C.S. § 2210."[26] The ALJ then proceeded under this standard to consider how the merger would affect, not just supply competition, but also "gas-on-gas" distribution competition.[27] Although Complaint Counsel disagree with the ALJ's conclusions concerning the competitive effects of this merger, for purposes of the present motion it is important that the ALJ recognized that the Section 2210 standard is applicable to competition for *distribution*, and carried out his analysis accordingly.

In sum, the Pennsylvania Legislature, in enacting Section 2210, contemplated and intended that only pro-competitive natural gas utility mergers would be permitted. As discussed above, this explicit articulation of the Legislature's pro-competition policy defeats the state action defense. *See California CNG*, 96 F.3d 1193 (where private parties act pursuant to a state

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25 *In re Equitable Resources, Inc.*, No. A-122250F5000 at 19 (Pa. P.U.C. Feb. 5, 2007).

26 *Id.* at 67.

27 *Id.* at 66-68.

policy authorizing only pro-competitive conduct, the state action defense is not available); *Surgical Care Center of Hammond*, 171 F.3d at 235 (state statute authorizing a public hospital to form joint ventures so as to compete "equally" with private hospitals does not authorize anticompetitive joint ventures); *United States v. Title Ins. Rating Bureau*, 700 F.2d 1247, 1253 (9th Cir. 1983) (no intent to displace competition where authorizing statute provides: "Nothing in this article is intended to prohibit or discourage reasonable competition . . ."); *Reazin v. Blue Cross & Blue Shield of Kansas*, 663 F. Supp. 1360, 1419 (D. Kan. 1987) (no intent to displace competition where authorizing statute provides: "Nothing in the . . . act is intended to prohibit or discourage reasonable competition . . .").

B. Pennsylvania's Certificate of Public Convenience Requirement Does Not Evidence a Policy to Authorize Anticompetitive Mergers

While the Natural Gas Choice and Competition Act by itself demonstrates that Pennsylvania has not clearly articulated a policy authorizing anticompetitive mergers of natural gas distribution companies, the same conclusion emerges from Pennsylvania's general statutes governing utility mergers. The Commonwealth's Public Utility Code permits the merger of natural gas distribution companies, but subject to conditions that include prior approval by the PUC.[28] There is nothing "inherently anticompetitive" about empowering a state agency to review

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[28] 66 Pa. C.S.A. § 1102 of the Public Utility Code provides in pertinent part:

§ 1102. Enumeration of acts requiring certificate

(a) General rule – Upon the application of any public utility and the approval of such application by the commission, evidenced by its certificate of public convenience first had and obtained, *and upon compliance with existing laws*, it shall be lawful:

(continued...)

mergers.[29] The mere fact that a state regulatory agency has authority to review and approve private conduct is not sufficient to preclude federal antitrust review. For example, in *Cantor*, the Supreme Court concluded that the utility's free light bulb policy, although approved by the state regulator, was subject to antitrust scrutiny. 428 U.S. at 598. In *Glaberson v. Comcast Corp.*, 2006 Trade Cas. (CCH) ¶ 75,531 (E.D. Pa. 2006), the district court concluded that a transaction that had been "approved by government authorities at the federal, state, and local levels" was subject to antitrust scrutiny. These are two of several cases that reject the state action defense even though the challenged conduct has been approved by a state agency.[30] If, as Respondents claim, there is a Pennsylvania policy to displace competition, it cannot be found in the mere existence of a procedure for agency review of mergers. It must instead be located in the substantive conditions that the Legislature has established before that merger may proceed.

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28 (...continued)

* * *

> (3) For any public utility or affiliated interest of a public utility . . . to acquire from, or transfer to, any person or corporation . . . by any method or device whatsoever, including the sale or transfer of stock, and including a consolidation, merger, sale or lease, the title to, or the possession or use of, any tangible or intangible property used or useful in the public service.

66 Pa. C.S.A. §1102(3) (emphasis added).

29 *Cf. Southern Motor Carriers*, 471 U.S. at 64 (rate setting by administrative agency is "inherently anticompetitive").

30 *See also Phonetele, Inc. v. AT&T*, 664 F.2d 716 (9th Cir. 1981); *United States v. Rochester Gas & Electric Corp.*, 4 F. Supp. 2d 172, 176 (W.D.N.Y. 1998); *Yeager's Fuel, Inc. v. Pennsylvania Power & Light Co.*, 1995-1 Trade Cas. (CCH) ¶ 71,034 (E.D. Pa. 1995); *AT&T v. IMR Capital Corp.*, 888 F. Supp. 221, 239 n. 9 (D. Mass. 1995); *United States v. Pacific Southwest Airlines*, 358 F. Supp. 1224, 1230 (C.D. Cal. 1973).

Section 1102 of the Public Utility Code specifies two prerequisites for the merger of natural gas distribution companies and other utilities. First, the parties must obtain from the PUC a Certificate of Public Convenience ("CPC"); this is the agency review mechanism referenced above. Second, the parties must otherwise comply with existing law.[31] In substance then, PUC review is one screen deliberately layered atop all other legal requirements relevant to a prospective utility merger, *e.g.*, tax law, securities law, environmental law.[32] Among the legal requirements applicable to a proposed merger – and left undisturbed by Section 1102 – is compliance with federal antitrust law as well as Pennsylvania's common law of antitrust. *In re Rodriguez*, 587 Pa. 408, 414-15, 900 A.2d 341, 345 (2003) (When interpreting state statutes, "we must assume that the General Assembly understands the legal landscape upon which it toils, and

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[31] This principle actually appears in two places in the Public Utility Code. First, as quoted above, Section 1102(a) specifies that compliance with existing laws is a prerequisite to a lawful merger. In addition, Section 103 of the Public Utilities Act provides generally for the continuation of existing law. *See* 66 Pa. C.S.A. § 103(a) ("Except as otherwise specifically provided in this part, it is the intention of this part to continue existing law."). Section 103(c) further provides that remedies shall be cumulative. *See* 66 Pa. C.S.A. § 103(c) ("Except as otherwise provided in this part, nothing in this part shall abridge or alter the existing rights of action or remedies in equity or under common or statutory law of this Commonwealth, and the provisions of this part shall be cumulative and in addition to such rights of action and remedies.").

[32] *Cf. Joint Application for Approval of the Merger of GPS, Inc. with First Energy Corp.*, Pennsylvania Public Utility Commission, 2001 Pa. PUC LEXIS 22 *33 (April 23, 2001) (this transaction is subject to shareholder approval, approval of the companies' registration statements and proxy by the Securities and Exchange Commission, Federal Energy Regulatory Commission approval, FTC/Department of Justice determination of compliance with the Hart-Scott-Rodino Antitrust Improvements Act, Federal Communications Commission approval of license transfers, Nuclear Regulatory Commission approval of the merger, and New York State Public Service Commission approval of the merger).

we, therefore, expect the General Assembly to state clearly any intent to redesign that landscape.").[33]

The courts of Pennsylvania have long recognized that agreements in restraint of trade are unlawful. *Collins v. Main Line Board of Realtors*, 452 Pa. 342, 304 A.2d 493 (1973) (collecting cases). In *Collins*, the Pennsylvania Supreme Court held that Pennsylvania's common law doctrine governing restraints of trade should be interpreted in accord with Section 1 of the Sherman Act. 452 Pa. at 349, 304 A.2d at 496.[34] A merger that is likely to harm competition is an unreasonable restraint of trade within the meaning of Section 1, and accordingly a violation of Pennsylvania law as well. *See, e.g., United States v. First National Bank & Trust Co. of Lexington*, 376 U.S. 665 (1964); *United States v. Rockford Memorial Corp.*, 898 F.2d 1278, 1281 (7th Cir. 1990) ("We doubt whether there is a substantive difference today between the standard for judging the lawfulness of a merger challenged under Section 1 of the Sherman Act and the standard for judging the same merger challenged under Section 7 of the Clayton Act.").

Given that Sections 1102 and 1103 do not pre-empt state antitrust law, it follows that there is no state authorization to displace competition in connection with the merger of natural

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[33] *See also March v. Philadelphia & West Chester Traction Co.*, 285 Pa. 413, 415 (1926) ("We have repeatedly said, and it is especially applicable in the instant case, that a statute should be so interpreted that 'it will accord, as nearly as may be, with the theretofore existing course of the common law.'"); *Todora v. Jones & Laughlin Steel Corp.*, 304 Pa. Super. 213, 219-20, 450 A.2d 647, 650 (1982) ("Our Supreme Court has held that in the absence of an express declaration, the law presumes that a statute is not intended to change the common law."), *aff'd*, 356 Pa. 349, 52 A.2d 205 (1947).

[34] *See also Huberman v. Warminster Township*, 1981 Pa. D. & C. 3d 312, 1981 Pa. Dist. & Cnty. Dec. LEXIS 511 (C. P. Bucks County 1981) (Sherman Act embodies Pennsylvania's common law doctrine concerning restraints of trade).

gas distribution companies. The applicability of Pennsylvania antitrust law to utility mergers defeats Respondents' state action defense.[35]

Even if one focuses solely on the requirements for issuance of a CPC, here too there is no clear articulation of a state policy to displace competition in the merger context. Pursuant to Section 1103(a), the application for a CPC may be granted by the PUC only if it finds or determines "that the granting of such certificate is necessary or proper for the service, accommodation, convenience, or safety of the public." 66 Pa. C.S.A. § 1103(a).[36] None of these conditions is incompatible with the preservation of effective competition. The legislative policy reflected in these particular statutory provisions is therefore neutral on the question of whether utilities are permitted to consummate anticompetitive mergers. This policy of neutrality is an insufficient basis for the state action defense. *Cf. City of Boulder*, 455 U.S. at 55-56; *Lockyer*, 266 F. Supp. 2d at 1056 ("If the state policy does not conflict with the goal of the federal antitrust laws, there is no need to apply the [state action] doctrine at all.").

On this issue, the closest precedent is *McCaw Personal Communications*, 645 F. Supp. 1166. Plaintiff alleged that the merger of Pacific Telesis and Communications Industries would lessen competition in the electronic paging market in violation of Section 7 of the Clayton Act.

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[35] When a state's antitrust laws are applicable to the challenged conduct, it follows that a state policy to displace competition is not present, and that the *Parker* defense must be rejected. *See Cedarhurst Air Charter, Inc. v. Waukesha County*, 110 F. Supp. 2d 891, 893-94 (E.D. Wisc. 2000); *Ehlinger & Assoc. v. Louisiana Architects Ass'n*, 989 F. Supp. 775, 785-86 (E.D. La. 1998), *aff'd*, 167 F.3d 537 (5th Cir. 1998); *United States v. Title Ins. Rating Bureau*, 517 F. Supp. 1053, 1059 (D. Az. 1981), *aff'd*, 700 F.2d 1247 (9th Cir. 1983).

[36] The Supreme Court of Pennsylvania has held that the proponent of a merger has the burden to show that the merger will affirmatively promote the public interest. *City of York v. Pennsylvania Public Utility Commission*, 449 Pa. 136, 141, 295 A.2d 825, 828 (1972).

645 F. Supp. at 1168. The California Public Utilities Commission had previously reviewed the acquisition, and upon finding that the transaction was in the public interest, permitted the transaction to go forward. *Id.* at 1171. The merging parties asserted that the merger was now immune from antitrust review per the state action doctrine. *Id.* at 1172. The court rejected this defense, explaining that PUC review under a public interest standard does not evidence the state's intent to displace competition with regulation:

> Pacific has made no showing that the State of California, through the PUC's review of acquisitions in the telecommunications field, intends to displace competition. Rather, given the antitrust component of the public interest standard applied by the PUC, it appears that California's intention was to foster competition rather than displace it. The state has not determined as a matter of policy that the conduct challenged by [plaintiff] – the acquisition of a competitor – is to be insulated from competition or competitive concerns. To the extent the State as sovereign has expressed an opinion at all, it is merely to assure that such acquisitions are in the public interest. Thus, the clear intention to authorize anticompetitive activity that existed in *Southern Motor Carriers* simply is not present here. Pacific's claim of state action immunity thus does not meet the first prong of the *Midcal* test . . .

Id.

As the Pennsylvania Public Utility Code does not itself evidence a policy to displace competition, Respondents may examine how the PUC has actually interpreted and implemented its authority to review utility mergers. If one is searching for a policy to displace competition, this too is a dry hole. As part of its assessment of whether a proposed merger is in the public interest, the PUC considers the likely effect of the transaction upon competition (similar to the test applied in *McCaw).*[37] The PUC has never asserted that it has the authority to approve an

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[37] *See, e.g.*, *Joint Application of PECO Energy Co. And Public Service Electric and Gas Co. for Approval of the Merger of Public Service Enterprise Group, Inc. with and into Exelon Corp.*, 2006 Pa. PUC LEXIS 2 (Feb. 1, 2006); *Joint Application of Bell Atlantic Corp.* (continued...)

anticompetitive merger. And as best we can determine, the PUC has never approved a merger that it judged to be anticompetitive. In this regard, Section 2210 (discussed in the previous section) may be viewed as a codification of long-standing state policy to preclude anticompetitive mergers involving natural gas utilities.

C. State Regulation of Natural Gas Distribution Companies Does Not Evidence a Policy to Authorize Anticompetitive Mergers

We anticipate that Respondents will claim that Pennsylvania regulation of the natural gas distribution industry forecloses application of the federal antitrust laws. This argument is inconsistent with the policy underlying the state action doctrine, as well as the state action case law, and should be rejected. As the Supreme Court observed in another context: "Even when an industry is regulated substantially, this does not necessarily evidence an intent to repeal the antitrust laws with respect to every action taken within the industry." *National Gerimedical Hosp. & Gerontology Center v. Blue Cross of Kansas City*, 452 U.S. 378, 389 (1981).

In applying the clear articulation prong of the *Midcal* test, courts ask whether the specific restraint that is challenged by the plaintiff (here, an anticompetitive merger) has been clearly articulated and affirmatively authorized as state policy. In this way, the court gauges whether it is the state's intent to permit the conduct at issue in the case. It is not sufficient to show that the state has determined to displace competition in some other aspects of Respondents' business. To the contrary, Respondents must show that the state intended to permit anticompetitive mergers, for it is the state's prerogative to determine which "discrete parts of the economy" should be

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[37] (...continued)
and GTE Corp. for Approval of Agreement and Plan of Merger, 1999 Pa. PUC LEXIS 86 (Nov. 4, 1999).

subject to antitrust enforcement, and which should be subject to regulation in lieu of competition. *See Ticor*, 504 U.S. at 632-33. The Commonwealth of Pennsylvania may choose to displace competition with regard to some conduct by regulated entities, but not other conduct by the same entities. *Patrick v. Burget*, 486 U.S. at 101 ("the state-action doctrine will shelter only the particular anticompetitive acts of private parties that, in the judgment of the State, actually further state regulatory policies"); *Cantor*, 428 U.S. at 594-95 n. 31. Stated differently, the state may impose an extensive regime of regulation upon utilities without thereby forfeiting the protection against anticompetitive mergers that is afforded by the federal antitrust laws.

Even if we assume pervasive state regulation in this instance, we know of no case in which the Supreme Court upheld the state action defense solely on those grounds. In *Cantor*, previously discussed, the Supreme Court declined to uphold the state action defense in connection with an electric utility's distribution of free light bulbs, despite the state's pervasive regulation of the defendant. The Court explained: "There is no logical inconsistency between requiring [a public utility] to meet regulatory criteria insofar as it is exercising its natural monopoly powers and also to comply with antitrust standards to the extent that it engages in business activity in competitive areas of the economy." 428 U.S. at 595-96. The very same analysis applies here. There is no inconsistency between a broad policy of rate regulation and at the same time maintaining competition (prohibiting anticompetitive mergers) where multiple suppliers exist.

Numerous lower courts have similarly rejected the pervasive regulation argument. For example, *Yeager's Fuel* involved a dispute between fuel oil dealers (plaintiffs) and an electric utility (defendant) over who would supply heat to Pennsylvania homeowners. 22 F.3d at 1263.

Plaintiffs alleged that the electric utility employed various marketing practices that violated the federal antitrust laws: (i) offering consumers a special rate for installation of high-efficiency electric heating systems; (ii) offering developers cash grants and other incentives for each new home in which an electric heat pump was installed; and (iii) in some cases, conditioning the availability of incentive offers upon the developer agreeing that the entire development will consist of only electrically heated units. *Id.* The electric utility was regulated by the state in a manner no less pervasive than the gas distribution company litigants here. Still, the Third Circuit did not award the electric utility blanket immunity from antitrust liability. Instead, each of the challenged practices was evaluated separately by the court – in each instance, looking for state authorization to engage in the challenged practice and foreseeable competitive harm in connection with that authorization, despite the pervasive regulatory scheme. The state action defense was upheld as to marketing practices (i) and (ii). *Id.* at 1273. Marketing practice (iii), the "all-electric development agreements," was unrelated to any statutory policy and therefore subject to antitrust scrutiny. *Id.* at 1270.[38]

If the pervasive regulation argument had merit, then there would be no federal antitrust enforcement in utility industries, or for other companies that are extensively regulated by the states. The reality is quite the opposite. Allegations that regulated utilities have acted to

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[38] *See Yeager's Fuel v. Pennsylvania Power & Light Co.*, 1995-1 Trade Cas. (CCH) ¶ 71,034, 1995 U.S. Dist. LEXIS 7972 at *2 n.2 (E.D. Pa. 1995). Following remand from the Third Circuit, plaintiff filed an Amended Complaint asserting a new and fourth claim. Again, pervasive regulation was not sufficient to establish a state action defense. The court focused on the specific marketing practice being challenged, and concluded that the practice was not authorized by a clear and affirmative policy to displace competition. *Id.* at *4-17. *See also Susquehanna Area Regional Airport Authority*, 470 F. Supp. 2d 462, 2006 U.S. Dist. LEXIS 85555 at *23 ("The Third Circuit has been careful to avoid equating broad delegations of power with foreseeability of anticompetitive conduct in the state-action doctrine context.").

eliminate competition or exclude competitors are subject to antitrust review when the specific conduct challenged by the plaintiff is not sufficiently authorized by the state. *E.g.*, *Columbia Steel Casting Co.*, 111 F.3d at 1437 ("the state did not approve the displacement of competition with territorial monopolies in the Portland market with the clarity required by *Midcal*"); *Consolidated Gas Co. v. City Gas Co.*, 880 F.2d 297, 300 (11th Cir. 1989) ("The mere fact that City Gas is regulated does not automatically exempt it from compliance with federal antitrust provisions."), *on reh'g en banc*, 912 F.2d 1262 (11th Cir. 1990), *vacated and remanded*, 499 U.S. 915 (1991), *on remand*, 931 F.2d 710 (11th Cir. 1991); *Phonetele, Inc.*, 664 F.2d 716; *Rochester Gas*, 4 F. Supp. 2d 172; *IMR Capital Corp.*, 888 F. Supp. 221 ("There is, therefore, nothing about the mere fact that a public utility is regulated by a state to suggest that the state has a policy of encouraging any particular anti-competitive practices by the utility, or of discouraging competition at all, as required by the first element of the *Midcal* test."); *AT&T v. North American Industries of NY, Inc.*, 783 F. Supp. 810 (S.D.N.Y. 1992) (rejecting pervasive regulation argument).

In sum, pervasive regulation does not constitute, and is not a substitute for, a clearly articulated state policy that authorizes anticompetitive mergers.

III. THE STATE REGULATORY SCHEME, AS CARRIED OUT BY THE PUC, IS INSUFFICIENT TO ACTIVELY SUPERVISE THE POTENTIAL ANTICOMPETITIVE CONDUCT OF THE MERGED FIRM

As set forth above, where private parties seek to claim state action immunity they must show that their allegedly anticompetitive conduct not only is authorized by a clearly articulated and affirmatively expressed state policy, but also that it is "actively supervised by the state itself." *Midcal*, 445 U.S. at 105. Accordingly, even if Pennsylvania somehow were found to have clearly articulated a policy displacing competition in favor of regulation with regard to mergers between natural gas companies, Respondents still must show that the state will actively supervise their conduct before immunity can be granted. Under *Midcal* and its progeny, however, the existing state scheme is insufficient to provide adequate active supervision over the conduct of the merged firm.

A. Where States Allow For the Displacement of Existing Competition Through Private Action, Courts Require Stringent Supervision Over Potentially Anticompetitive Conduct

When existing competition is eliminated as a direct result of private actions that carry out a purported state policy, courts require ongoing state oversight to meet the active supervision test. For example, in *P.I.A. Asheville,* the issuance of a Certificate of Need ("CON") approving a merger of psychiatric hospitals under state law was insufficient to afford immunity where the state did not "monitor the use of the acquisition." 740 F.2d at 278. Even where some state oversight is provided, courts require that it amount to comprehensive, ongoing involvement to be sufficient. Thus, in *New York v. Saint Francis Hospital*, 94 F. Supp. 2d 399 (S.D.N.Y. 2000), two hospitals were denied state action immunity for the formation of a potentially anticompetitive joint venture, even though some aspects were reviewed and approved in the course of CON applications.

> The [Department of Health's] approval of the Mid-Hudson establishment CON and [its] failure to object to the 'trades' and the 'Fairness Formula' does not constitute the kind of 'comprehensive, ongoing involvement' that justifies antitrust immunity. The 'active supervision' prong requires that the State 'exercise ultimate control over the challenged anticompetitive conduct.' The mere presence of some state involvement or monitoring does not suffice. Defendants fail to point to any continuing state involvement in their allocation of health care services after the Mid-Hudson establishment CON was approved. . . . Defendants further admit that the State has not reviewed its joint negotiations with third-party payers.

94 F. Supp. 2d at 410 (citations omitted).[39]

Even where the state itself creates monopoly power by granting exclusive contracts it must closely oversee the conduct of the monopolist. In *Electrical Inspectors v. Village of East Hills*, 320 F.3d 110 (2d Cir. 2002), the Second Circuit reviewed active supervision in the context of a grant of exclusive rights to one firm to conduct government-required electrical inspection services within a municipality. Addressing the requirement, the Court noted that the "Village 'may not confer antitrust immunity' – including immunity from such charges of monopolization – 'on private persons by fiat.' Unless the Village maintains 'ultimate control' over the monopoly it created, 'there is a real danger that [the defendant] is acting to further [its] 'own interests, rather than the governmental interests of the State.'" *Id.* at 127 (citations omitted). With regard to allegations that the defendant had engaged in "poor service and retaliatory threats" pursuant to its state-authorized exclusive position, the Court remanded the case for further consideration of the active supervision issues. *Id.* at 128. The Court noted, however, that "the Village's mere 'negative option' to replace the [firm] at any time is alone likely inadequate supervision." *Id.* (citations omitted).[40]

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[39] *See also Consolidated Gas Co. of Florida v. City Gas Co. of Florida*, 665 F. Supp. 1493 (S.D. Fla. 1987) (state did not sufficiently supervise territorial allocation where review was undertaken "after a hearing, *only* when someone complains to [the state] or petitions for review of the agreement"), *aff'd*, 880 F.2d 297 (11th Cir. 1989), *on reh'g en banc*, 912 F.2d 1262 (11th Cir. 1990), *vacated and remanded*, 499 U.S. 915 (1991), *on remand*, 931 F.2d 710 (11th Cir. 1991). Because there was "no evidence that the FPSC has established any standards for the creation of territorial agreements or that territorial agreements are reviewed on a regular basis in the absence of a petition by a party or utility customer for reconsideration," the court found that the second prong of *Midcal* had not been met. *Id.* at 1532.

[40] In *Englert v. City of McKeesport*, 637 F. Supp. 930 (W.D. Pa. 1986), the Western District of Pennsylvania found insufficient supervision in a similar grant by a municipality of
(continued...)

At a minimum, active supervision in this case would require *regular review* not only of the pricing of the merged firm, but also of other practices that may result in competitive harm in order to ensure that they comport with the state's policies. *Midcal*, 445 U.S. at 106 (state officials must engage in a "pointed reexamination" of private conduct). In addition, it requires that the state be able to eliminate practices of which it disapproves. *Patrick v. Burget*, 486 U.S. at 101 ("state officials [must] have and exercise power to review particular anticompetitive acts of private parties and *disapprove those that fail to accord with state policy*") (emphasis added). Because Pennsylvania will not adequately supervise the conduct of the merged entity, the state action defense cannot apply.

B. The Prevailing Legislative Scheme and Merger Settlement Proposal Are Insufficient to Provide Adequate State Supervision Over the Monopoly That Would Be Created

Pennsylvania's regulatory scheme is insufficient to provide the level of active supervision required under *Midcal*. The cases discussed in sections III.A. and I.D. above require that the state "have and exercise ultimate authority" over the challenged anticompetitive conduct. *Patrick v. Burget*, 486 U.S. at 106 (*quoting Southern Motor Carriers*, 471 U.S. at 51). When that conduct is a merger, the supervision required is over the potentially anticompetitive conduct of the merged firm. While the PUC will continue to regulate Equitable in the post-merger world as it does other natural gas distribution companies, including approving maximum rates to be charged and providing for the adjudication of certain customer disputes/complaints, there are

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[40] (...continued)
exclusive rights to perform electrical inspections, even though the city exercised control over standards, methods and/or practices employed by the private company in its inspections but maintained no control over the private party's fees. *Id.* at 933.

myriad means by which the merger could lead to the exercise of market power that would remain unsupervised, or under-supervised, by the state. For example, the merger may well lead to the elimination of discounting, service declines, or the discontinuation of contractual terms favorable to consumers, all outside the scope of normal PUC regulation. Consumers may in this way be harmed by conduct that hardly would seem to accord with any state policy, but that would appear to be beyond the current scope of the state oversight.

Title 52 of the Pennsylvania Code, 52 Pa. Code § 1.1 *et seq.* (2007), sets forth general terms of regulation for public utilities, and describes the standards and procedures to be followed by natural gas companies in conducting a variety of activities, such as filing tariffs, reporting service interruptions, investigating customer complaints, and the like. While these general regulations cover a wide swath of utility activity, they are far from comprehensive in terms of governing the potential anticompetitive effects of the proposed merger.

For example, distribution contracts typically contain an array of non-regulated or only partially-regulated terms, including discounted rates, contract length, and service requirements. Competition between Equitable and Dominion in these respects has resulted in better terms for customers. These improvements have occurred despite regulations that would allow for less. In some instances, the new terms improve upon regulation (such as when rates below the maximum tariff rate are negotiated or firms compete to develop service reputations). At other times, they bring benefits entirely outside the scope of regulation (such as when a utility offers a long-term contract, or makes performance guarantees in order to win a commercial account).

Post-merger, both kinds of benefits may be eliminated. Recognizing that the legislative scheme of supervision would be insufficient to protect against even the most obvious anticompetitive effects (imposition of higher rates, degradation of service) a number of objectors entered into short-term settlements with the merging parties in an attempt to mitigate potential competitive harm. As part of proposed settlement agreements before the PUC, the merging parties have agreed not to seek higher rate tariffs before January 1, 2009, and have committed to maintain service quality (at least in the short-term) through the imposition of a Service Quality Index ("SQI") that sets goals for service performance in seven categories. Although these settlement terms impose greater obligations than state regulations, they are temporary in nature, expiring at the companies' next base rate proceeding. *See Equitable Resources, Inc.*, No. A-122250F5000 at 69-72. Thus, there is no mechanism to ensure that the merged entity will remain committed to these higher levels of service. In short, the merged firm may be able to exploit its market power in numerous ways that are not actively supervised by the state.

IV. PUC APPROVAL OF THE PROPOSED MERGER DOES NOT PRE-EMPT FEDERAL JURISDICTION

Respondents may assert that even if the requirements of the state action defense are not established, PUC review and approval of the proposed merger still precludes the FTC from bringing a cause of action under Section 7 of the Clayton Act. The claim is that Pennsylvania law somehow pre-empts the federal antitrust laws, and that the PUC's jurisdiction over the proposed transaction is exclusive. As detailed below, this argument is without merit.

Under the Supremacy Clause contained in Article VI of the Constitution, when a state law conflicts with the federal law, or where the state law "stands as an obstacle" to the accomplishment of Congress' full objectives, it is the state law that is pre-empted. *Silkwood v.*

Kerr-McGee Corp., 464 U.S. 238, 248 (1984). Conversely, it is a "truism that States may not pre-empt federal law." *Adams Fruit Co., Inc. v. Barrett*, 494 U.S. 638, 649 (1990).[41]

Of course, a federal statute may provide for reverse pre-emption, in whole or in part. *See Genord v. Blue Cross & Blue Shield of Michigan*, 440 F.3d 802 (6th Cir. 2006) (discussing state law pre-emption of the federal antitrust laws as applied to the insurance industry, as expressly authorized by the McCarran Ferguson Act). But in the case of state-regulated utilities, Congress has not authorized states to pre-empt federal antitrust review, except as provided by the state action doctrine. Congress has <u>not</u> authorized states simply to displace the federal antitrust laws, so as to leave a state agency as the final and exclusive arbiter of whether or not a transaction is anticompetitive.

Recognizing the narrow scope of the state action doctrine, and consistent with the requirements of the Supremacy Clause, numerous courts have held that the mere fact that a state regulatory agency has reviewed and approved private conduct is not sufficient to preclude federal antitrust review.[42]

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[41] In *Adams Fruit*, the Supreme Court considered whether an exclusive remedy provision in the Florida workers' compensation law precluded migrant workers from invoking a private right of action under a federal law whose coverage overlapped with that of the state law. The Supreme Court expressly rejected the "reverse preemption principle," explaining that states are not empowered to withdraw federal remedies by establishing state remedies as exclusive. Instead, the general rule is that "Federal legislation applies in all States, and in cases of conflict between federal law and the policies purportedly underlying some state regulatory schemes, the scope of federal law is not curtailed." *Id.* at 648. *See also United States v. Murphy*, 96 F.3d 846, 848 (6th Cir. 1996) ("Quite simply, there is no conceivable constitutional basis for invalidating federal legislation on the ground that the conduct criminalized is also criminalized by state legislation. Such a proposition is extraordinary, and, we think, meritless.").

[42] *See Cantor*, 428 U.S. 579 (state agency approval of light bulb exchange program did not foreclose federal antitrust review); *Phonetele,* 664 F.2d 716*;* *Glaberson*, 2006-2 Trade
(continued...)

At a bare minimum, before the Commission even considers deferring to PUC review of the proposed merger of Equitable and Dominion Peoples, it should examine carefully the following question: Did the Commonwealth of Pennsylvania intend that the PUC's jurisdiction should be exclusive? The answer is clearly "No." Section 2210 of the Natural Gas Choice and Competition Act, in addition to directing the PUC to disapprove an anticompetitive merger of natural gas distribution companies, instructs that: "Nothing in this section shall restrict the right of any party to pursue any other remedy available to it." This is a clear signal that the state legislature did not conceive of the PUC as the exclusive arbiter of the permissibility of a proposed merger of natural gas distribution companies. The statute contemplates that the Pennsylvania Attorney General may challenge this merger under state antitrust law. A private party that is injured by the merger may pursue state and federal remedies. And of course the Federal Trade Commission is free to exercise its Congressionally mandated authority under the Clayton Act.[43]

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[42] (...continued)
Cas. (CCH) ¶ 75,531; *Lockyer*, 266 F. Supp. 2d at 1056 (upholding antitrust challenge to acquisition approved by state PUC because state policy was not to foster anticompetitive conduct); *Rochester Gas*, 4 F. Supp. 2d at 176 ("The fact that the New York Public Service Commission had approved the contract at issue does not mean that the State had authorized, and shielded from federal law, allegedly anticompetitive behavior."); *Yeager's Fuel, Inc.*, 1995-1 Trade Cas. (CCH) ¶ 71,034; *IMR Capital Corp.*, 888 F. Supp. at 239 n. 9 (approval of tariff does not mean that provisions thereof are the product of state policy); *McCaw Personal Communications*, 645 F. Supp. at 1172 (PUC review of acquisition designed to foster competition, rather than to displace it); *Pacific Southwest Airlines*, 358 F. Supp. 1224.

[43] *See* Pankiw Letter; Donahue Letter, *supra* note 3 and accompanying text.

V. CONCLUSION

For the reasons set forth herein, Complaint Counsel's motion to strike the affirmative defense of state action should be GRANTED.

Dated: April 11, 2007

Respectfully submitted,

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UNITED STATES OF AMERICA
BEFORE FEDERAL TRADE COMMISSION

COMMISSIONERS:	**Deborah Platt Majoras, Chairman** **Pamela Jones Harbour** **Jon Leibowitz** **William E. Kovacic** **J. Thomas Rosch**

In the Matter of EQUITABLE RESOURCES, INC., DOMINION RESOURCES, INC., CONSOLIDATED NATURAL GAS COMPANY, and THE PEOPLES NATURAL GAS COMPANY, Respondents.	Docket No. 9322

[PROPOSED] ORDER TO STRIKE
THE AFFIRMATIVE DEFENSE OF STATE ACTION

On motion of Complaint Counsel, and upon consideration of the briefs in support and in opposition thereto, it is hereby

ORDERED, that Complaint Counsel's Motion to Strike the Affirmative Defense of State Action, dated April 11, 2007, is hereby granted, and it is further,

ORDERED, that the First Defense of Respondent Equitable Resources, Inc. and the First Affirmative Defense of Respondents Dominion Resources, Inc., Consolidated Natural Gas Company, and The Peoples Natural Gas Company, are stricken from the record.

By the Commission.

ISSUED: ____________________

____
Donald S. Clark
Secretary

CERTIFICATE OF SERVICE

I, Robert E. LaRocca, hereby certify that on April 11, 2007:

I caused twelve (12) hard copies of the attached Complaint Counsel's **Motion to Strike the Affirmative Defense of State Action** to be served by hand delivery and one (1) copy by electronic mail upon the following person:

Office of the Secretary
Federal Trade Commission
H-135
600 Pennsylvania Avenue, N.W.
Washington, D.C. 20580

I caused one (1) copy of the Complaint Counsel's **Motion to Strike the Affirmative Defense of State Action** to be served by electronic mail and followed with one (1) copy by US mail delivery, first class postage prepaid, to the following persons:

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Federal Trade Commission

CX0001

Complaint Counsel's Exhibit List
Equitable, D.9233

CX Number	Document Description
0001	Complaint Counsel's Exhibit List
0002	Equitable Gas Co. v. Apollo Gas Co., Dkt. Nos. C-844028; C-844035, Initial Decision of Administrative Law Judge (Aug. 2, 1988)
0003	In re Equitable Resources, Inc., No. A-122250F5000 (Pa. P.U.C. February 5, 2007)
0004	15 P.S. § § 3541, 3542
0005	Amicus Brief of Pennsylvania Public Utility Commission Relating to Defendants' Motions to Dismiss Complaint, *City of Pittsburgh v. West Penn Power Co.*, Civ. No. 97-1772 (W.D. Pa. Nov. 18, 1997)
0006	Order Denying Petition of the Office of Trial Staff for the Commencement of an Investigation of Competitive Practices Between Natural Gas Distribution Companies (Oct. 6, 2005) (Pa. P.U.C. No. P-000052160)
0007	Letter from James A. Donahue, III, Chief Deputy Attorney General, Antitrust Section, Commonwealth of Pennsylvania, to Bohdan R. Pankiw, Chief Counsel, Pennsylvania Public Utility Commission (Nov. 14, 2006)
0008	Letter from Bohdan R. Pankiw, Chief Counsel, Pennsylvania Public Utility Commission, to Barbara Adams, General Counsel, Commonwealth of Pennsylvania (Oct. 13, 2006)
0009	Pennsylvania Public Utility Commission, Report to the General Assembly on Competition in Pennsylvania's Retail Natural Gas Supply Market (Oct. 2005)

CX0002

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Equitable Gas Company	:	C-844028
	:	C-844035
v.	:	
Apollo Gas Company	:	

Equitable Gas Company	:	C-844034
v.	:	
Carnegie Natural Gas Company	:	

DOCKETED
SEP 15 1986

Commission Trial Staff	-	participating
Office of the Consumer Advocate	-	participating
Guardian Industries Corporation	-	intervenor
The Peoples Natural Gas Company	-	amicus curiae
T. W. Phillips Gas and Oil Co.	-	amicus curiae
Columbia Gas of Pennsylvania, Inc.	-	amicus curiae
J W Wells Acquisition Corporation	-	amicus curiae

INITIAL DECISION

Before Joseph P. Matuschak
Administrative Law Judge

DOCUMENT FOLDER

History of the Proceedings

Equitable Gas Company (Equitable) filed two complaints against Apollo Gas Company (Apollo) and one complaint Carnegie Natural Gas Company (Carnegie) which are before us in this proceeding.

The complaint against Apollo, filed on February 27, 1984 and docketed at C-844028, alleges that Apollo is illegally serving an Equitable customer, Alon Processing Company (Alon), located in Tarentum, Allegheny County, Pennsylvania.

The complaint against Apollo, filed on March 2, 1984 and docketed at C-844035, alleges that Apollo is unlawfully displacing Equitable's customer of natural gas service to A. P. Green Refractories Company (A. P. Green), now Wulfrath Refractories (Wulfrath), also located in Tarentum, Allegheny County, Pennsylvania.

Equitable's complaint against Carnegie, filed on March 2, 1984, and docketed at C-844034, alleges that Carnegie has offered to provide natural gas service to three industrial customers presently served by Equitable, namely, Westinghouse Airbrake Division (WABCO) of American Standard, Inc. in Wilmerding, Allegheny County, Pennsylvania; the Fisher Body Division (Fisher Body) of General Motors Corporation in McKeesport, Allegheny County, Pennsylvania;[1] and the Westinghouse Electric Corporation (Westinghouse Electric) in East Pittsburgh, Allegheny County, Pennsylvania.

---

1 It was later determined that the Fisher Body plant is actually located in the Borough of West Mifflin, Allegheny County, Pennsylvania, and that its name has been changed to B. O. C. Group, Pittsburgh Plant, which is still a division of General Motors.

In each of the complaints, Equitable requested that the Commission enter an interim order prohibiting Apollo and Carnegie from serving the aforementioned customers pending a final decision on the merits of the cases.

A prehearing conference was held in Pittsburgh, Pennsylvania on March 9, 1984. It was agreed among the parties that the three complaints against Apollo and Carnegie be consolidated for hearing.

A hearing on the request for an interim order was held in Pittsburgh, Pennsylvania on April 17, 1984. Briefs were filed discussing the evidence as it related to an interim order request. No interim order had been issued in these cases.

On June 5, 1984, Equitable filed an amended complaint and request for an interim order at C-844034 against Carnegie. The amended complaint added Pennsylvania Float Glass Company (Float Glass), now Guardian Industries Corporation (Guardian Industries) as an additional specifically mentioned Equitable customer which Carnegie was allegedly unlawfully attempting to serve.

Timely answers to the complaints at C-844028 and C-844035 were filed by Apollo; and timely answer to the complaint and amended complaint at C-844034 was filed by Carnegie.

On April 17, 1984, a hearing on the merits of Equitable's within complaints against Apollo and Carnegie was held in Pittsburgh, Pennsylvania. It was stipulated that all testimony submitted at the hearing for interim orders would be considered in disposing of these matters on the merits.

At such hearing, Carnegie verified that a contract for the provision of gas service had been executed between Float Glass (now Guardian Industries) and Carnegie.

Further hearings were held on August 17 and December 18, 1984 and February 3, May 23, May 24, June 10, July 15, August 2 and August 6, 1985. A total of eleven days of hearings were held in these matters, comprising a record of 1,470 pages of transcript.

In addition, thousands of pages of written direct testimony and exhibits have been presented by the parties to this proceeding. Five numbered statements have been submitted on behalf of Equitable. Equitable, in addition, presented 26 separately identified exhibits, many of which are voluminous multi-page exhibits. Seven statements of testimony have been presented on behalf of Apollo and/or Carnegie. Forty-six numbered multi-page attachments were provided with some of those statements. Apollo and/or Carnegie also presented 14 separately numbered multi-page exhibits for the record. Commission Trial Staff submitted one statement for the record and seven numbered exhibits.

Commission Trial Staff (Trial Staff) actively participated in the proceedings. On September 19, 1984, Trial Staff filed with us a request for certification of a question to the Commission. The essence of the question was whether the Commission had ruled that where two fixed utilities serve the same territory, a customer of one must receive consent of the serving utility or the Commission approval before taking service from the other utility. By our order dated October 10, 1984, we denied the request for a certified question.

The Office of the Consumer Advocate filed a Notice of Intervention, but had not participated actively in these proceedings.

We granted _amicus curiae_ intervenor status to The Peoples Natural Gas Company (Peoples), T. W. Phillips Gas and Oil Co. (T. W. Phillips), Columbia Gas of Pennsylvania Inc. (Columbia) and J W Wells Acquisition Corporation (Wells).

At the hearing on August 2, 1985, we granted the intervention of Guardian Industries as a party to the proceeding at C-844034.

Briefs and/or reply briefs were submitted by Equitable, Apollo/Carnegie, Trial Staff, Guardian Industries/Wells, Peoples, Columbia and T. W. Phillips.

Findings of Fact
and
Summary of the Evidence

1. Equitable is a Pennsylvania public utility furnishing natural gas service to the public.

2. Apollo is a Pennsylvania public utility furnishing natural gas service to the public.

3. Carnegie is a Pennsylvania public utility furnishing natural gas service to the public.

4. Apollo and Carnegie are wholly owned subsidiaries of the United States Steel Corporation, now USX.

5. Historically, USX was one of Apollo's largest sales customers. In the case of Carnegie, well over 90% of it business was with USX.

6. The recent catastrophic decline in the steel industry has resulted in substantial sales volume losses for both Apollo and Carnegie. With the reduced USX requirements, Apollo and Carnegie find themselves in a position of having supplies of gas available which they are desirous of selling to customers not presently being served by either Carnegie or Apollo. (Apollo/Carnegie St. 1 at 21; Tr. 8/2/85 - 644).

7. Apollo has no minimum bill or take-or-pay obligation. Although Carnegie has minimum bill obligations, any and all minimum bill liability is billed directly to USX-Mon

Valley. As a result, no Carnegie customer other than USX-Mon Valley bears the cost burden of minimum bill deficiencies.

8. Carnegie's Supplement No. 10 to Tariff Gas - Pa. P.U.C. No. 17 is intended to facilitate the provision of service to customers not presently being served by Carnegie by unraveling the customer charge. (Apollo/Carnegie Ex. 2, Item 11; Tr. 89, 106)

9. Equitable, Carnegie and Apollo were incorporated under the Natural Gas Companies Act of 1885. (Equitable Ex. 10-C; Respondent's St. 1, Attachment 1, 14)

<u>Alon Processing Company</u>

10. Alon operates an aluminum impregnation facility in the Borough of Tarentum, Allegheny County, Pennsylvania.

11. Equitable has served the Alon plant at least since December 1966. From that time until February 1984 no other gas utility has provided service or has had the facilities in place to provide service to the Alon plant. (Equitable St. 1, at 8)

12. As recently as 1981, Alon's historic consumption was as high as 43,000 Mcf per year, representing approximately $235,000 in annual revenues. (Equitable St. 1, at 4-7)

13. Equitable has in place the necessary lines and other requisite facilities for continued service at Alon and is

fully capable of providing the volumes and pressures which Alon requires. (Equitable St. 1 at 9)

14. The natural gas service Equitable has provided in the past to the Alon plant has been fully adequate, safe, reasonable and consistent with the Commission's standards, rules, regulations and orders. (Equitable St. 1 at 8)

15. In February 1984, Equitable's facilities were disconnected by Alon and service to Alon has thereafter been provided by Apollo. (Equitable St. 1, pp. 7-8)

16. Apollo has not obtained Commission approval to provide service to Alon.

17. The Alon plant is in the vicinity of Creighton. (Tr. 469B-470B)

18. To begin providing service to Alon in February 1984, Apollo installed a meter, two regulators, a filter and pipe to connect Apollo's line to Alon's service line. These facilities were provided by Apollo at a cost of $11,000. (Tr. 99A-100A)

19. Alon constructed its own 40 foot service line to connect its plant to the Apollo line. (Tr. 99A-100A; 167B)

<u>Wulfrath Refractories, Inc. formerly A. P. Green Refractories</u>

20. The A. P. Green plant was sold during the pendency

of these proceedings and is now known as Wulfrath Refractories, Inc.

21. A. P. Green, now Wulfrath Refractories, operates a refractory production plant in the Borough of Tarentum, Allegheny County, Pennsylvania.

22. Equitable has served the A. P. Green plant since October 1959. From that time until October 1983, no other utility sold gas at retail to the A. P. Green plant. (Equitable St. 1 at 5-6)

23. As recently as 1981, A. P. Green's historic consumption was as high as 120,000 Mcf per year, representing $660,000 in annual revenues.

24. In October 1983, Equitable's service was totally supplanted by Apollo. Apollo has continued to provide exclusive service since that time, with the exception of 2 days in April 1984, when Equitable provided service on an emergency basis. (Equitable St. 1, pp. 6-7)

25. In 1972 Apollo began to transport natural gas from the A. P. Green's Climax wells (self-help gas) to the A. P. Green plant when Equitable was unable to provide additional volumes of gas on a firm year-round basis to certain A. P. Green facilities. (Equitable St: 1 at 5-6)

26. In 1972, when Apollo began to transport natural gas for A. P. Green, A. P. Green advised Equitable that the

Apollo transportation volumes would be used only to increase A. P. Green's level of then present production and would not be used to reduce volumes of gas purchased from Equitable. (Equitable St. 1 at 5-6; Equitable Ex. 3; Equitable Ex. 10A-1, Item 18; and Equitable Ex. 10A-2, Item 6)

27. In April 1983, Equitable was notified by A. P. Green that it was contemplating entering into an agreement with Apollo as a consequence of which the majority of the load served by Equitable would be displaced by gas purchased from Apollo. (Equitable St. 1, at 5)

28. In June 1983, A. P. Green reduced its consumption of natural gas from Equitable. (Equitable St. 1 at 5-6)

29. By October 1983, A. P. Green had ceased taking natural gas from Equitable, and Apollo now provides natural gas service to A. P. Green. (Equitable St. 1 at 5-6)

30. Equitable has in place the necessary lines and other requisite facilities for continued service to A. P. Green and is fully capable of providing the volumes and pressures which A. P. Green requires. (Equitable St. 1 at 6)

31. The natural gas service Equitable has provided in the past to the A. P. Green plant has been fully adequate, safe, reasonable and consistent with the Commission's standards, rules, regulations and orders. (Equitable St. 1 at 6)

32. In order to provide natural gas service to A. P. Green in 1972, Apollo constructed a 1,000 foot pipeline connection between its lines and the A. P. Green plant. (Tr. 455B-456B)

33. Later on, Apollo enlarged the diameter of a 40-50 foot section of this pipeline to accommodate A. P. Green's request for gas volumes from Apollo. (Tr. 456B)

34. Subsequent to the time A. P. Green switched completely from Equitable to Apollo, in October 1983, Apollo installed a larger capacity meter at a cost of $5,000 - $6,000. (Tr. 101A)

Service Rights Relating
to Complaints Against Apollo

35. Equitable's corporate charter, dated October 19, 1888, as subsequently amended by extension of territory, dated November 20, 1908, by Certificate of Enlargement of Territory and Extension of Pipelines dated December 22, 1913, authorizes it to provide natural gas service throughout Allegheny County. (Equitable Ex. 10c, Item 1, and Attachments (a) and (b) of Item 2)

36. Equitable has continuously provided natural gas service within Allegheny County since 1915. (Equitable Ex. 10c, Item 2, Attachments (c) (d) and (e))

37. Equitable's tariff authority to serve the Borough of Tarentum goes back to at least 1915. (Equitable St. 10c, Item 1)

38. As of December 31, 1984, Equitable provided service to 1,229 customers in the Borough of Tarentum through 76,000 feet of pipeline. (Equitable St. 5-1 at 3).

39. Apollo was incorporated in 1887 under the Natural Gas Companies act of May 29, 1885, to provide natural gas service in Apollo, Armstrong County and the vicinity thereabouts and in Westmoreland County on the opposite side of Kiskiminetas River from Apollo and vicinity. (Apollo/Carnegie St. 1, Attachment 1)

40. Allegheny County is not one of the places to which Apollo was incorporated. (Tr. 7/15/85 - 441)

41. By Certificate of Public Convenience dated March 12, 1917, at Application Docket No. 969-1917, the Public Service Commission approved an Agreement of Consolidation and Merger between Apollo and Versailles Fuel Gas Company. (Apollo/Carnegie St. 1 at 6-7)

42. The Agreement of Consolidation and Merger states that Versailles was incorporated for the purpose of supplying natural gas to consumers of "Versailles, North Versailles, South Versailles and Lincoln Townships, also the Townships of Mifflin, Baldwin, Lower St. Clair, Patton, Braddock, Sterret and Wilkins, together with the Boroughs of McKeesport, Reynoldton, Braddock,

Homestead and Wilkinsburg and the Cities of Pittsburgh and Allegheny, in the County of Allegheny." (Apollo/Carnegie St. 1, Attachment 2 at 1)

43. The Borough of Tarentum was incorporated on March 7, 1842 from East Deer and Frazier Townships. (Equitable Ex. 12B at 5)

44. The Borough of Tarentum, the existence of which predates the Versailles corporate charter by approximately 50 years, is not listed as one of Allegheny County boroughs which Versailles was incorporated to serve. (Tr. 7/15/85 - 442)

45. The Borough of Versailles is approximately 16 miles from Versailles Township and separated from Versailles Township by several municipalities.

46. In the 1971 period, when Apollo was amending its articles of incorporation, it was understood that Apollo <u>no longer served</u>". . . the locations authorized to Versailles Fuel Gas Company, with which Apollo was consolidated in 1917 . . . ." (Apollo/Carnegie Ex. 2, Item 13, Letter of Joseph Van Buskirk to David Dunlap)

47. On March 22, 1971, Apollo, in conjunction with the acquisition of certain wells and pipelines from PPG Industries, Inc. filed a <u>site specific</u> application seeking Commission approval only of the right to provide natural gas service to a

PPG and Columbia Cement Company in the unincorporated community of Creighton, in East Deer Township, Allegheny County.

48. At the time, PPG supplied natural gas to these plants by means of approximately 380 PPG-owned wells, gas leases, various gas purchase contracts, and approximately 360 miles of gas lines and appurtenances.

49. Apollo's application stated that PPG desired to sell the PPG gas properties to applicant on condition that applicant will thereafter sell gas to the plants at established tariff rates.

50. Apollo's application further stated:

> Applicant does not now furnish service in Ford City or in East Deer Township, and therefore does require your Commission approval under Section 202(a) of the Public Utility Law before it can meet the condition, stated in paragraph 5 above, upon which PPG is willing to sell the PPG Gas Properties.
>
> Applicant herein seeks that approval, limited however to the right to furnish natural gas to the plants referred to in paragraph 4, and not the general public.
>
> The Peoples Natural Gas Company and Equitable Gas Company now furnish gas service to the public in East Deer Township, Allegheny County; and the Peoples Natural Gas Company now furnishes natural gas service to the public in Ford City, Armstrong County. Both companies have assented to the granting of

> this application, limited as described in paragraph 9.

51. Apollo, in its said application, requested of the Commission, as follows:

> WHEREFORE, applicant prays your Commission to issue its Certificate of Public Convenience, evidencing its approval of the beginning by Applicant of the offering, rendering, furnish to supplying of natural gas service to the plant of PPG Industries, Inc., in Ford City, Armstrong County, and to the plants of PPG Industries, Inc. and Columbia Cement Company in East Deer Township, Allegheny County.

52. Equitable and Peoples assented to the Apollo application .

53. By order, dated April 5, 1971, the Commission approved the Apollo site specific application subject to the condition that Apollo confine its utility operations to the PPG and Columbia Cement plants and not furnish natural gas service to the general public without first obtaining Commission approval. Ordering paragraphs 1 and 2 of the April 5, 1971 Order provide as follows:

> 1. That applicant, Apollo Gas Company shall confine and restrict its utility operations in the aforesaid areas to the furnishing of natural gas service to (a) the existing Ford City plant location of PPG Industries, Inc., (b) the existing Creighton (East Deer Township) plant location of PPG Industries, Inc. and (c) the existing Creighton

(East Deer Township) plant location of Columbia Cement Company.

2. That applicant, Apollo Gas Company, its successors and assigns, shall not furnish natural gas service to the general public without the approval of the Commission first had and obtained.

(Apollo/Carnegie St. 1 at 8 and Attachment 6)

54. Apollo is now serving Alon and A. P. Green (Wulfrath) from lines acquired by Apollo from PPG. (Apollo/Carnegie St. 2 at 12)

55. The Borough of Tarentum, Allegheny County, in which the Alon and the A. P. Green (Wulfrath) plants are located is adjacent to, but is a political subdivision separate from East Deer Township, Allegheny County. (Equitable Ex. 12B)

56. The unincorporated community of Creighton, East Deer Township, Allegheny County, is approximately 2.9 miles from the Borough of Tarentum. (Equitable St. 3 at 4)

57. With the exception of a certificate approving the acquisition of certain U. S. Steel (USX) gas wells, the Certificate of Public Convenience granted by the Commission on April 5, 1971 is the only certificate approving service territory enlargements received by Apollo after the Apollo/Versailles merger in 1916. (Tr. 7/15/85 - 524 and 532-533)

58. Apollo's tariff does not refer to the Borough of Tarentum. (Equitable St. 3 at 4; Tr. 82)

Guardian Industries Corporation

59. Pennsylvania Float Glass Company, now Guardian Industries Corporation, operates a glass manufacturing facility in Jefferson Borough, Allegheny County, Pennsylvania.

60. Equitable's natural gas sales to Guardian Industries were 965,842 Mcf in 1983 and 952,074 Mcf in 1984. In 1983, Equitable's revenues from Guardian Industries exceeded $4,460,000. (Equitable St. 1-1 at 3; Equitable Ex. 7A)

61. Equitable has served the glass manufacturing facility presently occupied by Guardian Industries at least since 1936.

62. From that time until the completion of the pipeline hereinafter referred to, no other gas utility has provided service or has the facilities in place to provide service to the Guardian Industries plant. (Equitable St. 1-1 at 3)

63. Equitable has in place the necessary lines and other requisite facilities for continued service to Guardian Industries and is fully capable of providing the volumes and pressures which Guardian requires. (Equitable St. 1-1 at 3)

64. Equitable's natural gas service it has provided in the past to the Guardian Industries plant has been fully adequate, safe, reasonable and consistent with the Commission's

standards, rules, regulations and Orders. (Equitable St. 1-1 at 3)

65. In April 1984, Equitable personnel met with representatives of Pennsylvania Float Glass Company, the then owner of the Guardian Industries plant, at the request of Float Glass. Also present at the meeting was Dave Baird of Dave Baird Investments, Inc., who indicated that Float Glass had discussed the possibility of acquiring a supply of natural gas from Carnegie by constructing a pipeline from the plant to Carnegie's pipeline, an approximate distance of 3 miles. (Equitable St. 1-1 at 2-3; Equitable St. 5-1 at 2)

66. On August 1, 1984, Carnegie and Float Glass, Guardian Industries' predecessor, executed a gas service agreement whereby Carnegie agreed to sell approximately 2,600 Mcf of natural gas a day to Float Glass, enough to satisfy all of Guardian Industries' needs. Section 3 of the gas service agreement provides that title to all natural gas purchased and sold shall be considered as passing to and vesting in Float Glass at the outlet side of Carnegie's Station 40 + 00 located on Carnegie's pipeline D-228. (Equitable Ex. 6)

67. On or about March 18, 1985, PFP Pipeline (Dave Baird, President) commenced construction of a pipeline, the purpose of which was to transport natural gas to the Guardian

Industries (then Float Glass) plant. (Equitable St. 5, Attachment 1 at 2-3; Equitable Ex. 11B)

68. By Asset Purchase Agreement dated February 18, 1985, PFP Pipeline Company (Dave Baird, President), Dave Baird and Dave Baird Energy, Inc. transferred all of their natural gas pipeline design and construction business and pipeline assets to Guardian Industries. (Equitable Ex. 11B)

69. By April 19, 1985, approximately 600 feet of the pipeline had been installed. At that time construction ceased pending the transfer of PennDOT and Pennsylvania DER permits from PFP Pipeline Company (Dave Baird, President) to Guardian Industries and the receipt of a street opening and excavation permit from the Borough of Jefferson. (Equitable St. 5 at 2; Equitable St. 4)

70. By Asset Purchase Agreement dated May 7, 1985, Guardian Industries transferred the natural gas pipeline and construction business and pipeline assets to J W Wells Acquisition Corp., a wholly owned subsidiary of Guardian Industries. (Equitable Ex. 11-G)

71. By separate Pipeline Construction and Gas Transportation Agreement also dated May 7, 1985 J W Wells and Guardian Industries agreed that J W Wells would design and build the pipeline to be used to transport Carnegie gas to Guardian Industries. (Equitable Ex. 11-G)

72. Construction resumed on June 10, 1985 at which time the pipeline was less than 5% complete. On June 24, 1985, the work force was more than doubled from approximately 12 workers to approximately 28 workers. (Equitable St. 5-1 at 1)

73. By July 9, 1985, construction of that portion of the pipeline within the PennDOT Occupancy Permit had been completed and, as of July 16, 1985, approximately 14,100 feet of pipe had been installed with approximately 900 feet remaining. (Equitable St. 5-1 at 2)

74. Construction of the remaining 900 feet of pipeline could not be completed until Jefferson Borough issued a permit to J W Wells. (Apollo/Carnegie St. 7 at 4)

75. On September 16, 1985, Jefferson Borough issued its Resolution No. 30-85 granting J W Wells a permit to open the Borough's streets.

76. On October 6, 1985, construction recommenced and on October 5, 1985 construction was completed.

77. The completed pipeline ties into Carnegie's pipeline D-228. (Apollo/Carnegie St. 2 at 13)

78. As permitted by Equitable's expanded Rate 5, Equitable, in January 1985, lowered its price to Guardian Industries to a level equal to what Guardian would pay to

Carnegie plus an allowance for the avoided cost of building the three mile pipeline.

79. As a result of the transfer of the pipeline assets from Guardian Industries to J W Wells, the avoided cost of the pipeline to Guardian Industries decreased.

80. Subsequently, Equitable offered to transport Guardian Industries' own supply at a FERC regulated transportation Rate TS-1 of 15 1/2¢ per Mcf plus an allowance for shrinkage. FERC Rate TS-1 was subsequently increased to 25¢ per Mcf plus an allowance for shrinkage.

81. FERC's Rate TS-1 is less than Equitable's Pa. P.U.C. jurisdictional transportation Rates RS-2 and TS-3 and is available to Guardian Industries because Guardian Industries' supply of self-help gas would be transported through Equitable's transmission lines. (Tr. 8/2/85 - 625-627 and 630; and Tr. 8/6/85 - 795)

82. Guardian Industries accepted Equitable's Offer of TS-1 transportation service and began transporting gas on August 1, 1985. (Tr. 8/2/85 - 633; Equitable St. 1-2 at 14)

83. Guardian Industries originally estimated savings from Carnegie service at $470,000 in the first year, increasing to approximately $750,000 annually after the pipeline was paid off. (Apollo/Carnegie St. 3 at 10)

84. With Rate 5, Guardian Industries' estimated saving from Carnegie service decreased to $180,000 and $345,000 respectively. (Trial Staff Ex. 3)

85. With Rate TS-1, the estimated savings from Carnegie service are eliminated (Tr. 8/2/85 - 635), as the delivered price of gas under TS-1 is estimated to be $3.45 (Tr. 8/6/85 - 870), approximately $.45 less than the price of Carnegie gas of $3.75 plus $.15 transportation. (Tr. 5/24/85-251)

Service Rights Relating to Complaint against Carnegie's Proposed Service to Guardian Industries

86. Equitable's Corporate Charter, dated October 19, 1888, as subsequently amended by extensions of territory dated November 20, 1890, October 22, 1894 and December 27, 1913, authorizes Equitable to provide natural gas service throughout Allegheny County, which would include Jefferson Borough wherein Guardian Industries plant is located. (Equitable Ex. 10-C, Item 1 and Attachments (a) (b) and (c) of Item 2)

87. In 1980 Equitable began and has continued serving customers in Jefferson Borough and what was then Jefferson Township. (Equitable St. 5-1 at 2)

88. Equitable's tariff authority to serve Jefferson Borough and what was the Jefferson Township goes back to at least 1915. (Equitable Ex. 10-C, Item 2)

89. By order dated March 23, 1926, the Commission issued a certificate of public convenience approving Equitable's merger with Monongahela Natural Gas Company (Monongahela).

90. Monongahela's charter, dated June 7, 1889, as amended in May 1897, authorized Monongahela to serve customers in selected places in Allegheny County, including the Township of Jefferson, which became Jefferson Borough about 1952. (Equitable Ex. 10-C, Item 1)

91. As of December 31, 1984, Equitable served 1,531 customers in Jefferson Borough through approximately 50 miles of pipeline, some of which date back to 1890. (Equitable St. 5-1 at 2) Until the completion of the Baird/Guardian/Wells pipeline, no other gas utility has provided service or has had the facilities in place to provide service to the Guardian Industries plant.

92. Carnegie was incorporated in 1886 under the Act of May 29, 1885 (Apollo/Carnegie St. 1, Attachment 14)

93. Paragraph 4th of Carnegie's application for incorporation stated that the place or places where natural gas is to be supplied to consumers is "along the main line as well as several branches located in the townships of Patton, Wilkins,

Braddock, Sterrett, Mifflin and Baldwin, the boroughs of Braddock and Homestead Cities of Pittsburgh and Allegheny in Allegheny County." (Apollo/Carnegie St. 1, Attachment 14)

94. On May 15, 1889, Carnegie filed a certificate of enlargement of its territory which provides as follows:

> . . . the places or places where natural gas is to be mined for, or produced and obtained and supplied, are . . . Lincoln Township, Jefferson Township, Elizabeth Township and Forward Township, Allegheny County, Pennsylvania. . .

(Apollo/Carnegie St. 1, Attachment 15; Emphasis added)

95. By articles of amendment dated January 16, 1968, Carnegie amended Paragraph 4th of its articles to provide in relevant part as follows:

> 4th. The place or places where natural or manufactured gas is to be supplied to consumers is at any point along or within convenient connecting distances of its lines of pipe; and within territory now or formerly constituting . . . the Townships of Patton, Wilkins, Braddock, Sterrett, Mifflin, Baldwin, Jefferson, Elizabeth and Forward, the Borough of Braddock and Homestead and the Cities of Pittsburgh and Allegheny in Allegheny County, Pennsylvania . . . .

(Apollo/Carnegie St. 1, Attachment 17; Emphasis added)

96. Carnegie's primary reason for obtaining service rights in what was then Jefferson Township, Allegheny County, was

to provide service to the Clairton Works of U. S. Steel Corporation (now USX) in what was then the northeasternmost portion of Jefferson Township, now the City of Clairton.

97. Equitable serves 1,531 customers in Jefferson Borough. (Tr. 8/2/85 - 696)

98. Carnegie serves 50 customers in Jefferson Borough, none of which is any closer than 3 miles to Guardian Industries and the majority of which are more than 5 to 6 miles from the plant. (Apollo/Carnegie St. 1, Attachment 34)

99. Carnegie has actively produced, gathered and transported gas in Jefferson Township and Borough since 1889 and provided sales service in Jefferson Township and Borough since 1912.

100. Carnegie will provide service to Guardian through a line tap on its line D-228, with a meter and regulator set constructed.

101. Carnegie has entered into a gas pipeline inspection and maintenance agreement dated June 21, 1985 with J W Wells Acquisition Corp., a wholly owned subsidiary of Guardian.

102. Apollo was incorporated under the Natural Gas Companies Act of 1885.

103. Apollo acquired pipelines M-67 and G-190 from PPG Inc. in 1971.

104. Apollo commenced transportation service to A. P. Green in 1972 pursuant to a gas transportation agreement dated April 11, 1972.

105. Apollo commenced sale service to A. P. Green in 1975 pursuant to a gas transportation agreement dated May 11, 1973 and an application for gas service dated November 4, 1975.

106. Apollo increased sales to A. P. Green in October 1983 at the request of A. P. Green.

107. Apollo continued to provide service to A. P. Green plant upon acquisition thereof by Wulfrath.

108. Apollo provides service to Wulfrath from Apollo line G-190 which runs through the Wulfrath plant property.

109. Apollo began sale service to Alon in February 1984 pursuant to the application for gas service to Apollo by Alon dated December 4, 1983.

110. Apollo provides service to Alon from Apollo line M-67 which runs through Grantham Street adjacent to the Alon plant.

111. Apollo provides service to Wulfrath and Alon at rates set forth in its tariff on file with the Commission.

Discussion

The Stage

These three cases involve the "switching" of natural gas suppliers by certain specified former industrial customers of Equitable to service by either Carnegie or Apollo.

While there has been some evidence of alleged deficient service by Equitable as to one or two of these industrials, it is evident that the real reason for the switching has been the substantial difference in the rates of Equitable as against those of Carnegie or Apollo - e.g., in one case of $5.79 per Mcf as against $3.46 per Mcf, or a $2.33 per Mcf difference (approximately 42 1/2%).

The Commission is confronted not only with these three complaints of switching of natural gas suppliers by industrials or commercials. A number of other switching cases have been or are presently before the Commission. Equitable strongly urges that unless such switching is curtailed, chaos will result in the natural gas industry. It sets forth that it has 45 other industrial customers within approximately one mile of another southwestern Pennsylvania gas utility line which may be induced to leave Equitable's system unless such switching is not curtailed by this Commission. It predicts dire results to it, to other utilities, and to the "captive" natural gas customers if such switching is permitted.

Because southwestern Pennsylvania is served by six major natural gas distribution utilities, including Equitable, Carnegie and Apollo, extensive areas and industrial customers are and can be served by more than one utility. Overlapping of authorized distribution areas and pipelines make it possible for an industrial or commercial customer to be located in the proximity of two or more different natural gas distribution systems.

Historically, with some exceptions, industrial customers have been able to choose their principal natural gas suppliers at any given time, and sales to the companies have fluctuated a great deal between the natural gas utilities in the Pittsburgh area. Prior to public utility regulation by Commission in effect since January 1, 1914, the Natural Gas Companies Act of 1855 specifically prohibited the exclusive right to any corporation to deal with natural gas in any manner. This Commission, by its Policy Statement of November 28, 1957, prohibited the migration of commercial and residential natural gas customers except upon certain conditions or approval of the Commission; but it made no mention of the migration of industrial natural gas customers. Such statement of policy was revoked by the Commission on May 7, 1986 at <u>Columbia Gas of Pennsylvania, Inc. v. Carnegie Natural Gas Company</u>, C-844326.

Competition for industrial load has been further intensified by the following factors: (1) substantial increase in the cost of natural gas; (2) shrinking of residential, commercial markets as the result of conservation; (3) overlapping of authority and distribution lines; and (4) reduction in industrial economy, especially in the "smokestack" industries, reducing the need for natural gas consumption by such industries.

While in the past there have been some disputes litigated before this Commission and the appellate courts in regard to natural gas switching, the switching problem was not so great inasmuch as the rate differentials were less significant, competitive pressures in the industry were not so intense, and the supply of natural gas by any of the natural gas distribution utilities was limited so that no one distribution utility could at all times supply the demand of large industrials.

But the unanticipated swing from the natural gas shortages of the years through the 1970's to the natural gas surplus of the 1980's, together with the more significant rate differentials between natural gas distribution utilities, magnified the switching problem.

In these three cases, Equitable requests the Commission to restrain Apollo from providing natural gas service to Alon

(C- 844028) and Wulfrath (C-844035); and to restrain Carnegie from providing natural gas service to its former customers, Guardian Industries, WABCO, Fisher Body, Westinghouse Electric and any other existing customers of Equitable (C-844034).

The Issues

The issues involved in these proceedings may be summarized as follows:

(a) Is Carnegie and/or Apollo authorized to provide natural gas service in the service territories in which said Equitable's customers are located, and has such authorization persisted to date?

(b) If Carnegie, and/or Apollo, as well as Equitable, are authorized to serve in the service areas of Equitable's said industrial customers, is the replacement of Equitable's service to such industrials by Carnegie or Apollo on the basis of price differentials in the public interest?

Position of Equitable

Equitable's complaints and submissions in these cases, simply stated, are based upon the following propositions:

1. That Carnegie and/or Apollo are not authorized to serve the particular industrial customers of Equitable or the territories in which they are located.

2. That even if Carnegie and/or Apollo had been authorized to render service in the territories in which said Equitable's industrial customers are located, under their charter rights which had existed prior to 1914, such rights have been abandoned through non-use or abrogated by the issuance by the Commission of a certificate of public convenience to Equitable.

3. That even if Carnegie and/or Apollo are authorized to serve the territories in which said Equitable's customers are located, or otherwise to serve Equitable's industrial customers, and even if such authorization has not been abandoned or abrogated, service to said Equitable's industrial customers by Carnegie and/or Apollo is not in the public interest.

Equitable contends that the duplication of facilities and the switching of customers from an existing utility supplier to an alternate utility supplier is inimical to the public interest. It summarizes these factors to be considered in customer switching disputes:

1. That a customer's desire for service from an alternate utility and the alternate utility's desire to provide such service is not controlling but must be balanced against the public interest.

2. That where there are no service complaints concerning the quality of service rendered by the existing utility supplier, customer switching cannot be supported because of the alleged superior

quality of the alternate service offered.

3. That allowing customers to change utility companies primarily because of rate differentials between the utilities tends to create a competitive atmosphere between the utility companies. It states that this Commission has historically pursued a policy of rejecting unnecessary competition within the same territory by noncarrier public utilities, because unnecessary competition between utilities often results in duplication of facilities which would be harmful to the public interest as well as the utilities involved.

4. That if one customer is allowed to switch, others will attempt to do so.

5. That in two of the counties in western Pennsylvania, there are one or more southwestern gas utilities whose facilities are within approximately one mile or less of 45 of Equitable's industrial customers and which could provide service to such customers.

6. That in addition to loss of revenue by Equitable, customer switching exposes Equitable to greater minimum bill liability.

8. That customer switching also exposes Equitable to increased supply/demand forecasting uncertainties.

9. That switching by industrial customers could seriously impact those customers, primarily residential and commercial, not in a position to switch suppliers.

In addition, Equitable emphasizes that Apollo and Carnegie only want large customers which provide a significant payback. It cites the fact that Equitable provides service to approximately 243,000 residential and commercial customers, and that its residential customer load is well in excess of 50% of total retail load. In contrast, it states, Apollo and Carnegie serve mostly industrial load and far fewer residential and commercial customers and that their residential load is only 8.54% and 3.77%, respectively. In respect to Equitable, generally and historically, it asserts that the Commission's policy has been to have large volume customers subsidize residential customers. Equitable further contends that this "skimming the cream" approach will only create a system wherein low cost service is available only to industrial customers while the vast majority of residential and commercial customers will be required to pay much higher rates than they are presently enjoying, the net effect of which is against the public interest.

Equitable also submits that this Commission and the Superior Court considered and forcefully regarded a "skimming the cream" proposed in Re Service Gas Company, 15 P.U.R. (N.S.) 202 (1936), affirmed in Incorporators of Service Co. v. Pa. P.S.C., ____Pa. Super. Ct. ____, 190 A. 653 (1937). In that case certain incorporators having access to local production gas suppliers sought a certificate of public convenience to provide gas almost exclusively to industrial customers. This proposed service would have been at lower cost and in direct competition with existing facilities already serving all classes of customers in the region. The Commission there rejected the application, reasoning as follows:

> Speaking generally, it is clear law that a company rendering public service is entitled to a reasonable income based upon the value of its property used and useful in the public service. If it secures this income from three classes of consumers at certain rates, and one class ceases to take service, it is obvious that the burden of providing the income to which the company is legally entitled will fall upon the two remaining classes, thus necessitating an increase in the rates of these classes. This is particularly true where, as here, the eliminated class is the major source of income.
>
> * * *
>
> It is significant in this regard that the Service Gas Company proposes to serve only the large customers of gas, so that, even if only a small number of customers take service from it, the loss to the companies now in the field will be large in amount. Thus, the proposed corporation, if it benefits any one in the last analysis, would confer that benefit only upon industrial users of gas at the expense of domestic and commercial customers which applicants do not intend to serve. Such industrial customers as continue to take service from the established companies would also be in danger of having their rates increased.
> [15 P.U.R. (U.S.) at 205]

The Commission there went further to say that:

> One of the principal purposes of regulation under the Public Service Company Law is the prevention of ruinous rate competition between public service companies. Experience has demonstrated that where two or more such companies engage in rate war, the public, while possibly temporarily benefited, will ultimately be the loser.
>
> * * *
>
> It is therefore clear that any advantage which would accrue to certain industrial customers might be bought at too great a cost to the remaining industrial, commercial, and domestic consumers.
> [15 P.U.R. (N.S.) at 206-07]

In affirming the Commission, Equitable says the Superior Court recognized and reiterated the basic policy issue, stating as follows:

> It is clear that the volume of industrial business permits lower rates to domestic customers. The acquisition of this industrial business by protestants, would place inevitably, a greater burden upon the domestic and other customers served by the latter.
>
> * * *
>
> The question is not whether the granting of the application will be for the convenience and accommodation of some of the public, but whether it will be for the convenience, accommodation and advantage of the public generally and considered as a whole. [190A. at 685]

Equitable asserts that Carnegie's alleged right to serve along its pipelines under its charter does not authorize Carnegie to serve from pipeline extensions into streets or areas in which Carnegie does not now serve. Equitable contends that Carnegie's charter rights are restricted to those in place at the regulatory act effective January 1, 1914.

Furthermore, Equitable does not agree that Carnegie has authority to serve customers which are either along its lines or within the supply district. Equitable contends that the express language of the Natural Gas Companies Act requires the customer to be both along the lines and within the supply district.

In addition, Equitable argues that any pipeline right of Carnegie does not apply where the "point of usage" is not within convenient connecting distance of the pipeline.

It notes that the August 1, 1984 Gas Service Agreement between Carnegie and Float Glass, Guardian Industries' predecessor, provides that title to all natural gas purchased and sold shall be considered as passing to and vesting in Float Glass at the outlet side of Carnegie's Station 40 + 00 located on Carnegie's Pipeline D-228, i.e., the point of delivery. It notes that Guardian Industries' actual usage of Carnegie gas, i.e., the "point of usage" will be approximately three miles away from the Guardian Industries plant in the southeasternmost portion of Jefferson Borough. In this connection, Equitable refers to our May 9, 1985 ruling in Columbia Gas of Pennsylvania, Inc. v. Carnegie Natural Gas Company (Anchor Glass) at C-844082, where we said, in part:

> The obvious intent of the Natural Gas Companies Act is not that the point of delivery of gas service be made a convenient distance of the gas company's pipeline but, rather, that the service be furnished to a consumer who is located within a convenient connecting distance of the pipeline.
>
> It would be incomprehensible, indeed, to suggest that the provision in the Natural Gas Companies Act authorizing and requiring the furnishing of gas service to consumers along its pipeline, could be viewed so as to authorize or require any natural gas company to any would-be customer located throughout the State of Pennsylvania from any of its pipelines, by delivery of gas at the pipeline, where it is intended for transportation either by pipeline, by railroad, by motor vehicle, by helicopter, or in any other manner, to the customer's location at any point throughout the four corners of the Commonwealth .
> [Mimeo, p. 38]

Equitable also cites, in this connection, the case of Petition of Lukens Steel Company, 58 Pa. P.U.C. 256 (P-810310), where the Commission said:

> Lukens' argument in this proceeding that it has an absolute right to purchase electricity from PP&L so long as the point of delivery, as contrasted with the point of consumption of electric power, is located in the certificated area of PP&L, could have some validity, assuming the competitive argument would be favorable to Lukens, were it not for the fact that Lukens has no plant facility in the PP&L service territory.
> [58 Pa. P.U.C., 256,263; Emphasis supplied]

Equitable's complaints cite, inter alia, four reasons why it is not in the public interest to, in effect, permit the six industrial customers involved in these consolidated complaints to switch their gas suppliers in overlapping territories:

1. That customer switching results in wasteful facilities duplication.

2. That the switching of large volume industrial customers would expose remaining "captive" ratepayers to possible rate increases.

3. That customer switching impedes a utility's ability to perform effective supply/demand forecasting.

4. That precedential impact of permitting switching would result in chaos.

Position of Carnegie

Carnegie takes the position that it has a duty and a right to serve the Guardian Industries plant under its charter.

1. That Carnegie was incorporated under the Natural Gas Companies Act.

Carnegie was issued Letters Patent on March 10, 1886 granting its perpetual existence under the provisions of "An Act of provide for the incorporation of natural gas companies", approved May 29, 1885, (P.L. 29) (Natural Gas Companies Act).

The Natural Gas Companies Act established "districts" and "pipelines". It also established in natural gas companies a charter duty to provide service to customers located in their districts or along their pipelines.

> Section 1. Be it enacted, etc. That corporations may be formed in the matter mentioned herein by the voluntary association of five or more persons . . . for the purpose of producing, dealing in, transporting, storing and supplying natural gas to such persons, corporations, or associations, within convenient connecting distance of its line of pipe, as may desire to use the same, upon such terms and under such reasonable regulations as the gas company may establish . . . .
>
> Section 2.
>
> * * *
>
> Second. The place or places where natural gas is intended to be mined for and produced or received, the place or places where it is to be supplied to consumers, the general route of its pipe line or lines and branches, the location of its general office.
>
> * * *
>
> Section 10. The transportation and supply of natural gas for public consumption is hereby declared to be a public use, and it shall be the duty of corporations, organized or provided for under this act, to furnish to consumers along their lines and within their respective districts natural gas for heat or light or other purposes as the corporation may determine ... .
> [Sections 1; 2; Second; and 10, Natural Gas Companies Act of 1855]

2. <u>That Carnegie's charter rights are preserved</u>

Carnegie's rights and duties were preserved by the Public Service Commission Law (Act 1913, July 26, P.L. 1374, Art. 111. 12;) and by the Public Utility Law (Act 1937, May 28, P. L.

1053, Art. XIV, 1401); and again by the Public Utility Code of 1978, 66 Pa. C.S. 103(a). Section 103(a) of the Codes provides:

> Any public utility, ... having the right to render service on the day preceding the effective date of this part shall be entitled to the full enjoyment and the exercise of all and every right, power and privilege which it lawfully possessed on that date.

3. <u>That Carnegie has a right and duty to provide service in its charter district of supply</u>

Carnegie asserts that it has a right and duty to provide service in its charter district of supply. A company formed under the Natural Gas Companies Act has an obligation to furnish gas, if reasonably available, to consumers in its charter territory. <u>Pennsylvania Gas Co. v. Pa. P.S.C.</u>, 83 Pa. Super. Ct. 557, 566 (1924).

Carnegie states that case law supports the proposition that under the Public Utility Code, a utility with charter rights predating the 1913 Public Service Company Law is not required to obtain Commission approval in order to provide existing or additional service within its charter territory, citing <u>Harmony Electric Co. v. Pa. P.S.C.</u>, 275 Pa. 542, 119A. 712 (1923) <u>aff'g</u>, 78 Pa. Super. Ct. 271 (1922); <u>Dublin Water Co. v. Pa. P.U.C.</u>, 206 Pa. Super. Ct. 180, 213 A.2d 189 (1965); <u>New Castle Electric Co. v. Pa. P.S.C.</u>, 70 Pa. Super. Ct. 20 (1918); <u>Pennsylvania Utility Co. v. Pa. P.S.C.</u>, 69 Pa.Super Ct. 612 (1918). It asserts that the court in Dublin Water Co., 205 Pa. Super. Ct. at 187-88, 213 A.2d at 143 said:

> As stated in Harmony Electric Co. v. P.S.C., 275 Pa. 542, 545, 119A. 712, affirming 78 Pa. Super. 271: "The statute ... does not contemplate that a certificate of public convenience shall be obtained by a corporation like the appellee, which was already doing business on January 1, 1914, for each step taken in the advancement of its service within unabandoned chartered territory." To the same effect see Penna. Utilities Co. v. Lehigh Navigation Co., 254 Pa. 289, 98 A. 950; Penna. Utilities Co. v. P.S.C., 69 Pa. Superior Ct. 612; and New Castle Electric Co. v. P.S.C., 70 Pa. Superior Ct. 20.

4. That Carnegie has a right and duty to provide service from its pipelines

In addition to the right and duty to provide service in a charter district of supply, Carnegie submits that a natural gas company has a right and duty to serve from its pipelines, whether or not they are in a charter district of supply.

In Pennsylvania Gas Co. v. Pa. P.U.C., supra, the contention that a consumer must be both along the lines and within the service district of a gas company was dealt with directly. There the Court said (at page 561):

> (b) The contention that an applicant for service must be both along respondent's lines and within its district, is untenable. The transportation and supply of natural gas for public consumption is declared by the act of

respondent's creation to be a public use.

Position of Apollo

Apollo takes the position that under its charter under the Natural Gas Companies Act of 1885, it was authorized and required to furnish gas service to customers who are within convenient connecting distance from its pipelines, and that such charter rights have been preserved.

It contends that the Natural Gas Companies Act established "districts" of production and supply, in addition to "pipelines". It also established in natural gas companies a duty to provide service to customers located in their districts or along their pipelines:

> Section 1. Be it enacted, etc. That corporations may be formed in the manner mentioned herein by the voluntary association of five or more persons, or as otherwise provided herein, for the purpose of producing, dealing, transporting, stating and supplying natural gas to such persons, corporations, or associations, within convenient connecting distance of its line of pipe, as may desire to use the same, upon such terms and under such reasonable regulations as the gas company shall establish... .

It urges that Alon and Wulfrath are within convenient connecting distance from its pipeline acquired from PPG.

Position of Commission
Trial Staff

Commission Trial Staff takes the position that Apollo is without either charter or certificated authority to serve in Tarentum, Pennsylvania. It contends that Apollo's service to Alon and A. P. Green violates the Public Utility Code, which requires that utility service cannot be rendered by a public utility without first having obtained a certificate of public convenience from the Commission authorizing such service, or by possessing charter rights preserved by Section 103 of the Public Utility Code, 66 Pa. C.S. §103.

Its witness, Vernon E. Chandler, recommends that "the Commission act to "grandfather" the utility - customer gas supply arrangements which existed at the start of this proceeding and to indicate its approval to all parties of the concept of long-term contracts for large users." (Chandler St. pages 7-8) The upshot of this recommendation is to prevent Carnegie from providing service to large industrial customers who are served by other gas utilities (such as Equitable) and to prevent Apollo from continuing its gas service to A. P. Green/Wulfrath and Alon in Tarentum, Pennsylvania since they have been large industrial customers of Equitable.

Position of
Guardian Industries

Guardian Industries asserts that its glass manufacturing facility located in Jefferson Borough must operate in general market conditions which are extremely competitive. It states that despite the expenditure of $1.3 million by it to modernize its facility, the plant has been the worst performer among all Guardian Industries plants.

There are approximately 200 jobs provided by Guardian Industries in Jefferson Borough. William F. Block, Group Vice-President of Guardian Industries stated:

> Without competitive energy, there is no glass manufacturing plant at Floreffe... I feel that it is essential to the survival of the Floreffe plant that it be able to purchase all materials, including natural gas, at the lowest prices and from the most reliable vendor.

He further stated that cost of gas represents approximately 25% of the total cost of manufacturing at Jefferson Borough.

Guardian Industries contends that there is no evidence to suggest that Equitable will lose Guardian Industries as a customer. Although Guardian Industries purchases natural gas through its pipeline from Carnegie, Equitable continues to flow a significant amount of natural gas to Guardian Industries. As the natural gas market enters the new area of competition, it states that each utility's efficiency will become important, if not critical.

General Critical Aspects

Before entering into a discussion and resolution under the facts of each of the cases here involved, certain critical aspects must be noted:

1. Economic Phenomenon

Notably, the surplus of natural gas in the marketplace has not been attended by lower prices to most natural gas consumers. Strikingly, this phenomenon is contrary to the usual economic results of oversupply in the marketplace, as compared, for instance with the effect of the oil glut. With the reduction of the price of oil due to a surplus in supply, a reduction in the price of gasoline at the pump almost immediately followed. Not so with natural gas. This phenomenon has been a matter of great concern not only to the Commission, but to the Legislature as well.

2. Commodity Pressures

It is generally recognized that 75% to 85% of the burner-tip price of natural gas is due to the cost of the commodity itself. It must be recognized that if cost relief in natural gas to reflect supply conditions in the marketplace should be forthcoming attention must be primarily directed to the commodity portion of the costs.

The market price of natural gas in the new surplus environment has not been reflected in the cost of natural gas consumers, due, to some extent, to the long-term take-or-pay or minimum purchase contracts entered into by some but not all natural gas distribution utilities, or not to the same extent. Such contracts were entered into during a natural gas shortage to ensure future natural gas needs of the utility's consumers. As a result, those utilities subject to such contracts have found themselves in a market pressure to retain large user customers against competition from other fuels or from natural gas utilities not committed to such contracts. To some extent, this pressure has been reduced by utility "buy-out" of long-term or minimum purchase contracts and by Federal regulatory relief.

3. Precedential Guidance

In these proceedings, we said (Tr. p. 129) that: "Our difficulty here is that we can find decisions that will satisfy almost any position that anybody would want to take in this nature of a case." We also noted that:

> While all precedents have some value, we must also consider that there's an emerging problem that has arisen here under present-day conditions that may require some re-

examination of some prior decisions as to whether they are applicable in today's world. [Tr. p. 141]

In Re Lukens Steel Co., 58 Pa. P.U.C. 256, 262, this Commission stated:

> Based upon our review of applicable statutes and prior case law, we have concluded, ... that prior legal precedents do not specifically control in the factual issue before us.

Some decisions of this Commission and of the appellate courts appear to be conflicting; in other cases, they can be distinguished by the facts in each case.

In CAPCO Investigation at I-79070315 and I-79070317, we said:

> The Commission's exercise of its regulatory authority must be assessed in light of its purposes and consequences, and not by reference to isolated phrases from previous cases. Complex new problems require more than the application of ancient shibboleths. As we said in our Recommended Decision in Pa. P.U.C. v. Philadelphia Electric Co., R.I.D. 438 (1978), (pp. 23, 24):
>
> > "Responsible regulation is no longer the application of yesterday's solutions; it is the development of concepts befitting today's requirements. [Mimeo, pp. 20, 21]"

In this connection, on October 10, 1984, in the within proceedings, we denied the request of Trial Staff to certify the following question to the Commission (as an apparent attempt to quickly and easily resolve these proceedings):

> Did the Commission, by its pronouncement in its decision in Koppers Company, Inc. v. North Penn Company, 42 Pa. P.U.C. 730, 734 (1966), wherein the Commission admonished utilities having overlapping charter rights to conduct their public service operations so as to avoid competitive situations, intend to require that where two utilities have or may have charter rights to serve the same territory, and where one utility receives a service request from an established customer of the other utility, the first utility must attempt to obtain the other utility's consent prior to providing service, and if that consent is not obtained, must obtain a determination from the Commission prior to providing service that the proposed service is in the public interest?

In refusing to certify such question to the Commission, we said, in part:

> Commission Staff's "loaded" question purports to request this Commission to ascertain what another Commission "intended" by its dicta in Koppers 18 years ago, thereby seeking an affirmative answer which, in effect, would have this Commission retroactively enlarge the 1966 pronouncement in Koppers to implant thereto language tailored by Commission Staff establishing a regulatory mandate never expressed in Koppers. In Koppers the Commission said what it said, and not what the Commission Staff wish it had said, or what this Commission might think it intended to say.
>
> * * *
>
> The public interest may change with time and circumstances. What was in the public interest in 1966 - before the Arab oil embargo and before escalating gas rates in the face of a glut in the market - may or may not be in the public interest today. The public interest includes not only the interest of the utility or its customers or

classes of customers; it involves the whole general public.

In our opinion, to have this Commission determine the matter of public interest on the basis of a Commission decision made 18 years ago, without a full development of the effect of vast changes in the energy field since, the significance of other inconsistent decisions before and after, and the particular facts of each case, could bring into question such exercise of Commission discretion.
[Mimeo, pp. 4, 11]

4. Charter Rights

When natural gas was discovered in Pennsylvania, most (and perhaps all) of the companies organized to produce and sell natural gas had their markets in the more populous areas, although their producing areas were mainly in the rural areas. For example, a company organized to serve gas to consumers in Pittsburgh might draw its gas wells in the rural parts of Allegheny, Fayette, Greene, and Washington Counties.[2]

A number of natural gas companies were formed under the Corporation Act of 1874, P. L. 73, 15 P. S. §1, et seq. The case of Emerson v. Commonwealth, 108 PA. 111, involved a corporation's claim under the 1874 Act of the exclusive right to furnish natural gas for fuel purposes in the City of Pittsburgh. In that

[2] See Trial Staff Exhibit 5: Letter of David Dunlap, Esq. to W. A. Patch, Controller, Apollo Gas Company, dated September 27, 1971.

case, however, the Supreme Court of Pennsylvania adopted a strict construction of the 1874 Act and held that the 1874 Act was applicable to <u>manufactured</u> gas companies only. In addition, the Supreme Court there made this recommendation to the Legislature:

> In view of the immense stores of this valuable fuel which have so recently been discovered, and of the great public interest to be subserved by the legal authorization of corporations for supplying it, we think the subject should be brought to the attention of the legislature without delay so that appropriate legislation may be obtained. And we think it will be well for the lawmaking power to consider with great care the question whether it is expedient to confer upon any corporations it may authorize, the exclusive privilege contained in the Act of 1874.
> [108 Pa at p. 126]

The Natural Gas Companies Act of May 28, 1885, P. L. 29, 15 P. S. §3541, et seq. was subsequently enacted. Under this 1885 Act, prior to 1914, a charter territory was readily obtained from the Commonwealth, and there were no restrictions on overlapping territories. The charter was obtained by a fairly routine filing with the Secretary of the Commonwealth. There is nothing in the 1885 Act which suggests that the Legislature thought monopoly better than competition, or one source of supply better than two, or intended for any reason to give an existing supplier of gas for distribution in a particular community the privilege of exclusive rights to serve such community. In fact, the 1885 Act appeared to open the field of natural gas supply to free competition, in providing in Section 2 of the Act (15 P. S. §1983):

> Provided that neither this act nor any other shall be so construed as to confer, authorize or give color to any claim of exclusive right in any corporation, howsoever formed, dealing in any was or for any purpose in natural gas.

Further, in the interim between 1874 and 1885, there were occasional protests from persons living along the lines of gas companies that gas companies refused to serve them, and instead delivered all gas to the districts (populous centers) specified in the gas companies' charters. As the result, the 1885 Act, in Section 11, declared that the supply of natural gas is a:

> . . . public use, and it shall be the duty of corporations, organized or provided for under this act, to furnish to customers along their lines and within their respect districts natural gas . . .
> [Emphasis added]

Authority to Operate
as a Public Utility

A natural gas company could be authorized to provide natural gas service to the public by virtue of either (1) a charter granted to the corporation by the Natural Gas Companies Act (Act of May 29, 1885, P. L. 29, 15 P. S. §3541, *et seq.*) or (2) the grant of a certificate of public convenience granted by the Pennsylvania Service Commission, or its successor, the Pennsylvania Public Utility Commission.

The Natural Gas Companies Act, provided that corporations incorporated under the Act were granted two distinct types of territories, a territory of production (the place or places where natural gas is intended to be mined and produced or received), and a territory of supply (the place or places where natural gas is to be supplied to consumers). In addition, such corporations were granted the right to supply natural gas to consumers within convenient connecting distance of its pipe line.

The Natural Gas Company Act was supplanted by the enactment of the Public Service Company Law (Act of 1913, July 24, P. L. 1341, effective January 1, 1914); by the Public Utility Law (Act of May 28, 1937, P. L. 1053; and by the current Public Utility Code (Act of July 1, 1978, P. L. 598).

The Supreme Court of Pennsylvania, in Pennsylvania Gas Co. v. Pa. P. S. C. 83 Pa. Superior Ct. 557 (1924) explained:

> . . . The corporation is given the right of eminent domain for laying pipe lines for the transportation and distribution of its product. It is a fact within common knowledge that these companies, by virtue of their right of eminent domain, construct supply lines, for the transportation of gas, through districts where no gas is distributed or intended to be distributed; also where there are no consumers to take the gas. The right to appropriate private property for public use can be justified only on the ground of public necessity, and when the legislature granted natural gas companies this extraordinary power, it evidently intended to safeguard the public, within reasonable limits, in its right to make use of the corporation's facilities, thus

authorized to be constructed on and over private property.
[Emphasis added]

Such charter rights were preserved by the Public Service Act of 1913; by the Public Utility Law, Act of 1937, P. L. 1053, Art. XIV, §1401; and again by the Public Utility Code, 66 Pa. C. S. §103(a).

The Act of 1937 specifically states:

> Except as herein otherwise expressly provided, every existing public utility which has been rendering service continuously at least from January first, one thousand nine hundred fourteen, shall be entitled to the full enjoyment and the exercise of all and every rights, powers and privileges which it lawfully possessed on that date . . . .
> [Act 1937, May 28, P. L. 1053 Article XIV, §1401.]

Section 103(a) of the Public Utility Code provides that:

> Any public utility, ... having the right to render service on the day preceding the effective date of this part shall be entitled to the full enjoyment and the exercise of all any right, power and privilege which it lawfully possessed on that date.

Competition

The Public Utility Code, as well as predecessor regulatory statutes, commits the choice of when to permit fixed utilities to compete in the same territory to the sound discretion of the Commission. Painter v. Pa. P.U.C., 194 Pa. Superior Ct. 548, 169 A.2d 113, 117 (1961); Dublin Water Company

v. Pa. P.U.C., 206 Pa. Superior Ct. 180, 213 A.2d 139 (1965); Petition of Lukens Steel Company, P-810310 (at 24-25, January 17, 1984).

The courts of this State recognized and enforced the Legislative intent of the Natural Gas Companies Act of 1885 to open the field of natural gas supply to free competition. Peoples Natural Gas Company v. Pittsburgh, 1 Pa. County Ct. Rep. 311 (aff'd without opinion by the Supreme Court of Pennsylvania); Meadville Natural Gas Co. v. Meadville Fuel Gas Co., 2 Sadler 549 (Pa. Superior Ct.), reversing 1 Pa. County Ct. Rep. 448. In Peoples Natural Gas Company v. Pittsburgh, supra, the Court said (page 313):

> The Act of May 29, 1885 [P. L. 29], was intended to open the field of natural gas supply to free competition, and it expressly declares it shall not be so construed as to favor or give color to any monopoly in the business. It is the duty of city councils to carry out the act in good faith by appropriate local regulations. Any ordinance or acts of the local authorities intended to give special favors to one or more corporations, or to throw unreasonable obstructions in the way of new companies, is a violation of the letter and spirit of the Act.

The primary purpose of public utility regulation has been not to establish monopolies but to serve the public interest by ensuring to the public adequate and non-discriminatory rates. The extent to which competition is to be permitted in any field of public utility regulation is a matter of administrative discretion committed by the Legislature to the Commission. As the Court said in Sayre v. Pa. P.U.C., 161 Pa. Super. Ct. 182, 54 A.2d 95 (1947):

> We start with the well-established principle that "the primary object of public service laws is not to establish a monopoly or to guarantee the security of investment in public service corporations, but first and at all times to serve the interests of the public." Hoffman v. P.S.C., 99 Pa. Superior Ct. 417, 419; Columbo v. Pa. P.U.C., 159 Pa Superior Ct. 483, 487, 48 A.2d 59.
>
> * * *
>
> Whether there shall be competition in any given field and to what extent is largely a matter of policy and an administrative question that has wisely been committed to the sound discretion of the Public Utility Commission. Alto Express Lines v. Pa. P.U.C., 152 Pa. Superior Ct. 27, 30 A.2d 440.

Competition has a role to play in the regulation of the natural gas industry. Even limited competition would seem to encourage suppliers of natural gas to become more aggressive in proposing new rates and service and thereby increase the effectiveness of regulation by the Commission. It must be remembered that the Commission's power is largely a negative one; it must rely heavily on private initiative to propose projects and rates to meet the customer needs. Competition and direct regulation should complement each other to the benefit of the consumer generally.

Investors in the natural gas industry are allowed an <u>opportunity</u> for a "fair return" but by no means guaranteed freedom from risk or competition. Such occurrence would deprive competitors of the right to compete, inhibit efficient allocation of revenues, and deny the ultimate consumers the lowest prices to which they are entitled.

This Commission, in <u>Columbia Gas of Pennsylvania, Inc. v. Carnegie Natural Gas Company</u>, C-844326 on March 7, 1986 considering the public interest stated: "... It shall be our policy not to prohibit competition between gas utilities, where authorized service territories overlap." (Mimeo, p. 17)

In his remark to the Pittsburgh Chamber of Commerce on March 8, 1985, Commission Chairman Shane said:

> I believe regulation is a poor substitute for competition and, therefore, regulators should let competition do their work for them whenever possible. Competition is spreading through all phases of the public utility industry, and I think we regulators have a duty to nurture it where it is wholesome but being ever vigilant to make sure that spreading competition does not become predatory thus victimizing captive customers, primarily residential and commercial customers. In other words, while I advocate competition, I believe that regulators have a responsibility to oversee the process at the outset, instead of immediately moving toward complete deregulation.

It makes little sense for the Commission to deprive itself and ratepayers of the competitive test of utility efficiency by grandfathering existing customer service arrangements.

The practice of one company attempting to take business away from another company is, in and of itself, not predatory, but simply the essence of competition. Predatory pricing refers to situations in which a firm prices services below cost to take sales away from a competitor with the aim of driving the latter out of business. ~~In contrast,~~ competitive pricing means that prices reflect costs such as the most efficient firm secures the business.

In Pennsylvania Water and Power Co. v. Consolidated Gas, Electric, Light and Power Co., 184 F. 2d, 552, 567, the Court said:

> One of the most important duties of a public utility, inherent in its franchise to serve the public, is the duty to take the initiative in proposing reasonable rates and rendering adequate service, taking into account changing conditions; and the utility is not relieved from this duty because its activities are subject to governmental regulation, for a regulatory commission is not clothed with the responsibility or qualified to manage the utility's business...

In "A Changing Environment for Public Utilities", (Public Utilities Fortnightly, August 16, 1984) Illinois Commerce Commission Chairman, Philip R. O'Connor, said:

> In a few years most of these [regulated] industries will be characterized by competition, their monopoly dimensions will

> be significantly reduced in scope, and the barriers to competition will be largely removed. The driving force behind much of this change is the rapid development of technology which permits the public to become more selective and less reliant on a single supplier.
>
> * * *
>
> The gas industry is also experiencing shifts which indicate that the end of its monopoly structure is near. The increase in the number of businesses searching individually for lower priced gas and dealing directly with gas producers is resulting in a decline in the importance of the role of pipeline companies.

Even if gas companies do not obtain sufficient gas from their own production facilities, and have entered into long-term contracts, they may lack the spark to engage in the unpleasant business of renegotiating long-term contracts with producers; only competition or stringent regulation can be expected to prod them to do so. See Maryland's Peoples Counsel v. FERC, 761 F.2d 780 (1985).

The loss of, or the failure to obtain patronage, due to competition, does not justify imposition of charges that are exorbitant and unjust to the public.

It might be said that utility companies, like other concerns, operate at a certain risk in their management decisions; that while such decisions may or may not be imprudent, they may be unwise. Why then, should such utilities be insulated from the risk of their own management decisions by placing the cost of wrong management decisions upon the ratepayer?

Historically, for over a hundred years, industrial customers have been able to choose their principal gas suppliers at any given time, and sales to these customers have fluctuated a great deal between the public gas utilities in the Pittsburgh area.

Apollo and Carnegie provide some of the cheapest gas service in the State of Pennsylvania. The benefits of economical gas service and savings derived therefrom should not be denied the gas customers able to avail themselves of service from Carnegie or Apollo.

As Dr. Michael J. Ileo, witness for Apollo and Carnegie, testified:

> Unlike the philosophy underlying other regimes, our economic system rests squarely on the premise that competition is the principle force which creates efficiency-the largest production of goods and services at the lowest cost. As a society, we interfere with the workings of competition only in unusual circumstances, such as when it seems to be clear that by modifying and/or regulating competitive behavior greater economic efficiency can be achieved. In essence, we take such action and sacrifice the benefits of competition for what we think is a greater benefit. In the case of utilities, for example, competitive behavior is generally restricted because we believe that the resulting benefits of non-duplication of facilities under a regulated monopoly provision of service outweigh the efficiency benefits of competition.

> In Western Pennsylvania, however, the exception to the competitive rule does not appear to be applicable. This is true because the competitive provision of gas utility service predates utility regulation such that the benefits of non-duplication of facilities have already been lost for the most part. To impose Mr. Chandler's short-term recommendation on the structure of the gas utility industry in Western Pennsylvania would serve to do nothing more than to trade-off competition and its attendant benefits for the largely non-existent gains of non-duplication of facilities.
>
> ... Indeed, by discouraging competitive behavior through grandfathering ... the likely result will be that all gas utilities in Western Pennsylvania will operate less efficiently than would otherwise be the case.
>
> * * *
>
> Such large differentials of $1.38 to $2.25 per Mcf between the rates of Carnegie/Apollo and Equitable strongly suggest that either Equitable is inefficient or it is pricing service to large users improperly. This is true because under the theory of regulation, there should be no other form of economic organization which can provide services to a utility's customers at a lower cost than that incurred by the currently serving utility.

Public Interest

A reading of the various Commission and appellate decisions, without more, would indicate to one that there is a vast inconsistency in such decisions. But a close view of such decisions in the context of the prevailing public interest position of the Commission in the particular endeavor of activity, that is, gas, water, electricity, telecommunications, and transportation, provides more appreciation of the rationale of the various Commission and appellate decisions.

In this posture, one cannot group all public utilities together to arrive as to what the public interest may be at the time. At various times, and with changing conditions in the particular utility endeavor, what is and what is not in the public interest may vary.

Utility regulation of various public utilities, or of a particular utility endeavor at the time, does not require, and it would be improper to impose, such rigid regulation as would defeat rather than support the public interest with changing times and conditions. Commission or appellate court pronouncements and decisions, appropriate at the time of their issuance, may, however, be inappropriate at other times and under different conditions.

Most major gas utilities, including Equitable, are "backward vertically integrated"; that is, such utilities have affiliates who distribute natural gas through intrastate and interstate pipelines, both of which are regulated, and other affiliates, unregulated, which own significant gas exploration, development and production facilities. Such backward integration may provide significant incentive for gas utilities to pay above-market prices for the gas they purchase from affiliate producers, thus affording undue profits to their production affiliates.

Public utilities are charged with the responsibility of managing their affairs in such a way as to serve the public with just and reasonable rates for efficient and adequate service. The loss of load resulting from competition, inadequate rates of return, clothing other captive customers with a greater share of fixed charges, and take-or-pay and minimum bill obligations due to competition from other gas utilities are a function of past management decisions which have proved to be wrong. Where wrong management decisions have been made, the shareholders of the company and not ratepayers should be held accountable. Likewise any reduction in demand due to changes in the industrial climate is the usual risk assumed by all companies.

In addition, increased fixed cost burden upon remaining captive customers, if any, may be offset by reduction in commodity costs brought about by competiton.

The public interest also includes the interest of industrials, and their employees. Such industrials are engaged in daily competition with competing firms. To stay competitive, management seeks every avenue, including reducing utility costs, to assure lower production costs to meet competition.

The Commission is aware of the depressing business conditions in Western Pennsylvania. In consideration of the public interest, the Commission must seek to aid the manufacturing climate in the region, and not throw roadblocks to manufacturing ability to compete in national and world markets.

At any rate, the Commission's conclusion that competition between jurisdictional gas utilities, where authorized service territories may overlap, is in the public interest is binding upon us as the present policy of the Commission.

Carnegie Service to Guardian Industries, Fisher Body, WABCO, and Westinghouse Electric

1. Carnegie Charter

Carnegie was incorporated on May 10, 1886 under the Natural Gas Companies Act of 1885. Carnegie described, in its original charter, its district of production, its district of supply and the route of its pipelines, in part as follows:

> The place or places where natural gas is intended to be mined for and produced or received are... Patton Township, North Versailles and Penn Township, in the county of Allegheny, state of Pennsylvania.
>
> The place or places where it is to be supplied to consumers to the citizens and manufacturing establishments along the main line as well as the several branches located in the townships of ... Patton, Wilkins Braddock, Sterret, Mifflin and Baldwin, the boroughs of Braddock and Homestead and cities of Pittsburgh and Allegheny in Allegheny County.

> The general route of its pipeline or lines and branches is the main line to extend from a point in Franklin Township in Westmoreland County into and through the townships of ... Patton, North Versailles, Wilkins, Braddock and Sterret Townships, in Allegheny County to and into the city of Pittsburgh....

By Certificate of Enlargement of its territory, dated May 15, 1889, Carnegie extended its districts of production, districts of supply and pipeline routes. That certificate, in part, provides:

> The place or places where natural gas is to be mined for, or produced and obtained and supplied, in addition to the places previously provided for, and from which gas is now produced or supplied, are ... Lincoln Township, Jefferson Township, Elizabeth Township and Forward Township, Allegheny County, Pennsylvania ....
>
> The general route of the extension or extensions of its pipeline or lines and branches, are as follows, to-wit:
>
> * * *
>
> (c) Beginning at a point at Thompson's Run in Mufflin Township, Allegheny County, Pennsylvania; thence in a southeasterly direction across said Mifflin Township, and into and across Jefferson Township, Allegheny County, Pennsylvania ....

Since 1889 Carnegie has been conducting gas production, gathering and transmission activities in Jefferson Township and Jefferson Borough. Carnegie was providing service in Jefferson Township as early as 1912, and has been serving the Jefferson United Presbyterian Church continuously since approximately 1920.

Carnegie is presently serving 50 customers in Jefferson Borough. Carnegie provides service to approximately 170 residential, 40 commercial and 4 industrial customers in West Mifflin Borough, Allegheny County. Carnegie's pipeline M-81 passes through Wilmerding and East Pittsburgh Boroughs, Allegheny County.

2. Carnegie's Rights Under Its Charter

Carnegie has a right and duty to provide service in its charter district of supply. A company formed under the Natural Gas Companies Act has an obligation to furnish gas, if reasonably available, to consumers in its charter territory. This obligation is correlative to the right to provide service granted by the Act. Pennsylvania Gas Company v. Pa. P.S.C., 83 Pa. Super. Ct. 557, 566 (1924).

We agree with Carnegie that law supports the proposition that under the Public Utility Code, a utility with charter rights predating the 1913 Public Service Company Law is not required to obtain Commission approval in order to provide existing or additional service within its charter territory. Harmony Electric Co. v. Pa. P.S.C., 275 Pa. 542, 119A 712 (1923) aff'g 78 Pa. Super Ct. 271 (1922); Dublin Water Co. v. Pa. P.U.C., 206 Pa. Super. Ct. 180, 213 A.2d 189 (1965); New Castle Electric Co. v. Pa. P.S.C., 70 Pa. Super Ct. 20 (1918); Pennsylvania Utility Co. v. Pa. P.S.C., 69 Pa. Super Ct. 612

(1918). As stated by the court in Dublin Water Co., 205 Pa. Super Ct. at 187-88, 213 A.2d at 143:

> As stated in Harmony Electric Co. v. P.S.C., 275 Pa. 542, 545, 119A. 712, affirming 78 Pa. Super. 271: "The statute ... does not contemplate that a certificate of public convenience shall be obtained by a corporation like the appellee, which was already doing business on January 1, 1914, for each step taken in advancement of its service within unabandoned chartered territory." To the same effect see Penna. Utilities Co. v. Lehigh Navigation Electric Co., 254 Pa. 289, 98 A. 950; Penna. Utilities Co. v. P.S.C., 69 Pa. Superior Ct. 612; and New Castle Electric Co. v. P.S.C., 70 Pa. Superior Ct. 20.

In addition to the right and duty to serve in a charter district of supply, a natural gas company has a right and duty to serve from its pipelines, whether or not they are in a charter district of supply.

While Equitable contends that a customer must be both along the lines and within the service district of a gas company, the Pennsylvania Supreme Court in Pennsylvania Gas Company v. Pa. P.S.C., held otherwise, holding that:

> The contention that an applicant for service must be both along respondent's lines and within its district is untenable. [at 561]

Thus, the Natural Gas Companies Act imposes a duty to serve customers along utility lines. Carnegie has a charter right and duty to provide service both in its charter district of supply and along and within convenient connecting distance of its lines, even though they are outside the district of supply.

Equitable's contention that the prior rights which are preserved are only those which a public utility has been continuously rendering from January 1, 1914 is without merit.

As we said in Columbia Gas of Pennsylvania, Inc. v. Carnegie Natural Gas Co., C-844082, at page 33:

> It is evident that the purpose of provision in the Natural Gas Companies Act, providing for natural gas service to consumers along or in the immediate vicinity of the gas company lines, was to maintain an element of fairness. When the Legislature gave gas companies the extraordinary right of eminent domain to take private property for the construction of its pipelines, basic fairness required that at least those whose private property was thus invaded (as well as nearby parties inconvenienced by the construction of the pipeline in the area) should have the right to make use of such pipeline facilities of the gas company, even though the gas company did not otherwise intend to serve the area. Pennsylvania Gas Co. v. Pa. P.S.C., 83 Pa. Superior Ct. 557; Beck v. Pennsylvania Gas Co. 18 Dist 245.

3. a. Guardian Industries
Pennsylvania Float Glass

Pennsylvania Float Glass Company (now Guardian Industries) is a manufacturer of glass with a plant located in Floreffe, Jefferson Borough, Allegheny County, which was formerly a part of Jefferson Township.

Carnegie and Pennsylvania Float Glass entered into a gas service agreement dated August 1, 1984. This agreement provides for the point of delivery for all natural gas by Carnegie to Pennsylvania Float Glass at the outlet side of Carnegie's measuring and regulating station to be established at Station 40 + 00 on Carnegie's line B-228 in Jefferson Borough. Pennsylvania Float Glass was to construct the pipeline from its plant to the connection on Carnegie's line.[3]

b. Fisher Body

Fisher Body Division of General Motors Corporation (Pittsburgh plant) filed an application with Carnegie for service dated October 12, 1954. Fisher Body has been a customer of Carnegie since that time. Carnegie is not considering constructing additional facilities to serve Fisher Body, has not made an offer of additional service to Fisher Body and is not considering additional service to Fisher Body.

[3] Equitable on June 26, 1985, filed a complaint against J W Wells, alleging that J W Wells, in constructing a natural gas pipeline between the plant of Guardian Industries, located in Jefferson Borough, Allegheny County, and a Carnegie pipeline in said Borough, is providing unauthorized public utility service in violation of the Public Utility Code.

We dismissed the complaint for lack of Commission jurisdiction. We reached the conclusion that the gas service provided by J W Wells, subsidiary of Guardian Industries, constituted service by and for itself and was not public utility service.

c. WABCO

Carnegie is not providing service to WABCO, however, it has met with representatives of WABCO who do not appear to be interested in Carnegie's service.

d. Westinghouse Electric

Carnegie is not providing services to Westinghouse Electric nor building facilities to connect Westinghouse. In April 1984 an offer of service at Carnegie's rates was made to Westinghouse.

Apollo Service to Alon
and A. P. Green/Wulfrath

1. Apollo Charter

Apollo was incorporated April 1, 1887 under the Natural Gas Companies Act of 1885. By Agreement and Consolidation an Merger dated December 30, 1916, Apollo merged with Versailles Fuel Gas Company, also organized under the Natural Gas Companies Act. Apollo was incorporated to provide natural gas service in a supply district described as "Apollo, Armstrong County and the vicinity thereabouts and in Westmoreland County on the opposite side of the Kiskiminetis River from Apollo and vicinity."

By articles of Incorporation dated March 25, 1971, Apollo amended its Articles of Incorporation to provide, in part, the following:

> 7. The places where natural or manufactured gas is to be supplied to customers along or within convenient connecting distance of the lines of pipe of the Corporation, including without limitation places presently supplied in or in the vicinity of the community of Creighton, East Deer Township, in Allegheny County ....
> [Apollo Stat. No. 1, Attach. No. 5]

2. <u>Apollo Service to Alon and A. P. Green (Wulfrath)</u>

Apollo approved Alon's application for gas service on November 15, 1983. To serve Alon, Apollo constructed a meter and regulator set and tapped its line M-67 in Grantham Street, Tarentum. Alon constructed the service line from Apollo's M-67 to the meter set. Line M-67 was acquired from PPG Industries, Inc. in 1971 by Apollo.

Apollo's line M-67, from which Alon is served and line G-190, from which Wulfrath is served, were both acquired by Apollo from PPG as part of the PPG acquisition. Transportation service has been provided to A. P. Green, the predecessor of Wulfrath, since April 1972 and sales service has been provided to A. P. Green since at least November 1975. Sales service has been provided to Alon since February, 1984.

Both Alon and Wulfrath have plants located <u>along</u> or adjacent to Apollo's line. In the case of Alon, Apollo's line, M-67, is located in Grantham Street, on which the Alon property is located. Line G-190 of Apollo runs through the Wulfrath property.

In Corbet v. Fuel Supply Co., 21 Pa. Super Ct. 80 (1902), the fuel company was seeking to discontinue gas service after five years of service. The court there said:

> ... the defendant company was incorporated under the Act of May 29, 1885, P. L. 29, and its supplement of May 11, 1897, P. L. 50, and under its charter it became its duty "to furnish gas to persons, corporation and associations within convenient connecting distance of its line of pipe, as may desire to use the same, upon such terms, and under such reasonable regulation, as the gas company shall establish."
> [at 87]

In Belusich v. United Natural Gas Company, 3 Pa. P.S.C. 1263 (1919) the complainant sought to compel service from the gas company which had a distribution main in the street on which complainant was located. The gas company alleged that it had "no charter right to serve the public in" that borough. The Commission ordered service.

Apollo was advised in a letter of its counsel, David Dunlap, dated September 27, 1971, which includes the statement:

> The company is also obliged to serve "along its lines" in political subdivisions in which it has no right or duty to serve the public generally.

The certificate of public convenience issued by the Commission to Apollo in conjunction with the acquisition of the PPG natural gas system to prohibit Apollo from providing service (without subsequent Commission approval) to "the general public" in Creighton or East Deer Township. Service to Alon and Wulfrath, both located in Tarentum, does not violate the conditions of the certificate of public convenience.

<u>Abandonment or Forfeiture of Rights of Carnegie</u>

Equitable in its Main Brief, and Peoples in its Brief as *Amicus Curiae*, assert that Carnegie has abandoned charter rights to serve in Jefferson Borough, Allegheny County, Pennsylvania, and therefore the Commission has the discretion to order Carnegie not to provide service to Guardian Industries in Jefferson Borough.

In this connection, it is noted that Equitable in its complaint against Carnegie regarding the proposed service of Carnegie to Guardian Industries (Pennsylvania Float Glass) did not allege that Carnegie lacked service rights to serve. Indeed, in its Amended Complaint, Equitable's only allegation is that Carnegie's service to Float Glass/Guardian Industries is unlawful in that such service is not in the "public interest".

Equitable in its Amended Complaint did not assert that Carnegie lacked charter rights to serve Float Glass/Guardian Industries in Jefferson Borough. To the contrary, paragraph 7(b) of the Amended Complaint recognizes "the overlapping service territories of natural gas utilities in southwestern Pennsylvania."

There is no evidence that Carnegie had abandoned its charter rights to render service in Jefferson Borough, Allegheny County, Pennsylvania. In order to find abandonment, the Commission must first find an intention to abandon, together with "external acts" by which the intention is carried into effect. Lacy v. East Broad Top Railroad and Coal Company, 168 Pa. Super Ct. 351, 71 A.2d 706 (1951). See also In Re General Electric Company, 58 Pa. P.U.C. 97 (1984)

Conclusions of Law

1. The Commission has jurisdiction over the parties and subject matter is this proceeding.

2. The matter is properly before the Commission.

3. The primary objective of the public service laws and the primary purpose of public utility regulation in Pennsylvania is to serve the public interest.

4. The Commission has adjudicated that it will not prevent competition between jurisdictional gas utilities where authorized service territories may overlap.

5. Apollo has a charter right and duty to provide gas service from and within convenient connecting distance of its lines of pipe.

6. Apollo has a right and duty, upon application, to provide gas service to Alon and Wulfrath.

7. Carnegie has a charter right and duty to provide gas service in its charter districts of production and supply and along and within convenient connecting distance of its line or pipe.

8. Carnegie has a right and duty to provide gas service in Jefferson Borough to Guardian Industries.

9. Carnegie has a right and duty to provide gas service in West Mifflin Borough to Fisher Body Division of General Motors Corporation.

10. Carnegie has a right and duty upon application, to provide gas service to WABCO in Wilmerding Borough.

11. Carnegie has a right and duty, upon application, to provide gas service to Westinghouse Electric Corporation in East Pittsburgh.

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Equitable Gas Company
v.
Apollo Gas Company

C-844028

ORDER

IT IS HEREBY ORDERED:

That the Complaint of Equitable Gas Company against Apollo Gas Company, at Docket No. C-844028 is hereby dismissed.

August 2, 1988

JOSEPH P. MATUSCHAK
Administrative Law Judge

CX0003

THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Joint application of Equitable Resources, Inc., and : The Peoples Natural Gas Company, d/b/a Dominion : Peoples, for approval of the transfer of all stock and : rights of The Peoples Natural Gas Company to : Equitable Resources, Inc., and for the approval of : the transfer of all stock of Hope Gas, Inc., dba : Dominion Hope, to Equitable Resources, Inc. :	A-122250F5000

INITIAL DECISION

Before
John H. Corbett, Jr.
Administrative Law Judge

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I. HISTORY OF THE PROCEEDING

This decision approves, without modification, the Joint Petition for Settlement of this application, which the parties joining therein filed on December 1, 2006.

On March 31, 2006, Equitable Resources, Inc. ("Equitable") and The Peoples Natural Gas Company, d/b/a Dominion Peoples ("Dominion Peoples"), (collectively the "Applicants" or the "Companies"), filed a joint application seeking Commission approval for the sale of all of the common stock of Dominion Peoples and Hope Gas, Inc., dba Dominion Hope[1] ("Dominion Hope"), by their parent company, Consolidated Natural Gas Company, to Equitable. Notice of the application was published in the *Pennsylvania Bulletin* on April 15, 2006. The notice announced that formal protests and petitions to intervene were to be filed with the Commission on or before May 1, 2006.

The Office of Trial Staff ("OTS") entered an appearance in this application proceeding. The Office of Consumer Advocate ("OCA") filed a protest, as did the Office of Small Business Advocate ("OSBA"), which also filed a notice of intervention. Numerous other parties either petitioned to intervene or submitted protests, including: Amerada Hess Corporation ("Hess"), Constellation NewEnergy-Gas Division, LLC ("Constellation"), Northway Group, L.P., Columbia Gas of Pennsylvania, Inc. ("Columbia Gas"),[2] the Peoples/Equitable Merger Intervenors ("PEMI"),[3] The National Energy Marketers Association ("NEMA"), Pittsburgh Theological Seminary, Amore Management Company, McKinney Properties, Inc., Crossgates Management, Inc., Independent Oil and Gas Association of Pennsylvania ("IOGA"), Elmhurst Company L.P., Energy Savers, Inc., International Brotherhood of Electrical Workers Local 1956 ("IBEW"), Utility Workers Union of America Local 69 Division 1 ("UWUA"), NRG Energy Center of Pittsburgh, LLC ("NRG"), Pittsburgh Allegheny County Thermal, Ltd. ("PACT"),

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1 No slashes separate the "dba" for Dominion Hope in its home state of West Virginia.

2 Columbia Gas petitioned to intervene on a limited basis to monitor this proceeding.

3 While somewhat fluid throughout this proceeding, PEMI's *ad hoc* membership at the time of this decision includes: Albermarle Corporation, Allegheny Ludlum Corporation, BNZ Materials, Inc., Kopp Glass, Inc., Precoat Metals, PPG Industries, Inc., Union Electric Steel Corporation, and the University of Pittsburgh Medical Center.

United Cerebral Palsy Association, Agway Energy Services, LLC, Mozart Management, Benedictine Sisters of Pittsburgh, NDC Real Estate Management, Inc., Allegheny Cemetery, UGI Energy Services, Inc., and Mon Valley Unemployed Committee ("MVUC").

On May 25, 2006, a prehearing conference was held. A Prehearing Order on June 2, 2006, *inter alia*, established a litigation schedule and modified the Commission's rules on discovery. Thereafter, eighteen Interim Orders were issued. On June 7, 2006, a First Interim Order granted a motion for admission *pro hac vice* of counsel for Dominion Peoples. A Second Interim Order, together with an Amended Second Interim Order, amended the service list for this case on June 12, 2006. Those Orders granted a letter request dated June 8, 2006 seeking to withdraw the intervention of Energy Savers, Inc. *See*, 52 Pa. Code §5.94. The following entities also were removed from the active service list: Agway Energy Services, LLC, Allegheny Cemetery, Amore Management Company, Benedictine Sisters of Pittsburgh, Crossgates Management, Inc., Elmhurst Company L.P., Energy Savers, Inc., McKinney Properties, Inc., Mozart Management, NDC Real Estate Management, Inc., Northway Group, L.P., Pittsburgh Theological Seminary, and the United Cerebral Palsy Association.

A Third Interim Order granted the motion of Pennsylvania State Representative Jake Wheatley, Jr. to intervene in this action. During the interim, the Applicants on June 19, 2006 petitioned the Commission for interlocutory review and answer to a material question pursuant to 52 Pa. Code §5.302 requesting that the litigation schedule established at the prehearing conference be expedited. Several of the parties, including the OTS, OCA and OSBA, filed briefs in opposition thereto. By Opinion and Order entered July 21, 2006, the Commission granted the petition for interlocutory review, but answered the material question in the negative. The Fourth through Tenth, Fourteenth and Fifteenth Interim Orders ruled on discovery matters. An Eleventh Interim Order granted the motion of the International Brotherhood of Electrical Workers Local 1956 to withdraw its petition to intervene. *See*, 52 Pa. Code §5.94. A Twelfth Interim Order declassified material previously deemed proprietary. A Thirteenth Interim Order denied a motion to strike testimony. A Sixteenth Interim Order granted NRG's request for leave to withdraw its protest on November 6, 2006. *Id.* A Seventeenth Interim Order granted the request of PACT for leave to withdraw its petition to intervene on November 16, 2006. *Id.* An Eighteenth Interim Order issued on November 17, 2006 modified the litigation schedule.

Public input hearings were held in Pittsburgh on July 18, 2006 at 2:00 p.m. and 7:00 p.m. respectively. Altogether, a total of 18 persons testified at these public input hearings. The testimony admitted into the record at the public input hearings is summarized, *infra*. During technical evidentiary hearings on November 14-17, 2006,[4] various parties submitted prepared written testimony and cross-examined sponsoring witnesses. Altogether, the prehearing conference and these hearings produced 554 pages of notes of testimony.

On December 1, 2006, Equitable, Dominion Peoples, OTS, OCA, State Representative Jake Wheatley, Jr., MVUC, IOGA and Hess/Constellation (hereinafter collectively referred to as the "Joint Petitioners") executed and filed a Joint Petition for Settlement (the "Settlement"). On the same day, the Joint Petitioners also served copies of the same upon all other active parties, who did not join in the Settlement. The Settlement is attached hereto and is incorporated herein by reference.[5] The Joint Petitioners and those active parties opposing the Settlement filed main and reply briefs urging adoption or rejection of the proposed Settlement or portions thereof as their respective interests dictate.[6] The record closed on January 12, 2007.

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[4] A hearing scheduled for November 13, 2006 was cancelled at the request of the parties in order to accommodate settlement discussions. Evidentiary hearings commenced on the afternoon of November 14, 2006.

[5] The terms of the Settlement are expressed in three executed term sheets (Appendices A, B & C to the Joint Petition for Settlement). Unless otherwise expressly stated, no Joint Petitioner supports settlement terms other than those presented in its individually executed settlement term sheet. The Applicants submit that these terms, taken together, "represent a resolution of a broad and diverse array of interests which… confirm the public interest and benefit the transaction" (Petition at ¶12; OTS M.B. at 2, n. 1).

[6] The Applicants, OTS, OCA, IOGA and Hess/Constellation filed main and reply briefs, while MVUC only filed a main brief supporting the Settlement. Rep. Wheatley submitted a letter/statement supporting the Settlement in lieu of a brief. The OSBA, UWUA, NEMA and PEMI filed main and reply briefs opposing all or portions of the Settlement.

II. THE PUBLIC INPUT HEARINGS

A. 2:00 p.m., July 18, 2006, Pittsburgh, Pa.

1. State Representative Michael Turzai represents the Twenty-eighth District in the Pennsylvania General Assembly. He lives at 29 Meetinghouse Lane, Bradford Woods, Pennsylvania 15015. Rep. Turzai supports the application, because he believes the acquisition will bring 200 additional jobs to Southwestern Pennsylvania as the Applicants declare in the application. He believes multiple gas lines of the two utilities running in the same area is a wasteful redundancy that this acquisition will cure by according the Applicants an opportunity to engage in economies of scale and save their customers money (N.T. 73-86).

2. Alexander Nichols, who resides at 2057 Carriage Hill Road, Allison Park, Pennsylvania, is the president of the Pittsburgh Regional Minority Purchasing Council ("PRMPC"), which is affiliated with the National Minorities Supplier Development Council ("NMSDC"). NMSDC is a 34-year-old organization created by corporate America with the assistance of the U.S. Department of Commerce, Office of Minority Business Enterprises in 1972 for the specific purpose of providing opportunities for minority-owned businesses. It currently serves more than 3,600 corporations and its database has more than 16,000 certified minority-owned businesses, served through a network of 39 affiliated councils in the United States and Puerto Rico. In 2004, it reported more than $89 billion in contracting with minority suppliers. In Pittsburgh, PRMPC has 110 certified minority businesses and 80 corporate members. Historically, both Equitable and Dominion Peoples were members of the PRMPC, but Equitable dropped its membership in 2002 and has not been visible since. On the other hand, Dominion Peoples has been a very supportive member of the PRMPC and reported $49 million in purchases from minority suppliers in 2004 and it has participated in every event that PRMPC sponsored. With the announcement of the acquisition, however, Dominion Peoples has not renewed its membership in the PRMPC and it has not participated in any PRMPC event this year. Mr. Nichols is concerned that Equitable's lack of interest will mean less participation in the PRMPC in the future (N.T. 87-90).

3. John Robert Laymon, who resides at 236 Charlemma Drive, Pittsburgh, Pennsylvania 15214, is the owner and president of JRL Enterprises, which supplied temporary personnel services to Equitable for 15 years. He notes that several African-American Equitable employees instrumental in maintaining a good business relationship with JRL recently left their employment and were not replaced by African-Americans. Afterwards, Equitable held an auction for the services that JRL provided and awarded the contract to another supplier. He believes that "Equitable's handling of this entire process was mean-spirited and would not have occurred when African-Americans sensitive to diversity were in responsible positions." He has noticed a significant decline in the amount of minority business with Equitable. If the acquisition is approved, Mr. Laymon would like to see improvement in Equitable's handling of diversity relationships (N.T. 91-93).

4. Samson McMahon, who resides at 1922 Shaler Drive, Glenshaw, Pennsylvania, is self-employed with Verification Services Company and he has been a customer of Dominion Peoples for 35 years. He opposes the acquisition, because he believes captive customers will shoulder a disproportionate share of the cost and he believes Equitable's management has been evasive about the effects of this transaction (N.T. 93-111).

5. James R. Behr has owned Energy Savers, Inc., located at 306 McKnight Park Drive, Pittsburgh, Pennsylvania, for 24 years. He markets electric and natural gas service to commercial properties. He opposes the acquisition, because he believes Equitable presents no substantive evidence to support it. While noting that Equitable claims that this transaction is an acquisition and not a merger, Equitable has already started notifying customers that discounted contracts will be eliminated and competition will no longer exist. One local hotel has received notice that its natural gas prices will increase $150,000 annually. Mr. Behr asserts that healthy competition among the three natural gas utilities in Pittsburgh has allowed older buildings in the city that are less energy efficient to compete for tenants with more modern energy efficient facilities in the suburbs. He believes that if the Commission approves the acquisition, Dominion Peoples will abandon its interstate gas suppliers in favor of using Equitrans, an Equitable affiliate, at a higher cost (N.T. 111-17).

6. Randall C. Hillard is a senior vice president for National Development Management Corporation ("NDC") with offices located at 4415 Fifth Avenue, Pittsburgh, Pennsylvania 15213. NDC, the largest Pittsburgh-based property management company, manages approximately 100 properties on the East Coast and about 9,000 apartments. Because of the existing competition between Equitable and Dominion Peoples, he has been able to obtain competitive rates. Without competitive rates, his gas bill will increase $160,000 annually, which he cannot pass on to his tenants. Consequently, the increased gas cost would mean that he would have to eliminate five employees. His experiences with Dominion Peoples have been very cordial, while he has found the relationship with Equitable to be very difficult (N.T. 117-22).

B. 7:00 p.m., July 18, 2006, Pittsburgh, Pa.

7. Joel S. Barton is a staff accountant with Elmhurst Company, with offices located at 1 Bigelow Square, Pittsburgh, Pennsylvania 15219. Elmhurst is a Pittsburgh-based business that acquires and develops high-quality real estate, which includes over 2 million square feet of office, distribution, hotel and flex space in western Pennsylvania. Mr. Barton works with Mr. Behr of Energy Savers to obtain natural gas service at the best rates for Elmhurst's buildings. Recently, he negotiated with Dominion Peoples to obtain natural gas service for the Doubletree Hotel. But once the proposed acquisition was announced, all further negotiations ceased. When he attempted to negotiate with Equitable, its representative informed him that since competition no longer existed, Equitable was no longer offering discounted contracts. Further, once it received approval of the acquisition, Equitable informed him that Elmhurst would be expected to pay the full tariff rate. Mr. Barton explains a full tariff rate would mean a threefold increase of approximately $150,000 a year for the Doubletree Hotel. Elmhurst cannot pass this increase on to hotel guests or to its other commercial tenants (N.T. 138-44; Public Input Hearing Exh. 1).

8. William W. Belt, who resides at 2304 Center Avenue, Pittsburgh, Pennsylvania 15219, is a security guard at the University of Pittsburgh. He is president of the Association of Community Organizations and Reform Now ("ACORN") and vice president of the Coalition of Black Trade Unionists. He is concerned that any increase in gas prices resulting from this acquisition will negate the recently won raise in the minimum wage (N.T. 145-46).

9. Richard LeGrande, who resides at 726 Anaheim Street, Pittsburgh, Pennsylvania 15219, is the manager of the Ship of Zion Project, a faith-based initiative connecting welfare and entry-level employees with places of employment. Formerly, he was a moderator of the Presbyterian Hunger Committee for the Pittsburgh Presbytery, where he encountered many instances of gas service termination and its effect upon low income individuals. If the acquisition is approved, he urges a safety net for these people (N.T. 146-48).

10. Nettie Pelton, who resides at 90 Industry Street, Pittsburgh, Pennsylvania, is a retired hotel worker. She is concerned about the effect of the proposed acquisition upon the utilities' low income customers and the Customer Assistance Program ("CAP") and Low Income Home Energy Assistance Program ("LIHEAP") (N.T. 148-50).

11. Willamae Tot, who resides at 2011 Zimmerman Street, Pittsburgh, Pennsylvania 15210, is retired from the City of Pittsburgh School District. She is also a member of ACORN and two grandparent support groups. She opposes the proposed acquisition, finding that it will not assist low income people (N.T. 150-51).

12. Jack Harris, who resides at 548 Rosedale Street, Pittsburgh, Pennsylvania, is currently receiving disability income. He also expresses concern about how the proposed acquisition will affect low income people (N.T. 151-52).

13. Michael Maloney, who resides at 715 Marzolf Road Extension, Shaler Township, Allegheny County, is an employee of Equitable, performing service terminations. He wonders whether the 200 jobs that the acquisition promises will remain in this area. As a Dominion Peoples customer, he finds the cost of his natural gas to be $2.00 less per Mcf than with Equitable and without competition, he believes his gas rates will increase (N.T. 153-55).

14. Paul LoDico, who resides at 849 Deely Street, Pittsburgh, Pennsylvania 15217, is a director of the Mon Valley Unemployed Committee ("MVUC"). He is concerned about obtaining quality jobs with family-sustaining wages for this region. He wants to hold Equitable to its promise that this acquisition will create 200 new jobs. He wonders why this

proposed transaction is termed an acquisition and not a merger. He wants assurance that assistance will be available to low income people, if this acquisition is approved (N.T. 156-64).

15. James Eichenlaub is the director of governmental affairs for the Apartment Association of Metropolitan Pittsburgh with offices located at 2041 Boulevard of the Allies, Pittsburgh, Pennsylvania. This organization represents 250 owners and vendors of multifamily rental properties in southwestern Pennsylvania, predominantly in Allegheny County. While this organization has not taken a position on the proposed acquisition, its representatives have met with Equitable to discuss its concerns. This organization was uncertain whether it would seek to intervene in this proceeding (N.T. 164-69).

16. Lillian Griffen Allen, who resides at 140 Robinson Street, Pittsburgh, Pennsylvania 15213, is a 97-year-old retired beautician. She wants to know what will happen to her gas line insurance, if this acquisition is approved (N.T. 170-72).

17. John Kelly, who resides at 350 Turngate Drive, Bethel Park, Pennsylvania 15102, is a community organizer for ACORN, which is a grass-roots organization working to advance the causes of low to moderate income working families. He is concerned that the acquisition will mean higher gas prices for not only himself, but also for low income people. He is also concerned about the accountability of a larger gas company after the acquisition (N.T. 172-75).

18. James Maloney, who resides at 25 Arlor Drive, Pittsburgh, Pennsylvania 15214, is a retired employee of Equitable. He was employed with Equitable for 35 years, reading meters, shutting off gas service and working in the warehouse. He opposes the acquisition, because he believes Equitable is not fiscally responsible. Equitable has fewer employees and it subcontracts more work now, including meter reading (N.T. 175-78).

III. FINDINGS OF FACT

1. Equitable Resources, Inc. ("Equitable") is a publicly held, Pennsylvania corporation formed in 1925 by the consolidation and merger of Equitable Gas Company and Monongahela Natural Gas Corporation with a corporate history dating to 1888. Headquartered in Pittsburgh, Equitable is an integrated energy company, with an emphasis on Appalachian area natural gas supply activities including production and gathering and natural gas distribution and transmission (Applicants Exh. 1 at 3-4; and Equitable St. 1 at 4).

2. Equitable Gas Company ("Equitable Gas") is the operating utility division of Equitable. It provides natural gas service to approximately 257,000 customers in ten Pennsylvania counties, including the City of Pittsburgh, and to 13,474 and 3,702 customers in West Virginia and Kentucky, respectively (Applicants Exh. 1 at 3-4; and Equitable St. 1 at 4).

3. The Peoples Natural Gas Company, d/b/a Dominion Peoples, is a public utility corporation incorporated in Pennsylvania in 1885 that provides natural gas service to approximately 357,000 customers in 16 Pennsylvania counties. Dominion Hope is a natural gas public utility operating in West Virginia subject to the jurisdiction of the Public Service Commission of West Virginia ("PSCWV") (Applicants Exh. 1 at 3; and Equitable St. 1 at 5).

4. Dominion Peoples and Dominion Hope are direct, wholly-owned subsidiaries of The Consolidated Natural Gas Company ("CNG"), a holding company incorporated in Delaware. CNG is a direct, wholly-owned subsidiary of Dominion Resources, Inc., a holding company organized under the laws of the Commonwealth of Virginia (Applicants Exh. 1 at 3; and Equitable St. 1 at 5).

5. If this application is approved, Equitable will acquire Dominion Peoples and Dominion Hope in a stock transaction under which Dominion Peoples and Dominion Hope will become direct, wholly-owned subsidiaries of Equitable. Under terms of the Stock Purchase Agreement, Equitable will acquire all of the outstanding capital stock of Dominion Peoples and Dominion Hope (Applicants Exh. 1 at Appendix A).

6. Dominion Peoples will continue to exist as a Pennsylvania public utility corporation and remain subject to regulation by this Commission. It will adhere to its existing tariff until changed by this Commission's approval. Dominion Hope will continue to exist as a West Virginia public utility corporation and remain subject to the regulation of the PSCWV (Applicants M.B. at Appendix A, ¶6).

7. The consideration for the stock acquisition is approximately $970 million, which was determined by competitive bidding and arms-length negotiation (Applicants Exh. 1 at 6; and Equitable St. 1 at 4-6).

8. Equitable will pay cash for the stock and finance the transaction through a combination of equity and debt securities and possible asset sales. Equitable will register the appropriate securities certificate with the Commission prior to issuing securities associated with the transaction (Applicants Exh. 1 at 6; and Equitable St. 1 at 8).

9. The acquisition will enhance Equitable's corporate presence in Pennsylvania and return ownership of Dominion Peoples to Pennsylvania. Equitable's corporate headquarters is located in Pittsburgh in a revitalized area on the North Shore of the Allegheny River. Equitable will expand its presence on the North Shore, benefiting the City and region (Applicants Exh. 1 at 8-9; and Equitable St. 1 at 3, 9-11).

10. Equitable claims the acquisition may add 200 new jobs in the Pittsburgh and northern West Virginia region, while honoring Dominion Peoples' labor contracts. New jobs in corporate shared services, information technology and customer services will be necessary to replace part of Dominion Peoples' support operations in Ohio and Virginia, which will remain with Dominion's other business units (Applicants Exh. 1 at 8; Equitable St. 1 at 9, 14; and Equitable St. 1-R at 12-13 and Attachment A thereto).

11. The acquisition offers an opportunity over time to reduce annual purchased gas costs ("PGC") by approximately $10 million or $0.154 per Mcf through the elimination of interstate pipeline transportation and storage contracts that Dominion Peoples has

with Texas Eastern ("TETCO"), Tennessee ("TGP") and Dominion Transmission ("DTI") (Equitable St. 1-R at 4, 12; and Equitable St. 3-R at 15-16).

12. Equitable projects potential savings approximating $145 million will exist as a result of the acquisition eliminating redundant pipe in overlapping service territories:

- Savings of $114,887,000 were identified under the assumption that 74.4 miles of bare steel and cast iron pipe of either company could be eliminated and the cost to replace these segments avoided, because of the proximity of pipe from the other company;
- Savings of $4,190,000 were identified under the assumption that approximately 4 miles of coincidental steel-installed from 1961-1971 could be eliminated should leakage justify replacement;
- Savings of $500,000 per year were projected from the avoidance of mainline extension costs due to the elimination of competition to serve new load;
- Operational savings of $489,500 per year were estimated in the areas of leak surveillance and leak repair associated with the elimination of coincidental pipe;
- Anticipated future projects, which would enhance system operation on Dominion Peoples' system on a stand-alone basis but likely will be unnecessary if the systems are combined, were identified to save $20.5 million;
- Unquantified savings identified include opportunities for cost avoidance in the areas of mandatory relocations, elimination of single feed systems and distinct regulating stations, and future potential replacements of critical feeds and crossings.

(OCA St. 3S, Attachment RCS-2S).

13. As a result of these investment and operational savings, customer rates could be lower than they otherwise would be absent the stock acquisition. Elimination of redundant pipe in overlapping service territories will create substantial savings that could not be achieved absent the stock acquisition (Equitable St. 1-R at 4, 17-18).

14. Subject to certain limited exceptions, Equitable and Dominion Peoples will not file a general increase in base rates under Section 1308(d) of the Public Utility Code (the "Code") before January 1, 2009. This Rate Case Stay-out provision will provide ratepayers with a measure of rate stability into 2009 (Joint Petition for Settlement, Appendix A at ¶1).

15. Any acquisition premium and transaction costs, including all tax effects, will be excluded from rates. Expenses and capital costs associated with the acquisition will be accounted for in accordance with GAAP and not deferred for future recovery (Joint Petition for Settlement, Appendix A at ¶2).

16. The Settlement provides for the creation of a service quality index (SQI") with proposed annual performance standards in certain areas. If the SQI standards are not met during the effective period of the Settlement, the Commission may open a formal proceeding to investigate the non-attainment of the performance standards in question (Joint Petition for Settlement, Appendix A at ¶6).

17. The Joint Applicants and other interested parties will form a Universal Service Collaborative Group to discuss universal service and energy conservation issues. The Group, *inter alia*, will meet as needed, but not less than semi-annually and discuss Universal Service program changes, best practices and integration issues prior to any Universal Service program modification and before any filing is made with the Commission to merge the former Dominion Peoples' program with the Equitable program. Dependent on the receipt of adequate program funding, Joint Applicants agree not to impose any ceiling on Customer Assistance Program ("CAP") enrollment (Joint Petition for Settlement, Appendix A at ¶5).

18. The Settlement recognizes the importance of providing market access and economic opportunities to diverse businesses and people. Equitable's senior management and Rep. Wheatley agree to work together to accomplish diversity objectives (Joint Petition for Settlement, Appendix A at ¶8).

19. The acquisition will add approximately 357,000 customers to Equitable's Pennsylvania operations providing opportunities for economies of scale that might not otherwise occur absent the transaction. Over time, Equitable expects the expanded customer base and resulting opportunities for economies of scale to produce rates for distribution service lower than the rates that would otherwise have occurred (Applicants Exh. 1 at 9; Equitable St. 1-R at 5, 19-20; and Equitable St. 2 at 7).

20. Equitable believes a combined pool of 568,000 potential residential choice customers will provide an opportunity for natural gas suppliers ("NGSs") to benefit from economies of scale through reduced transaction costs and reductions in the cost to acquire customers (Applicants Exh. 1 at 9; Equitable St. 1-R at 5, 19-20; Equitable St. 2 at 7).

21. The concentration of payment-troubled customers is higher in Equitable's service territory than anywhere else in the Commonwealth outside of Philadelphia. Equitable posits spreading Universal Service costs more widely throughout western Pennsylvania is consistent with the Natural Gas Choice and Competition Act and a public benefit (Applicants Exh. 1 at 9; Equitable St. 1 at 12-14; and Equitable St. 1-R at 5-6, 20).

22. For a period of three years, Equitable Gas and Dominion Peoples will maintain contributions to hardship funds and the local community at least at the level of direct contribution amounts attributable to Equitable Gas and Dominion Peoples in 2005, net of the contributions made to the 2005 Stay Warm Pennsylvania Program (Joint Petition for Settlement, Appendix A at ¶5).

23. Equitable will contribute sufficient amounts to the Pension Plan for Dominion to meet ERISA and Pension Protection Act of 2006 safeguards thereby securing the pension benefits of Dominion Peoples employees (Joint Petition for Settlement, Appendix A at ¶4).

24. Equitable agrees to use aerial patrols to monitor transmission lines for excavation activity and encroachment. It will review and implement procedures similar to

Dominion Peoples' program for identifying areas of active corrosion on cathodically unprotected pipelines. Equitable will aggressively review the existing valves in its and Dominion Peoples' distribution systems in order to isolate relatively small areas in the event of an emergency and install new valves where necessary. Upon completion of the transaction, Equitable will also begin to develop an action plan to address bare steel and cast iron pipe on the Dominion Peoples system (Equitable St. 1 at 15).

25. As part of a later proceeding combining the tariffs of Equitable and Dominion Peoples, Equitable will file tariff provisions that promote development of the competitive retail natural gas supply market in the combined Equitable/Dominion Peoples service territory. Prior to commencing any proceeding to combine tariffs, Equitable agrees to form a users group of marketers to make recommendations concerning the proposed merged tariff (Joint Petition for Settlement, Appendix C at pp. 3-4).

26. Any diminution in benefits which Equitable/Dominion Peoples customers may have derived by elimination of gas-on-gas distribution competition between Equitable and Dominion Peoples will be mitigated through the development of an effectively competitive retail gas commodity market (NEMA/Hess/Constellation St. 1-R at 3-4).

27. To advance the competitive retail natural gas supply market, Equitable will begin exiting its Agency Service program as it presently exists and will limit provision of its Agency Service going forward. As part of this process, Equitable will advise its customers that they can receive their natural gas supply from an NGS of their choice and Equitable will provide them with a list of all current NGSs, including Equitable Energy, that are licensed to supply gas in the service territory (Joint Petition for Settlement, Appendix C at pp. 1-3).

28. Equitable will implement certain Dominion Peoples' operational rules and practices for pool operators, including a monthly gas accounting methodology and an historical meter production/nomination methodology to simplify movement of locally produced Pennsylvania natural gas. Equitable agrees to integrate its Apollo District with its Equitable District and with the Dominion Peoples system and charge producers one set of uniform rates for

the entire Equitable/Dominion Peoples transmission/distribution system/gathering system (Joint Petition for Settlement, Appendix B at ¶¶1-2).

29. Historically, Equitable has tried to increase local gas production on its system. If the Commission approves this transaction, Equitable believes the potential exists for lower cost local Appalachian production to displace 10-15 Bcf of interstate pipeline supplies on an annual basis (Equitable St. 3 at 15; and Equitable St. 3-R at 20, 23-25).

30. Equitable posits the proposed acquisition will have no effect on Equitable or Dominion Peoples employees or their authorized collective bargaining agents. No workforce reductions are proposed (Equitable St. 1 at 18).

IV. DISCUSSION

A. Introduction

Equitable is a publicly held, Pennsylvania corporation formed in 1925 by the consolidation and merger of Equitable Gas Company and Monongahela Natural Gas Corporation with a corporate history dating to 1888. Headquartered in Pittsburgh, Equitable is an integrated energy company, with an emphasis on Appalachian area natural gas supply activities including production and gathering and natural gas distribution and transmission. Equitable Gas Company ("Equitable Gas") is the operating utility division of Equitable. It provides natural gas service to approximately 257,000 customers in ten Pennsylvania Counties,[7] including the City of Pittsburgh, and to 13,474 and 3,702 customers in West Virginia and Kentucky, respectively (Applicants Exh. 1 at 3-4; Equitable St. 1 at 4).

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[7] Equitable Gas provides service in all or a portion of the following counties: Allegheny, Armstrong, Butler, Clarion, Fayette, Greene, Indiana, Jefferson, Washington and Westmoreland (Applicants Exh. 1, n. 6).

Dominion Peoples is a public utility corporation incorporated in Pennsylvania in 1885 that provides natural gas service to approximately 357,000 customers in 16 Pennsylvania counties.[8] Dominion Hope is a natural gas public utility operating in West Virginia subject to the jurisdiction of the Public Service Commission of West Virginia ("PSCWV"). Dominion Peoples and Dominion Hope are direct, wholly-owned subsidiaries of CNG, a holding company incorporated in Delaware. CNG is a direct, wholly-owned subsidiary of Dominion, a holding company organized under the laws of the Commonwealth of Virginia (Applicants Exh. 1 at 3; Equitable St. 1 at 5).

Equitable wishes to acquire Dominion Peoples and Dominion Hope in a stock transaction under which Dominion Peoples and Dominion Hope will become direct, wholly-owned subsidiaries of Equitable. Under the terms of the Stock Purchase Agreement,[9] Equitable will acquire all of the outstanding capital stock of Dominion Peoples and Dominion Hope. Dominion Peoples will continue to exist as a Pennsylvania public utility corporation and remain subject to this Commission's regulation. It will adhere to its existing tariff until changed with this Commission's approval. Dominion Hope will continue to exist as a West Virginia public utility corporation and remain subject to the regulation of the PSCWV. The consideration for the transfer is approximately $970 million, which was determined by competitive bidding and arms-length negotiation (Applicants Exh. 1 at 6; Equitable St. 1 at 4-6).

Equitable will pay cash for the stock and finance the transaction through a combination of equity and debt securities and possible asset sales. Equitable will register the appropriate securities certificate with the Commission before issuing securities associated with the transaction. Equitable is an A-rated company with almost $4 billion of assets and deferred debits and will have no difficulty securing the financing necessary to complete the transaction (Equitable St. 1 at 8; Applicants Exh. 1 at 6).

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[8] Dominion Peoples provides service in all or a portion of the following counties: Allegheny, Armstrong, Beaver, Blair, Butler, Cambria, Clarion, Fayette, Greene, Indiana, Lawrence, Mercer, Somerset, Venango, Washington and Westmoreland (Applicants Exh. 1, n. 4).

[9] The Stock Purchase Agreement is attached as Appendix A to Applicants' Exhibit 1.

Equitable is proceeding with this transaction in a fashion consistent with the approach it previously used with this Commission's oversight in acquiring Carnegie Natural Gas Company in 1999. Equitable intends to complete the stock transaction, become completely familiar with the Dominion Peoples and Dominion Hope systems and operations, and with Commission approval, ultimately combine the assets of Equitable Gas and Dominion Peoples into one operational unit with one set of rates and one Commission-approved tariff (Applicants Exh. 1 at 8; Equitable St. 1 at 6-7; and Equitable St. 1-R at 4-5).

B. Applicable Legal Principles

Section 332(a) of the Public Utility Code, 66 Pa. C.S. §332(a), provides that the party seeking affirmative relief from the Commission bears the burden of proof. As the parties seeking approval of their proposed transaction, the Applicants here bear that burden of proof. The term "burden of proof" means a duty to establish a fact by a preponderance of the evidence. Se-Ling Hosiery v. Margulies, 364 Pa. 45, 70 A.2d 854 (1954); Samuel J. Lansberry, Inc. v. Pa. P.U.C., 578 A.2d 600 (Pa. Cmwlth. 1990); and Feinstein v. Philadelphia Suburban Water Company, 50 Pa. P.U.C. 300 (1976). The term "preponderance of the evidence" means one party must present evidence which is more convincing, by even the smallest amount, than the evidence presented by the other party. *Id.* Accordingly, one must review the record in this application to determine whether the Applicants have satisfied their burden of proof.

Furthermore, the Applicants must obtain Commission approval, in the form of a certificate of public convenience, for Equitable to acquire the stock of Dominion Peoples and Dominion Hope, and for Dominion Peoples and Equitable to transfer used and useful property by means of a stock purchase. Section 1102 of the Public Utility Code, 66 Pa. C.S. §1102, provides, in pertinent part:

> Upon application of any public utility and the approval of such application by the commission, evidenced by its certificate of public convenience first had and obtained, and upon compliance with existing laws, it shall be lawful:

> (3) For any public utility or affiliated interest of a public utility as defined in section 2101 . . . to acquire from, or transfer to, any person or corporation . . . by any method or device whatsoever, including the sale or transfer of stock, including a consolidation, merger, sale or lease, the title to, or the possession or use of, any tangible or intangible property used or useful in the public service.
>
> (4) For any public utility to acquire 5% or more of the voting capital stock of any corporation.[10]

In City of York v. Pa. P.U.C., 449 Pa. 136, 295 A.2d 825 (1972), the Supreme Court of Pennsylvania explained in the context of a utility merger that before it may issue a certificate of public convenience, the Commission must find that an affirmative public benefit will result from the transaction:

> [A] certificate of public convenience approving a merger is not to be granted unless the Commission is able to find affirmatively that a public benefit will result from the merger . . . . [T]hose seeking approval of a utility merger [are required to] demonstrate more than the mere absence of any adverse effect upon the public . . . . [T]he proponents of a merger [are required to] demonstrate that the merger will affirmatively promote the "service, accommodation, convenience, or safety of the public" in some substantial way.

Id., 295 A.2d at 828.

To ensure that a transaction is in the public interest, the Commission may impose conditions on granting a certificate of public convenience. Joint Application for Approval of the Merger of GPU, Inc. with FirstEnergy Corp., Docket No. A-110300F0095, 2001 Pa. P.U.C. LEXIS 23 (2001). Section 1103(a) of the Code, 66 Pa. C.S. §1103(a), provides in part:

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[10] *See also*, 52 Pa. Code §69.901, which explains the Commission's Statement of Policy relating to application of its jurisdiction over a transaction resulting in a different entity becoming the beneficial holder of the largest voting interest in a utility, regardless of the acquiring entity's tier in the corporate organization.

> A certificate of public convenience shall be granted by order of the commission, only if the commission shall find or determine that the granting of such certificate is necessary or proper for the service, accommodation, convenience, or safety of the public. The commission, in granting such certificate, may impose such conditions as it may deem to be just and reasonable.

Moreover, when evaluating the consolidation of two natural gas distribution companies, Section 2210 of the Natural Gas Choice and Competition Act (the "Competition Act"), 66 Pa. C.S. §2210, requires the Commission to consider:

> Whether the proposed merger, consolidation, acquisition or disposition is likely to result in anticompetitive or discriminatory conduct, including the unlawful exercise of market power, which will prevent retail gas customers from obtaining the benefits of a properly functioning and effectively competitive retail natural gas market.

The Competition Act also authorizes the Commission to impose necessary terms and conditions to preserve the benefits of a properly functioning and effectively competitive retail natural gas market. 66 Pa. C.S. §2210(b). If the Commission finds that a proposed transaction is likely to result in anticompetitive or discriminatory conduct, including the unlawful exercise of market power, which will prevent retail gas customers from obtaining the benefits of a properly functioning and effectively competitive retail natural gas market, the Commission shall not approve the proposed transaction, except upon such terms and conditions as it finds necessary to preserve the benefits of a properly functioning and effectively competitive natural gas market. *Id.*

In addition, the Commission must also consider the effect of the proposed transaction upon the employees of the natural gas distribution company and on any authorized collective bargaining agent representing those employees. 66 Pa. C.S. §2210(a)(2).

Finally, the Commission's standards for reviewing a non-unanimous settlement, as proposed here, are the same as those for deciding a fully contested case. Pa. P.U.C. v. PECO Energy Company, Docket Nos. R-00973953 and P-00971265; 1997 Pa. P.U.C. LEXIS 51, *17-

*18 (Order entered December 23, 1997). Accordingly, substantial evidence consistent with statutory requirements must support the proposed settlement. Popowsky v. Pa. P.U.C., 805 A.2d 637 (Pa. Cmwlth. 2002); and ARIPPA v. Pa. P. U.C., 792 A.2d 636 (Pa. Cmwlth. 2001).

C. The Merits of the Transaction

1. Overview

Equitable maintains the proposed acquisition will enhance its corporate presence in Pennsylvania and return ownership of Dominion Peoples to this Commonwealth. Equitable is a Pennsylvania corporation with a corporate history dating back to 1888. Its corporate headquarters is located in Pittsburgh in a revitalized area of offices, restaurants and entertainment facilities situated between PNC Park and Heinz Field on the North Shore of the Allegheny River. Its commitment, along with the commitment of other entities, has spurred additional development in this area.[11] If the Commission approves this application, Equitable will expand its presence on the North Shore to benefit the City and the region. Equitable is fully capable of consummating the transaction and continuing to provide safe, efficient, reasonable and adequate local distribution service through its Equitable Gas Division and its new Dominion Peoples subsidiary (Applicants Exh. 1 at 8-9; Equitable St. No. 1 at 3, 9-11).[12]

2. Job Creation

Equitable claims the acquisition will add up to 200 new jobs to the region in Pittsburgh and Northern West Virginia while honoring all of Dominion Peoples' labor contracts.

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11 Equitable is investing in Dominion Peoples for the long term and has no plan to transfer Dominion Peoples after closing (Applicants Exh. 1 at 10; and Applicants M.B. at 12, n. 9).

12 As an existing provider of public utility service, Equitable is presumed fit to proceed with the proposed transaction. *See*, Re Pennsylvania-American Water Company, 1995 WL 945231, 85 Pa. P.U.C. 548 (1995). The burden of proof to rebut the presumption is on a protestant. Re Byerly, 440 Pa. 521, 270 A..2d 186 (1970); and Morgan Drive-Away, Inc., v. Pa. P.U.C., 293 A.2d 895 (Pa. Cmwlth.1972). Equitable's utility services fully comply with the requirements of the Public Utility Code (Equitable St. 1 at 4). While no party challenges Equitable's fitness to proceed with this transaction, see UWUA's objection in the next section, *infra*.

New jobs in corporate shared services, information technology and customer services will be necessary to replace part of Dominion Peoples support operations in Ohio and Virginia, which will remain with Dominion's other business units. Equitable is interviewing applicants for these positions. Equitable has confirmed to the Governor's Action Team that it has approved the hiring of 101 employees and has pending approval to hire 75 more employees. With some 15 additional employees to be hired in West Virginia, Equitable anticipates hiring a total of approximately 191 new employees (Applicants M.B. at 13; Applicants Exh. 1 at 8; Equitable St. 1 at 9, 14; and Equitable St. 1-R at 12-13 and Attachment A thereto).

While conceding that approval of this transaction will return Dominion Peoples to Pittsburgh-based ownership, the OSBA remains skeptical that transfer of ownership of Dominion Peoples will ultimately result in a net gain of 200 jobs to the region. The application states that Equitable's ultimate intention is to merge Equitable Gas and Dominion Peoples, thus realizing synergies created by the elimination of "inefficiencies caused by overlapping service territories" (Application at 9; Equitable St. 1 at 6, 10). Taken to its ultimate conclusion, the OSBA points out that the synergies resulting from the elimination of overlapping service territories must include the elimination of duplicative equipment and personnel. Since this application seeks approval for only a stock acquisition, the OSBA argues it is inappropriate for the Commission to rely upon alleged synergies resulting from some future merger rather than the transaction as proposed (OSBA M.B. at 12).

The UWUA is even more blunt. It notes that on March 1, 2006, just before announcing the proposed transaction, Dominion Peoples had approximately 400 field employees, who were members of UWUA. By close of the record, that number declined by more than 10% to 355,[13] which is the lowest level of employment at Dominion Peoples in the union's history (UWUA St. 1 at 3). UWUA also notes that after announcing this transaction, Equitable closed its call center, resulting in the loss of 37 jobs (PEMI St. 1 at 18). This reduction represented nearly 50% of the IBEW Local 1956 membership (UWUA M.B. at 5-6; UWUA R.B. at 3).

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[13] Dominion Peoples gives the number of employees lost as 33 (Dominion Peoples St. 1-R at 11-12).

Further, the UWUA notes that when it was preparing its bid to purchase Dominion Peoples, Equitable prepared an analysis that estimated the likely efficiencies from combining these companies (OCA St. 1, Sch. RCS-3). That analysis estimated that it would be possible to reduce the companies' combined field work force, if the transaction occurred. The assumed reduction in fact is nearly identical to the actual reduction in Dominion Peoples' work force since the announcement of the transaction (UWUA M.B. at 6).

For their part, PEMI contend that unsubstantiated assertions of job creation do not evince a public benefit. Such assertions, in PEMI's view, contain no enforceable commitment by Equitable. PEMI's further claim, however, that Equitable has not quantified the cost impact of these new jobs *vis-à-vis* their cost to serve, thus making it possible for the transfer of positions to actually increase ratepayer costs, is itself speculative (PEMI M.B. at 11; PEMI R.B. at 5-6; PEMI St. 1 at 18; PEMI St. 1-S at 8).

In response, Equitable counters that Dominion Peoples' workforce reduction was precipitated by employee retirements — not by layoffs. These vacancies, according to Equitable, were not filled, because the work being performed was deemed "non-core"[14] and the expertise was available externally. The Company viewed the remaining vacancies as unnecessary based upon the local workload and productivity enhancements (Applicants M.B. at 48-49; Applicants R.B. at 20, 33; Dominion Peoples St. 1-R at 12, 14).

While this latter fact may be true insofar as it goes, the over-arching point is that the Applicants have touted job creation as an affirmative benefit to flow from the proposed transaction. Viewing only the gain of potential jobs to be created by returning Dominion Peoples' corporate headquarters to western Pennsylvania without also considering the offsetting loss of jobs, through whatever means, in the corporate makeup of these companies due to their anticipated combination ignores the facts. It certainly fails to supply the requisite substantive evidence to support their assertion.

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[14] "Non-core" refers to work that Dominion Peoples' personnel need not perform, but can be done according to its standards. Examples include: electricians, meter reading, leak detection and mechanics (Dominion Peoples St. 1-R at 13; N.T. 234).

While perhaps warranting further scrutiny in another proceeding, the UWUA's additional claim that these workforce reductions compromise the utilities' obligation under Section 1501 of the Code, 66 Pa. C.S. §1501, to provide safe and reliable service to the public finds no support in this record (UWUA M.B. at 5-7). Mere conjecture or surmise constitutes an insufficient basis upon which to base a decision. Norfolk & Western Ry. Co. v. Pa. P.U.C., 489 Pa. 109, 413 A.2d 1037 (1980); Erie Resistor Corp. v. Unemployment Comp. Bd. of Review, 194 Pa. Superior Ct. 278, 166 A.2d 96 (1961); and Murphy v. Pa. Dept. of Public Welfare, White Haven Center, 480 A.2d 382 (Pa. Cmwlth. 1984).

Moreover, under the "management discretion doctrine," the Commission may not interfere with or micromanage utility management decisions, unless there is a manifest abuse of discretion or some showing of arbitrary utility action. Pa. P.U.C. v. Philadelphia Electric Company, 522 Pa. 338, 561 A.2d 1224 (1989); and Petition of Frank Bankard, Docket No. P-00052172 (Order entered April 21, 2006). The Commission may not issue a blanket disapproval of a utility's method of performing its public service function, absent evidence that the particular method chosen is leading to inadequate or unreasonable service. Peoples Cab Co. v. Pa. P.U.C., 216 Pa. Superior Ct. 18, 260 A.2d 490 (1969); Peoples Cab Co. v. Pa. P.U.C., 185 Pa. Superior Ct. 628, 137 A.2d 873 (1969); and Moyer v. PECO Energy Co., Docket No. C-00003176 (Order entered January 26, 2001). No such showing appears here.

3. Purchased Gas Costs

a. Pipeline Contracts

If the Commission approves this transaction, Equitable will eliminate interstate pipeline transportation and storage contracts that Dominion Peoples has with TETCO, TGP and DTI as may be necessary in order to reduce annual PGC costs by approximately $10 million or $0.154 per Mcf. Both Equitable and Dominion Peoples have interstate pipeline transportation and storage contracts with TETCO, TGP and DTI. Dominion Peoples' contracts with these pipelines expire on March 31, 2007. Equitable claims Dominion Peoples' contracts with TETCO, TGP and DTI can be terminated and the capacity associated with them replaced with:

(i) additional local Appalachian supplies that are delivered directly into the distribution systems; (ii) additional local production delivered into either Equitrans, LP or DTI; and, (iii) Equitable's existing contracts, which can be used at a higher load factor rate (Applicants M.B. at 13-14; Equitable St. No. 1-R at 4, 12; Equitable St. No. 3-R at 3-4, 15-16).

For its part, OTS initially expressed concern with this proposal for fear that it would remove direct control of assets needed to serve Dominion Peoples customers prior to merging the two companies. After reviewing Equitable's rebuttal testimony (Equitable St. 3-R at 11-12) and through settlement discussions, however, OTS became aware that termination of these contracts will allow the remaining assets to be used more efficiently and generate significant gas cost savings, while still ensuring that Equitable and Dominion Peoples ratepayers are served in a safe, reliable and efficient manner (OTS M.B. at 7-8). Accordingly, OTS agrees with the Settlement (Settlement, Appendix A).

Also in agreement on this issue, the OCA notes that both Equitable and Dominion Peoples have similar contracts with TETCO. Equitable's contract provides for a level of capacity that exceeds its needs on a stand-alone basis. This excess capacity, in the OCA's view, when combined with a planned increase in local Appalachian gas supplies, will make up for the level of capacity eliminated with cancellation of Dominion Peoples' TETCO contract (OCA St. 1 at 3). Dominion Peoples also holds a contract with the Tennessee Gas Pipeline, which may also be eliminated due to increased local Appalachian supplies and construction of a planned interconnection between Dominion Peoples' system and Equitrans (a non-regulated pipeline company affiliated with Equitable) (OCA St. 1 at 4). Dominion Peoples' third transportation contract with Dominion Transmission, Inc. can be replaced with a similar service from Equitrans. The OCA agrees the estimated PGC savings from elimination of these three pipeline contracts is approximately $10 million annually (OCA M.B. at 14-16; OCA R.B. at 6-7; OCA St. 1 at 3-5; Equitable St. 3 at 28).

IOGA applauds what it believes to be an enhancement of local Appalachian gas production that will promote development of a competitive retail natural gas market on Equitable's and Dominion Peoples' systems. Equitable will integrate its "Apollo District" with its "Equitable District" to enable local Appalachian supply to flow more efficiently and economically on Equitable's system (Settlement, Appendix B). Equitable will also integrate its system with Dominion Peoples' system to enable local Appalachian supply to flow between the Equitable and Dominion Peoples systems. *Id.* These actions, IOGA believes, will increase the production, transportation and use of local Appalachian supply, which will provide affirmative public benefits to producers and marketers of local Appalachian supply, as well as to Equitable and Dominion Peoples retail customers. These actions will also ameliorate the effects of eliminating gas-on-gas distribution competition between Equitable and Dominion Peoples, as well as promote the development of a competitive retail natural gas market on the Equitable and Dominion Peoples systems (Equitable St. 3 at 8; Equitable St. 3-R at 3, 9-11, 19-20, 22-25; IOGA St. 1 at 7-8; IOGA St. 2 at 1-2, 7; IOGA St. 2-SR at 13-14). IOGA further avers the increased use of local Appalachian supply is also consistent with Commission policy as stated at 52 Pa. Code §60.1 (IOGA M.B. 7-8; IOGA R.B. at 7-8).

Opposing this proposal, NEMA questions whether non-renewal of these interstate pipeline contracts can achieve $10 million in savings because after the acquisition, Equitable and Dominion Peoples will have the same number of customers consuming the same amount of gas with the same usage profile in their combined service territory. Next, comparing Equitable's and Dominion Peoples' tariffs, NEMA notes the capacity charge to deliver gas to Equitable's citygate is $1.71/Mcf with a balancing charge of $0.18/Mcf, while Dominion Peoples' capacity and balancing charge is $0.66/Mcf. Such an increase in delivery costs of gas to the citygate will raise all customers' costs, regardless of whether those customers are consuming system gas or obtaining gas from a marketer. NEMA suggests the aggregate effect of moving Dominion Peoples' gas supply through the Equitrans system will increase costs in excess of $88 million dollars annually. Finally, NEMA is concerned that as Equitable seeks to optimize its delivery system, it may in the process abandon transmission interconnection or distribution lines (NEMA M.B. at 13-16, NEMA St. 1 at 11).

PEMI joins NEMA in opposing this proposal (PEMI M.B. at 12; PEMI R.B. at 6-8). PEMI claim the Applicants fail to disclose how increased reliance on local production and Dominion Peoples' on-system storage will negatively impact large transportation customers.

Currently, PEMI notes Dominion Peoples' on-system storage is at full capacity (PEMI St. 1 at 15). The proposal to increase reliance on local production and Dominion Peoples' on-system storage to serve the Companies' PGC customers will displace some current on-system storage users, including transportation customers and their suppliers (PEMI St. 1 at 15-16). As a result, transportation customers may be forced to increase their reliance on interstate gas transportation for gas supplies, which may place upward pressure on total operating costs (PEMI St. 1 at 15).

In response, Equitable states that it will replace capacity with a combination of utilizing additional local Appalachian supplies, additional local production delivered to Equitrans, LP or Dominion Transmission, and using Equitable's existing contracts at a higher load factor rate (Equitable St. 3-R at 15-16). Gas supplies delivered will be the same — the only difference being that the supplies will come from different sources (Equitable St. 3-R at 13). Utilizing these alternatives, Equitable proposes to provide safe and reliable service, while simultaneously reducing annual PGC costs by approximately $10 million (Applicants R.B. at 12-13, 19). Further, the OCA shows how eliminating these contracts due to overlap is possible and in fact has already begun to occur (OCA St. 1-S at 4). Equitable details how the two companies will coordinate cancellation of these contracts and describes the exact steps that it will use to replace this capacity (Equitable St. 3-R at 4-9). Elimination of these contracts is not merely theoretical and the savings that will result from this action are real (OCA R.B. at 6-7).

On the subject of abandoning transmission interconnections or distribution lines without notice to marketers, Equitable professes no intention of abandoning any interconnections on either the Equitable or Dominion Peoples systems (Equitable St. 3-R at 8-9). Equitable identifies existing interconnections between Equitrans and Dominion Peoples and states:

> It is Equitable's intent to continue to use all of the existing interconnections on Equitable's system as well as Dominion Peoples' system. In fact, Equitable will build additional interconnections in the future to facilitate the movement of gas supplies between these two systems in an attempt to optimize the requirements of the PGC and end-user transportation customers.

(Equitable St. 3-R at 9).

Although it is clear that Equitable does not plan abandonment at this time, NEMA requests that Equitable be required to apply for Commission approval to abandon an interconnection or distribution line and provide suppliers notice of any such abandonment application (NEMA M.B. at 15-16). Indeed, before a public utility may abandon service to the public, the utility must obtain Commission approval. 66 Pa. C.S. §1102(a)(2). But, no such requirement exists for any NGDC to request Commission approval to abandon a line or interconnection, if service will not be adversely affected. The Commission ensures that ratepayers receive safe and reliable gas service, but it does not micromanage the day-to-day operations of a utility. Philadelphia Electric Company, *supra*. Accordingly, the concerns that NEMA and PEMI express fail to provide a compelling justification to reject this proposal.

NEMA also argues that the joint Section 1307(f), 66 Pa. C.S. §1307(f), filings contemplated by the Settlement cannot take place until after Equitable and Dominion Peoples have merged (NEMA M.B. at 18). This argument opposing a future filing is premature. The Settlement does not seek to bar any party in interest from challenging any joint Section 1307(f) filing.

b. Revenue Neutral Blended PGC Rate

The OSBA expresses alarm that the application as filed requests that Equitable Gas and Dominion Peoples be allowed to implement a revenue-neutral "blended" PGC rate upon approval (Application, ¶19 at 8). Since the Applicants concede they are not affiliated interests within the meaning of Chapter 21 of the Code (Application, ¶10) and the application is not requesting a certificate of public convenience to approve a merger of the two NGDCs in this proceeding (Equitable St. 1 at 6), the OSBA posits the Applicants have no authority to seek a blending of their PGC rates (OSBA M.B. at 13-14; OSBA R.B. at 11).[15]

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[15] Further, the OSBA identifies its principal problem with the proposed acquisition as the fact that if Equitable achieves single-tariff pricing, the rates charged to Dominion Peoples' customers will have to increase in

PEMI express concern that any blending of PGC rates would also include blending of the balancing rates for transportation customers. Currently, PEMI note significant differences exist in the Companies' rates (PEMI St. 1, Exh. AC-3). The differences exist because Equitable and Dominion Peoples use different methodologies to compute balancing and standby charges (PEMI St. 1, Exh. AC-1 at 8). Notably, Equitable imposes a $.25/Mcf daily imbalance charge on all daily imbalances in excess of 3.5%, even though its basic rate already includes a "balancing charge" of $.18/Mcf applied to all throughputs (PEMI St. 1 at 14). Dominion Peoples has no daily imbalance charge. *Id.* Because balancing charges are adjusted in annual Section 1307(f) proceedings, if PGC rates are blended, PEMI argue transportation customers could experience an almost immediate rate hike due to the proposed transaction. *Id.* In addition, much of the PGC "savings" that will accrue by blending will occur at the expense of customers on Dominion Peoples' system (OSBA St. 1 at 6-7). Thus, PEMI suggest any merger "savings" stemming from this application will be offset by significant increases in PGC maximum tariff rates and balancing charges for customers on Dominion Peoples' system, as well as increases in transportation rates for customers on both systems (PEMI M.B. at 10-12; PEMI R.B. at 7; PEMI St. 1 at 14).

Indeed, Equitable originally proposed to immediately combine the capacity and commodity costs (the "C-factors"). OTS responded that the C-factors should not be combined until the next PGC cycle for several reasons (OTS M.B. at 8-9; OTS R.B. at 12-13; OTS St. 1 at 9-12). First, from a timing perspective, this application proceeding hopefully will reach a resolution in the spring of 2007, which is in the middle of the current PGC cycle that runs from October 1, 2006 to September 30, 2007. Equitable and Dominion Peoples 2006-2007 purchasing plans received Commission approval based on meeting the needs of separate customer groups. Contracts for capacity and storage have already been entered into and minimal, if any, cost savings could accrue during the remainder of the current PGC cycle. Therefore, little reason

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order to catch up with the rates that Equitable Gas charges. Absent the acquisition, OSBA points out Dominion Peoples' customers would not have had to face that threat (OSBA M.B. at 13, 17). Equitable, however, is not proposing a single combined tariff for Equitable Gas and Dominion Peoples in this proceeding. The Settlement does not present a single combined tariff for Commission approval (Applicants R.B. at 4).

exists to immediately combine the C-factors. OTS opines the Settlement appropriately keeps the PGCs separate until the next PGC cycle.

Second, OTS expressed concern that cross-subsidization by either Peoples or Equitable PGC customers would occur, if the C-factors were immediately combined. Under the Settlement, this cross-subsidization will not immediately occur. Time will give OTS and other interested parties the opportunity to analyze the finalized numbers during the next PGC proceeding.

Third, from a practical standpoint, deferring the combining of the C-factors gives Equitable more time to become familiar with Dominion Peoples' system and plan its purchasing strategy with a better understanding of customer requirements. Thus, by filing joint and separate 2007 PGC filings, the Companies will be able to explore capacity and storage cost savings, while still giving interested parties the opportunity to fully analyze the combined C-factor in the appropriate context of a Section 1307(f) proceeding rather than in the instant application.

To reiterate, Equitable is no longer proposing a single combined tariff for Equitable and Dominion Peoples in this proceeding. The Settlement does not present a single combined tariff for Commission approval. Equitable ultimately plans to seek permission under the Code to merge the two entities. Bringing the two utility operations together may result in additional application, tariff, affiliated interest and/or other regulatory filings, which are permitted under the Code (Applicants R.B. at 4). As they occur, the OSBA and PEMI, as well as other interested parties, will have the opportunity to participate and present their concerns. To address them in this proceeding is premature. Conjecture about what might be proposed in future regulatory filings is not a basis for denying either the application or the Settlement. The idea of returning to the Commission with additional applications or other filings as operations are brought together is entirely consistent with established regulatory practice and case law precedent. In In Re: Application of Pennsylvania Power & Light Company, *et al.*, Docket Nos. A-120650F0006, A-122050F0003; 1998 Pa. PUC LEXIS 33 (Order entered July 24, 1998), PPL first reorganized, then acquired Penn Fuel and, after still further reorganization, merged Penn Fuel into PPL Gas, all with continuing Commission oversight and approval.

Here, Equitable anticipates filing a combined Section 1307(f) PGC application with the Commission along with separate filings for each company. Any party in interest, including the OSBA and PEMI, will have a full opportunity to participate in these proceedings. The combined purchasing activity in the meantime is expected to produce savings for customers of both Equitable and Dominion Peoples. Equitable argues it is not, as the OSBA fears, a revenue-neutral, averaging of PGC costs between the two companies. The purchased gas cost savings anticipated as a result of combining the purchasing function will benefit not just Equitable customers, but Dominion Peoples customers as well (Applicants R.B. at 5; Settlement, Appendix A at ¶3.c; Equitable St. 3-R at 24-29).

Additionally, NEMA questions whether consolidation of capacity and commodity costs are properly addressed in a base rate proceeding rather than a Section 1307(f) application, because review in a base rate proceeding will allow review of the allocation between delivery and commodity rates (NEMA M.B. at 18). NEMA is mistaken. Consolidation is proper in a Section 1307(f) proceeding, where the C-factor, which is comprised of capacity and commodity costs, is reviewed annually. NEMA argues these costs should be reviewed in a base rate case in order to have an opportunity to review a cost of service study to reallocate rates determined in each Company's last base rate case. While the C-factors are properly consolidated in a Section 1307(f) proceeding, the costs can not be reallocated there, as that is a function of a base rate proceeding.

c. <u>Change in Accounting Methodology</u>

Under terms of the Settlement, Equitable agrees to not pursue its originally proposed change in accounting for Dominion Peoples' gas in storage (Settlement, Appendix A at ¶3.b). OTS and OCA oppose this accounting change, which would make layers of lower cost gas available to ratepayers and result in an immediate and significant one-time gas cost savings (Equitable St. 1 at 17-18). OCA forecasts possibly $40 million in one-time PGC reductions by changing the way Dominion Peoples accounts for its natural gas in storage (OCA M.B. at 16-17, OCA St. 1 at 5-8). This accounting change, however, would increase the value of Dominion Peoples' gas inventory and create an annual increase in base rates which, over the long term, might be detrimental to ratepayers. Moreover, OTS was concerned that spreading the benefit of this accounting change to Equitable's ratepayers would be a short-term windfall at the expense of Dominion Peoples' customers. For these reasons, OTS and OCA maintain the agreement to not pursue the change in accounting methodology is in the public interest (OTS M.B. at 8; OTS R.B. at 10-11; OTS St. 1-R at 2-4; OTS St. 1-SR at 2-3; OCA M.B. at 16-17; OCA St. 1 at 5-8).

NEMA, however, claims this resolution is inadequate, because Equitable will seek to change this accounting methodology in a Section 1307(f) proceeding in which marketers are not traditionally granted standing to intervene.[16] Accordingly, NEMA requests that any request to change the accounting methodology be required as part of a base rate case to ensure that marketers will be permitted to participate (NEMA M.B. at 16-17). Further, NEMA asks that Equitable be instructed not to change Dominion Peoples' LIFO storage accounting (NEMA St. 1 at 24). Equitable's withdrawal of the proposed accounting change through the Settlement term effectively satisfies NEMA's recommendation (Applicant's R.B. at 13).

Whatever Equitable will plan on proposing in a future Section 1307(f) proceeding on this subject is purely conjectural at this point. Moreover, in whatever proceeding this subject might arise, NEMA will have to satisfy the appropriate eligibility requirements for intervention. The solution is not, as NEMA suggests, dictating the forum in which Equitable must request this accounting change. Rather, NEMA must demonstrate that it possesses the requisite right or interest to intervene.

4. Rate Case Stay-out

Subject to certain limited exceptions expressed in the Settlement with OTS, OCA, Representative Wheatley and MVUC, Equitable and Dominion Peoples will not file a general increase in base rates under Section 1308(d) of the Code, 66 Pa. C.S. §1308(d), any earlier than January 1, 2009 (Settlement, Appendix A at ¶1). The parties concurring in this Settlement term assert this rate case stay-out provides ratepayers with a measure of rate stability until sometime

[16] *See*, 52 Pa. Code §5.72.

in 2009. A stay-out provision, wherein a utility waives its statutory right under the Code to seek rate relief, they claim, is a significant concession and is frequently cited in transactional proceedings as an affirmative public benefit. *See, e.g.*, Application of UGI Utilities, Inc., *et al.*, Docket No. A-120011F2000 (Order entered August 18, 2006) (Applicants M.B. at 15-16; Applicants R.B. at 11-12; December 15, 2006 Letter of Rep. Wheatley).

For its part, OTS suggests the stay-out proposal resolves all cost of service issues including synergy savings related to this transition. OTS maintains that the benefits of the proposed stock acquisition cannot be easily quantified and may not result in immediate savings; however, during the stay-out period, best operating practices can be shared, duplicative facilities can be identified, and the goal of combining neighboring systems with an expanded customer base creates economies of scale that, in all likelihood, will lead to increased opportunities for savings. Additionally, the stay-out provides for a significant period of rate stability for Equitable and Dominion Peoples ratepayers. Therefore, maintaining the *status quo* and not allowing a base rate increase to be filed before January 1, 2009 is in the best interest of the ratepayers and the Companies as it will allow them adequate time to identify and implement merger savings and synergies (OTS M.B. at 6-7; OTS R.B. at 3-8).

Concurring in this proposal, OCA points out that the rate case stay-out, while twenty-four months in duration, will provide ratepayers with at least thirty-three months of rate protection, because of the nine-month suspension period applicable to contested base rate filings. OCA also notes that there is no requirement that either Company file a base rate case in January 2009 (OCA M.B. at 10).

Regarding the public benefits from this provision, OCA cites the language of the stay-out provision, which explains that "[t]he stay-out will resolve all cost of service issues, including purported synergy savings, related to this proceeding" (Settlement, Appendix A at ¶1). Thus, this firm commitment to forgo rate increases for the term of the stay-out period is a binding commitment on the part of Equitable and Dominion Peoples that they will look to expected synergy savings and revenue enhancements — rather than ratepayers — for rate relief over the next thirty-three months. This concession, in OCA's view, is significant for as an

Equitable witness declared earlier, Equitable "is currently in need of rate relief, and existing rates do not reflect almost $200 million of new plant placed in service since our last base rate case" (Equitable St. 1-R at 19). Equitable declares it has not filed a general base rate increase in almost ten years. In the absence of the stay-out, it asserts it would look to do so, possibly as early as the first quarter of 2007 (Applicants R.B. at 12). Thus, OCA posits the rate case stay-out will protect ratepayers from any increases based on these factors for the duration of the stay-out and subsequent suspension of any proposed tariff rate changes (OCA M.B. at 10-12; OCA R.B. at 7-8).

While not a signatory, OSBA concedes the most significant ratepayer benefit of the Settlement is the agreement that Equitable Gas and Dominion Peoples will not file a base rate case earlier than January 1, 2009. Such a stay-out is one possible mechanism for assuring that ratepayers share in the synergies that the Applicants forecast (OSBA M.B. at 17; OSBA R.B. at 9; OSBA St. 3 at 2; N.T. 436, 471).

On the other hand, NEMA believes the proposed rate case stay-out will deprive consumers of proper embedded cost-based unbundled rates, which could have a significant negative impact on development of a competitive retail gas market. If Equitable does not file a base rate case in which rate unbundling can be thoroughly examined for many years, NEMA argues Equitable's customers then will be deprived of appropriate price signals pertaining to competitive functions, as well as be subject to duplicative costs and loss of available assets and revenues if they decide to choose a competitive supplier. NEMA discovers extensive disparities in distribution rates between Equitable Gas and Dominion Peoples, with Equitable's distribution rates being markedly higher (NEMA St. 1 at 11; NEMA St. 1-SR at 18). NEMA suggests one reason for the distribution rate disparity is the lack of embedded cost-based unbundled rates that properly allocate the costs of competitive-related functions to competitive rates (NEMA M.B. at 11-12).

NEMA argues Equitable should not be permitted to continue charging current customers, as well as new Dominion Peoples customers its current distribution rates, when those rates continue to improperly include commodity-related costs. This would be inequitable for two reasons. First, Equitable's distribution rates are significantly higher than Dominion Peoples'. There is no record justification for the difference. Upon completion of the acquisition, captive customers will likely be required to pay those higher rates. Equitable most likely will initiate the process of increasing transportation rates of customers that had below-tariff-maximum pricing (NEMA St. 1-R at 21). Such increases, combined with a stay-out provision, NEMA contends, will allow Equitable to realize a windfall gain that is not reconcilable. If the stay-out provision is to be effective at maintaining the existing rate structures and levels then Equitable and Dominion Peoples must be instructed that all existing transportation contracts be renewed at the same rates that currently exist and not be increased. Any revenue increases from renegotiated transportation contracts should be accrued and refunded to all customers (NEMA M.B. at 12).

Second, to the extent that inflated distribution rates are cross-subsidizing artificially low commodity rates, NEMA claims it inhibits the growth of customer choice opportunities. Unbundled rates should properly reflect the fully loaded cost of serving retail customers, which will allow consumers to see and respond to accurate market pricing signals and to make an informed comparison between competitive alternatives and their value propositions. All suppliers providing commodity service to customers at retail, including default service and competitive suppliers, incur costs to do so in addition to the wholesale cost of the energy commodity. These costs include: no notice service, pipeline capacity charges, city-gate delivery requirements, and related commodity charges, a share of operating expenses including labor-related costs, credit costs, risk management premiums, load shape costs, commodity acquisition and portfolio management, working capital, taxes, administrative and general expenses, metering, billing, collections, bad debt, information exchange, regulatory compliance, and customer care. These costs are incurred by competitive energy suppliers and are included in competitive energy supplier pricing (NEMA M.B. at 12-13).

Many of these same costs are also incurred by utilities, but are not allocated to utility commodity pricing. Failure to identify, unbundle and credit migrating customers with these costs, NEMA contends, results in a double payment. Price signals cannot operate efficiently, if such costs remain in utility delivery service pricing. By requiring utility bills to identify, unbundle and price each competitive service separately from monopoly services, NEMA suggests the Commission will encourage true competition on the basis of pricing, quality of service, and provision of value-added services. Accordingly, NEMA recommends that Equitable be required to submit an embedded cost based study, as well as accompanying unbundled rates that properly allocate competitive commodity-related costs at the earliest possible date (NEMA M.B. at 13; NEMA R.B. at 6-7).

Equitable responds that it went through an unbundling of rates during its restructuring at Docket No. R-00994784 (Equitable St. 2-R at 5). One of the standards for restructuring in the natural gas industry included unbundling services and charges. *See*, 66 Pa. C.S. §2203(2). Thus, contrary to NEMA's suggestion, Equitable with this Commission's approval has already addressed the subject of rate unbundling. Significantly, Equitable notes NEMA was a party to Equitable's restructuring proceeding. The fact that differences exist in the distribution rates of Equitable and Dominion Peoples does not mean that unbundling did not occur (Equitable St. 2-R at 5).[17] The Commission may address further unbundling of any kind, including unbundling of the kind that NEMA proposes, "only through a rulemaking," 66 Pa. C.S. §2203(3), which this application proceeding obviously is not.[18] Equitable assures that when it submits its next general base rate filing after running of the stay-out period, it will include with its supporting information such cost of service and other studies that may be required by Commission regulations (Applicants R.B. at 11-12). Accordingly, NEMA's price signal argument lacks merit.

Next, PEMI, representing eight large commercial and industrial customers, also fault the stay-out provision. PEMI concede that the signatories to this provision, *i.e.*, OTS, OCA, MVUC and Rep. Wheatley, consider the benefits that residential customers will obtain from

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17 Equitable is not proposing any change in tariff rates as a result of this proceeding. Equitable agrees to honor all existing contractual commitments that are not currently in dispute. Charging of tariff based distribution rates does not create a situation of windfall gain (Applicants R.B. at 11, n. 10).

18 In conducting an unbundling rulemaking under Section 2203(3), the Commission must consider the impact of such unbundling on the labor force, the creation of stranded costs, safety, reliability, consumer protections, universal service and the potential for unbundling to offer savings, new products and additional choices or services to retail customers. The Commission's decision must assure that standards and procedures for safety and reliability, consumer protections and universal services are maintained at levels consistent with the Competition Act.

avoiding any rate increases during the stay-out. Conversely, PEMI argue large commercial and industrial customers receiving service from the Companies under negotiated contracts could experience significant and unexpected rate increases during this time (PEMI M.B. at 8, n. 2, 27-29; PEMI St. 1 at 12-13).

PEMI explains that because Equitable has failed to explain how it will recoup the $970 million cost of this transaction, a logical assumption must be that Equitable ultimately will turn to ratepayers to recover at least some of these costs (PEMI St. 1 at 12). The Companies' agreement not to implement a general rate increase during the stay-out ensures that Equitable will be unable to recoup any monies from customers on tariffed rates. Instead, Equitable will have to turn to contract customers. Several PEMI members have contracts with Dominion Peoples for distribution service, which expire in 2007 (PEMI St. 1 at 39-40). PEMI members with Equitable contracts have expiration dates that range from 2006 to beyond 2009. *Id.*

Because the proposed transaction will eliminate gas-on-gas competition, PEMI conclude many of these customers will no longer have the ability to negotiate competitive contracts. Once customers' current contracts expire, Equitable will be in a position to refuse to negotiate further contracts and instead increase these customers' transportation rates to the maximum tariff levels (PEMI St. 1 at 12). Given that Equitable has already analyzed increasing its margins from its current top twenty-five customers, as well as the date of elimination of discounts provided by Dominion Peoples to current "competitive" customers over the next fifteen years, PEMI suggest the possibility of Equitable implementing such a plan in order to recoup its transaction costs from these customers is extremely probable (PEMI M.B. at 27-28; PEMI St. 1 at 13).

Moreover, PEMI assert the Companies' willingness not to file for a rate increase until 2009 ensures that the maximum rates remitted by these customers are above "just and reasonable" levels (PEMI St. 1-S at 18). Maximum transportation rates in western Pennsylvania are set at a "value of service," rather than a "cost of service," level to account for customers being able to utilize competitive leverage to reduce transportation prices. *Id.* In other words, Equitable's and Dominion Peoples' transportation rates are set at higher than cost of service levels under the assumption that these customers will be able to negotiate rates below the ceilings based upon competitive alternatives. *Id.*

Once the leverage that gas-on-gas competition provides expires, however, PEMI foresee that large commercial and industrial customers will no longer be able to negotiate transportation rates below the maximum level. As a result, these customers will be forced to take service at the maximum rate, which is significantly above the cost of providing this service and contrary to the Commission's intention when setting these ceilings (PEMI St. 1-S at 18). PEMI argue the stay-out that Equitable gives up is actually a windfall for the Companies, as it enhances their guaranteed revenue stream from captive transportation customers on both systems, who will be forced to take service at unjust and unreasonable rates. *Id.* Even if the Commission requires extensions of contracts for ten or fifteen years, PEMI aver commercial and industrial transportation customers will be harmed unless the Commission also, during the interim, undertakes necessary steps to establish proper, cost-based transportation rates for all customers, regardless of any arguments by other customer classes that the movement to cost-based rates must be gradual. Compounding this problem for PEMI is the provision in the Settlement seeking to eliminate Equitable's agency program and Dominion Peoples' Rate CER[19] (PEMI M.B. at 28-29; PEMI R.B. at 10-11).

Setting aside PEMI's concerns about the effect of eliminating gas-on-gas competition, which will be addressed, *infra*, it is sufficient to note here that the analysis that PEMI cites in support of its argument is inaccurate and not supported either by a prior or current cost of service study. For both Equitable and Dominion Peoples, existing maximum tariff rates were determined on a cost of service basis (N.T. 275).[20] Hence, negotiated rates that are less than the tariff maximum are also below cost of service (Applicants R.B. at 27).

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19 Elimination of these programs will be discussed, *infra*.

20 PEMI's concept of a cost based rate appears at odds with Commission regulations. Section 60.2 of the Regulations, 52 Pa. Code §60.2, provides that the maximum rate allowed for transportation shall be the weighted average retail rate for the otherwise applicable retail service less costs related to natural gas supply and that the maximum rate for transporting gas produced in the Commonwealth shall be based on a cost of service study. On the other hand, PEMI apparently believes that rates that have been produced by these regulations are above cost of service (PEMI M.B. at 17-18; N.T. at 323; NEMA M.B. at 11-13). The cost of service arguments of PEMI and

Further, Equitable represents that it will honor all of its existing contracts with PEMI members. For competitive reasons, Equitable does not know the status of Dominion Peoples' contracts with PEMI members. Equitable, however, will honor Dominion Peoples' contracts with PEMI members, unless the contracts were in dispute at the time of this application filing. In the latter regard, Equitable knows of no Dominion Peoples' contracts with PEMI members that were in dispute (Applicants R.B. at 28; Equitable St. 1-R at 35).

Going forward, Equitable promises to extend contracts on mutually agreeable terms for PEMI members in overlapping service territories. It expresses no interest in driving customers out of business with excessive charges. It does ask that PEMI customers pay their fair share of the delivery cost of service, as residential and other customers have for many years (Equitable St. 1-R at 24). PEMI members may also qualify for other discounts depending on their unique circumstances, so long as they fall within the Commission's recent enunciation of those situations where such discounts may be warranted (Applicants R.B. at 29; Equitable St. 1-R at 35).

Upon consideration of the various arguments, the stay-out provision creates affirmative public benefits that outweigh the concerns of those opposed.

5. Acquisition Premium and Transaction Costs

Equitable agrees to exclude any acquisition premium and transaction costs, including all associated tax effects, from rates (Settlement, Appendix A at ¶2). Expenses and capital costs associated with the acquisition will be accounted for in accordance with Generally Accepted Accounting Principles ("GAAP"), and not deferred for future recovery. Moreover, capital items associated with the acquisition will be placed in the plant-in-service account upon

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NEMA are not only at odds with Commission regulations, but also suggest a departure from established principles of cost allocation and rate design or unbundling as well. Their arguments are also at odds with Section 2203(3) of the Competition Act, 66 Pa. C.S. §2203(3), which, as discussed above, provides that the Commission may address further unbundling of services "only through a rulemaking." Matters such as these are more appropriate for consideration in the stakeholder process now ongoing as a result of the Commission's Order entered October 6, 2005, in Investigation into the Natural Gas Market, and then in the statutorily required rulemaking proceeding, rather than in this acquisition application.

entering service and will be depreciated according to GAAP. Insulating ratepayers from paying these merger related costs is in the public interest. Similar provisions in other transactional proceedings have been seen as an affirmative public benefit. *See, e.g.*, Application of UGI, *supra*; and Joint Application of Pennsylvania-American Water Company, *et al.*, Docket No. A-212285F0096, 221 PUR 4th 487 (2002); (Applicants M.B. at 16; OTS M.B. at 7).

The combination of these provisions will provide significant ratepayer protection. The acquisition premium is approximately $388 million. The remaining expenses associated with the acquisition have been estimated to be as high as $61 million. These provisions provide firm, specific and enforceable terms and conditions that ensure recovery of costs and expenses associated with this acquisition are either excluded from rates or have a reduced rate impact (OCA M.B. at 12-14; OCA R.B. at 8). No party opposes this provision.

6. On-System Storage

Acknowledging that it raises an issue not addressed in the Settlement, NEMA expresses concern that upon completion of the acquisition, Equitable will transfer Dominion Peoples' on-system storage assets to Equitrans, an affiliated transportation utility. NEMA notes that a significant difference exists between the location of Dominion Peoples' and Equitable's storage assets (NEMA St. 1 at 18-20). Dominion Peoples obtains storage from pipeline suppliers, which have their own storage fields on their distribution systems, while Equitable obtains storage from pipeline suppliers, which have no storage fields on their distribution systems (NEMA St. 1 at 18). Dominion Peoples allocates its on-system storage to marketers on a *pro-rata* basis, meaning they receive appropriate amounts of storage based on the needs of their customers. Since Equitable's storage is located on Equitrans, marketers must buy their storage from Equitrans at FERC-approved rates, which cost more to operate (NEMA St. 1 at 19).

So, NEMA recommends that storage and utilization rights should be assigned to individual customers as they leave Equitable's system supply for that of a competitive supplier. The storage and utilization rights should be under the same terms and conditions as that customer would have received as a sales customer. NEMA suggests that the Commission require

Equitable to notify all competitive suppliers of its intent to transfer storage assets currently held by Dominion Peoples and that it be required to obtain Commission approval of such transactions (NEMA M.B. at 27-28; NEMA R.B. at 5).

Equitable responds that it is not proposing to move Dominion Peoples' storage upstream (Equitable St. 2-R at 3). Indeed, Equitable acknowledges transfer of storage might ultimately be in the public interest and in the best interests of ratepayers (Equitable St. 2-R at 3-4). But, it professes no present plan to transfer Dominion Peoples' on-system storage to Equitrans or any other entity and it readily acknowledges that a transfer of storage will require Commission approval. *Id.* Equitable suggests the assignment of storage that NEMA proposes is itself a transfer, which should not be considered in this proceeding (Applicants M.B. at 40-41; Applicants R.B. at 17-18). Resolution of this issue in this proceeding is premature.

7. Agency Service

Rule 11.7 of its tariff Rules and Regulations describes Equitable's agency service as follows:

> If requested by the customer, and agreed to by the Company, the Company will act as agent for the customer in securing storage services and transportation capacity on transmission pipelines to transport customer's gas to the pipeline delivery points on the Company's system. This service shall be administered by the Company subject to the same terms, conditions and rates placed on other pool operators operating under Equitable's tariff. The Company shall not be responsible for storage and transportation charges incurred on behalf of the customer, nor for the performance, non-performance or continued availability of any pipeline transportation service. The charges for this service shall be determined by negotiation between the Company and the customer.

(Equitable St. 2-R at 7).

Conceptually, agency appears to be a transportation service in which the natural gas distribution company purports to assist customers by acting as their "agent" in arranging and contracting for customers' natural gas supply (Equitable St. 2-R at 7-9). To implement agency service, a customer enters into two contracts with Equitable: a standard delivery contract for transportation service, and a separate Gas Services Agreement authorizing Equitable to obtain gas supply for the customer (Equitable St. 1-SR at 2; NEMA/Hess/ Constellation St. 1-R at 8).

Hess/Constellation contend Equitable's continued use of the agency program following the acquisition, whether for itself or for Dominion Peoples, is inconsistent with the Competition Act and the public interest, because it forecloses NGSs from competing in a large segment of the market. Using information that Equitable provided, Hess/Constellation calculate Equitable was able through its agency program to direct 68% of the total volume of all third party gas supplied on its distribution system to its affiliate, Equitable Energy, taking customers that unaffiliated marketers were trying to serve (NEMA/Hess/Constellation St. 1-SR at 5, 14).

Hess/Constellation posit the terms outlined in Appendix C to the Settlement endeavor to redress this situation and promote competition in the combined territory of Equitable and Dominion Peoples by bringing an end to agency service and allowing all marketers — not just Equitable Energy — to compete for these customers. In Paragraph 1 of Appendix C, Equitable agrees that it will not act as an agent on behalf of customers to secure supply services, except in the limited circumstance of a customer attempting to bypass or otherwise leave its distribution system. Paragraph 2 of Appendix C enumerates the conditions that need to be satisfied in order to invoke this limited exception (Hess/Constellation M.B. at 6-7).

Recognizing that Equitable has existing customers, who are entitled to the benefit of the agency contracts they negotiated, Paragraph 3 of the Settlement provides that all existing agency service contracts will be grandfathered and assigned to Equitable Energy, which is currently providing the gas supply. Nevertheless, to ensure that customers are aware of their competitive options, Paragraph 3 of the Settlement mandates that, at the time of the assignment, Equitable will send all customers then receiving agency service written notice, informing them that upon the expiration of the assigned contracts, they will be required to receive their natural gas supply from an NGS of their choice, and listing all current NGSs, including Equitable Energy, that are licensed to supply gas in Equitable's service territory. Similar treatment is provided for agency service customers of Dominion Peoples, though Dominion Peoples also has the option of simply letting the agency service contracts expire at the end of their present terms (Settlement, Appendix C at ¶5).

The Settlement further provides that any existing agency contracts with terms expiring during the consideration of this application may be renewed, but for no longer than a twelve (12) month term (Settlement, Appendix C at ¶6). Also, Paragraph 4 of the Settlement mandates that all services that Equitable provides to Equitable Energy in conjunction with the assigned contracts be subject to the Natural Gas Supplier Standards of Conduct, 52 Pa. Code §62.142 (Hess/Constellation M.B. at 7-8).

For its part, Equitable relates that its purchase of Dominion Peoples' stock will have no negative impact on the retail supply of natural gas. Presently, 11 natural gas suppliers ("NGS") are active on Equitable's distribution system providing supply service to approximately 30,000 residential customers and 3,400 commercial and industrial customers. No NGS will exit the market as a result of the proposed transaction. Dominion Peoples' retail marketing affiliate, Dominion Retail, Inc., is not part of the transaction and will remain independent of Equitable. Dominion Retail presently intends to continue marketing natural gas on both the Equitable and Dominion Peoples systems after consummation of this transaction. Equitable Energy, a licensed NGS, will also continue to market gas supplier services on both systems after the acquisition (Applicants Exh. 1 at 11; Equitable St. 1 at 20; Equitable St. 2 at 4-5).

In the Settlement with Hess/Constellation, Equitable, agrees, as part of a later proceeding combining the tariffs of Equitable and Dominion Peoples, to file tariff provisions that promote the development of the competitive retail natural gas supply market in the combined Equitable and Dominion Peoples service territory. Prior to commencing any proceeding to combine tariffs, Equitable will form a marketers' users group to make recommendations concerning the proposed merged tariff. Equitable posits this commitment is wholly consistent with the Commission's desire to improve the retail natural gas supply market.[21] As addressed more fully below, Equitable claims the development of an effectively competitive retail natural gas market will also mitigate the effects of eliminating gas-on-gas distribution competition that has been available to a limited number of customers on the Companies' systems (Applicants M.B. at 21-22).

PEMI, on the other hand, urge the Commission not to allow the agency program to pass away. If the agency program is eliminated, PEMI argue Equitable will be under no commitment to modify the tariffs to provide for more competitively friendly provisions that will ensure an increase of NGSs in the combined service territories. NGSs are under no obligation to provide service to customers within the service territories and neither Hess/Constellation nor any other NGS are willing to commit to serving customers, even if the agency program disappears (N.T. 489-90). PEMI claim this Settlement provision only intensifies the proposed transaction's anticompetitive impacts by removing a viable competitive option (and in the instance of Equitable — the only competitive option) that is currently available to ratepayers in these service areas without providing any guarantee of a replacement. Accordingly, PEMI urge continuation of the agency program, because it provides retail customers with an additional means of bringing competitive market forces to bear on supply prices (PEMI M.B. at 29; PEMI R.B. at 27-28; PEMI St. 1-R at 2, 5, 9-10).

Conversely, NEMA argues the existence of any agency program hinders the development of a truly competitive market. It objects to a number of the provisions in the Settlement permitting the continued existence of the agency program for these utilities. In particular, NEMA faults the provision that continues to allow Equitable to use its existing agency program under circumstances where "a customer [is] attempting to bypass or otherwise leave the Equitable system." In NEMA's view, this contingency is unnecessary and should not be permitted (NEMA M.B. at 19-23).

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21 *See*, Investigation into the Natural Gas Supply Market, Docket No. I-00040103 (Order entered October 6, 2005). Both Equitable and Dominion Peoples have dedicated resources to participate in the stakeholder group process that was convened as a result of that Investigation (Applicants M.B. at 22, n. 13; Equitable St. 2 at 4).

NEMA notes that Equitable claims a need for the agency program to deal with competitive bypass or distribution switching threats with other local distribution companies, such as T.W. Phillips Gas & Oil Company and Columbia Gas of Pennsylvania, Inc. But, NEMA finds that Dominion Peoples currently faces similar competitive threats from the same competitors and manages all of its competitive practices without using an agency program. Through the years, Dominion Peoples migrated all of its former agency customers to discounted transportation service (NEMA St. 1-SR at 16-17). NEMA suggests Equitable should adopt the same practice (NEMA M.B. at 19-20).

NEMA also objects to Equitable's agreement to "attempt to obtain offers for supply services from at least three different natural gas suppliers," finding it provides little guidance on how these offers will be gathered, shared, evaluated or used. NEMA suspects this practice will serve as a way to gather market intelligence to undercut competitive offerings. In addition, if Equitable intends to obtain quotes and actual gas supply for a customer, this practice will effectively remove the customer from the decision making process (NEMA M.B. 20).

Next, NEMA faults Equitable's commitment not to sign up customers using Dominion Peoples' Rate CER or any transportation agency service. Since Dominion Peoples currently serves no customers under either provision, NEMA finds this an empty commitment. NEMA does object to the provision that allows Equitable to seek "to replace these provisions with the proposed language contained in paragraph 2" that lists five criteria allowing the use of agency, which NEMA characterizes as a step backwards. Instead, NEMA suggests Dominion Peoples should be directed to eliminate the agency language from its existing transportation tariffs (NEMA M.B. at 20-21).

Under the Settlement, NEMA notes existing agency contracts will be grandfathered and assigned to Equitable's marketing affiliate, which will merely transfer the contracts from one Equitable-controlled entity to another. Under Equitable's agency program, utility customer representatives manage the sales process for gas supplied by their affiliate, Equitable Energy, thereby affording the affiliate a significant competitive advantage of no-cost customer acquisition (NEMA St. 1 at 8). As made clear in Equitable's contract renewal language, customers must provide Equitable with the terms of competitive supplier offers and to renew with Equitable on those terms creating a perpetual lock-in to successive renewals (NEMA St. 1 at 9). Customers generally do not understand that they are receiving commodity from an affiliate and not from the utility itself. NEMA reveals that Equitable enjoys a substantial financial interest in its agency program, as well as an overwhelming market share. Revenues collected by the program were $66.2 million in 2003, $72.5 million in 2004, $80.5 million in 2005 and by July 31st of this year, they already totaled almost $52 million (NEMA St. 1-SR 4). For these reasons, NEMA voices reservations about the agency program continuing in any guise (NEMA M.B. at 21).

NEMA finds unclear how transfer of the grandfathered customers to Equitable's affiliate will be accomplished consistent with the Standards of Conduct and the effect of the transfer of revenues from a regulated entity to an unregulated entity. If Equitable maintains that the entire book of agency business should be assigned to an energy marketer, then NEMA proposes that Equitable sell the agency book of business to a non-affiliated supplier with the sale going to the highest bidder. Any future customer acquisition activity by Equitable's affiliate, Equitable Energy, should be undertaken in conformance with the rules that exist in the Code of Conduct. Equitable Energy should receive an affirmative customer consent on a new contract to acquire a customer, similar to what any other marketer must obtain (NEMA M.B. at 21-22).

Further, NEMA suggests Equitable should provide customer information, including contract expiration dates, of all agency customers to all registered marketers. Contract termination notices should then be sent to these agency customers and the customers should be allowed to sign up for gas supply service from any marketer (NEMA M.B. at 22).

NEMA finds well-placed PEMI's apprehension about the affects of the agency program's elimination upon competition, as well as its concern as to whether Equitable will actually implement competition friendly tariffs. NEMA agrees that reform of Equitable's choice tariff should be a part of the comprehensive resolution of this proceeding. However, even if the Commission decides that Equitable's stakeholder collaborative is a sufficient safeguard, NEMA recommends that it should not forestall elimination of the agency program. Agency is a significant barrier to competitive entry and marketer participation. The elimination of this program in Equitable's service territory has the potential to advance the development of the competitive retail market. Likewise, ensuring that an agency program is not instituted in Dominion Peoples' service territory will protect the advances achieved in market development in that service territory (NEMA R.B. at 8-9).

For these reasons, NEMA urges the Commission to require Equitable to eliminate its agency program as soon as possible and by a date certain. In NEMA's view, the anticompetitive affect of a utility competing with marketers as gas suppliers to customers in its own territory cannot be overstated. A litany of products and services that might be available to customers from natural gas suppliers in the competitive market will not occur, so long as the regulated utility, with its significant market power, is also offering products in direct competition with marketers on an uneven playing field. To facilitate economic development in Equitable's service territory, NEMA submits Equitable should offer customers a delivery rate discount and encourage customers to seek competitive offers for commodity supply (NEMA M.B. at 23; NEMA R.B. at 3-5, 7-9).

Upon careful review, it appears the Settlement terms relating to agency service will actually allow marketers to participate in those limited situations where Equitable will continue to act as an agent. Section 2 of the settlement requires Equitable to obtain offers for supply service from at least three different natural gas suppliers in those situations where the service can be offered. Upon request, documentation of these offers and other information will be provided to the Commission, which will oversee the modified service offering. The Settlement further provides that all services provided in conjunction with the assignation of contracts to Equitable's marketing affiliate will be subject to Natural Gas Supplier Standards of Conduct (Applicants R.B. at 14).

Responding to NEMA's recommendation that the Commission eliminate agency service as soon as possible and by a date certain, the Settlement essentially accomplishes that objective by limiting the availability of agency service and requiring a tariff filing within 30 days after closing that provides for a change in the Rule 11.7 tariff language restricting the availability of agency service as discussed, *supra*. Consequently, a marketer will face no competition from agency service, unless the marketer is involved in a potential bypass or other situation whereby the end user could leave Equitable's system. In such a situation, the marketer is no longer competing for the opportunity to provide retail service to an end user. It is involved in a bypass or gas-on-gas distribution situation. The public interest, therefore, supports continuation of a modified agency service that allows Equitable to continue to respond to these situations (Applicants R.B. at 16).

As will be discussed *infra* in this decision, elimination of gas-on-gas competition will have a dramatic negative affect on customers in the Companies' service territories, unless these customers can actually reap the benefit of a truly competitive market. By discontinuing the current form of agency service and mandating collaboration between Equitable and marketers to address operational issues which hinder the growth of competition, the Settlement promotes a properly functioning and effectively competitive retail natural gas market, because it: (1) encourages new entry of NGSs in the competitive natural gas supply market; (2) provides incentives for existing and new NGSs to expand their competitive offerings to natural gas customers; (3) generates more choice for customers; and (4) strengthens the competitive market for NGSs on the Applicants' distribution systems (Hess/Constellation R.B. at 4).

As to PEMI's assertion that "there is nothing unfair about pricing gas supplies under the agency program based on the laws of supply and demand" (PEMI M.B. at 20-21), the record amply demonstrates that the current agency program is not governed by competitive market forces, but by the anticompetitive practices of the utility and its affiliate, which the Settlement seeks to eliminate. Agency has allowed Equitable to utilize its position as the regulated utility to unfairly gain and maintain customers' supply business and then subsequently create an unfair advantage for its supplier affiliate, Equitable Energy, by handing over to it all or nearly all of the agency gas supply business (NEMA/Hess/Constellation St. 1-R at 8; NEMA/Hess/Constellation St. 1-SR at 6, 20). Through the agency program, Equitable Gas utilizes its position as the regulated utility to gain and maintain customers by not providing them with any documentation indicating who was supplying their gas demands (NEMA/Hess/Constellation St. 1-R at 8). Its employees directly market agency service to customers and directly contract with customers for agency supply, having the potential effect of masking the true nature of agency supply as a competitive commodity obtained by a competitive gas supplier (NEMA/Hess/ Constellation St. 1-R at 8-9).

Although Equitable maintains it is "indifferent" as to who supplies the gas, it has obtained all or nearly all of the gas for the agency program from its affiliate, Equitable Energy (NEMA/Hess/Constellation St. 1-SR at 6, 20). Through the agency program, Equitable Gas was able to direct 68% of the total volume of all third-party gas supplied on its distribution system to its affiliate, Equitable Energy (NEMA/Hess/Constellation St. 1-SR at 5, 14). This practice has resulted in significant growth in the agency program: in 2005, Equitable supplied 7,425,714 Mcf of gas through the agency program, with associated revenue of $80,532,006. The volume was on track to be even higher in 2006 (NEMA/Hess/Constellation St. 1-SR at 4). Large commercial and industrial customers, precisely the customers most likely to be served by competitive gas suppliers, account for nearly all of this volume of gas — receiving more than 92% of all gas supplied through the agency program in each year from 2004 through 2006 (NEMA/Hess/ Constellation St. 1-SR at 5, 14).

The Settlement ends the anticompetitive effect of Equitable's agency program and it will enhance the natural gas supply market. The Settlement allows competitive suppliers, not just Equitable Energy, to compete for agency customers. The Settlement provides that Equitable will not act as an agent on behalf of customers to secure supply services, except in the limited circumstances where a customer demonstrates a *bona fide* attempt to bypass or otherwise leave Equitable's distribution system (Settlement, Appendix C, ¶1). Paragraph 2 of the Settlement enumerates the conditions that must be satisfied in order to invoke this limited exception: (1) the customer, not Equitable Gas, must initiate the request for agency service — which prevents Equitable Gas from utilizing agency service as a marketing tool to gain and maintain customers; (2) the customer must be an existing customer of the Company — which prevents Equitable from using agency service to entice new customers; (3) the customer must represent that it has a *bona fide* offer from another company to bypass or to otherwise leave Equitable's distribution system — which prevents unrealistic bypass proposals from triggering the right to use agency; (4) Equitable Gas must attempt to obtain offers for supply services from at least three different

NGSs — which provides marketers, other than Equitable Energy, the opportunity to serve agency customers; and (5) Equitable must furnish the Commission with appropriate documentation that it has met these conditions (Hess/Constellation R.B. at 6-7).

The Settlement represents movement toward a more effective competitive retail market in southwestern Pennsylvania, where a level playing field will exist between all affiliated and nonaffiliated suppliers and where more choices for customers will materialize. Since the Settlement, by greatly modifying Equitable's agency program, advances the natural gas market in accordance with the Competition Act, it is in the public interest.

PEMI also argue that Section 2203(14) of the Competition Act, 66 Pa. C.S. §2203(14), requires the Commission to continue the agency program, since its elimination would otherwise remove an option that was available to certain ratepayers in the Equitable service area at time of passage of the Act (PEMI M.B. at 28). Section 2203(14), however, provides that a natural gas distribution company "<u>may</u> continue to provide natural gas service to its customers under all tariff rate schedules and riders incorporated into its tariff, and policies or programs, existing on the effective date of this chapter." (Emphasis added). Thus, a plain reading of this Act's provision shows it is merely permissive, not mandatory. Accordingly, the Commission retains discretion to determine whether a program, tariff or policy, which existed at the time of the Act's passage, is no longer in the public interest and should, therefore, be discontinued. Here, the record shows that the effect of Equitable's existing agency program is anticompetitive, inconsistent with the Competition Act and consequently, not in the public interest. The Settlement addresses these concerns, since it discontinues the anticompetitive implementation of the agency program.

8. <u>Operational Practices</u>

A necessary component to restricting use of the agency program to create a more open marketplace is the operational rules that will govern the natural gas distribution system. Obviously, if these rules are overly and unjustifiably punitive and restrictive, they limit the efficiency and value the NGSs pass along to their customers (NEMA/Hess/Constellation St. 1

at 21). These concerns are especially acute in the instant proceeding, because the operational rules on Dominion Peoples' system are more conducive to competition than those on Equitable's system. *Id.* Only 11 NGSs are currently active on Equitable's system, while 20 NGSs are currently providing natural gas supply service on Dominion Peoples' system (NEMA/HESS/ Constellation St. 1-SR at 2).

The Settlement terms contained in Appendix C set forth three provisions to ameliorate this imbalance. First, as part of a future proceeding to combine the tariffs of Equitable and Dominion Peoples, Equitable commits to filing tariff provisions that promote the development of a competitive market in the combined service territory. Equally as importantly, Equitable agrees to form a users group of marketers to make recommendations concerning the proposed merged tariff prior to commencing any such proceeding (Settlement, Appendix C, pp. 3-4, at ¶1). The Commission has long encouraged this type of collaboration (Hess/ Constellation M.B. at 8-9).

NEMA argues that the Settlement falls short of ensuring that the ultimate choice tariff rules will indeed support development of a competitive retail gas market. It claims that the Settlement raises more questions than it answers and that the Commission should require Equitable to adopt Dominion Peoples' choice program rules (NEMA M.B. at 23-26; NEMA R.B. at 4). Equitable's commitment, however, to file tariff provisions that promote the development of the competitive market combined with Equitable's agreement to form a users group of marketers to make recommendations for such tariff provisions is a reasonable approach to this issue. Blanket adoption of Dominion Peoples' choice tariff falls short of an effective solution because, although the Dominion Peoples' rules generally are better than Equitable's, some of them may not be transferable without modification or tailoring, and others may need improvement as well. Even NEMA admits there may be "valid reasons for departing from one of the Dominion rules" (NEMA M.B. at 25). Accordingly, a users group consisting of NGSs, who compete on these systems, will help identify the problems and solutions, thus potentially improving the level of natural gas supply competition in this market (Hess/Constellation R.B. at 10-11).

The remaining two provisions of Appendix C to the Settlement deal with Equitable's system for data management and marketer interface (the ALTRA system). In connection with the acquisition, Equitable did not purchase the E-Scripts electronic system that Dominion Peoples uses for communicating with NGSs to effectuate functions necessary to serve customers, such as nominating and scheduling gas for customers (NEMA/Hess/Constellation St. 1 at 22-23). E-Scripts, however, offered more functionality and depth to marketers than ALTRA in its current form. *Id.*

Now, Equitable recognizes that following any acquisition, since E-Scripts will no longer be available, it must install a system at Dominion Peoples that will continue the same functionality as E-Scripts. Accordingly, it must upgrade its existing ALTRA system for use on both Equitable's and Dominion Peoples' systems. In Appendix C to the Settlement, Equitable agrees to convene a marketers' users group to obtain NGS input for purposes of testing modifications to its ALTRA system to achieve the functionality that E-Scripts had (Hess/Constellation M.B. at 4).

NEMA contends these Settlement terms lack commitment (NEMA M.B. at 26). NEMA's discussion overlooks a chart attached to the Settlement term sheet, listing specific functions that Equitable intends for ALTRA. The functions include transportation pool type, storage service type, IT systems and website. The chart also presents subcategories within each function. Contrary to NEMA's contention, the Settlement clearly provides that the users group that will be convened may recommend and Equitable will consider changes to operational rules and practices that are necessary to achieve the functionality on the chart. Significantly, the Settlement also provides for the users group to test the new ALTRA system before it is implemented. A collaborative meeting of interested parties is preferred over a litigated resolution. The public interest and the advancement of a competitive market will benefit by allowing Equitable and those marketers actually engaged in the marketing function to work together to address the details and functionality of the ALTRA system as proposed in the Settlement (Applicants R.B. at 17; Hess/Constellation R.B. at 11-12).

9. Enhanced Use of Pennsylvania Natural Gas

Equitable agrees to integrate its "Apollo District" with its "Equitable District" to enable local Appalachian supply to flow more efficiently and economically on Equitable's system (Settlement, Appendix B at ¶2). Equitable also agrees to integrate its system with Dominion Peoples' system to enable local Appalachian supply to flow between the Equitable and Dominion Peoples systems. This action will increase the production, transportation and use of local Appalachian supply, which will benefit producers and marketers of local Appalachian Supply, as well as Equitable, Dominion Peoples and their retail customers. It will also ameliorate the effects of eliminating competition between Equitable and Dominion Peoples, and it will promote development of the competitive retail natural gas market on the Companies' systems. The increased use of local Appalachian supply is also consistent with Commission policy. *See*, 52 Pa. Code §60.1 (IOGA M.B. at 7-8).

Equitable touts its record of increasing local production on its own system and it believes that opportunities exist to displace with local gas approximately 6-7 Bcf annually of interstate pipeline supplies that Dominion Peoples currently purchases and injects into on-system storage. Equitable further believes that there may be opportunities to use some of the existing interconnects that Dominion Peoples has with interstate pipelines to displace an additional 4-8 Bcf annually of interstate supplies. In total, provided that operational and reliability matters are addressed, Equitable believes the potential exists for 10-15 Bcf of interstate pipeline supplies to be displaced by local Appalachian production on an annual basis with minimal capital investments. This displacement will occur on both Equitable's system, as well as Dominion Peoples' system. As this level of local production increases, Equitable suggests the western Pennsylvania economy also should be stimulated with increases in tax revenue, new employment opportunities for drillers and pipeline crews and the resulting trickle down effect of increased deliverability (Applicants M.B. at 23-24; Equitable St. 3 at 15; Equitable St. 3-R at 20, 23-25).

To resolve IOGA's concerns with Equitable's gathering fees, charges and practices, Equitable agrees to charge producers one set of uniform rates for the entire Equitable/ Dominion Peoples transmission/distribution/gathering system and to not impose additional or separate charges without IOGA and/or producer approval. Equitable agrees to resolve other gathering issues in another proceeding (IOGA M.B. at 8-9; Settlement, Appendix B).

To address IOGA's concerns with Equitable operating Dominion Peoples as a separate company and system without adopting Dominion Peoples' pro-competition operational rules and practices, Equitable agrees to adopt Dominion Peoples' historical meter production/ nomination methodology and monthly gas accounting methodology. This action will permit producer pool operators to manage their nominations and deliveries more efficiently and economically. Equitable also addresses IOGA's concerns on these issues by its agreement with Hess/Constellation, as explained *supra* (IOGA M.B. at 9). NEMA agrees that these Settlement provisions are in the public interest (NEMA M.B. at 18-19).

On the other hand, PEMI argues the parties proposing the Settlement provisions fail to explain how the proposed modifications to Equitable's operational rules and practices will affect customers or whether enhancements will actually occur. PEMI's argument ignores the nearly unanimous view of the marketer parties, including NEMA, that Dominion Peoples' operational rules pertaining to producers and marketers that purchase gas from local producers are fairer and more reasonable than Equitable's, and that Equitable's adoption of Dominion Peoples' rules in general will result in enhanced production and use of Appalachian supply (Applicants R.B. at 14; IOGA R.B. at 3-4).

10. Synergy Savings

The Applicants have not quantified specific synergy savings from this transaction. The Commission, however, consistently recognizes in transactional proceedings that the economies of scale of an expanded customer base have a beneficial effect on existing customers. *See, e.g.*, Application of Aqua Pennsylvania, Inc., Docket No. A-210104F0071 (Order entered August 23, 2006); Application of Little Washington Wastewater Company, Inc., Docket No. A-230240F0027 (Order entered August 23, 2006); and Application of Aqua Pennsylvania, Inc., Docket No. A-210104F0073 (Order entered September 19, 2006). Here, the acquisition will add approximately 357,000 customers to Equitable's Pennsylvania operations providing opportunities for economies of scale that might not otherwise occur absent the transaction. Ultimately, over time, Equitable expects the expanded customer base and resulting opportunities for economies of scale will produce lower rates for distribution service than the rates that would otherwise have been the case. Equitable claims a combined pool of 568,000 potential residential choice customers will provide an opportunity for NGSs to benefit from economies of scale, such as reduced transactional costs and reductions in the cost to acquire customers (Applicants M.B. at 19; Applicants Exh. 1 at 9; Equitable St. 1-R at 5, 19-20; Equitable St. 2 at 7).

The OSBA disagrees. While Equitable expects the eventual merger of the two NGDCs will produce synergies that result in some delivery cost savings, OSBA notes the Applicants have not requested permission to merge the NGDCs in this proceeding. If this application is approved, OSBA argues Equitable will not realize any of these benefits, unless and until a merger application is filed and approved. Furthermore, the Applicants offer no quantitative assessment as to how the approval of the proposed acquisition will translate into lower rates or better service for the customers of Dominion Peoples. In fact, OSBA concludes that absent sufficient synergy savings, consolidation of the delivery charges of the two NGDCs will likely result in an increase in distribution rates for Dominion Peoples' customers. The Applicants provide no plan to use the synergies to mitigate the harm of increased rates for Dominion Peoples' ratepayers that will follow, if the Commission's approval of the proposed acquisition leads to a blending of the two NGDCs' distribution rates (OSBA M.B. at 13, 15; OSBA R.B. at 14; OSBA St. 1 at 8).

NEMA also worries about captive customers paying higher rates (NEMA M.B. at 12; NEMA R.B. at 6), but it agrees that "it is reasonable to assume that one consistently applied Choice program for a combined pool of 568,000 potential residential choice customers provides an opportunity for NGSs to benefit from economies of scale such as, reduced transactional costs, *e.g.* nominations, accounting, *etc.* and reductions in the cost to acquire customers" (NEMA M.B. at 24; Equitable St. 2 at 7).

PEMI argue the claimed synergy savings are speculative. Neither Company has performed any detailed studies or analyses to substantiate the alleged cost savings nor have they provided any detailed quantification of other purported benefits. Equitable admits opportunities for synergies cannot be identified until the proposed transaction is consummated. PEMI declare that the evidence, in fact, indicates approval of the application will impose substantial costs on ratepayers. PEMI contend customers will face higher transportation rates, higher balancing charges, and potentially higher natural gas supply costs on Dominion Peoples' system through reduced access to on-system storage for local gas supplies. Equitable's own documents demonstrate that it intends to take most transportation customers to maximum rates upon expiration of existing contracts (PEMI St. 1 at 13). Thus, PEMI protest the speculative cost savings that the Applicants calculate do not outweigh these costs (PEMI M.B. at 8-9; PEMI R.B. at 15-16).

Contrary to these protestations, it is not unusual for applicants in an acquisition proceeding to be unable to quantify rate savings. Perhaps more importantly, there is no requirement in Pennsylvania law that applicants do so. In the recently concluded proceeding concerning UGI's acquisition of PG Energy, the applicants could not identify specific, quantified savings associated with that transaction. They explained, as do the Applicants here, that it was simply too early in the transactional process to provide such information. The UGI position was adopted despite demands from intervenors that the immediate flow-through of anticipated synergies and efficiencies was required. Application of UGI, *supra*. (Equitable St. 1-R at 6).

Similarly, the applicants did not quantify savings in Application of Newtown Artesian Water Company and Indian Rock Water Company, 76 Pa. PUC 260 (1992); Application of United Water Company of Pennsylvania, Inc., Docket No. A-210013F0014 (Order entered January 27, 2000); and Application of Pennsylvania-American, *supra*. In Application of Pennsylvania-American at 14, the Commission stated:

> Furthermore, in every major water utility merger or acquisition since Newtown Artesian, this Commission has relied upon findings that the transaction would likely produce lower capital costs or reduce other expenses without demanding that either the level of such savings or their impact on rates be quantified.

Further, the Commission rejected arguments that quantification of synergies was required, stating:

> The OTS relies on the Commission's Opinion and Order approving the GPU/First Energy merger as support for its 'quantification' mandate. However, GPU/First Energy can be distinguished from this proceeding in many respects. Most notably, GPU bundled its application for merger approval with a request to recover over $300 million in purchased electric power costs by GPU's subsidiaries, Metropolitan Edison Company (Met Ed) and Pennsylvania Electric Company (Penelec). Nevertheless, neither GPU/First Energy nor the Commonwealth Court's opinion affirming the Commission's merger approval in that case made the 'quantification' of public benefits an element of the City of York test.

Id. at 13.

In Joint Application of Philadelphia Suburban Water Company and Borough of Media, Docket No. A-212370F0018 (Order entered March 31, 1995), the Commission declined to mix rate matters into application proceedings. In the application proceeding preceding UGI's acquisition of PG Energy, where the Commission approved Southern Union's acquisition of PG Energy, the Commission similarly concluded that the flow through of savings to ratepayers is an issue for a future rate proceeding and not the pending application proceeding (Equitable St. 1-R at 7-8).

In the case *sub judice*, Equitable, however, identifies various areas that should offer cost savings going forward. The main area is in capital costs relating to pipeline replacement. As noted, *supra*, portions of the service territories of Equitable and Dominion Peoples overlap with each company having its own facilities in these areas. Michael R. Baker Jr. Inc. ("Baker") performed a study of the overlapping pipeline facilities of Equitable Gas and Dominion Peoples and identified over $145 million of potential savings over the next twenty years. The Baker Report reached the following conclusions:

- Savings of $114,887,000 were identified under the assumption that 74.4 miles of bare steel and cast iron pipe of either company could be eliminated and the cost to replace these segments avoided because of proximity to pipe from the other company.

- Savings of $4,190,000 were identified under the assumption that approximately 4 miles of coincidental steel pipe installed from 1961-1971 could be eliminated should leakage justify replacement.

- Savings of $500,000 per year were projected from the avoidance of mainline extension costs due to the elimination of competition to serve new load.

- Operational savings of $489,500 per year were estimated in the areas of leak surveillance and leak repair associated with the eliminated coincidental pipe.

- Anticipated future projects which would enhance system operation on Dominion Peoples' system on a stand alone basis, but that likely are unnecessary if the systems are combined, were identified to be $20.5 million.

- Identified unquantified savings include opportunities for cost avoidance in the areas of mandatory relocations, elimination of single feed systems and district regulating stations, and future potential replacements of critical feeds and crossings.

(Applicants M.B. at 14-15; OCA St. 3-S, Attachment RCS-2-S).

These savings will obviously reduce the financial burden on customers (Equitable St. 1 at 15). Equitable also identifies significant potential annual PGC savings resulting from the acquisition as addressed, *supra*. The presence of these synergies is compelling (Equitable St. 1-R at 5-6).

Any concern that a future consolidation will result in a rate increase is premature and sheer speculation. The Commission must approve any changes in rates in a proceeding in which all interested parties will have an opportunity to participate. Of equal significance, due to the rate case stay-out provision of the Settlement, any changes in base rates will occur no sooner than 2009.

11. Elimination of Gas-on-Gas Distribution Competition

In southwestern Pennsylvania, the historical nature of the discovery and development of natural gas in 1878 in Murrysville, along with the rapid growth of Pittsburgh as the industrial center of the United States at the turn of the last century, led to an overlap of service territories as newly formed natural gas providers expanded their areas of service to serve new customers. Among the companies formed to serve the emerging market was Equitable Gas Company, founded in 1888, and The Peoples Natural Gas Company, founded in 1885. These unique historical circumstances allowed these companies to not only provide natural gas service to the same general area, but often to install pipelines on the same street (Applicants M.B. at 30, n. 18; OCA St. 3-S, Attachment RCS-2-S at 1).

Equitable posits gas-on-gas distribution competition is a "negative (or zero) sum game" in which all customers, collectively, are harmed even though some few customers benefit. What one customer wins via rate discounts through gas-on-gas distribution competition, others lose via higher tariff rates. Indeed, Equitable argues eliminating overlapping service territories and gas-on-gas distribution competition is in the public interest, because maintaining the *status quo* prolongs the extent and duration of the present economic inefficiency (Equitable St. 6-R at 10-11). Here, when coupled with the market-favoring terms and conditions proposed in the Settlement, Equitable claims eliminating gas-on-gas distribution competition is a clear and obvious affirmative public benefit (Applicants M.B. at 31-32, n. 19).

The OSBA disagrees, citing the anticompetitive prospect of increased market power should the acquisition occur. 66 Pa. C.S. §2210(a). It notes that approximately 2,000 transportation customers and more than 20,000 residential sales customers currently have the ability to choose between Equitable Gas and Dominion Peoples for delivery service (OSBA St. 1 at 5). In addition, Dominion Peoples currently serves 522 commercial customers and 29 industrial customers that have Equitable Gas as a competitive service option. *Id.* Consequently, if the operations of Equitable Gas and Dominion Peoples are consolidated, small business customers will be deprived of a competitive option they now enjoy (OSBA M.B. at 15-16).

The OSBA further notes the Applicants intend to offer renewed contracts to these small business customers on what are likely to be less favorable terms and conditions than have been available previously (OSBA St. 1 at 5; OSBA St. 3 at 1-2). Thus, the OSBA argues the acquisition will eliminate significant competitive pressure (OSBA M.B. at 16).

Not surprisingly, PEMI, as beneficiaries of the current system, join the OSBA in voicing their objections. Rather than competing against each other, PEMI argue the Companies' common objective will be to maximize profits (PEMI St. 1 at 33). In evaluating a merger, PEMI note "the probable general effect of the merger upon rates is certainly a relevant criterion of whether the merger will benefit the public." City of York, 295 A.2d at 829. PEMI claim eliminating gas-on-gas competition, particularly in the Pittsburgh area, will place upward pressure on customer rates in the overlapping service area due to the elimination of customers' current bargaining power (PEMI M.B. at 18; PEMI St. 1 at 33).

Equitable has analyzed increasing its margins from its current top 25 customers and eliminating discounts that Dominion Peoples furnishes to current "competitive" customers over the next 15 years as contracts expire (PEMI St. 1 at 33; OSBA St. 1 at 5). Presumably, the Companies will seek to recoup transaction costs through the imposition of maximum rates. Public input testimony confirms that Equitable has declared that competition is over, and it will not negotiate rates with businesses such as the Doubletree Hotel in downtown Pittsburgh (N.T. 14). Thus, without competition to discipline natural gas prices, the Companies will have every incentive to set rates at maximum tariff levels, at the expense of ratepayers (PEMI M.B. at 18-19).

In addition to the $970 million acquisition price, PEMI note the associated merger costs include: $7.1 million in transaction expenses, $26.9 million in outside services, $11.6 million for materials and supplies, and over $17 million in employee costs (PEMI St. 1 at 11, Exh. AC-2). The acquisition price alone exceeds alleged merger savings. *Id.* Thus, even if Equitable is permitted to retain any resulting cost savings, the Companies still must increase revenues in order to break even on the investment and even more so, if stockholders will receive a return on their investment. Because Equitable agrees in the Settlement that it will not seek to recover transaction costs in rates, PEMI assert the Companies will undoubtedly seek to recoup these expenses by increasing transportation customers' rates. The post-transaction opportunity to move all transportation customers to excessive maximum tariff rates and increase balancing and other charges will provide the windfall Equitable needs to make this transaction profitable at the expense of business and industry in southwestern Pennsylvania (PEMI M.B. at 19).

In addition, PEMI argue the Applicants' allegation that the merger may entice additional gas suppliers to enter the Companies' market area by eliminating gas-on-gas competition is pure conjecture (Equitable St. 1 at 21). This claim is not based on any formal competitive market analysis or any survey of current or potential gas suppliers in western Pennsylvania (PEMI St. 1 at 25). Even if this speculation proves true, PEMI assert it will not constitute a merger benefit, because it will be offset by the adverse competitive impacts associated with the elimination of gas-on-gas competition between the Companies. *Id.* PEMI contend it is illogical to believe competition for transportation service between Equitable and Dominion Peoples impacts marketers' willingness to enter the territories to provide gas supply services (PEMI M.B. at 13).

Moreover, if the proposed transaction is approved and Equitable's retail market regulations are applied to Dominion Peoples' service area, the level of market participation by alternative suppliers could actually suffer (PEMI St. 1 at 40). More marketers participate on Dominion Peoples' system than Equitable's system (PEMI St. 1 at 39). In the absence of a formal study, PEMI argue it is no more reasonable to conclude that more marketers will serve on the merged system than it is to conclude the contrary. Further, it may be more reasonable to conclude that marketers will leave the system when the corporate entity with the worse track record, *i.e.*, Equitable, takes over. Because both tariffs currently allow gas-on-gas competition for transportation service and supply service, PEMI urge the Commission to question whether the mere existence of this competition inhibits market entry and, by extension, whether its elimination will solve the issues that have led to the disparate levels of marketer entry into the two territories. Speculation regarding enhanced competition does not represent, in PEMI's view, an affirmative, substantial benefit of this merger (PEMI M.B. at 13; PEMI R.B. at 21-22).

Contrary to Equitable's "cost of service" claim, PEMI insist the Commission set maximum transportation rates in western Pennsylvania above cost of service levels, with the understanding that customers could use any available competitive leverage, including gas-on-gas competition, to reduce their transportation prices below this rate ceiling (PEMI St. 1-S at 18). Furthermore, the Commission's natural gas transportation regulations clearly contemplate that this type of negotiation will occur. *See*, 52 Pa. Code §60.2(1)-(6). Thus, PEMI opine if these customers will no longer be able to negotiate and instead will be subject to maximum rates, they will be forced to take service at unjust and unreasonable rates (PEMI R.B. at 23; PEMI St. 1 at 29).

Because of the energy-intensive nature of their industrial processes, PEMI assert commercial and industrial customers are sensitive to energy cost increases and can ill afford further increases associated with the proposed transaction (PEMI St. 1 at 32; N.T. 115). Many commercial and industrial customers, including various PEMI members, compete in domestic and international markets to sell their products. Some commercial and industrial customers also compete with sister facilities in lower cost regions for production opportunities and capital investment. Facilities that can provide a cost advantage to the company and the consumer are favored, while higher cost facilities will not have access to capital investment and face a higher risk of closure or sale. *Id.* In the face of escalating energy costs and strong international, domestic, and intra-company competition, simply passing through increased energy costs to their customers, PEMI contend, is not a realistic option for these customers. In simplistic terms, doing so will result in a finished product that is not competitively priced and may target commercial and industrial customers, including PEMI member facilities in western Pennsylvania, as unprofitable (PEMI R.B. at 23-24).

Further, PEMI insist transportation rate negotiation is a legitimate cost management tool. PEMI argue that transportation rate discounting is economic, as the existence of negotiated rates demonstrates that customers in the overlapping territories are deriving concrete economic benefits from competition between the Companies (PEMI St. 1 at 29-30; PEMI St. 1-R at 5). In addition, Equitable and Dominion Peoples have been able to recover the full cost of facilities constructed to serve new "competitive" transportation customers through negotiated rates over two- and six-year periods, respectively (PEMI St. 1 at 36). Consistent with the Commission's expectations at the time these maximum transportation rates were established, PEMI opine competition creates incentives for Equitable to match or beat Dominion Peoples' service terms and conditions to secure the business of existing and potential gas customers and to operate efficiently. *Id.* PEMI insist it is illogical to categorize an activity that provides a utility with full cost recovery for new facilities (as opposed to merely a return on the new facilities added to rate base) over such a short period as "inherently uneconomic" (PEMI R.B. at 24-25).

PEMI also dispute the Companies' contention that these costs are borne by other customers, since it ignores the fact that maximum transportation rates in the region are set well in excess of cost and were justified based on what the market may bear. Consequently, rate discounting does not automatically create an under-recovery of fixed costs that must be absorbed by other customers (PEMI St. 1-S at 16). No evidence exists that any negotiated contract is set below cost (PEMI St. 1-S at 20-21). The existence of a higher rate ceiling allows the Companies to discount transportation charges without creating a cost under-recovery that could potentially be absorbed by other customers (PEMI R.B. at 25; PEMI St. 1-S at 17).

Finally, PEMI disagree with the Companies' characterization of gas-on-gas distribution competition as creating a situation of "dead weight loss" (PEMI St. 1-S at 20-21). PEMI find no merit in the Applicants' claim that customer acquisition costs are a dead weight loss to the acquiring utility's customers (PEMI R.B. at 25).

After giving careful consideration to the various offerings of the parties on this vitally important issue, it appears the Applicants present the correct economic analysis. As further explained by NEMA/Hess/Constellation expert witness Crist, customers in the long run will benefit more from an effectively competitive retail market through choice and opportunities for savings on gas commodity purchases than they will from gas-on-gas distribution competition. Any benefits removed by the elimination of gas-on-gas distribution competition between Equitable and Dominion Peoples will be mitigated through the development of an effectively competitive retail market (NEMA/Hess/Constellation St. 1-R at 3-4).

As Equitable's expert witness Dr. Hieronymus postulates, gas-on-gas distribution competition is a "negative (or zero) sum game" in which all customers, collectively, are harmed even though some few customers benefit. What one customer wins via rate discounts through gas-on-gas distribution competition, others lose via higher tariff rates. Dr. Hieronymus characterizes gas-on-gas distribution competition that creates rate discounts as a dead weight loss and wholly uneconomic (Equitable St. 6-R at 7). He explains:

> In response to a question concerning the wasteful duplication of gas distribution facilities at Page 35 of his testimony, [PEMI expert witness] Mr. Chalfant supplies data that purport to show that additional revenues collected by Equitable and Peoples, respectively, from customers taken from each other as a result of gas-on-gas distribution competition have a payback period of only six and two years, respectively. He then opines that "If the negotiated distribution contracts are bringing benefits to the customers involved and the utilities are not materially harmed (as demonstrated by the rapid return of their investment), then it is difficult to categorize this as 'wasteful.'" In his exhibit he shows investments in such gas-on-gas distribution competition (since 2004) as $3.23 million for the two companies. He reasons that because incremental distribution revenues return these investments within 2 to 6 years, they must be economic.
>
> There are both factual and conceptual errors in this analysis. The factual error is that the costs of gas-on-gas distribution competition are deemed to be limited to the direct, customer-specific costs of pipeline extensions, whereas the largest cost doubtless is the maintenance of duplicate facilities that are so geographically proximate that the customer can be reached by the utility that was not serving them at such low costs. The conceptual error is that the revenues gained by the utility that acquired the customer are treated as a benefit that offsets the cost of the incremental investments. This, however, ignores the revenue loss accruing to the distributor that lost the customer.
>
> In fact, the substitution of one distributor for the other creates no new revenues. Indeed, what is lost by Equitable if Peoples gains a customer is almost assuredly more than Peoples gained (otherwise, the customer would not switch). Once the effects of the transaction are flowed through revenue requirements, Equitable's remaining customers will lose the revenues previously garnered from the customer while Peoples customers will benefit from a

> smaller increment of revenues and bear the dead-weight loss of the incremental costs incurred to gain the customer. For customers other than the customer who benefits, the loss will be equal to the cost of accessing the customer plus the additional discount that the customer was able to bargain for.

(Applicants M.B. at 32-33; Equitable St. 6-R at 8).

Further, Dr. Hieronymus explains that eliminating gas-on-gas distribution competition will not adversely impact economic development. Equitable and Dominion Peoples, with or without an actual merger, will retain the ability and incentives they have today to provide economic development discounts (Equitable St. 6-R at 10). Also, he addresses the subject of duplicative facilities as sunk costs as follows:

> By definition, investments in existing facilities that lack alternative uses are sunk. I also would agree that it is less wasteful to maintain existing duplication of facilities than it would be to create it from the beginning. However, this misses the point. Had service territories in western Pennsylvania been rationalized years ago, as they were elsewhere, I have little doubt that today's revenue requirements would be lower. Maintaining the status quo merely prolongs the extent and duration of inefficiency.
>
> Moreover, acknowledgement that existing facilities are sunk ignores the fact that these distribution facilities are to a substantial degree old and require significant maintenance and replacement in order to continue safe operation. Rationalizing the facilities by eliminating duplication can save significant sums. My understanding is that company witnesses are testifying to significant capital savings that can be gained from such rationalization and to other, operating cost savings likely to be made available through reducing duplication once an actual merger is accomplished. While I am not qualified to testify to these savings as such, I am hardly surprised that their magnitude is substantial.

(Applicants M.B. at 33; Equitable St. 6-R at 10-11).

Furthermore, Dr. Hieronymus' conclusion that maintenance of gas-on-gas distribution competition is poor public policy (Equitable St. 6-R at 11-13) finds support in two Commission decisions. In Application of Equitable Gas Company, Docket No. A-121100F0003 (Order entered 1999), this Commission concluded that "[p]resent Commonwealth law and public policy do not favor competition among gas distribution utilities" and it further stated that:

> We agree with the ALJ's finding that the building of a competitive distribution system would necessarily result in wasteful duplication of facilities contrary to the public interest. The creation of another distribution pipeline system and related facilities for the physical delivery of gas supplies to a competitor's gas customers' premises is contrary to the public interest. We agree with the Protestants that gas-on-gas distribution competition in overlapping service territories is wasteful and a duplication of fixed distribution facilities. We shall adopt the ALJ's finding as our own that there is nothing in the record that shows how that result might be in the public interest.

(Applicants M.B. at 34; Equitable St. 6-R at 11-12; emphasis in original).

In September 2005 decisions involving, respectively, Equitable's and Dominion Peoples' purchased gas costs, this Commission indicated that it would not permit gas purchase related discounts to be recovered from other customers when such discounts arose from gas-on-gas distribution competition. The Commission concluded that:

> On consideration of the record, we conclude that it is unreasonable to allow a gas utility to transfer the costs of discounts in waived retainage and other gas delivery requirements to "captive" or PGC customers where these costs were incurred in order to entice a customer from a jurisdictional NGDC and as a reaction to defend against another jurisdictional utility. The purpose of "gas on gas" competition is to encourage improvement and efficiencies in the utilities' operations. This is hardly accomplished by discounting of fuel retainage factors and other gas delivery requirements and subsequently recovering these charges from firm sales customers, for example, through Rider B and waivers of banking charges, balancing charges or migration charges.

(Applicants M.B. at 34; Equitable St. 6-R at 12).

While PEMI decry the lack of a formal study or analysis to support the Applicants' assertion that natural gas marketing will be enhanced through the elimination of gas-on-gas distribution competition, they ignore the Settlement's overall terms and conditions garnered to enhance competition, as well as the support the marketers give this Settlement.

Furthermore, the record is devoid of any evidence to support PEMI's contention that elimination of gas-on-gas distribution competition will cause production cost increases that will "erode intra-company, national, and international competitiveness" (PEMI M.B. at 16). In fact, when Equitable attempted to discover the specific economic circumstances of each PEMI member, including circumstances outside the Pittsburgh area, PEMI declined to provide the information (Applicants R.B. at 24; Eighth Interim Order dated September 8, 2006). PEMI witness Chalfant, moreover, could not identify the location of PEMI member facilities or the businesses engaged in by PEMI members (N.T. 301). PEMI avoided addressing the specific economic circumstances of any PEMI member or the existing rates or potential rates of any member. Certain PEMI members declined to make their contracts available to their own expert witness; Mr. Chalfant was only aware of the actual rates paid by "probably about half" of the eight PEMI members (Applicants R.B. at 25-26; N.T. 315, 327).

As to its argument concerning maximum rates, PEMI's concept of a cost based rate is at odds with Commission regulations.[22] For both Equitable and Dominion Peoples, the existing maximum tariff rates were determined on a cost of service basis. Equitable witness Dr. Hieronymus explains that negotiated rates that are less than the tariff maximum are below cost of service (N.T. 275):

> I looked at the decisions that [PEMI witness] Chalfant had as attachments to his surrebuttal testimony and as best I can determine from those decisions, Peoples' so-called value of service rate, its maximum tariff rate for transportation of non-Pennsylvania

[22] *See* footnote 20, *supra*.

> gas under transport contracts - - depending on which of the decisions you read - - is either just a little bit above or just a little bit below cost of service. Effectively it's equal to cost of service.
>
> The Equitable decision that he appended [to his written testimony] seems to indicate that Equitable's maximum transportation tariff rate for non-Pennsylvania gas is five percent above the cost of service rate of Pennsylvania gas. So, again, there isn't much difference between the maximum rate and cost of service in any event ....

Hence, the evidence supports the Applicants' theory that gas-on-gas competition tends to harm the general customer base. Without some analysis of individual PEMI contracts, no evidence is present in this case to verify that PEMI members individually will suffer adversely from elimination of gas-on-gas competition.[23]

Clearly then, discounts arising from gas-on-gas distribution competition are not in the public interest, because they have a negative impact on captive customers. When evaluating the consolidation of two natural gas distribution companies, the Commission must consider whether the proposed consolidation is likely to result in anticompetitive or discriminatory conduct, which will prevent retail gas customers from obtaining the benefits of a properly functioning and effectively competitive retail natural gas market. 66 Pa. C.S. §2210. A properly functioning and effectively competitive retail natural gas market must be one which assures an opportunity for all customers to benefit — not just a select few. In Middletown Township v. Pa. P.U.C., 482 A.2d 674 (Pa. Cmwlth. 1984), the Commonwealth Court stated that "when the 'public interest' is considered, it is contemplated that the benefits and detriments of the acquisition be measured as they impact on all affected parties, and not merely on one particular group or geographic subdivision as might have occurred in this case."

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[23] PEMI members have contracts with Equitable for distribution and/or agency supply service that range from less than 1 year (ending in 2006) to 13 years (ending in 2019) (PEMI St. 1 at 38-39). A PEMI customer with a long term contract is protected from "harm" for the length of the contract. For those PEMI members with expiring contracts, Equitable will extend the contracts on mutually agreeable terms. Equitable asks that PEMI customers pay their fair share of delivery cost of service, as residential customers and other customers do (Equitable St. 1-R at 24). PEMI members may also qualify for other discounts depending on their unique circumstances, so long as they fall within the Commission's recent enunciation of those situations where discounts may be warranted (Applicants R.B. at 22-23, 31; Equitable St. 1-R at 35).

Solid economic theory supports the conclusion that the eventual disappearance of discounts arising from gas-on-gas distribution competition is in the public interest (Equitable St. 6-R at 12-13). But, this acquisition will only effectuate the intended consequences, if the combined systems of both Companies are truly open to an effectively competitive retail natural gas market. As explained in this decision, the various Settlement provisions promote such a competitive retail natural gas market on the Companies' combined systems. Therefore, the Settlement is in the public interest.

12. <u>Gas Safety</u>

Gas safety is a concern in this proceeding because, through the stock acquisition, Equitable will become responsible for managing approximately 1,900 miles of bare steel and cast iron pipe in Dominion Peoples' system in addition to approximately 800 miles of pipe it currently owns. OTS identified multiple areas where gas safety improvement was needed to ensure proper management of Equitable's current lines, as well as the additional lines that it will acquire in this transaction (OTS M.B. at 16-18; OTS St. 2 at 12-13; OTS St. 2-SR at 12-13).

To address these concerns, the Applicants agree first to use aerial patrols to monitor transmission lines for excavation activity and encroachment (Settlement, Appendix A at ¶7). Dominion Peoples currently employs aerial patrols, but Equitable's patrolling practice involves walking the right-of-way on a quarterly basis. While both practices comply with minimum pipeline safety regulations, aerial patrols are superior, because they provide a better view of pipeline rights-of-way and a better opportunity to discover activity and encroachment (Applicants M.B. at 21; OTS M.B. at 16; OCA M.B. at 24; OCA R.B. at 9).

Next, Equitable agrees to review and implement procedures similar to Dominion Peoples' program for identifying areas of active corrosion on cathodically unprotected pipelines. Corrosion is the leading cause of natural gas leaks and can lead to pipeline accidents (OTS St. 2 at 8-10; OTS St. 2-SR at 7-9). Dominion Peoples evaluates its cathodically unprotected pipelines with a leak history within the 18 months. A Corrosion Supervisor reviews the records, taking into account leak history, type of material and overall pipe condition. Identified areas of active corrosion are then sent to the engineering department for replacement within 15 months. Currently, Equitable uses a computer analysis to detect active areas of corrosion based on leak history. Pipeline safety regulations require active corrosion to be determined by a person that is qualified in pipeline corrosion control methods. Because Equitable's system is based on a computer program without input from personnel to evaluate corrosion indicators, the system that Dominion Peoples employs to determine active corrosion areas is superior. Consequently, adoption of Dominion Peoples' procedure will ensure better oversight of Equitable's and Dominion Peoples' pipelines (OTS M.B. at 17).

Finally, Equitable agrees to review existing valves in its and Dominion Peoples' distribution systems and install new valves where necessary. Proper valve placement is necessary to regulate the flow of gas in a pipeline quickly and easily. It is critical to stop the flow of gas to a failed pipe section quickly to prevent gas loss and unsafe conditions. OTS notes that Equitable has not always used critical valves in emergencies to decrease the number of customers affected by a shut down. By agreeing to aggressively review valve placement and install new valves where necessary, the Settlement will allow fewer customers to be affected by shut downs, while at the same time ensuring that shut downs occur in a timely manner for public safety (OTS M.B. at 18).

PEMI's concern that Equitable's commitment to raise the level of its gas safety procedures to match that of Dominion Peoples will actually result in the long term degradation of Dominion Peoples' system is speculative at best and finds no support in the record (PEMI R.B. at 18). Accordingly, these provisions of the Settlement are in the public interest.

13. <u>Service Quality</u>

The OTS and OCA held concerns that in an acquisition, the acquiring company tends to focus its immediate attention on creating synergies that produce savings and on revenue enhancements. Because of this tendency to concentrate on revenue-enhancing activities, customer service can suffer. Hence, the Settlement (Appendix A at ¶6) creates the following Service Quality Index ("SQI") for residential and small business customers that establish performance standards to ensure that service quality to ratepayers will not decline as a result of this acquisition:

Performance Indicator	Proposed Annual Performance Standard
1. Call Center: % calls answered w/in 30 seconds	70% for 2008, and 75% for 2009
2. Call Center: Average Busy-out Rate	1% (Dominion performance in 2004)
3. Call Center: Average Call Abandonment Rate	7% for 2008, and 6% for 2009
4. # of Customer disputes not issued a report within 30 days	No more than 3% of the Total Number of disputes filed
5. % of Meters not read as required by 56.12(4) (ii-6 mos.) and (iii-12 mos.)	Not read in 6 months: .25% Not read in 12 months: .03% (Dominion performance 2004 and 2005)
6. Gas Safety Response Time	No degradation from the Companies three-year average response times.
7. Percent of bills not rendered once every billing period	.01% for Dominion, .05% for Equitable, effective 1/1/2008

The Applicants, OTS and OCA agree the terms of this Settlement fully address their concerns with regard to telephone access, meter reading, billing and the handling of disputes (Applicants M.B. at 16-17; OTS M.B. at 12-16; OTS St. 3; OTS St. 3-SR; OCA M.B. at 23-24).

Commission regulations require NGDCs to report the percentage of calls answered within 30 seconds with the representative ready to render assistance and process the call. In 2005, 64% of Dominion Peoples calls were answered within 30 seconds, while only 37% of Equitable's calls were answered in 30 seconds (OTS St. 3 at 9). The Settlement performance standard requires a 30 second answer rate of 70% of in 2008 and 75% in 2009.

The Settlement sets an average busy-out rate of 1%. The busy-out rate, as defined in reporting requirements, is the number of calls to an NGDC's call center that receive a busy signal divided by the number of calls received. In 2005, both Equitable and Dominion Peoples reported a 1% average busy out rate. The SQI will continue the 1% standard.

The Settlement sets an average call abandonment rate of 7% for 2008 and 6% for 2009. The call abandonment rate is the number of calls to an NGDC's call center that are abandoned divided by the total number of calls received. In 2005, Equitable showed an average call abandonment rate of 14%, while Dominion Peoples' call abandonment was 7%. *Id.* Under the SQI, the call abandonment rate of 7% will continue in 2008, but it must improve to 6% in 2009. This new performance standard is an improvement over Equitable's current rate by bringing it up to the Peoples' standard in 2008 and requires both Companies to improve in 2009.

If a customer registers a dispute with a utility about any matter covered by Chapter 56 regulations, 52 Pa. Code §§56.1, *et seq.*, the utility must issue a report to the complaining party within 30 days of the initiation of the dispute pursuant to 52 Pa. Code §56.151(5). In 2005, Dominion Peoples responded to all disputes within 30 days, whereas Equitable failed to respond to 154 disputes within 30 days. Under the SQI, the Companies agree that no more than 3% of the total number of disputes filed will be responded to in excess of the 30-day time period.

The SQI mandates no degradation from the three-year average of gas safety response time.

Commission regulations require NGDCs to report the percentage of residential meters from which the company has failed to obtain an actual or ratepayer-supplied meter reading within the past six and 12 months. 52 Pa. Code § 56.12(4)(ii) and (iii). In 2005, Dominion Peoples failed to read .25% of its meters in 6 months and .08% in 12 months. Equitable, in 2005, failed to read 1.70% of residential meters in 6 months and .40% in 12 months. Under the SQI, the Companies must meet a new standard of .25% of meters not read in 6 months and .03% meters not read in 12 months. Although this is a higher level than provided for in the Commission's regulations, it represents a significant improvement over Equitable's current performance levels and ensures that Dominion Peoples service quality will not deteriorate as a result of this stock acquisition.

The Code requires a bill to be rendered once every billing period to all customers. 66 Pa. C.S. §1509; 52 Pa. Code §56.11. In 2005, Dominion Peoples' rate of not rendering residential bills once every billing period was .01%; it was .02% for small business customers (OTS St. 3 at 14). Equitable's percentage of bills not rendered once every billing period in 2005 was .1% for residential customers and .3% for small business customers. *Id.* Beginning in 2008, the SQI establishes a standard for residential and small business customers of .01% for Dominion Peoples and .05% for Equitable.

In addition to these SQI performance standards, the Joint Petitioners agree that these standards must remain in effect until the next base rate proceeding. If the standards are not met, the Commission may open a formal investigation as to why the performance standards were not achieved (Settlement, Appendix A at ¶6(d)). As part of this investigation, the Companies will be required to report what caused the failure and what steps they will take to ensure they will meet the standard the following year. In addition, within 90 days of the conclusion of each calendar year, Equitable must provide a report to the Commission and the parties and post on its website an analysis of its performance in achieving these standards.

The Settlement defining these standards does not in any way limit the authority of the Commission, its Bureau of Consumer Services, or any other bureau from performing their duties and making recommendations for failure of the Companies to perform in any of the areas identified. Moreover, the Joint Petitioners retain their rights to file a complaint or petition for an investigation in response to other indices that are not directly measured in the SQI. The service quality Settlement terms substantially promote the accommodation, convenience or safety of the public by ensuring that service quality will not suffer and, in some instances, will improve during the stock acquisition transition period.

14. Universal Service

Universal services are those services provided and related costs incurred to assist residential customers, who lack the ability to pay the full cost of their utility service. Equitable Gas has one of the highest concentrations of payment-troubled customers of any NGDC in

Pennsylvania, second only to Philadelphia Gas Works (Equitable St. 1 at 10). In response to the concerns of the OTS, OCA and the MVUC about the negative impact the proposed acquisition could have on this customer group, Equitable commits to forming a Universal Service Collaborative Group (the "Collaborative"), which will consist of Company representatives and other parties who wish to participate, including Community Based Organizations ("CBOs") or other low-income stakeholders or representatives. The Collaborative will provide a forum, whereby low-income advocates and other stakeholders can participate with Equitable in shaping its future plans for low-income and energy conservation programs (Settlement, Appendix A at ¶5) (Applicants R.B. at 21-22; OTS M.B. at 10-12; OTS R.B. at 15-16; OCA M.B. 19-23; OCA R.B. at 8-9; OCA St. 2; OCA St. 2-S; MVUC M.B. at 4-8).

The Companies also commit to continued funding for community organizations and for the Hardship Fund at least at the level contributed in 2005 over the next three years, net of the contributions made to the 2005 Stay Warm PA Program (Settlement, Appendix A, at ¶5).

The CBOs that provided support to administer the Companies' various universal service programs as of November 1, 2006 will remain in place for the stay-out period and the Companies will consider with the Collaborative the feasibility of contracting with additional CBOs, including those whose contracts were terminated as a result of bringing the Customer Assistance Program ("CAP") enrollment process in-house. *Id.*

Under the terms of the Settlement, applicants will face fewer barriers to CAP enrollment (MVUC St. 1 at 28). The Companies will not impose any ceiling on CAP enrollment, provided they receive adequate program funding. *Id.*

During the base rate stay-out period, Equitable may require a security deposit for returning CAP participants in an amount no greater than two months' usage at the last applicable CAP rate. During the same stay-out period, Dominion Peoples will continue its current policy of waiving security deposits for CAP participants. *Id.* CAP participants unable to maintain their utility service and experiencing disconnection, often face the hurdle of paying upfront, as much as two months' usage charges at the prevailing market rate to be reconnected (MVUC St. 1

at 29-30). Notwithstanding PEMI's criticism of the "socializing" of universal service costs (PEMI M.B. at 12-13; PEMI R.B. at 13-14), the reduction in reconnection requirements will substantially benefit low-income households experiencing this problem. Moreover, since industrial customers are not exposed to the costs of universal service, PEMI's views on this subject are entitled to little weight.

Universal service settlement criteria similar to the foregoing have been cited in other transactional proceedings as affirmative public benefits. *See, e.g.*, Application of UGI, *supra*; and Application of PECO, *supra*. These settlement criteria are also consistent with the universal service goals legislated in the Competition Act. *See*, 66 Pa. C.S. §§2203(7) & (8).

15. Minority Hiring

Under terms of the Settlement, the Companies will attempt to develop a program with the assistance of the Pittsburgh Urban League and the MVUC to increase hiring of minority and low-income applicants (Settlement, Appendix A at ¶5h). This provision addresses the concern of the MVUC that some of the jobs that the Applicants anticipate creating as a result of this acquisition should benefit the Companies' payment-troubled customer base (Applicants M.B. at 18; OTS M.B. at 11; OTS R.B. at 15-16; OCA M.B. at 21; OCA R.B. at 9; MVUC M.B. at 6-7; MVUC St. 1 at 26-28).

16. Diversity

Rep. Wheatley encourages Equitable to increase the racial and ethnic diversity of its employees and its utilization of Minority Business Enterprises ("MBEs"). The Settlement recognizes the importance of providing market access and economic opportunities to diverse businesses and people. Equitable's senior management and Rep. Wheatley agree to work together to accomplish these diversity objectives (Settlement, Appendix A at ¶8). Their discussions have included consideration of outreach initiatives, creation of an advisory committee and adoption of various guidelines developed by the National Association of Regulatory Utility Commissioners' ("NARUC") Utility Marketplace Access Partnership program. NARUC encourages utilities to voluntarily consider these guidelines to promote MBE marketplace access. NARUC concludes that those utilities and the economy benefit when a utility's supplier base reflects the demographics of its customer base. The Settlement recognizes the importance of providing market access and economic opportunities to diverse businesses and people. Equitable agrees to continue to work with Rep. Wheatley to develop and implement specific and measurable processes and plans to accomplish these objectives (Applicants M.B. at 18; Rep. Wheatley Letter in Lieu of Brief).

17. Maintaining the Workforce

Equitable proposes no workforce reductions here. *Compare, e.g.*, Application of The United Telephone Company, d/b/a Sprint and Sprint Long Distance, Inc., Docket No. A-313200F007 (Order entered April 7, 2006); and In re: Investigation of AT&T, Inc., Docket No. I-00060111 (Orders entered May 8 and 19, 2006). Equitable has a collective bargaining agreement ("CBA") for 76 utility employees for which the IBEW is the authorized collective bargaining representative. Dominion Peoples has a CBA for 392 employees (as of October, 2005) for which the UWUA is the authorized collective bargaining representative. Equitable and Dominion Peoples will continue to be bound by their existing CBAs for the remainder of the contract terms, unless negotiated otherwise.

Equitable will continue employing all of Dominion Peoples' non-union employees at the time of closing for at least one year with total compensation (base salary and incentive opportunities) and benefits in the aggregate, being comparable to those currently available. If any employees are terminated, other than for cause, prior to the end of that one-year period, they will receive severance benefits of at least equal value to those of the current Dominion Peoples' severance plan (Applicants M.B. at 24-25; Equitable St. 1 at 19).

18. Pension Benefits

On the subject of pension funds for the Companies' employees, the Settlement provides:

> Equitable agrees to contribute sufficient amounts to the Pension Plan for Peoples Natural Gas in order to meet ERISA[24] and Pension Protection Act of 2006 safeguards. The Pension Protection Act of 2006 requires companies with a defined benefit pension plan to fully fund their pension obligation over a seven year period. Equitable will fully comply with the funding obligations and will make additional contributions in payments applicable to under-funded plans.

(Settlement, Appendix A at ¶4). OTS, OCA and Rep. Wheatley join the Applicants in urging approval of this provision (Applicants M.B. at 20, 25, 41-47; Applicants R.B. at 32-41; OTS M.B. at 10; OTS R.B. at 13-15; OCA M.B. at 18; OCA R.B. at 8). The UWUA does not.

The pension fund covering Dominion Peoples' employees and retirees is over-funded. According to the most recent actuarial study for the plan, pension fund assets total $189.7 million, but projected liabilities are only $61.5 million (N.T. 228). Thus, Dominion Peoples has not made any cash contributions to its pension plan in several years. Further, if the proposed transaction does not occur, Dominion Peoples need not make additional contributions for many years (UWUA M.B. at 8).

If the proposed transaction occurs however, Dominion, the parent of Dominion Peoples, will not transfer the pension fund to Equitable (N.T. 220). Instead, Dominion will retain the pension fund and treat existing Dominion Peoples employees as "terminated vested employees." As "terminated vested employees," Dominion Peoples' employees will be entitled to receive only 45% of the pension benefits they would have received, if they had retired as active employees (UWUA St. 1 at 3). Equitable will provide additional pension benefits, if any, and it will fund them on an on-going basis (UWUA M.B. at 8; N.T. 391).

Further, the UWUA notes that Equitable makes no commitment to keep a pension plan for Dominion Peoples' employees. The Stock Purchase Agreement ("SPA") only obligates Equitable to retain a pension plan for Dominion Peoples' non-union employees for 12 months

[24] The Employee Retirement Income Security Act of 1974 ("ERISA"), 29 U.S.C. §§1001, *et seq.*

after closing (N.T. 391). For Dominion Peoples' union employees, Equitable will abide by the collective bargaining agreement ("CBA"), but that agreement expires on May 1, 2007 (N.T. 230, 339, 390). While Equitable expresses no intimation of what it will do with the pension plan once that agreement expires, the UWUA notes that Equitable eliminated pension plans for former employees of Carnegie Natural Gas Company, United Steelworkers-represented employees, and salaried employees (UWUA M.B. at 8-9; N.T. 388-390).

In a situation where Dominion will keep a pension fund worth more than $100 million and Equitable will make a minimal, short-term commitment to retain a pension plan for Dominion Peoples' employees for one year or less, the UWUA argue the effect on Dominion Peoples' employees will be severe. In the view of the UWUA, the Settlement provision states only that Equitable will comply with federal law regarding the funding of any pension plan that it has for Dominion Peoples' employees, but it does not require Equitable to have a pension plan. In other words, the Settlement term says only that if Equitable has a pension plan for Dominion Peoples' employees, Equitable will comply with federal law.

While this arrangement might be good for Dominion, the UWUA contends it is not in the public interest for either Dominion Peoples' employees, whose pension benefits are at risk, or Dominion Peoples' customers, who might be required to contribute to a Dominion Peoples' pension plan. City of York, *supra*; 66 Pa. C.S. §1103(a). Noting that the Commission is authorized to impose conditions on its approval of this transaction, the UWUA, nevertheless, concedes that it does not appear that the Commission can order a fundamental change in the transaction itself or otherwise impose conditions that are beyond the scope of its jurisdiction. Rheems Water Co. v. Pa. P.U.C., 620 A.2d 609 (Pa. Cmwlth. 1993). Consequently, the UWUA urges rejection of the proposed transaction in its entirety as not in the public interest (UWUA M.B. at 9-12; UWUA R.B. at 5-12).

At the threshold, one must note that the Commission, as an administrative agency, is wholly a creature of legislation. It is limited to the authority granted to it in its enabling legislation and it is limited to those powers necessary to carry out the mandate of the statute. PECO Energy Co. v. Pa. P.U.C., 791 A.2d 1155 (Pa. 2002); and City of Phila. v. Pa. P.U.C., 822 A.2d 94 (Pa. Cmwlth. 2003). The Commission is not granted the power to monitor pensions[25] and it has no statutory or regulatory authority to condition approval of the application on a matter over which it has no jurisdiction. Application of UGI Utilities, Inc., *et al.*, Docket No. A-120011F2000 (Order entered August 18, 2006).

Section 2210(a)(2) of the Competition Act, 66 Pa. C.S. §2210(a)(2), merely requires the Commission to consider the effect of a proposed merger, consolidation, acquisition or disposition on a NGDC's employees and on any authorized collective bargaining agent representing those employees. The Competition Act remains silent on the remedy available, if the Commission finds that harm will occur. The record, however, fails to demonstrate any evidence of detriment or adverse change to the *status quo*.

Indeed, the SPA and the Settlement preserve the *status quo* for the Companies' employees. Under the SPA, Equitable agrees to assume the CBA currently in place between UWUA and Dominion Peoples (Dominion Peoples St. 1R at 2; Applicants Exh. 1, Appendix A, Section 5.7(b), at 26). The level of benefits and compensation, including any pension benefit or payout, does not change with this transaction. These benefits cannot change without negotiations with the Union. *Id.*

Further, pursuant to the SPA, Dominion retains both the assets and liabilities for pre-closing pension plan obligations; Equitable agrees to create a mirror plan into which it will contribute assets to meet post-closing pension plan obligations (Dominion Peoples St. 1R at 3; Applicants Exh. 1, Appendix A, Section 5.7(d), at 27). The benefits provided by the two plans will be equal (Dominion Peoples St. 1R at 6). Equitable will give employees credit for service accumulated at Dominion Peoples (Dominion Peoples St. 1R at 7; Applicants Exh. 1, Appendix A, Section 5.7(d), at 27, and Section 5.7(h), at 28). The only change that employees will discover will be the sources from which they will receive their pension benefit (Dominion

[25] Indeed, the "Commission's only authority with regard to pension funds is to determine how much of the funding obligation can be passed through to customers in rate proceedings." Application of UGI, *Slip Op.* at 66. Other Pennsylvania administrative agencies have taken a similar approach. *See, e.g.*, International Ladies' Garment Workers' Union v. Human Relations Comm'n of the City of Allentown, 417 A.2d 1279 (Pa. Cmwlth. 1980) (local agency's regulation of a union's benefit plan was preempted by ERISA).

Peoples St. 1R at 100). Therefore, the impact on the UWUA and employees is no greater than what they face presently. What may happen as a result of future collective bargaining obviously cannot be predicted or known at this time. This unpredictability, including future pension plan treatment, exists whether Dominion Peoples, Equitable, or some other company is the employer.

Furthermore, concerns relating to the "over-funded" status of Dominion Peoples' plan and Equitable's future ability to fund a post-closing plan have been addressed. First, while over-funding is technically accounted for as income, it is a non-cash item that, under ERISA, cannot be used for any purpose other than payment of pension obligations. 29 U.S.C. §1103(c)(1). Second, the Settlement resolves the UWUA's concern regarding Equitable's willingness to fund a pension plan by Equitable's agreement to contribute sufficient amounts to the pension plan to meet ERISA and the Pension Protection Act of 2006 safeguards. The latter Act requires a company to fully fund its pension obligation over no longer than a seven year period (Settlement, Appendix A, at 2 & 4).

As the UWUA concedes, federal law circumscribes the extent of Commission review in this area. Specifically, "ERISA's comprehensive regulatory scheme was intended to establish the regulation of benefit plans as 'exclusively a federal concern.'" Department of Public Welfare v. Lubrizol, 737 A.2d 862, 867 (Pa. Cmwlth. 1999), quoting Pilot Life Insurance Co. v. Dedeaux, 481 U.S. 41, 107 S. Ct. 1549 (1987). Congress enacted ERISA "to establish a comprehensive scheme to protect the interests of employees and their beneficiaries in employee benefit plans." Carpenters Local 261 Health and Welfare Fund v. Nat'l Union Fire Insurance of Pittsburgh, 686 A.2d 1373, 1374 n.1 (Pa. Cmwlth. 1996).[26] In doing so, Congress defined the extent to which ERISA preempts state law; that is, Section 514(a) states that ERISA "shall

[26] ERISA applies to any employee benefit plan, if it is established or maintained by, *inter alia*, "any employer engaged in commerce or in any industry or activity affecting commerce." 29 U.S.C. §1003(a)(1).

supersede any and all State laws[27] insofar as they may now or hereafter relate to any employee benefit plan."[28] 29 U.S.C. §1144(a).

What the UWUA seeks to redress in this proceeding is exactly that which is preempted. Not only does it attack the structure of the pension plan under the SPA, it attacks the SPA's proposed rules governing payment to recipients, claiming the Applicants have not "fairly allocated pension assets and obligations" between the two companies (UWUA M.B. at 2, 8, 12). That is, any decision that the Commission could render, either to deny the application or to condition approval based upon the Applicants' treatment of the structure and payments under the pension, would "act immediately and exclusively" on the pension plan and would have a "connection with" the plan. The federal policy of insuring against failure to pay employees' pension benefits would be implicated by such a ruling. While the Commission has been given the power and duty to regulate utilities through, *inter alia*, determining whether to approve an application, ERISA contemplates preemption of substantial areas of traditional state regulation, when such regulation treads on areas implicating the policy behind ERISA.

Moreover, the Applicants have considered the interests of Dominion Peoples' employees. First, the SPA provides exactly what UWUA bargained for in the most recent collective bargaining process. Namely, the current CBA, at Article II, Section 2, provides that, if there is a sale of the company, the "exact terms of this agreement . . . [shall be] conditioned upon the purchaser . . . assuming all the obligations of the agreement until its expiration . . . ." The CBA requires it to be transferred in whole, including the pension benefits provisions, to any acquiring company (Dominion Peoples Cross-examination Exh. 3, Article II, Section 2, at 2). The UWUA admits this CBA provision benefits the Union (N.T. 343).

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27 "State law" includes "all laws, decisions, rules, regulations, or other State action having the effect of law, of any State." 29 U.S.C. §1144(c)(1).

28 A State law "relates to" an ERISA plan, "if it is specifically designed to affect employee benefit plans, if it singles out such plans for special treatment, or if the rights or restrictions it creates are predicated on the existence of such a plan." Carpenters Local 261, 686 A.2d at 1375 (citation omitted).

Second, under the SPA structure, the UWUA and the employees it represents are in a *status quo* position. The SPA requires Equitable to step into Dominion Peoples' shoes with regard to the CBA, which is exactly what the UWUA negotiated for in the collective bargaining process. Nowhere does the CBA require an acquiring company to assume any certain method of pension payment; rather, under the CBA, Equitable must assume the obligation to provide a pension plan. This obligation is retained; the only change members of the UWUA will see is that the obligation will be paid in the form of two checks, rather than one. Further, this transaction does not change at all the UWUA's protection or the power it has in the collective bargaining process. After expiration of the current CBA, the UWUA and its employer company — whether that employer is Dominion Peoples, Equitable, or some other company — will have to collectively bargain for another mutually agreeable CBA.

Third, the UWUA is protected by Dominion Peoples' commitment to pay pension obligations up to closing. That commitment is not subject to future collective bargaining; it is guaranteed.

Fourth, the UWUA's comparison of the decision in Application of UGI Utilities, *supra*, wherein ALJ Colwell characterized the applicants' treatment of the pension as "appalling," to the current application is misplaced. Unlike the situation in Application of UGI, Dominion Peoples has met with the UWUA's president and its members to discuss the transaction and what it means to them (Dominion Peoples St. 1-R at 5). In that meeting, Dominion Peoples orally shared information with the UWUA. It submits written documentation of the questions and answers that were discussed there (Dominion Peoples St. 1-R at 5; Dominion Peoples Exh. 1). In addition, Dominion Peoples expressed a willingness to meet further with the UWUA to discuss any remaining concerns (Dominion Peoples St. 1-R at 5). The UWUA declined this invitation (N.T. 340). Moreover, ALJ Colwell acknowledged that pension considerations are preempted by federal law, are not a proper consideration for this Commission, and cannot be used either to deny or condition the transaction. Application of UGI, *Slip Op.* at 59. Even though ALJ Colwell expressed displeasure with the companies, she recommended approving the application.

Finally, the UWUA speculates that the proposed transaction will "slash [employees'] pension benefits by 50% or more" because, it alleges, Equitable does not promise that it will keep a pension plan for Dominion Peoples' employees, but that it will only commit to abide by the CBA that expires on May 1, 2007 (UWUA M.B. at 8-9). The UWUA's concerns find no evidentiary support and are not raised in the appropriate forum. Rather, all Equitable employees are covered by some type of defined pension or contribution plan (N.T. 387-89). The UWUA cannot seek, through this application proceeding, that which otherwise is only available through the collective bargaining process. The UWUA's concern for what type of pension plan will exist after expiration of the current CBA is a matter for collective bargaining. The UWUA cannot acquire further "pension protection" beyond the *status quo* in this application proceeding, when it is preempted by federal law and not authorized by state statute.

D. The Overall Effect of the Settlement

The Commission encourages parties in contested on-the-record proceedings to settle cases. *See*, 52 Pa. Code §5.231. Settlements eliminate the time, effort and expense of litigating a matter to its ultimate conclusion, which may entail review of the Commission's decision by the appellate courts of Pennsylvania. Such savings benefit not only the individual parties, but also the Commission and all ratepayers of a utility, who otherwise may have to bear the financial burden such litigation necessarily entails.

By definition, a "settlement" reflects a compromise of the parties' positions, which arguably fosters and promotes the public interest. When parties in a proceeding reach a settlement, the principal issue for Commission consideration is whether the agreement reached suits the public interest. Pa. P.U.C. v. CS Water and Sewer Associates, 74 Pa. P.U.C. 767, 771 (1991). In their supporting briefs, the Joint Petitioners conclude, after seven and a half months of extensive discovery, exchanging and reviewing written testimony and numerous exhibits, and conducting lengthy settlement discussions, that this Settlement resolves those contested issues of interest to them in this case. The Joint Petitioners declare this Settlement is in the public interest and it should be approved for the reasons expressed in the foregoing sections of this decision.

Conversely, PEMI object that the non-unanimous Settlement reflects only each Joint Petitioner's interest as proclaimed in a particular Settlement term sheet to which that Joint Petitioner is a signatory. Neither the Code nor applicable legal precedent, however, requires each and every interest of each and every party to be accommodated in a settlement. In Middletown Township, *supra*, the Court stated that "when the 'public interest' is considered, it is contemplated that the benefits and detriments of the acquisition be measured as they impact on all affected parties, and not merely on one particular group or geographic subdivision as might have occurred in this case."

Here, PEMI, while significant consumers of natural gas, represent only eight of the nearly 600,000 customers of these Companies. The Applicants have demonstrated substantial public benefits from the proposed acquisition, including, *inter alia*, a rate case stay-out, significant reductions in annual purchased gas costs, capital cost savings through elimination of redundant pipe, the return of Dominion Peoples ownership to Pennsylvania, a rejuvenated retail natural gas market and the enhanced production, transportation and use of less expensive Pennsylvania natural gas. Commitments to meet with interested parties in a collaborative setting to discuss and address issues of interest are likewise identifiable benefits consistent with Commission policy to resolve regulatory matters without litigation. These benefits inure to the profit of all of the Companies' customers and those who serve them. For these reasons, the application with the Settlement will be approved.

V. CONCLUSIONS OF LAW

1. The Commission has jurisdiction over the subject matter and the parties to this proceeding. 66 Pa. C.S. §§501, *et seq*.

2. The Applicants bear the burden of proving that they are entitled to the relief they are seeking in this application proceeding. 66 Pa. C.S. §332(a).

3. The degree of proof required to establish a case before the Public Utility Commission is by a preponderance of the evidence. Se-Ling Hosiery v. Margulies, 364 Pa. 45,

70 A.2d 854 (1954); Samuel J. Lansberry, Inc. v. Pa. P.U.C., 578 A.2d 600 (Pa. Cmwlth. 1990); and Feinstein v. Philadelphia Suburban Water Company, 50 Pa. P.U.C. 300 (1976).

4. Joint Applicants have demonstrated by a preponderance of the evidence that the proposed transaction, as described in the Stock Purchase Agreement and the Joint Application and as subject to the terms and conditions contained in the Joint Petition for Settlement, is necessary or proper for the service, accommodation, convenience or safety of the public, as required by Section 1103 of the Public Utility Code, 66 Pa. C.S. §1103.

5. Joint Applicants have demonstrated by a preponderance of the evidence that the proposed transaction, as described in the Stock Purchase Agreement and the Joint Application and as subject to the terms and conditions contained in the Joint Petition for Settlement, will affirmatively promote the public interest in a substantial way, as required by City of York v. Pa. P.U.C., 449 Pa. 136, 295 A.2d 825 (1972).

6. Joint Applicants have established by a preponderance of the evidence that the proposed transaction, as described in the Stock Purchase Agreement and the Joint Application and as subject to the terms and conditions contained in the Joint Petition for Settlement, will not result in any anti-competitive or discriminatory conduct, including unlawful exercise of market power in the retail natural gas market, as required by Section 2210(a)(1) of the Natural Gas Choice and Competition Act, 66 Pa. C.S. §2210(a)(1).

7. Joint Applicants have established by a preponderance of the evidence that the proposed transaction, as described in the Stock Purchase Agreement and the Joint Application and as subject to the terms and conditions contained in the Joint Petition for Settlement, will not produce any unreasonable adverse effect on the employees of Equitable or Dominion Peoples or on any authorized collective bargaining agent representing those employees, as required by Section 2210(a)(2) of the Natural Gas Choice and Competition Act, 66 Pa. C.S. §2210(a)(2).

8. Based on the record developed in this proceeding and a thorough review of the positions of the parties, Equitable's acquisition of the common stock of Dominion Peoples and Dominion Hope is in the public interest.

VI. ORDER

THEREFORE,

IT IS ORDERED:

1. That the Joint Petition for Settlement submitted by Equitable Resources, Inc., The Peoples Natural Gas Company, d/b/a Dominion Peoples, the Office of Trial Staff, the Office of Consumer Advocate, State Representative Jake Wheatley, Jr., the Mon Valley Unemployed Committee, the Independent Oil and Gas Association of Pennsylvania, Hess Corporation and Consolation New Energy-Gas Division, LLC, at Docket No. A-122250F5000, including all terms and conditions, is hereby approved.

2. That the Joint Application of Equitable Resources, Inc. and The Peoples Natural Gas Company, d/b/a Dominion Peoples, for approval of the transfer of all stock and rights of The Peoples Natural Gas Company to Equitable Resources, Inc., and for the approval of the transfer of all stock of Hope Gas, Inc., dba Dominion Hope, to Equitable Resources, Inc., is hereby approved, subject to the terms and conditions of the Joint Petition for Settlement.

3. That Equitable Resources, Inc. may acquire all of the common stock of The Peoples Natural Gas Company, d/b/a Dominion Peoples, and Hope Gas, Inc., dba Dominion Hope, as proposed in the Stock Purchase Agreement, the Joint Application and the Joint Petition for Settlement and a certificate of public convenience is hereby issued evidencing such right.

4. That any protest or petition to intervene filed in this proceeding that is not satisfied or withdrawn pursuant to the terms of the Joint Petition for Settlement is hereby denied.

5. That the record at Docket No. A-122250F5000 is hereby marked closed.

Date: February 5, 2007

John H. Corbett, Jr.
Administrative Law Judge

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for damages now pending in any court of this commonwealth. 1869, April 24, P.L. 93, § 1.

Renumbered from section 1333 of this title.

Historical Note

This act directly supplements Act 1857, March 11, P.L. 77, section 3501 et seq. of this title.

It repealed section 11 of the act of 1857, and substituted the provisions of the text therefor.

Constitutional Provisions

Const. art. 1, § 10 prohibits taking of private property for public use without authority of law and without just compensation being first made or secured.

Cross References

Certificate of public convenience required, see section 1124 of Title 66, Public Service Companies.

Condemnation proceedings by water company, see section 3248 et seq. of this title.

Eminent domain proceedings,

Generally see section 1—101 et seq. of Title 26, Eminent Domain.

Corporations, see section 3021 et seq. of this title.

Notes of Decisions

Library references

Gas ⟹14.50.
Waters and Water Courses ⟹195.
C.J.S. Gas §§ 38, 39.
C.J.S. Waters § 309.
P.L.E. Gas § 11.
P.L.E. Waters § 173.

1. Proceedings for assessment of damages

Where the owners of land claimed ownership of the waters of a brook appropriated by a gas and water company, their claim of ownership must be first heard by viewers. Lackawanna Mills v. Scranton Gas & Water Co., 120 A. 814, 277 Pa. 181, 1923.

In petition asking for appointment of viewers to assess damages sustained by reason of taking of the waters of a stream by a gas and water company, that no mention was made in the resolution of the company of the specific quantity of water appropriated, or of the rights claimed by petitioners, did not prevent the approval of petitioners' application to have damages assessed. Id.

On petition by landowners for the assessment of damages for the appropriation of waters from a brook, failure to file a bond in the name of those injured was not material. Id.

Petitioners for the assessment of damages for appropriation of water from a brook claiming under the same assignor may properly join in prayer for relief, and the rights of each will be considered separately. Id.

ARTICLE IV.—NATURAL GAS COMPANIES

Cross References

Applicability of general law to corporations under this article, see sections 1003, 1004 and 1006 of this title.

Injury to pipes and property of company, see section 3787 of Title 18, Crimes and Offenses.

§ 3541. Formation and general powers

Corporations may be formed in the manner mentioned herein by the voluntary association of five or more persons, or as otherwise provided herein, for the purpose of producing, dealing in, transporting, storing and supplying natural gas to such persons, corporations or associations, within convenient connecting distance of its line of pipe, as may desire to use the same, upon such terms and under such reasonable regulations as the gas company shall establish, and when so formed, each of them, by virtue of its existence as such, shall have the following powers:

First. To have succession by its corporate name for the period limited by its charter, and when no period is limited thereby, perpetually, subject to the power of the General Assembly, under the Constitution of the Commonwealth.

Second. To maintain and defend judicial proceedings.

Third. To make and use a common seal, and alter the same at pleasure, and have a capital stock, not exceeding five million dollars, divided into shares such as each company may determine.

Fourth. To produce, mine, own, deal in, transport, store and supply natural gas, for either light, heat or both, or other purposes, and have all the rights and privileges necessary or convenient therefor.

Fifth. To hold, acquire, purchase, take, receive, maintain, lease, own and use, mortgage, sell, and transfer such real and personal property including pipes, tubing, tanks, office and such other machinery, devices or arrangements, situated in or out of this Commonwealth, as the purposes of the corporation require, to purchase, take, acquire, own, hold and use, the rights, franchises, property and privileges of any other natural gas company incorporated under the laws of this Commonwealth or of any other state or commonwealth, so that all the property rights, powers, franchises and privileges, then by law vested in such other corporation, shall be transferred to and vested in the corporation purchasing, taking, or acquiring the same, and to have and possess the right also to enter upon, take and occupy such lands, easements and other property as may be required for the purpose of laying its pipes for transporting and distributing gas.

Sixth. To appoint and remove such subordinate officers and agents as the business of the corporation requires and to allow them suitable compensation.

Seventh. To make by-laws, not inconsistent with the law, for the election and regulation of its directors and officers, the management of its property, the regulation of its affairs and the subscription, collection and transfer of its stock. 1885, May 29, P.L. 29, § 1; 1939, June 24, P.L. 869, § 1.

Renumbered from section 1981 of this title.

Historical Note

Sections 20 and 22 of this act, relative to the plugging of abandoned wells, were repealed by section 8 of Act 1921, May 17, P.L. 912. Section 21 imposed a penalty for violations of section 20 and became obsolete or inoperative with the repeal of that section. Sections 1 to 7 of the act of 1921 are sections 4 to 10 of Title 58, Oil and Gas.

Prior to the 1939 amendment the fifth paragraph of this section provided: "To hold, purchase, maintain, lease, mortgage, sell, and transfer such real and personal property, including pipes, tubing, tanks, office and such other machinery, devices or arrangements, as the purposes of the corporation requires, and the right also to enter upon, take and occupy such lands, easements and other property as may be required for the purpose of laying its pipes for transporting and distributing gas."

As enacted by Act 1885, May 29, P.L. 29, § 1, this section contained a paragraph designated "VIII" reading as follows: "To enter into any obligation necessary to the transaction of its ordinary affairs."

Cross References

Approval by public utility commission, requirement, see section 1121 of Title 66, Public Service Companies.

Corporations generally, see section 1301 et seq. of this title.

Gas and water companies, see section 3501 et seq. of this title.

Pipe line companies, see section 3351 et seq. of this title.

Purposes and powers generally, corporations, see section 3012 of this title.

Regulation, see 15 U.S.C.A. § 717 et seq.

Transportation and supply of natural gas as a public use, see section 3547 of this title.

Notes of Decisions

In general 1
Conflicting franchises 4
Incorporation, organization and franchises 2
Leases 5
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Taxation 6

Library references

Gas ⇐5.
C.J.S. Gas § 7.
P.L.E. Gas § 2.

1. In general

Fact that a company is authorized to supply natural gas in a certain township does not impose on it the duty to supply gas to every individual in the township. United Natural Gas Co. v. Pennsylvania Public Utility Commission, 33 A.2d 752, 153 Pa.Super. 252, 1943.

When a company is empowered by special charter to buy, maintain or manage in its own name or otherwise any public or private work which may tend or be designed to improve, increase, facilitate or develop trade, travel, transportation and conveyance of freight, live stock, passengers, or other traffic, it may engage in the production, distribution and supply of natural gas. Carothers v. Philadelphia Co., 12 A. 314, 118 Pa. 468, 1886.

2. Incorporation, organization and franchises

A corporation for the supply of natural gas could not be incorporated under Act 1874, April 29, P.L. 73 (incorporated in this title). Emerson v. Com., 108 Pa. 111, 1885; Sterling's Appeal, 2 A. 105, 111 Pa. 35, 56 Am.Rep. 246, 1886.

A natural gas company, organized under Act 1874, April 29, P.L. 73 (incorporated in this title), supplying a borough with natural gas, which accepts the provisions of this act, and continues to supply the borough with gas, and is consolidated under Act 1901, May 29, P.L. 349 (now supplied) with another company, having a right to serve the borough with restrictions as to price, may serve the borough with gas under its franchise, notwithstanding such restrictions where the latter company had never availed itself of the right to furnish the gas. Punxsutawney Borough v. T. W. Phillips Gas & Oil Co., 85 A. 1003, 238 Pa. 23, 1913.

That the stock of a gas company was acquired by the owners of the stock of another company, and that the proceeds of its product, after payment of expenses, were turned into the treasury of the latter company, does not extinguish the former company's individual franchise or rights. Id.

An application under this act cannot be refused, nor can the governor require as a condition of granting it a statement limiting the powers asked for, merely because those powers may conflict with the exclusive rights of another gas company. Citizens' National Gas Co., Op. Atty.Gen., 9 C.C. 290, 1890.

3. Regulation

This act does not exempt natural gas companies from the reasonable police regulations of boroughs as to the use of borough streets. Edgewood Borough v. Scott, 29 Pa.Super. 156, 1905; but a natural gas company will not be enjoined from using the streets of a borough for its pipes, on the ground that the pipes are defective, when it does not appear that they constitute a public nuisance. Butler Borough's Appeal, 6 A. 708, 5 Cent.Rep. 669, 1886.

A natural gas company, organized under the laws of Pennsylvania, which supplied gas under a special contract to another natural gas company, which in turn served a municipality within the first company's field of supply, is a public service company and subject to the provisions of the Public Service Company Law with respect to the sale of natural gas to the other company. People's Natural Gas Co. v. Public Service Commission of Commonwealth of Pennsylvania, 79 Pa.Super. 560, 1922.

4. Conflicting franchises

A gas company organized under a special act, with the exclusive right to furnish manufactured gas for light to the citizens of a municipality, has no exclusive right as against a natural gas company, incorporated under this act to supply natural gas for lighting purposes to the citizens of the same municipality. Warren Gas Light Co. v. Pennsylvania Gas Co., 29 A. 101, 161 Pa. 510, 1894, affirming 13 C.C. 310; and a natural gas company organized under this act, which has supplied a borough and its inhabitants with natural gas for illuminating purposes, is not prevented from continuing to do so by the incorporation of a gas company under Act 1874, April 29, P.L. 73 (incorporated in this title), though under section 1384 (repealed) of this title, the latter company may have had the exclusive privilege to manufacture gas for light only. Hagan v. Fayette Gas-Fuel Co., 21 C.C. 503, 46 Pitts. 229, 1898.

5. Leases

Clause V does not authorize a natural gas company, by lease or other contracts, to turn over to another company, its entire plant for a long period; and such a lease or contract cannot be made without special authority conferred by charter or statute. Stowe v. Citizens' Natural Gas Co., 23 C.C. 273, 1898.

6. Taxation

Company organized under this act, for purpose of producing and dealing in natural gas, is not vender or dealer within contemplation of Act 1899, May 2, P.L. 184 (incorporated in Title 72; Taxation and Fiscal Affairs), and is not subject to mercantile tax. Allegheny Heat Co. v. Mercantile Appraiser, 3 Corp. 44, 63 Pitts. 421, 1915.

§ 3542. Subscription and contents of charter and certificate

The charter of such intended corporation must be subscribed by five or more persons, three of whom, at least, shall be citizens of this Commonwealth, who shall certify in writing to the Governor:

First. The name of the corporation.

Second. The place or places where natural gas is intended to be mined for and produced or received, the place or places where it is to be supplied to consumers, the general route of its pipe line or lines and branches, the location of its general office.

Third. The term for which said corporation is to exist, which may be limited as to time, or be perpetual.

Fourth. The names and residences of the subscribers, and the number of shares subscribed by each.

Fifth. The number of its directors, and the names and residences of those chosen directors for the first year.

Sixth. The amount of its capital stock, and the number and par value of shares into which divided. 1885, May 29, P.L. 29, § 2; 1929, March 27, P.L. 72, § 1.

Renumbered from section 1982 of this title.

Cross References

Corporations generally, see section 1204 of this title.

Notes of Decisions

1. Territory included in charter

A natural gas company cannot include in its charter territory in an adjoining state. United Natural Gas Co., Op.Dep. Atty.Gen., 1 C.C. 468, 1886.

§ 3543. Notice of application for charter; requisites of certificate; presentation, approval and recording

Notice of the intention to apply for any such charter shall be published one time in at least two newspapers, one of which shall be a newspaper of general circulation and the other the legal newspaper, if any, designated by the rules of court for the publication of legal notices; otherwise, in two newspapers of general circulation printed in the county named in the charter of said corporation; and if more than one county is named in the charter, then in at least one newspaper of general circulation printed in each such county named: Provided, That where there is but one newspaper of general circulation published in the county or counties publication of notice in such newspaper shall be sufficient. Notice shall be published at least three days prior to the day fixed in the advertisement for the presentation of the application to the Governor, and shall set forth briefly the character and object of the corporation to be formed, and the intention to make application therefor, and the places where its business in its various branches is to be conducted. The certificate to the Governor shall state that ten per centum of the capital stock named therein has been paid in cash to the treasurer of the intended corporation, and the name and residence of the treasurer shall be therein given; said certificate shall be acknowledged by at least three of the subscribers thereto, before the recorder of deeds of the county in which its principal office is situate,[1] and the subscribers shall also make and subscribe an oath or affirmation before him, to be endorsed on the certificate, that the statements contained therein are true; the certificate so endorsed, accompanied with proof of publication of notice as heretofore provided, shall then be produced to the Governor of the Commonwealth,

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IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA

CITY OF PITTSBURGH, Plaintiff, vs. WEST PENN POWER COMPANY d/b/a ALLEGHENY POWER; ALLEGHENY POWER SYSTEM, INC.; DUQUESNE LIGHT COMPANY; and DQE, INC., Defendants.	)	CIVIL ACTION NO. 97-1772

AMICUS BRIEF OF THE PENNSYLVANIA PUBLIC UTILITY COMMISSION RELATING TO <u>DEFENDANTS' MOTIONS TO DISMISS COMPLAINT</u>

The Pennsylvania Public Utility Commission ("PUC") files this *amicus* brief because defendants' motions to dismiss plaintiff's complaint raises important policy questions as to the effect of the recently enacted Electricity Generation Customer Choice and Competition Act, 66 Pa. C.S. □□ 2801-12 ("Act"), on merger enforcement in the electric utility industry. This Act gives the PUC authority to review and approve or disapprove electric utility mergers depending on whether the merging parties would be able to exercise unlawful market power after the merger's consummation.

Defendants' argue, inter alia, that the City of Pittsburgh's ("City") Clayton Act section 7 claim, 15 U.S.C. □ 18, should be dismissed because the new Act gives the PUC primary or exclusive jurisdiction to decide the issue and the state action doctrine bars the City's challenge to the merger. In making these arguments, defendants assert that the PUC is required by law to review the proposed merger and, in fact, has opened a proceeding to investigate this transaction. Therefore, this Court should defer to the PUC, which, according to defendants', is far better situated than this Court to review the proposed merger.

While the PUC takes no position on the merits of the underlying dispute between the parties, it strongly believes that defendants have misread the provisions of the Act as barring all private rights of action to challenge unlawful electric utility mergers. Nothing could be more from the truth.

While it is true that the PUC has certain obligations and jurisdiction conferred upon it by the Act in relation to reviewing and approving mergers, the state legislature clearly intended and the provisions of Chapter 28 provide that much market power remediation litigation, including merger enforcement, would be conducted in the courts of the United States through public and private actions.

For example, as defendants admit, section 2811(d)(1) of the Act, 66 Pa. C.S. □ 2811(d)(1), expressly requires the PUC to refer its market power findings to the Pennsylvania Attorney General, which has authority to bring federal and state antitrust actions on behalf of the Commonwealth and its citizens. 71 P.S. □

732-204(c). The Pennsylvania Attorney General has parens patriae authority to challenge unlawful mergers under the federal antitrust laws. Pennsylvania v. Russell Stover Candies, Inc., 1993-1 Trade Cas. (CCH) □ 70,083 (E.D. Pa. 1993). However, these federal enforcement actions by the state Attorney General are considered private causes of action under the federal antitrust laws.

If defendants' interpretation of the Act was adopted by this Court, then the state Attorney General and any other private right of action would be barred in all instances. Such an interpretation would render meaningless the referral of market power findings by the PUC under section 2811(d)(1) of the Act. See 1 Pa. C.S. □ 1922(1)(in ascertaining the intent of the legislature in enacting a statute, it is presumed that the legislature "does not intend a result that is absurd, impossible of execution or unreasonable"). There is no express language in Chapter 28 that gives the PUC primary or exclusive jurisdiction to decide electric merger cases. It is well settled that repeal of federal antitrust laws by implication are disfavored. City of Lafayette v. Louisiana Power & Light Co., 435 U.S. 389, 398 (1978).

As for defendants' state action immunity argument, that doctrine generally immunizes otherwise anticompetitive private conduct where the state has clearly articulated and actively supervised the conduct in question. California Retail Liquor Dealers v. Midcal Aluminum, Inc., 445 U.S. 97 (1980). In the instant case, the PUC has not yet decided whether the merger should or should not be approved. Further, the Act itself has not authorized these mergers to occur, but only gave the PUC nonexclusive authority to review them. There is no automatic immunization of this merger from private challenge simply because of enactment of this new law. See, e.g., Northeast Utilities Service Co. v. FERC, 993 F.2d 937, 948 (1st Cir. 1993) ("Petitioners may rest assured that were FERC to approve a merger of utilities which ran afoul of Sherman Act or other antitrust policies, the utilities would be subject to either prosecution by government officials responsible for policing the antitrust laws, or to suit by private citizens meeting the requirements of standing")(citation omitted).

For these reasons, this Court should not apply the primary or exclusive jurisdiction or state action doctrines to the City's Clayton Act section 7 claim.

Dated: November 18, 1997

Respectfully submitted,

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Assistant Counsel

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CX0006

PENNSYLVANIA
PUBLIC UTILITY COMMISSION
Harrisburg, PA 17105-3265

Public Meeting held October 6, 2005

Commissioners Present:

Wendell F. Holland, Chairman
James H. Cawley, Vice Chairman
Bill Shane
Kim Pizzingrilli
Terrance J. Fitzpatrick

Petition of the Office of Trial Staff for the Commencement of an Investigation of Competitive Practices Between Natural Gas Distribution Companies

Docket No. P-00052160

ORDER

BY THE COMMISSION:

On April 19, 2005, the Office of Trial Staff ("OTS") filed the above-captioned petition requesting that this Commission commence an investigation into competition for customers between/among jurisdictional natural gas distribution companies with overlapping service territories. For reasons stated below, the petition will be denied without prejudice.

DISCUSSION

The OTS files its petition pursuant to Section 306(b)(1) of the Public Utility Code. This section reads as follows:

> The Office of Trial Staff shall be responsible for and shall assist in the challenge of, and representation on the record of all matters in the public

> interest in all commission proceedings except those involving transportation, safety , eminent domain, siting, service issues having no impact on rates and ability to pay, provided that the Director of Trial Staff may petition the commission and may be directed by the commission to intervene to protect the public interest in any proceeding involving transportation, safety, eminent domain, siting, service issues having no impact on rates and ability to pay. . . . <u>If the Director of Trial Staff is of the opinion that the initiation of a proceeding is necessary to protect the public interest, he shall request that the commission initiate the appropriate proceeding.</u> When he participates in a commission proceeding, it shall be the duty and the responsibility of the Director of Trial Staff to prosecute the proceeding.

66 Pa. C.S. §306(b)(1)(emphasis added).

Answers were filed by the Office of Consumer Advocate ("OCA"), the Office of Small Business Advocate ("OSBA"), T.W. Phillips Gas and Oil Company ("T.W. Phillips"), The Peoples Natural Gas Company ("Peoples"), Equitable Gas Company ("Equitable"), PPL Gas Utilities Corporation ("PPL Gas"), and Columbia Gas of Pennsylvania, Inc. ("Columbia").

On September 2, 2005, the Industrial Energy Consumers of Pennsylvania ("IECPA") filed a petition to intervene in this proceeding. No answers were filed to this petition.

OTS Petition

In its petition, OTS made specific requests, namely: (1) that the Commission order the commencement of an on-the-record investigation of competitive practices between jurisdictional natural gas distribution companies; (2) that the Commission direct the Office of Administrative Law Judge ("OALJ") to conduct such investigation and issue an Investigation Report following the conclusion of the evidentiary record; (3) that the Commission direct OTS to prosecute such investigation; and (4) that the Commission direct that the investigation be conducted in a timely manner to allow the Commission to issue a Final Order resolving the proceeding no later than seven months from the date of the Commission Order commencing the investigation. *OTS Petition*, pp. 1-2. OTS also proposes a list of 23 questions that it wanted published in the Pennsylvania Bulletin.

In support of its petition, OTS states that certain jurisdictional NGDCs, particularly in western Pennsylvania, are engaging in business practices to compete for customers that may constitute predatory pricing and/or unfair competition, a practice that the Commission may determine is contrary to the public interest. OTS identifies these practices as follows:

> 3. OTS is currently aware of the aforecited competition practices by individual NGDCs, i.e. the discounting or waiving of fuel retainage charges, cash-in/cash-out tolerances or penalties and/or monthly balancing charges for customers in overlapping service territories, as a result of attempts by individual NGDCs to collect the revenues lost by said practices from firm sales customers during their annual Commission Section 1307(f) proceedings. In such proceedings, OTS had consistently opposed these attempts by a NGDC to recover waived/lost revenues from firm sales, i.e. 1307(f), customers.

OTS Petition, p. 5, ¶3.

OTS also states that it became aware of the discounting/waiver of fuel retainage, monthly balancing tolerances and cash in and cash out tariff provisions in Equitable Gas Company's Section 1307 (f) proceeding at Docket No. R-00049154. OTS also states that the issue of a company waiving the retainage charge for certain transportation customers while collecting the cost of lost and/or unaccountable gas from all of its 1307(f) customers was at issue in the Section 1307(f) proceeding involving The Peoples Natural Gas Company d/b/a Dominion Peoples, docketed at R-00049153. OTS Petition, pp. 3-4, fn 5.

OTS postulates that these practices result in a loss in revenue and financial harm to the NGDC and its customers because of the loss of the customer's contribution to the payment of the NGDC's fixed costs of service. OTS Petition, p. 6, ¶ 5. As a result of this loss of revenue, OTS contends that the NGDC must recover its existing fixed costs by filing a base rate case or allow its shareholders to absorb the loss. OTS Petition, p. 6, ¶ 6. OTS then describes a bidding war that could potentially take place between two NGDCs for a customer that might result in the customer paying a rate where little, or no contribution is being made to recover the fixed costs of the system. OTS states that such a situation would adversely affect the value and efficiency of the traditional rate making process in the Commonwealth and would be contrary to the public interest. OTS Petition, p. 7, ¶ 7.

OTS also states that the act of discounting or waiving fuel retainage charges, cash in/cash out tolerances, monthly balancing charges and/or any other charges or penalties to appropriate a new customer is unfair and unlawful rate discrimination to the NGDC's existing customers since the new customer is being charged a lower rate under circumstances not intended or authorized by its existing flexing tariff provisions. OTS Petition, p. 7, ¶8. OTS states that it will argue in any ordered investigation that the flexing of charges or penalties should not be authorized by the Commission for any NGDC-on-NGDC competition purposes. OTS Petition, p. 7, fn 11.

Other possible negative consequences of competition among NGDCs are cited by OTS as follows:

- increased inefficiencies as competing NGDCs construct duplicative facilities to serve the same customers,
- gas safety issues related to the identification, maintenance and repair of active pipelines in the proximity of inactive (but pressurized) and dormant pipelines;
- unfair gas supply competition since alternative gas suppliers cannot flex or waive certain charges compete on price with the NGDC.

OTS Petition, pp. 8-10.

PPL Gas Answer

In its Answer, PPL Gas requests that if the Commission initiates an investigation of NGDC v. NGDC competition that it be excluded as a respondent to the proceeding. PPL Gas Answer, p. 2. PPL Gas states that it has not exercised it authority to flex or reduce rates for large volume delivery service customers in order to meet competition from other NGDCs. PPL Gas Answer, p. 2. PPL Gas also states that it has limited its reductions of base rates to situations in which customers threaten to bypass the distribution system to receive large volumes of gas from interstate pipeline companies or local producers. PPL Gas Answer, p. 2. PPL states that it believes that any investigation initiated by the Commission should be limited to issues involving rates for recovery of purchased gas cots. Issues related to base or distribution rates should be addressed in base rate proceeding, in which NGDCs, other parties, the Commission will have the ability to address all base rate issues and adjust rates as appropriate for each rate class to reflect any decision to allow or restrict competition among NGDCs. PPL Gas Answer, p. 4, ¶ 5.

OCA Answer

The OCA states that discounting and the waiver of otherwise applicable fuel retainage charges, cash-in/cash-out tolerances or penalties and/or monthly balancing charges by competing NGDCs with overlapping service territories may result in financial harm to other captive customers of the NGDCs. For this reason, OCA supports the OTS petition. OCA Answer, pp. 2 - 3.

OSBA Answer

The OSBA supports OTS to the extent it focuses on issues that were the subject of previous settlements. OSBA Answer, pp 1-2. Specifically, OSBA states that an investigation is not the proper forum for considering ratemaking issues proposed in questions 8, 12, 14, 15, 16 and 21; and that question 9 should be addressed in the *Investigation into Competition in the Natural Gas Supply Market*, Docket No. I-00040103. OSBA Answer, p. 4, ¶12. OSBA opposes the requested 7 month time limit if proposed questions 8, 9, 12, 14, 15, 16 and 21 are included in the proposed investigation. OSBA Answer, p. 4, ¶12.

Columbia Gas Answer

In its answer, Columbia Gas of Pennsylvania (Columbia) supports the institution of an investigation limited to the reductions of tariff charges for recovery of costs that are credited as recovery of gas costs under Section 1307 (f) of the Public Utility Code. Columbia Answer, p.1.

Columbia states that it has overlapping service territories with other NGDCs, but does not reduce its tariff charges to recover costs that are credited in the annual reconciliation of gas costs and recoveries to compete with NGDCs. Columbia believes that other NGDCs who are doing so are increasing purchase gas cost rates to non-competitive customers to subsidize such unfair competition. Columbia supports the Commission investigating this practice and prohibiting it where it exists. Columbia Answer, p. 2.

Columbia does not support the Commission investigation into competition between NGDCs with overlapping service territories because the existence of overlapping service territories predates, and is preserved by the Public Utility Code. See 66 Pa. C.S. §103. Columbia states that matters such as the extension of facilities in grandfathered service areas and the reduction of non-gas cost rates should not be addressed in a generic investigation and are properly addressed only in the context of base rate proceedings. Columbia Answer, p. 3.

T.W. Phillips Answer

In its Answer, T.W. Phillips states that it supports the OTS Petition for an investigation to the extent that it is limited to the discounting and waiving of otherwise applicable fuel retainage charges, cash in /cash out tolerances or penalties; and/or monthly balancing charges for the purposes of inducing an existing customer of another NGDC to switch gas service. T.W. Phillips also states it does not believe that the Commission can prohibit NGDCs from providing service to customers in overlapping territories; that reduction in non-gas cost rates to compete with other NGDC does not necessarily increase charges to other customers because any reduction in revenues can be only be recovered prospectively in base-rate proceedings.

T.W. Phillips further states that the inability to reduce non-gas costs charges to meet competition may result in a loss of a customer and related revenue to cover the NGDC fixed costs of service, relocation of businesses outside the overlapping territories with resulting impact on the local economy. T.W. Phillips believes that the issue should be addressed in base rate cases and not in a generic investigation.

Equitable Gas Company Answer

Equitable Gas Company states that it does not oppose the opening of an investigation and any comment that it might have in regard to the presented issues will be presented in the context of the investigation.

The Peoples Natural Gas Company Answer

In its Answer, the Peoples Natural Gas Company states that it does not object to the proposed investigation provided that the Commission adopt Peoples' primary reason for entering into a settlement agreement supporting a joint petition for such an investigation, namely that the investigation be "broad-based, with the goal of putting all NGDCs on an equal footing." Peoples Answer, p. 2. Peoples also states that it does not object to the investigation provided that any decision that the Commission might make to change its current and longstanding policy involving free and open competition among NDGCs with overlapping service territories be made prospectively so that it is not applicable to existing contracts that were entered into in good faith in reliance on this policy. Peoples Answer, p. 2. Peoples indicates that if an investigation is opened that it would want an additional question asked: What has been the benefit of competition to large business customers, and how has that benefit, if any, accrued to residential and small business customers? Peoples Answer, p. 8.

Peoples also states that it is concerned that OTS has asked the Commission to open an investigation in a document that expresses OTS's definitive position on certain issues that will be the subject of this investigation. Peoples further states that it would be inappropriate for the Commission to open an investigation based on conclusions as held and as expressed by OTS, and could amount to a pre-judgment on the questions to be addressed in and decided after the investigation, in violation of a part's right to an unbiased tribunal free of any pre-judgment. Peoples Answer, p.2. In answer to the numbered paragraphs of the OTS Petition, Peoples admits that it does waive fuel retainage charges in some instances and such waiver has been allowed by Peoples' Commission approved tariff since at least 1989. Peoples Answer, p. 3, ¶2.

Peoples also explains that competition among NGDCs is due to the historic overlap of service territories and it has been the Commonwealth's and the Commission's policy to encourage this competition. Peoples then presented a short history of the establishment of gas company service territories under the Natural Gas Companies Act of 1885 and of the Commission's policy regarding NGDC-on NGDC competition. Peoples Answer, pp. 3-6, ¶ 4. Peoples does not object to the formal investigation within the conditions it specified.

CONCLUSION

No party that filed an answer to the OTS Petition completely opposed the idea of an investigation. However, a number of valid points were made regarding the scope of the investigation. Columbia, OSBA and PPL Gas point out that certain issues relating to base or distribution rates should not be addressed in a generic investigation, but need to be resolved in a base-rate case for the utility. Columbia Answer, p. 3; OSBA Answer, ¶ 12, p. 4; PPL Gas Answer, p. 4, ¶ 5. Columbia identifies the following areas as appropriate for a base rate case rather than a generic investigation: (1) what effects on utility non-gas cost revenue would result if reduction of non-gas cost charges is prohibited; (2) whether such prohibition would cause a utility to be required to seek a base-rate increase from other customers to compensate for loss of customers resulting from such a prohibition; (3) whether removal of such historic competition between utilities with overlapping service territories creates a disincentive to development in the communities served. Columbia Answer, p. 3. Columbia also states that the extension of facilities into grandfathered service areas and the reduction of non-gas cost rates in conjunction with NGDC on NGDC competition are matters only appropriately considered in a rate-case. *Id.* Likewise, OSBA references OTS's proposed list of questions to identify issues that should be deferred to a utility base-rate case. OSBA Answer, p. 4, ¶12.

After careful consideration of the pleadings, we believe that a generic investigation into competition between NGDCs with overlapping service territories is not warranted at this time. Central to our decision is the fact that many of the issues that OTS proposed be investigated are better addressed in individual rate proceedings rather than in a generic investigation[1]. Thus, to preserve these issues so that they might be raised at a later more appropriate time, we will deny the OTS Petition without prejudice. Consequently, IECPA's Petition to Intervene is moot.

That having been said, the Commission agrees with the general proposition raised by the Respondents that it cannot prohibit an NGDC from serving customers located within its grandfathered service territory. However, the Commission is concerned that the business practices engaged in by an NGDC to compete against other NGDCs for customers located in overlapping service territories may also affect the ability of an NGS to compete for those customers.

The Commission is today releasing its Report to the General Assembly on the *Natural Gas Competition Investigation* at Docket No. I-00040103 ("*Report*"). As a result of the investigation, the Commission has found that effective competition does not exist in the retail natural gas supply market on a statewide basis, and in accordance with Section 2204(g) of the Public Utility Code[2] has directed the stakeholders in the natural gas industry to convene to explore avenues to increase competition.

The Commission's *Report* specifically identifies two barriers to supplier participation in the retail natural gas supply market for consideration by the Stakeholder

1 For example, the issue of an NGDC transferring the costs of discounts in retainage and other gas delivery requirements to captive Purchase Gas Cost customers was litigated and disallowed in *Pa. PUC v. Equitable Gas Company*, Order entered September 28, 2005 at Docket No. R-00050272, pp. 41-43. In this proceeding, the Commission also expressly rejected the idea of a generic proceeding to address this issue for all NGDCs. *See also Pa. PUC v. The Peoples Natural Gas Co. d/b/a Dominion Peoples*, Order entered September 9, 2005 at Docket No. R-00050267, pp. 32-34.

2 66 Pa. C.S. §2204(g).

Group: (1) the failure to recognize non-commodity costs related to natural gas supply procurement in the Price to Compare (PTC); and (2) the inadequacy of the quarterly adjustment of the PTC to provide meaningful price signals to induce greater customer participation in the market. Because of Trial Staff's experience in rate matters and Section 1307(f) proceedings, its participation in the Stakeholder Group[3] could be helpful to the other participants and, at the same time, would allow it to represent the public interest in this forum. Therefore, we will apprise OTS of the opportunity for it to participate in this collaborative group.

Finally, the *Report* discusses another possible barrier to competition in the retail natural gas supply market that was also raised in the OTS Petition: the NGDC's establishment of fines, fees and other penalties that prove to be an anti-competitive barrier to supplier entry. *Report*, pp. 53-55. In its Petition, OTS claims that some NGDCs waive these fines, fees and other penalties to retain customers in overlapping service territories and recommended them as issues to be addressed by the stakeholders. OTS Petition, p. 9, ¶11. While we have declined to open a separate investigation regarding NGDC on NGDC competition, the Commission is confident that stakeholders, in crafting solution to remove this and other barriers to effective competition, will marginalize any impact that such practices might have on competition for customers, be it among NGDCs or between NGDC and NGS, so as to provide for a level playing field for all retail natural gas supply market participants;

THEREFORE,
IT IS ORDERED:

[3] IECPA, as a stakeholder in the natural gas industry, will likewise be able to represent the interests of its members in the collaborative process.

1. That Petition of the Office of Trial Staff for the Commencement of an Investigation of Competitive Practices Between Natural Gas Distribution Companies is denied without prejudice.

2. That the Petition of Industrial Energy Consumers of Pennsylvania to intervene in this proceeding is dismissed as moot.

BY THE COMMISSION:

James J. McNulty,
Secretary

(SEAL)

ORDER ADOPTED: October 6, 2005

ORDER ENTERED: October 6, 2005

CX0007

COMMONWEALTH OF PENNSYLVANIA
OFFICE OF ATTORNEY GENERAL

November 14, 2006

TOM CORBETT
ATTORNEY GENERAL

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VIA – HAND DELIVERY

Bohdan R. Pankiw, Chief Counsel
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Dear Mr. Pankiw:

As you know, this Office and the Federal Trade Commission have been reviewing the proposed acquisition of the stock of Dominion Peoples subsidiary of Dominion Resources, Inc. by Equitable Gas for several months. On September 27, 2006, Barbara Adams of the Office of General Counsel sent the Commission a letter regarding this transaction. That letter has been brought to the attention of the Office of Attorney General. This Office believes a response to both the propriety of the letter and substantive issue raised in the letter is appropriate. This letter does not express the views of the Federal Trade Commission.

As a preliminary matter, the Office of General Counsel has no authority for the enforcement of the federal and state antitrust laws on behalf of the Commonwealth. That authority exclusively rests with the Attorney General. 71 P.S. § 732-204(c). Moreover, to the extent the Public Utility Commission needs a legal opinion, and it has not asked for one in this case, such an opinion can only be rendered by the Attorney General, 71 P.S. § 732-204(a), upon the request of a head of the agency.

Substantively, the legal analysis outlined in the September 27, 2006, letter is incorrect. State action immunity applies when a conflict exists between a state regulatory scheme and the federal antitrust laws. Where there is no conflict, there is no immunity. See Lockyear v. Mirant Corp., 266 F. Supp. 2d 1046, 1056 (N.D.

Cal. 2003). (If state policy does not conflict with the goal of federal antirust law, there is no need to apply state action doctrine). In 1999, the Pennsylvania legislature deregulated the natural gas market. In reviewing mergers, the Commission is to consider:

> Whether the proposed merger, consolidation, acquisition or disposition is likely to result in anticompetitive or discriminatory conduct, including the unlawful exercise of market power which will prevent retail gas customers from obtaining the benefits of a properly functioning and effectively competitive retail natural gas market.

66 Pa. C.S. § 2210(a)(1).

This is not the type of displacement of competition with regulation which would warrant the application of the state action doctrine. Actually, it is the opposite – the displacement of regulation with competition. Federal courts have denied the application of the state action doctrine where the relevant state policy is designed to foster competition. County of Stanislaus v. Pacific Gas & Electric Co., 1994 WL 706711, 22 (E.D. Cal. 1994); Anheuser-Busch, Inc. v. Goodman, 745 F. Supp. 1048, 1052 (M.D. Pa. 1990). The goal of the Natural Gas Choice and Competition Act is to promote competition. 66 Pa.C.S.A. § 2204(g); § 2203(2).

This Office has not concluded its review of this transaction. When it does, we will provide the Commission with copies of any correspondence we send or legal actions we file.

If you have any questions, do not hesitate to contact me.

Very truly yours,

James A. Donahue, III
Chief Deputy Attorney General
Antitrust Section

JADIII/dmh/Pankiw.ltr

cc: Barbara Adams
Robert Friedman, Federal Trade Commission
Debra Dermody, Esquire, Counsel for Equitable
Mark Webb, Esquire, Counsel for Dominion

CX0008

COMMONWEALTH OF PENNSYLVANIA
PENNSYLVANIA PUBLIC UTILITY COMMISSION
P.O. BOX 3265, HARRISBURG, PA 17105-3265

IN REPLY PLEASE REFER TO OUR FILE

October 13, 2006

VIA FACSIMILE and FIRST CLASS MAIL

Barbara Adams, General Counsel
Office of General Counsel
Commonwealth of Pennsylvania
225 Main Capitol Building
Harrisburg, PA 17120

Re: Equitable Resources, Inc. – Acquisition of Dominion Peoples Gas Company

Dear Ms. Adams:

This is in response to your September 27, 2006 letter relating to the Public Utility Commission's pending review of the above-captioned transaction. In your letter, you ask that I write to the Federal Trade Commission (FTC) to explain the Commission's merger/competitive review process and to express my view, if it is my view, that this process is exclusive and preempts any FTC review.

As you may know, the United States Department of Justice and the FTC are expressly authorized by separate federal statutory provisions, 15 U.S.C. §§ 25 & 53(b), to obtain appropriate relief to prevent violations of section 7 of the federal Clayton Act relating to mergers and acquisitions. 15 U.S.C. § 18. This federal statutory authority appears to be independent of any statutory authority granted to the Commission to review mergers or acquisitions involving public utilities.

In fact, an analogous preemption issue arose in 1997 in regard to the authority granted the Commission under the Electric Competition Act to investigate market power remediation and merger issues relating to the electric utility industry. 66 Pa. C.S. §§ 2811. During the pendency of the Commission's review of a proposed merger between Allegheny Energy's predecessor company and DQE, Inc. shortly after passage of the Electric Competition Act, a private cause of action was filed by the City of Pittsburgh challenging the merger on antitrust grounds. Allegheny and DQE filed a motion to dismiss alleging that the Commission had exclusive jurisdiction and thereby exempted the private right of action. The Commission filed an amicus brief opposing this motion, asserting that its jurisdiction to review such mergers is not exclusive and rejecting the applicability of the state action defense under those facts. A copy of that amicus brief is enclosed for your review.

The Commission's authority to review gas industry mergers and market power issues is virtually the same as in section 2811. *See* 66 Pa. C.S. §§2209-2210. Moreover, section 2210(c) provides that, "Nothing in this section [pertaining to Commission review of gas industry mergers] shall restrict the right of any party to pursue any other remedy available to it." This language tends to undercut the view that the Commission's review of the Dominion acquisition would be exclusive.

Under these circumstances, I must respectfully decline your request to write to the FTC to express the view that the Commission has exclusive jurisdiction to review this proposed transaction. I hope this explanation fully responds to your request.

Very truly yours,

Bohdan R. Pankiw
Chief Counsel

Enclosure

cc: Wendell F. Holland, Chairman
James H. Cawley, Vice Chairman
Kim Pizzingrilli, Commissioner
Terrance J. Fitzpatrick, Commissioner
Johanna O'Loughlin, General Counsel,
Equitable Resources, Inc.
David J. Spigelmyer, Director, External Affairs,
Equitable Resources, Inc.

CX0009

Report to the General Assembly on Competition in Pennsylvania's Retail Natural Gas Supply Market

From the

Investigation into the Natural Gas Supply Market,

Docket No. I-00040103

October 2005

PENNSYLVANIA

PUC

PUBLIC UTILITY COMMISSION

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I. EXECUTIVE SUMMARY

In accordance with Section 2204(g) of the Public Utility Code, 66 Pa. C.S. §2204(g), by Order entered May 28, 2004 at Docket No. I-00040103, the Pennsylvania Public Utility Commission ("Commission") initiated an investigation into competition in Pennsylvania's retail natural gas supply market. Section 2204(g) directs the Commission to investigate and evaluate the retail natural gas supply market as restructured under "The Natural Gas Choice and Competition Act" to assess the resulting level of competition five years after the effective date of the Act. Section 2204(g) also directs the Commission to report its findings to the General Assembly. Section 2204(g) further directs the Commission, if it determines that "effective competition" does not exist, to reconvene the stakeholders in the natural gas industry "to explore avenues, including legislative, for encouraging increased competition in this Commonwealth." 66 Pa. C.S. §2204(g).

In the Commission's judgment, the existence of "effective competition" in the retail natural gas supply[1] market in Pennsylvania would be demonstrated by participation in the market by many buyers and sellers, the lack of substantial barriers to market entry for suppliers, the lack of substantial barriers that would discourage customer participation, and the presence of sellers offering buyers a variety of products and services. Based on this standard and the record in this proceeding[2], there is not effective competition in the retail natural gas supply market on a statewide basis at this time. The Commission's competitive outlook is based on seven key conclusions:

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[1] "Natural Gas Supply Services" are defined at 66 Pa. C.S. §2202 as including "(i) the sale or arrangement of the sale natural gas to retail gas customers; and (ii) services that may be unbundled by the commission under section 2203(3)(relating to standards for restructuring of natural gas utility industry."

[2] *Investigation into Competition in the Natural Gas Supply Market*, Docket No. I-00040103.

(1) The record demonstrates a lack of participation by natural gas suppliers and buyers in the retail natural gas supply services market on a statewide basis.

(2) The record indicates that natural gas distribution companies tend to act as price leaders in their respective service territories because many customers are not aware that that the commodity price of natural gas, i.e., the "Price to Compare" or "PTC," is a quarterly reconcilable price, based on projections, rather than a fixed annual price.

(3) According to suppliers, substantial barriers to entry in the retail natural gas supply market exist because of differing security requirements among natural gas distribution companies.

(4) According to suppliers, substantial barriers to entry and continued participation by natural gas suppliers in the retail natural gas service supply market exist as the result of the omission of procurement, administrative and other costs from the natural gas distribution company's commodity price of natural gas, i.e. the PTC.

(5) According to suppliers, substantial barriers to supplier participation in the retail natural gas supply market exist because of penalties placed on suppliers that vary among natural gas distribution company systems and that are not cost-based.

(6) The regulatory lag in establishing and implementing quarterly price adjustments by natural gas distribution companies tends to mask the current market price of natural gas.

(7) The marketplace lacks accurate and timely price signals; as a result, the market cost of natural gas supply service offered by natural gas distribution companies is not communicated immediately to customers.

In light of the above findings and conclusion, the Commission directs, pursuant to 66 Pa. C.S. §2204(g), that the stakeholder group in the natural gas industry reconvene to explore avenues, including legislative (if appropriate), for encouraging increased competition in Pennsylvania's retail natural gas supply service market. The collaborative shall examine the above listed issues and other matters that are relevant to the retail natural gas supply service competitive market, and develop recommendations regarding changes that need to be made to the market structure and operation. Also, the stakeholders shall recommend any amendments that need to be made to the Natural Gas Choice and Competition Act and the Public Utility Code and revisions that need to be made to Commission regulations that will enhance competition.

The Commission anticipates that the first stakeholder meeting will be held before the end of this year.

II. HISTORY OF THE PROCEEDING

Section 2204(g) of the "Natural Gas Choice and Competition Act" ("Competition Act") requires the Commission to initiate an investigation or other appropriate proceeding to determine whether effective competition for natural gas supply exists in the Commonwealth. The proceeding must be launched five years after the effective date of the Act, July 1, 1999. The statute provides for participation by all interested parties, and requires the Commission to report its findings to the General Assembly.

On May 28, 2004, the Commission entered an Order initiating an investigation into the effectiveness of competition in the natural gas industry.[3] In its order the Commission directed natural gas distribution companies ("NGDCs") and natural gas suppliers ("NGSs") to file specific data relating to the natural gas market. Also, the PUC invited other interested parties to provide comments or written testimony addressing topics that are relevant in assessing the level of competition in that market. Twenty-four commenters, including one pipeline company,[4] filed comments. The commenters included Office of Consumer Advocate ("OCA"); Office of Small Business Advocate ("OSBA"); Energy Association of Pennsylvania ("EAP"); the Mack Service Group ("Mack"); Equitable Gas Company ("Equitable"); Columbia of Pennsylvania ("Columbia"); Independent Oil and Gas Association ("IOGA"); NRG Energy Center Pittsburgh ("NRG"); Constellation New Energy –Gas Division ("New Energy"); Amerada Hess Corporation ("Amerada Hess"); PEPCO Energy Services ("PEPCO"); Interstate Gas Supply Inc. ("Interstate Gas Supply"); Natural Fuel Resources, Inc. ("NRG"); UGI Utilities, Inc. – Gas Division ("UGI"); Peoples Natural Gas Co ("Dominion Peoples"); Texas Eastern Transmission, Inc. ("Texas Eastern"); Shipley Energy Company ("Shipley"); Dominion Retail, Inc. ("Dominion Retail"); National Energy Marketers Association ("NEMA"); Agway Energy Services ("Agway"); PEPCO

[3] A copy of this order is reproduced in the Appendix to this Report.

[4] Texas Eastern Transmission, Inc.

Energy Services ("PEPCO"); Utilitech, Inc. "Utilitech"); Shell Energy Company ("Shell Energy"); and Direct Energy Services ("Direct Energy").

Responses to data requests were filed by all of the NGDCs.[5] Nineteen licensed NGSs[6] filed responses to the Commission's questions.

The PUC held an *en banc* hearing on September 30, 2004 to further explore the level of competition in Pennsylvania. Ten witnesses[7] representing the Energy Association of Pennsylvania ("EAP"), the Office of Consumer Advocate ("OCA"), the Office of Small Business Advocate ("OSBA"), and various NGSs testified at the hearing. Representatives from the NGDCs did not present testimony but were available to be questioned by the Commissioners.

Reply comments were permitted to be filed by October 12, 2004. Nine reply comments were filed. Reply commenters included EAP, T.W. Phillips, Inc. ("Phillips"); New Energy, Industrial Energy Customers of Pennsylvania ("IECPA"), OSBA, Dominion Peoples, Equitable, and Amerada Hess filed separate comments. Joint Comments were filed by Direct Energy, Dominion Retail, Interstate Gas, Shell Energy, and Shipley Energy.

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[5] The NGDCs filing responsive data include natural gas distribution companies with annual operating income greater than $6,000,000, 66 Pa. C.S. §2202, and the Philadelphia Gas Works.

[6] NGSs are defined at 66 Pa. C.S. §2202 to include entities other than NGDCs that provide natural gas supply service to retail gas customers utilizing the jurisdictional facilities of the NGDC. The number of suppliers varies as suppliers enter and exit the market. As of September 30, 2004, there were 82 licensed NGSs in Pennsylvania.

[7] Witnesses testifying at the hearing represented EAP, Amerada Hess, Direct Energy, Dominion Retail, Interstate Gas, Shell Energy, Shipley, NRG, OCA and OSBA.

III. INTRODUCTION

A. Section 2204(g)

Section 2204(g) of the Competition Act, 66 Pa. C.S. §2204(g), directs the Commission to investigate and evaluate the existing level of competition in the restructured natural gas supply service market five years after the Competition Act went into effect, and to report its findings to the General Assembly. If the Commission determines that "effective competition" does not exist in the market, the Commission is required to reconvene stakeholders to explore avenues, including changes to the legislation, for encouraging increased competition in this Commonwealth. The Competition Act, by not defining "effective competition," deferred to the Commission to use its expertise to define effective competition, to determine how to measure competition and to ascertain what constitutes effective competition. Accordingly, consistent with this charge, the Commission has set forth in this report the standards that it used to evaluate the effectiveness of competition in the retail natural gas supply market statewide, and its conclusions regarding the level of competition.

B. Industry Structure[8]

The natural gas industry has three segments: production, transmission and distribution. In the early 1970s, all three segments of the industry were price-regulated. The federal government, then through the Federal Power Commission ("FPC"), regulated the prices paid by interstate pipelines to producers for gas at the wellhead. The FPC also regulated interstate pipelines which transported this gas to the city gates of local natural

[8] The description of regulation of the natural gas industry was taken in part from the *UGI Comments* at pp. 4-8 and was derived from testimony presented in hearings by UGI's now retired president, Richard Bunn, before the House Consumer Affairs Committee in 1997, concerning legislation which later was enacted as the Competition Act.

gas distribution companies ("NGDCs") and sold the gas to the local gas distribution utilities at bundled rates. Finally, state utility commissions regulated bundled rates charged by the NGDCs for sales of gas at retail to end-user customers.

When federal regulation of wellhead prices proved to be unsuccessful, resulting in severe shortages of natural gas, Congress addressed these problems in several ways. In 1977, Congress reorganized the FPC into the Federal Energy Regulatory Commission ("FERC"). Congress really began the process of increasing maximum allowable natural gas prices in the late 1970s, beginning with the *Natural Gas Policy Act of 1978*, and deregulated all vintages of natural gas prices in 1989,when it passed the Wellhead Decontrol Act that removed all regulation from the gas commodity by 1993. *Natural Gas Decontrol Act of 1989*, H.R.Rep.No.101-29, 101st Cong., 1st Sess.,(1989). This deregulation greatly stimulated production.

The second segment of the natural gas industry is comprised of the federally-regulated interstate pipelines that deliver gas from the production areas to Pennsylvania's NGDCs. This segment of the natural gas industry was also restructured, but not deregulated, by federal authorities in the 1980s and 1990s. In the 1980s these pipelines were required to open their systems to transportation as an alternative to bundled city gate sales service, and in the 1990s were required, as a practical matter, to exit the so-called merchant function of making such bundled sales.[9] In 1986, the Commission adopted formal rules requiring the availability of such service on all Pennsylvania distribution systems.[10]

[9] *See* FERC Order 436, *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, Order No. 436, 50 FR 42408 (Oct. 18, 1985), FERC Stats. & Regs. [Regulations Preambles 1982-1985] 30,665 Docket Nos. RM91-11-000 and RM87-34-065, and FERC Order 636. *Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation Under Part 284 of the Commission's Regulations; Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, ORDER NO. 636 (April 8, 1992), [FINAL RULE], Docket Nos. RM91-11-000 and Docket No. RM87-34-065.

[10] 52 Pa. Code Ch. 60 (relating to natural gas transportation service).

Customers with varying needs for interstate pipeline transportation and storage services share the same transmission and distribution systems with smaller, space heating customers. For example, larger Commercial and Industrial ("C&I") customers with higher load factors have a flat load and utilize the same amount of gas on a relatively constant basis throughout the year. In contrast, smaller Commercial customers and residential customers have loads that fluctuate throughout the year, and usage varies on a seasonal basis.

Consequently, larger C&I customers have little need for storage services used to accommodate heating customers' seasonal swings in demand. Further, larger C&I customers may be able to use interstate pipeline capacity efficiently because they do not need to reserve and pay for pipeline capacity to meet seasonal peak demands as they have the discretion to move production schedules, supplement with alternative fuels or implement selective shut downs. Therefore, such customers may have a low unit cost for pipeline capacity under federal pricing methodologies that require payment for pipeline capacity throughout the year, regardless of whether the capacity is needed throughout the year.

The third segment of the natural gas industry is composed of NGDCs. Under the Competition Act, the NGDC segment of the industry was to remain fully regulated and largely unaffected, except that rates would be unbundled to facilitate implementation of competition by natural gas suppliers for small customers.

Today, the natural gas commodity market is a more mature market. NGDCs and NGSs (and C&I customers because of the availability of transportation service[11]) all compete to purchase natural gas supplies in the same wellhead markets at prices set by competition and the economic law of supply and demand.

[11] The increased availability of transportation service to customers is discussed *infra.* at pp. 11-13.

C. History of Competition in Natural Gas Industry

1. Competition Among Gas Companies Overlapping Service Territories

The Commission has been encouraging competition in the gas industry since the early 1980's. Commission policy favoring competition among natural gas companies with overlapping service territories[12] had its inception in cases where a customer was permitted to choose its gas company. In *Montefiore Hospital Assn. of Western Pa.*, 54 Pa. PUC 566 (1981), the Commission ruled that one gas company could serve an existing customer of another gas company where the companies' service territories overlapped.[13] This Commission "customer choice" policy passed judicial muster in *Borough of Grove City v. Pa. PUC*, 505 A.2d 346 (Pa. Cmwlth. 1986).

Two years later in *Columbia Gas of Pa. Inc. v. Carnegie Natural Gas Co.*, 61 Pa. PUC 313 (1986), the Commission advised jurisdictional natural gas utilities that it would no longer prohibit competition among natural gas utilities with overlapping service territories, and the Commission expressly revoked a 1957 policy statement that prohibited

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[12] Overlapping service territories in Western Pennsylvania resulted from the manner in which gas companies could claim service territories under the Natural Gas Company Act of 1885 (Act of May 29, 1885, P.L. 29, No. 32). To acquire a certain territory, the gas company would file a charter indicating "[t]he place or places where natural gas is intended to be mined for and produced or received, the place or places where it is to be supplied to consumers, [and] the general route of its pipe line or lines and branches. . . ." Section 2 of the *Natural Gas Companies Act of 1885*, 15 P.S. §3542. Subsequently, in Western Pennsylvania where natural gas supplies were plentiful and terrain was challenging to traverse, competing companies constructed gathering lines, transmission lines and distribution lines sometimes side by side, and therefore claimed overlapping territories under the Act. *See Equitable Gas Company v. Apollo Gas Company and Equitable Gas Company v. Carnegie Natural Gas Company*, Order entered September 5, 1990 at Docket No. C-844028; C-844035; C-844034. *See also, People's Natural Gas Co. v. American Natural Gas Co.*, 82 A. 935 (Pa. 1911); *The Peoples Natural Gas Company v. Pa. PUC*, 567 A.2d 642 (Pa. 1989).

[13] *Compare Equitable Gas Company v. Apollo Gas Company and Equitable Gas Company v. Carnegie Natural Gas Company*, Order entered September 5, 1990 at Docket No. C-844028; C-844035; C-844034 (gas company ordered to stop serving a customer located outside of the gas company's service territory's boundaries as defined by predecessor companies' charters or certificates of public convenience).

a natural gas utility from providing service to a customer of another natural gas utility without prior Commission approval.

The Commission reiterated its policy favoring competition in *Petition of Equitable Gas for Declaratory Order*, order entered August 26, 1986 at Docket No. P-850053. In its order the Commission dismissed as moot the Petition which sought Commission approval for the initiation of service by a gas company to a new customer located on the site of a building formerly served by another gas company. The Commission's policy was affirmed by Commonwealth Court in *Peoples Natural Gas Co. v. Pa. PUC*, 554 A.2d 585 (Pa. Cmwlth. 1989).

The result of this Commission policy encouraging competition in the natural gas industry was the western Pennsylvania gas wars--customer/territorial disputes that erupted among gas distribution companies with contiguous service territories. Western Pennsylvania with its overlapping gas company service territories provided a perfect arena for such competition. Participants in the gas wars included Peoples and Apollo (*Peoples Natural Gas Co. v. Apollo Gas Co.*, Docket No. C-850521); Peoples and T.W. Phillips (*Peoples Natural Gas Co. v. Pa. PUC*, 554 A.2d 585 (Pa. Cmwlth. 1989)); and Equitable and Apollo (*Equitable Gas Co. of Equitable Resources, Inc. v. Apollo Gas Co.*, Docket Nos. C-844028 and C-844035).

2. Bypass

The Commission also considered competition faced by local distribution companies from unregulated entities that sought to compete with gas companies in their own service territories. On July 10, 1987, the Pennsylvania Gas Association filed a "Petition for Issuance of a Regulation" which sought a ruling that any person or entity seeking to provide natural gas sales or transportation service must first obtain a certificate of public convenience or an order declaring that the proposed service does not require such a certificate. *Petition of the Pennsylvania Gas Association for the Issuance of a Regulation Setting Forth the Conditions Precedent to the Provision of Natural Gas Sales or Transportation Services Within the Commonwealth of Pennsylvania*, 66 Pa. PUC 383 (order entered February 2, 1988 at Docket No. P-870236). This petition was filed because of the perceived threat of bypass to local distribution companies. The Commission denied the petition but did initiate an investigation into the possibility of harm to Pennsylvania ratepayers from bypass activities. *Investigation into the Bypass of Gas Utilities by Gas Suppliers*,18 Pa. B. 1295 (order entered February 25, 1988 at Docket No. I-880878). As the result of this investigation, the Commission concluded that although the bypass of gas companies by producers, interstate pipelines, or others remained a potential threat, there was no basis to compel regulation of these entities. However, the Commission determined that the issue of bypass should continue to be addressed on a case-by-case basis. *Re: Bypass of Gas Utilities by Gas Suppliers*, 70 Pa. PUC 446, 453 (order entered August 18, 1989 at Docket No. I-880078).

3. Gas Transportation

Another aspect of gas competition involves gas transportation. The benefit of a customer purchasing gas directly at the wellhead from an interstate pipeline or from a gas marketer is immediately apparent. Even with the transportation expense, the total cost is usually less than the price charged by most gas companies for sales of gas. This makes gas transportation service very attractive economically.

Pursuant to a petition filed by the Pennsylvania Gas Association for an expedited rulemaking regarding gas transportation by natural gas utilities, Docket No. P-850040, on October 16, 1986, the Commission adopted at Docket No. L-860016 uniform transportation regulations governing natural gas transportation service. These regulations, while originally promulgated to facilitate local natural gas competition in Pennsylvania, were designed to complement transportation regulations previously enacted by FERC.

However, smaller natural gas customers were prohibited from participating in gas transportation because of the minimum annual volume of MCF required to be transported. The issue of minimum levels of transportation gas was considered by the Commission in *Pa. PUC v. Peoples Natural Gas Co.*, 58 Pa. PUC 293 (1984). There the Commission directed a major distributor of natural gas to set a minimum transportation volume of 50,000 MCF per year and to permit buyers' groups of three or less. Gas transportation regulation in the Commonwealth followed the policy established in *Peoples* for a number of years. When the Commission later promulgated regulations for gas transportation service, the limit of three buyers in each buyers' group (absent gas company concurrence in a larger group size) was incorporated into those rules. 52 Pa. Code §60.3(b). However, the minimum level to qualify for transportation service was left to be established on a company-by-company basis.

On July 15, 1991, the Commission acted to further amend the transportation regulations by: (1) reducing the minimum volume of the transported natural gas to 5,000 MCF; (2) increasing the number of individual customers or buyers' groups eligible for transportation service from three to ten; and (3) requiring customers classified as Priority 1 under 52 Pa. Code §69.21(a)(1) to purchase standby sales service unless a customer can demonstrate that the facility for which it seeks to transport has adequate installed alternate fuel capability.[14]

At the federal level, FERC issued a series of orders extending its prior efforts to increase flexibility and competition in the natural gas industry. Order 637 and its follow-up orders provided for increased pipeline services in the secondary market, market segmentation and capacity release, all of which have increased the value of primary transportation. *Order No. 637, Regulation of Short-Term Natural Gas Transportation*

[14] *Minimum Threshold for Natural Gas Transportation* Service Order entered June 27, 1991at Docket No. L-890050. The regulations became effective March 20, 1992, 21 Pa. B. 5819.

Services and Regulation of Interstate Natural Gas Transportation Services, FERC Stats. & Regs. [Reg. Preambles 1996-2000] (CCH) P 31,091 (2000); *Order No. 637-A*, Order on Rehearing, *Regulation of Short-Term Natural Gas Transportation Services And Regulation of Interstate Natural Gas Transportation Services*, FERC Stats. & Regs. [Reg. Preambles 1996-2000] (CCH) P 31,099 (2000); Order No. 637-B; Order Denying Rehearing, *Regulation of Short-Term Natural Gas Transportation Services And Regulation of Interstate Natural Gas Transportation Services*, 92 FERC 61,602 (2000).

On April 8, 1992, FERC issued its Final Rule in *Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation Under Part 284 of the Commission's Regulations* (Docket No. RM91-11-000); and *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol* (Docket No. RM87-34-065). FERC's Order 636 essentially restructured the gas industry allowing for the unbundling of the pipelines' merchant function. Commission regulations at 52 Pa. Code Chapter 60 (relating to natural gas transportation service) were revised to be consistent with the new federal policy.[15]

4. Natural Gas Choice and Competition Act

On June 22, 1999, then Governor Thomas J. Ridge signed into law the "Natural Gas Choice and Competition Act", effective July 1, 1999, 66 Pa. C.S. §2201-§2212. The Competition Act established the Commission's role of steward of competition in Pennsylvania's retail natural gas market and allowed retail consumers in the Commonwealth to purchase natural gas supplies from independent suppliers commonly called "natural gas suppliers" while still receiving distribution services from their local natural gas distribution company. In particular, the Competition Act provides for retail natural gas consumers to choose among NGSs for natural gas supply or to receive default

[15] *Gas Transportation Tariffs*, Order entered May 13, 1996 at Docket No. L-00930084.

supply service from an NGDC, requires the licensing of suppliers, and mandates the unbundling of NGDC supply services and non-discriminatory access by suppliers to the NGDC distribution facilities. At the same time, the Act, as emphasized by EAP,[16] also requires the Commission to "ensure safety, and reliability of the natural gas and distribution service." 66 Pa. C.S. §2203(1). Accordingly, the rules for natural gas supply competition were promulgated so as not to compromise the safety and reliability of natural gas service for customers.

Beginning on November 1, 1999, retail customers had the ability to choose their natural gas supplier pursuant to the rules and regulations established by the Commission to implement the Competition Act.

[16] EAP Comments, p. 2.

IV. EFFECTIVE COMPETITION

A. Commission Authority to Define Competition

Pursuant to Section 501(a) of the Public Utility Code, 66 Pa.C.S. §501(a), the Commission has all necessary powers to carry out the provisions and the intent of the Public Utility Code. These powers by necessity provide the Commission with the authority to define terms that appear in the Public Utility Code, but that are not defined therein, such as "effective competition."

The Courts have consistently deferred to this Commission in the interpretation of its enabling legislation unless the Commission's interpretation bears no reasonable relationship to the regulatory purpose of the legislation. *Popowsky v. Pa. PUC*, 669 A.2d 1029 (Pa. Cmwlth. 1995), *appeal granted in part*, 680 A.2d 1165 (Pa. 1995), *rev. in part*, 706 A.2d 1197 (Pa. 1997). *See also Mid-Atlantic Power Supply Association v. Pa. PUC*, 746 A.2d 1196 (Pa. Cmwlth. 2000).

Moreover, the courts have consistently recognized this Commission's authority to determine the degree of competition appropriate within any jurisdictional market. *Peoples Natural Gas Co. v. Pa. PUC*, 554 A. 2d 585 (Pa. Cmwlth. 1989). *See also, Dublin Water Company v. Pa. PUC*, 213 A. 2d 139 (Pa. Super. 1965) and *Sayre v. Pa. PUC*, 54 A. 2d 95 (Pa. Super. 1947). In other words, the courts are in agreement that the determination of the amount of competition among utilities which will best serve the public interest is a matter within the administrative discretion of the Commission. *Columbia Gas of Pennsylvania, Inc. v. Pa. PUC*, 521 A.2d 105 (Pa. Cmwlth. 1987); *Pa. PUC v. Purolator Courier*, 355 A.2d 850 (Pa. Cmwlth. 1976); *Merz White Way Tours v. Pa. PUC*, 201 A.2d 446 (Pa. Super. 1964). *See Elite Limousine v. Pa. PUC*, 832 A.2d 428 (Pa. 2003)(where the legislature provided no definition of specific criteria to grant a certificate of public convenience, the PUC could formulate its own criteria, and omit the showing of inadequacy of existing service to increase competition in motor carriers).

In the past, when the Commission has needed to define a term that had not been previously defined in the Public Utility Code or by the courts, the Commission has referred to definitions of similar terms in legislation and case law in other jurisdictions. For example, in *Application of Paper City Transfer, Inc.*, Order entered October 7, 1993, Docket No. A-00109453 F.0001, the Commission defined "destructive competition" by reference to definitions of "unfair competition" and "harmful competition" established by the courts in *Brinks, Inc. v. Pa. PUC*, 424 A.2d 1010, 1012, note 2 (Pa. Cmwlth. 1981).

The Commission has also looked to other disciplines to define certain "terms" that were necessary to its analysis in certain matters. In the *Investigation Upon the Commission's Own Motion With Regard to PJM Installed Capacity Credit Markets*, Order entered June 13, 2002 at Docket No. I-00010090, the Commission described the term "elasticity" by reference to its use in economics and mathematics in its order concluding an investigation into possible anti-competitive activity. The term "elasticity" had been used by PJM Interconnection, LLC's market monitoring unit in a report.

As previously stated, the General Assembly, by enacting the Competition Act, has determined that competition in the retail natural gas supply market is in the public interest. However, the task of defining "effective competition" was delegated to the Commission. Accordingly, it is appropriate for this Commission, as it has done in the past, to consider fundamental principles of traditional economics as well as law from other jurisdictions to formulate a workable definition of "effective competition" for use in this report.

B. General Economic Classifications of Competitive Activity

Classic economics does not provide a definition of "effective competition." However, it does provide a framework for classifying the type of competitive activity that exists within an industry. Four general categories used to describe the level of competitive activity have been identified. They are: (1) pure competition, (2) monopolistic competition, (3) oligopoly, and (4) pure monopoly.[17]

Markets where there is "pure competition" are characterized as having a large number of independent sellers producing a standardized product. Also, each seller exerts no significant control over price. New sellers have easy entrance and exit to and from the market: No significant legal, technical, or financial obstacles exist.

There are various forms of competition which are not quite "pure." These forms would exist where there are fewer than a large number of sellers; or where the product was not quite standard; or where a group of suppliers might be able to exert some control over price.

Monopolistic competition falls between pure competition and pure monopoly, but it is closer to pure competition.[18] There are a large number of sellers acting independently. Product differentiation is a major feature of monopolistic competition, and the reliability of the seller to stand behind its product is of critical importance. Customers may have specific preferences for certain sellers and small price increases will not cause them to change. Entry is a little more difficult than in the pure competition market. Considerable advertising may be necessary to inform customers of the existence

[17] W.J. Baumol and A.S. Binder, *ECONOMICS: Principles and Policy*, (New York: Harcourt Brace Jovanovich, 1985), page 505.

[18] *Id.*

of a new entrant to the market and to convince them to switch. Because products are differentiated, competition is based on product quality, advertising, and conditions of service.

A third theoretical market structure involves oligopoly. An oligopoly's major characteristic is that a few sellers dominate the market for a product.[19] These sellers can produce standardized products or differentiated products. There may be significant obstacles to entry, and a new entrant must devote considerable resources to advertising and promotion. Oligopoly markets can be quite complex and economists identify three types[20]: (1) Collusion, (2) Price Leadership Model, and (3) Kinked-demand Model. Collusion occurs when firms attempt to control price. The Price Leadership Model features a dominant seller. The dominant seller benefits from economies of scale and could drive the other sellers out of the market by price-cutting. This seldom happens because of the dominant seller's fear of government intervention.[21] The Kinked-demand Model features several large sellers that make pricing decisions independently.

A pure monopoly is a one-seller industry. There are no substitutes available for the product. The monopoly has considerable control over price, and the barriers to market entry are quite significant.

The following table outlines the four forms of competition. It allows for a quick comparison between each.

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[19] J. Bruce Lindeman, Microeconomics Hauppauge, (New York: Barrons Educational Series, Inc., 1992), p. 101. ("Linderman")

[20] *Id.*

[21] Lindeman, *op. cit.*, p. 103.

Type of Market Structure	Number of Sellers	Nature of Product	Barriers to Entry	Examples
Perfect Competition	Many	All companies produce and sell identical products (ex. Wheat)	None	Some agricultural markets and parts of retailing come close
Monopolistic Competition	Many	Different companies produce and sell somewhat different products (Ex. Restaurant meals)	Minor	Most of the retailing sector, textiles, restaurants
Oligopoly	Few	Companies produce and sell identical or differentiated products (Ex. Tooth paste)	May be considerable	Much of the manufacturing sector, esp. autos, steel, and cigarettes
Pure Monopoly	One	Unique product	May be considerable	Public utilities

C. Commenters' General Assessment of the Level of Competition

In the May 28, 2004 Order that initiated this Investigation, the Commission requested comments on different factors that it should take into account in assessing whether "effective competition" exists in the natural gas supply service market. May 28, 2004 Order at p. 2. These factors included price, consumer education, customer information and service, supplier financial security requirements, and natural gas distribution company penalties and other costs. The Commission also requested that commenters assess the level of competition in Pennsylvania's natural gas supply service market and suggest ways to encourage increased competition.

The Commenters' assessment of competition in the market fell along expected lines. The EAP and the NGDCs that responded separately believed that competition exists in the market place.[22] The suppliers and customers believe that competition is lacking and could be encouraged if certain changes were made.[23]

Regarding the specific criteria that the Commission should use in assessing competition, the commenters again were split. Some commenters argued that the falling numbers of customers and suppliers participating in the market demonstrated the lack of competition.[24] EAP and others argued that the numbers of suppliers and customers were not an indication of effective competition.[25] This was the case with regard to the other four criteria upon which the Commission sought comment making it necessary to discuss each criterion separately below.

As to the definition of "effective competition" in Section 2204(g), no commenter volunteered a definition of the term.[26] Accordingly, the Commission, as the agency responsible for interpreting its own enabling legislation, will define "effective competition." *Popowsky, supra.*

[22] EAP Reply Comments, p.1, EAP Testimony, Tr. 9; Columbia Comments, pp. 1-2; UGI Comments, p. 9; Dominion Peoples Comments, pp. 8-9.

[23] Utilitech Comments, p.1; Shell Energy Comments, p. 2; Dominion Retail Comments, pp. 1-2; NRG Testimony, Tr. 56.

[24] IOGA Comments, p. 2; Shipley Comments, p. 3.

[25] Dominion Peoples Comments, p. 9 (Dominion Peoples considers competition on its system to be a success even though suppliers have dropped from 37 in 1999 to 20 in 2005).

[26] The Commission's Order did not request that commenters provide a definition of "effective competition."

D. Definitions of "Effective Competition" and Similar Terms from Other Jurisdictions and Resources.

The Competition Act does not define "effective competition," and the term is not defined in any other Pennsylvania statute.[27] However, other jurisdictions have formulated definitions of "effective competition" and other similar terms. For example, Nevada law defined "effective competition" as follows:

> "effective competition" means, with respect to a particular service, a market structure and a process under which an individual seller is not able to influence significantly the price of the service as a result of:
> (1) The number of sellers of the service;
> (2) The size of each seller's share of the market;
> (3) The ability of the sellers to enter or exit the market; and
> (4) The price and availability of comparable substitutes for the service.

NAC § 704.7931 ("effective competition" defined).

On the other hand, New Mexico law lists several factors used to determine whether a particular telecommunications service was subject to effective competition:

> (1) the extent to which services are reasonably available from alternate providers in the relevant market area;
> (2) the ability of alternate providers to make functionally equivalent or substitute services readily available at competitive rates, terms and conditions; and
> (3) existing economic or regulatory barriers.

NMSA 1978, § 63-9A-8(B).

See also The Mountain States Telephone And Telegraph Company v. N.M. State Corporation Commission, et al., 109 N.M. 504; 787 P.2d 423 (N.M. 1990)

Missouri telecommunications law, likewise, sets forth factors that the Missouri Commission must consider in determining whether "effective competition" exists in regard to a particular telecommunications service:

> (a) The extent to which services are available from alternative providers in the relevant market;

[27] The term "effective competition" is used in, but not defined in the *Feature Motion Pictures Fair Business Practices Law* at 73 P.S. §203-2. Likewise, there is no case law interpreting this term.

(b) The extent to which the services of alternative providers are functionally equivalent or substitutable at comparable rates, terms and conditions;
(c) The extent to which the purposes and policies of chapter 392, RSMo., including the reasonableness of rates, as set out in section 392.185, RSMo., are being advanced;
(d) Existing economic or regulatory barriers to entry; and
(e) Any other factors deemed relevant by the commission and necessary to implement the purposes and policies of chapter 392, RSMo.

Section 386.020(13) RSMo.

See also State of Missouri ex rel., Acting Public Counsel John Coffman, Missouri Independent Telephone Group, et al., v. Public Service Commission of the State of Missouri, et al., 154 S.W.3d 316 (Mo. App. 2004).

In defining "effective and sustainable competition," the Public Service Commission of Wisconsin took a more quantitative approach to assess competition in its electric generation market. Relying on classic economic concepts, the Wisconsin Commission first created a "workable competition" standard.[28] The standard consisted of:

(1) A reasonable number of suppliers (HHI[29] of 2,000 to 2,500);

[28] *Investigation on the Commission's Own Motion into the Need for Changes in Natural Gas Regulation for City Gas Company; Florence Municipal Gas Utility; Madison Gas and Electric Company: Midwest Natural Gas, Inc.; Natural Gas, Inc.; Northern States Power Company; St. Croix Valley Natural Gas Company; Superior Water, Light and Power (Phase III) Company; Wisconsin Fuel and Light Company; Wisconsin Gas Company; Wisconsin Natural Gas Company; Wisconsin Power and Light Company; and Wisconsin Public Service Corporation (Wisconsin Electric Power Company, Gas Operations, formerly Wisconsin Natural Gas Company).* Public Service Commission of Wisconsin, Docket 05-GI-108.

[29] The Herfindahl-Hirschman Index (HHI) is a well-known measure of industrial competition and it helps gauge how competitive an industry is. *See, e.g.*, M. W. Frankena and B. M. Owens, *Electric Utility Mergers: Principles of Antitrust Analysis*, (Westport, Connecticut: Praeger: 1994)("*Frankena and Owens*") The HHI is calculated as the sum of the squares of market share. For example, a monopoly has a market share of 100%, and so the HHI for a monopoly is $100^2 = 10,000$. For a very competitive industry, each firm has a very small market share and the HHI is close to zero. *Frankena and Owens.*

"As an intuitive guide, analysts assessing market concentration (i.e.. whether competition exists) view an HHI below 1,000 as a competitive market. HHI's between 1,000 and 1,800 suggest that the market is more concentrated and less competitive. HHI's over 1,800 indicate strong market concentration, and the need for further analysis to determine if adequate competition exists in the market. However, it is widely recognized that the HHI thresholds are not based on empirical evidence concerning the relationship between concentration/competition and the likelihood that market power will be exercised." *Frankena and Owens.*

(2) Low barriers to competition;
(3) Sufficient available capacity;
(4) Responsive suppliers; and
(5) Informed customers.

Using this standard, the Wisconsin Commission determined that an "effectively competitive" market would have a reasonable number of firms, low barriers to competition, sufficient available capacity, responsive suppliers and informed customers.

The Council for the District of Columbia has also established a definition for "effective competition" in regard to electric generation competition:

> "Effective competition" means, with respect to the markets for electricity supply, billing, and those services declared . . . to be potentially competitive services a market structure under which an individual seller is not able to influence significantly the price of the service as a result of the number of sellers of the service, the size of each seller's share of the market, the ability of the sellers to enter or exit the market, and the price and availability of comparable substitutes for the service.

Council of the District of Columbia, 47 D.C. REG. 1091, §101 (16).

Definitions for terms similar to "effective competition" have been adopted by other entities and include concepts that are worthy of consideration in defining "effective competition." Staff from the Energy Information Administration (EIA), U.S. Department of Energy,[30] listed signs of a "sufficiently competitive" market as including one or more of the following characteristics:

(1) Many buyers and sellers
(2) Many product options
(3) Relative ease of entry and exit
(4) Risk, on the part of the service provider, of losing money if they do not operate efficiently.

[30] The Energy Information Administration was created in 1977 by Congress and is the statistical agency of the U.S. Department of Energy. The EIA provides policy, independent data, forecasts and analyses to promote sound policy making, efficient markets and public understanding of energy and its interaction with the economy and the environment.

Mariner-Volpe, Barbara, and Trapmann, William, Energy Information Administration, *The U.S. Natural Gas Markets and Industry, (EIA PowerPoint Presentation)*, May 13, 2003, Slide 21 of 40.

The Independent Regulators Group ("IRG") from the European Union[31] in an Internet article[32] states that "effective competition" can be defined as the "persistent absence of players with market power."[33] IRG explains that while perfect competition is a static theoretical concept, "effective competition involves a more dynamic practical view."[34] Hence, for a market to be effectively competitive, it is necessary that this situation be sustainable. In other words, the possibility that one or more players can acquire market power is not consistent with effective competition. *Id.* As to its defining characteristics, IRG states that "effective competition" retains the main features of the competitive process in that:

(1) Agents (buyers or sellers) behave competitively.
(2) Consumers are offered a variety of products.
(3) Firms are efficient and are able to innovate.

IRG Article, ¶2.3.

IRG also states that the importance attached to effective competition is better appreciated in terms of its outcomes for consumers. According to IRG, consumers are better off in an effectively competitive market because they are more likely to find a better deal to meet their needs. *IRG Article*, ¶ 2.5. Therefore, in addition to the traditional structural criteria, consideration is given to particular aspects of customer care,

[31] Established in 1997, Independent Regulators Groups for telecommunications includes members from 15 countries from the European Union, the European Economic Space (Iceland, Norway and Liechtenstein), Switzerland and from the candidate countries to the European Union (Bulgaria, Poland, Czech Republic, Hungary, Romania, Latvia, Lithuania, Slovak Republic, Slovenia and Estonia and Cyprus). The groups work as informal forums of discussion and information exchange about issues relating to the regulation and development of the European telecommunications market.

[32] Independent Regulators Group, *Principles of Implementation and Best Practice on Effective Competition in Electronic Communications Market* (February 19, 2001) ("*IRG Article*"), found May 12, 2005 at http://www.regtp.de/imperia/md/content/internatio/pibs_on_effective_competition.pdf.

[33] *IRG Article* ¶2.3.

[34] *Id.*

responsive pricing, availability of innovative services, the extent of choice available, availability of appropriate information on prices and quality, evidence of efficiency in the provision of service and value for money. *Id.*

E. "Effective Competition" Defined.

As discussed previously, Pennsylvania's General Assembly delegated the task of defining "effective competition" to the Commission. The Competition Act does not provide specific guidance to the Commission in this task. However, it would seem reasonable that the parameters adopted by others in defining "effective competition" and other similar terms would be same ones that the Commission should consider, and in fact, did solicit comment on in its investigation order:

(1) number of active suppliers;
(2) number of retail customers served by alternate suppliers;
(3) volume of natural gas transported on NGDCs' systems for customers served by NGSs.
(4) effect of price of natural gas on competition.
(5) presence of possible barriers to market entry, participation and exit by NGSs (NGDC security requirements, penalties for under delivery, mandatory assignment of capacity).
(6) presence of possible barriers that may limit customer participation (lack of accurate immediate pricing information, lack of consumer education).

Commission Order entered May 27, 2004 at Docket No. I-00040103, Annex A.

Accordingly, for the purpose of this Investigation, the Commission adopts the following factors as indicia of "effective competition" in the defined retail natural gas supply market:

(1) Participation in the market by many sellers so that an individual seller is not able to influence significantly the price of the commodity.
(2) Participation in the market by many buyers.
(3) Lack of substantial barriers to supplier entry and participation in the market.
(4) Lack of substantial barriers that may discourage customer participation in the market.
(5) Sellers are offering buyers a variety of products and services.

F. Methodology.

Pursuant to its authority at Section 335(a) of the Public Utility Code, 66 Pa. C.S. §335(a), the Commission is the ultimate finder of fact and makes all determinations as to the weight and credibility of evidence. *PP&L Industrial Consumer Alliance v. Pa. PUC*, 780 A.2d 773 (Pa. Cmwlth. 2001); *Borough of Duncannon v. Pa. PUC*, 713 A.2d 737 (Pa. Cmwlth. 1998). The court may determine only whether Commission findings are supported by substantial evidence; the court may not substitute its judgment for that of the Commission, nor "indulge in the processes of weighing evidence and resolving conflicting testimony." *Popowsky, et al. v. Pa. PUC*, 706 A. 2d. 1196 (Pa. 1997). *See also Johnstown-Pittsburgh Express, Inc. v. Pa. PUC*, 291 A.2d 545, 547 (Pa. Cmwlth. 1972).

In Section 2204(g) the General Assembly charged the Commission with the duty of evaluating competition in the retail natural gas market as it developed under the Competition Act. This Investigation was undertaken to fulfill that duty.

The record in this Investigation consists of comments, reply comments, responses to data requests submitted by the NGSs and NGDCs and testimony and exhibits presented at the September 30, 2004 *en banc* hearing before the Commission. The Commission carefully studied the record of this Investigation and assigned what it concludes is the proper weight to the evidence.

The statistical data provided in response to specific Commission data requests simplified our evaluation. On the other hand, the comments and testimony regarding the existence and magnitude of barriers to market entry and participation created by security requirements, capacity assignments and penalties for non-delivery were more difficult to assess.

However, after examining the statistical data submitted by NGDCs and others, it is not difficult to conclude that only a small number of suppliers are actually participating in Pennsylvania's retail natural gas market. Because a competitive market needs to attract and retain competitors, it is necessary to consider carefully the suppliers' concerns about the operation of the current market, including the existence and magnitude of barriers that the suppliers have identified that may have led them to make business decisions to forego participation in the market.

V. ANALYSIS

A. Number of Market Participants

1. Natural Gas Distribution Companies

The natural gas distribution companies provide natural gas distribution services and may provide natural gas supply services and other services as defined in 66 Pa. C.S. §2202. They are companies with annual operating revenues over $6,000,000 and include: Columbia, Dominion Peoples, Equitable, National Fuel, PECO Gas, PG Energy, PGW, PPL Gas, T.W. Phillips, UGI, Southern Union Company, Valley Energy, Inc. and GASCO Distribution Systems.

2. Natural Gas Suppliers

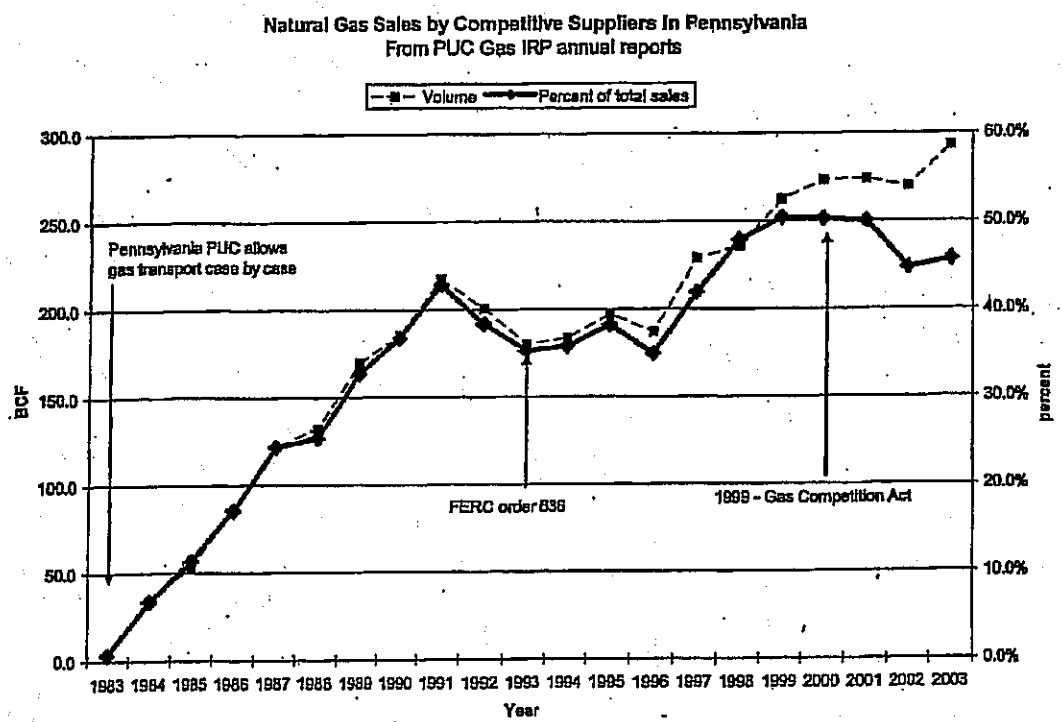
A natural gas supplier is an entity, other than an NGDC, but including an NGDC marketing affiliate, that provides natural gas supply services to retail customers using the jurisdictional facilities of an NGDC.[35] The term includes an NGDC that serves outside its certified territory and a municipal corporation that serves outside its corporate or municipal limits. The term expressly excludes an entity that provides free gas under the terms of an oil or gas lease. Note that an NGS is not a public utility.[36]

[35] 66 Pa. C.S. §2202 (relating to definitions).

[36] Commonwealth Court has held that natural gas suppliers are not "public utilities" and as such, are not subject to assessment for the funding of Commission regulatory activities pursuant to 66 Pa. C.S.§510. *Independent Oil and Gas Association of Pa., et al. v. Pa. PUC, Office of Consumer Advocate and Office of Small Business Advocate,* 804 A.2d 693 (Pa. Cmwlth. 2002).

a. Volume of Gas Transported

The Commission collects data on competitive activities through its Annual Resource Planning Report filings.[37] As shown in the following graph, since 1983, the volume of natural gas flowing under transportation rates has increased dramatically. However, since the inception of the Competition Act in 1999, there has been little to no change in the throughput[38] of competition volumes. In 1999, approximately 50% of the gas flowing in Pennsylvania was under a competitive tariff. In 2004, the volume is approximately 47.5%.

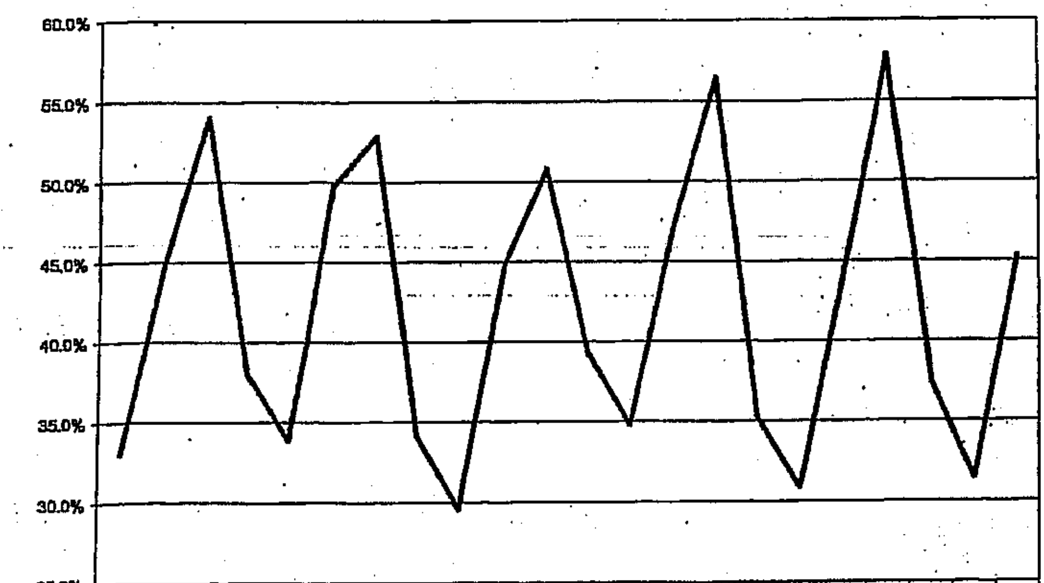


[37] *See* 52 Pa. Code §§59.81-59.84 (relating to Annual Resource Planning Report).

[38] The term "throughput" is commonly used to describe the volume of natural gas moved over an NGDC's system during the course of some time frame, *e.g.*, the total volume of gas moved over an NGDC's system during one year. Usually, throughput is measured on an MCF, or thousand cubic feet, basis. However, some systems calculate throughput on a therm, or BTU, or heat content basis.

The quarterly data, like the annual data, shows that the volumes transported for NGSs have remained nearly constant over time. This is demonstrated in the following graph.

Percent of Total NG Transported by NGSs by Quarter



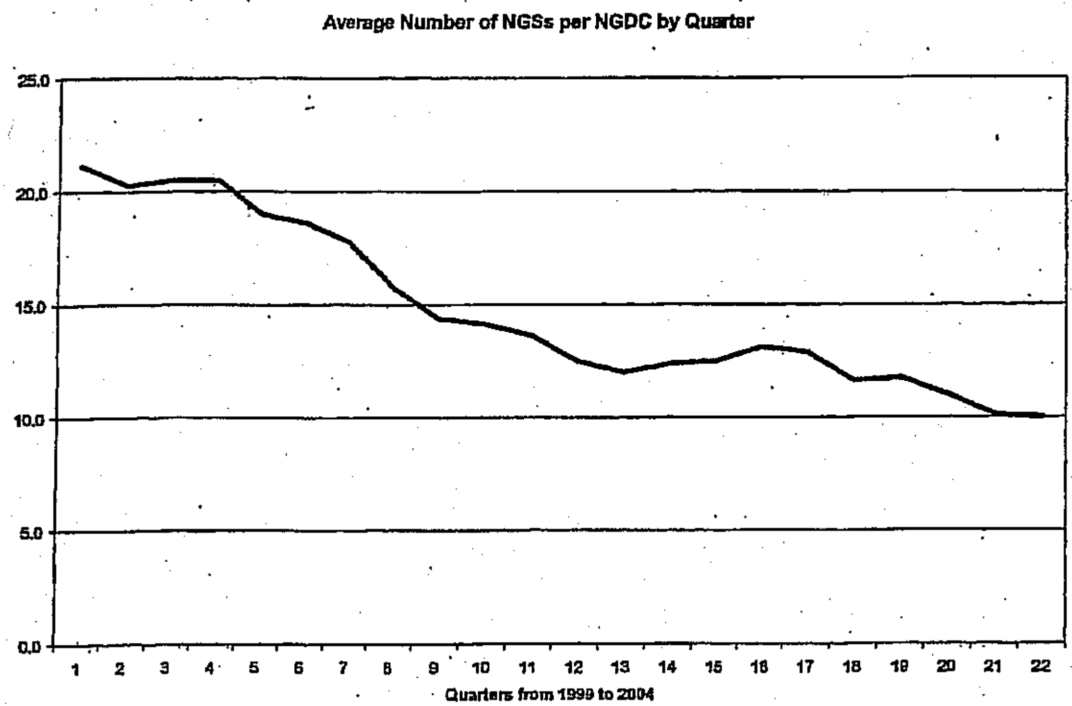
	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22
Percentage	33.0	44.9	54.0	38.0	33.9	49.7	52.8	34.2	29.6	44.7	50.8	39.3	34.8	47.2	56.4	35.3	30.9	44.5	57.8	37.4	31.5	45.3

Percentage of Gas Transported by Quarter from 1999 to 2004

b. Number of Suppliers

In Annex A to its Investigative Order, the Commission asked the NGDCs and NGSs to supply data for the Commission to review. These data responses formed the basis for the following analysis. Generally, nine of the ten major NGDCs filed data in a form that could be analyzed. Of the nine service territories, five had fewer NGSs operating on their systems in 2004 than in 1999. Two had more NGSs, and one had the same number of NGSs. One did not respond. Of the nine, three had increased competitive volumes flowing in 2004, over 1999. Five had the same, or equivalent volumes from 1999 to 2004. One did not respond.

The following chart demonstrates the average number of suppliers per NGDC per quarter from, 1999 to 2004. A point on the graph represents the average of the sum total of each responding NGDC's estimate of the total number of active NGSs serving customers in its service territories in a quarter.[39] By the way of explanation, if there were 6 NGSs serving customers in one territory and 2 NGSs serving customers in another territory, there would be a total of 8 NGSs. To get the average, take 8 NGSs divided by 2 territories to get an average of 4 NGSs per NGDC. As shown, early in 1999 the average number of NGSs per NGDC was just over 20. That number has dropped to 10 NGSs per NGDC in the fourth quarter of 2004.



[39] During the second quarter of 2004, Peoples had 20 NGSs active and serving load, while TW Phillips had 1 NGS.

Not only the average number of NGSs per NGDC is decreasing, but also the total number of NGSs has decreased slightly. According to Commission records regarding licensing, as of May 2005, there are 81 NGSs licensed to provide natural gas supply services.

NATURAL GAS SUPPLIER LICENSES

YEAR	# JAN 1	GRANTED	CANCELLED	# DEC 31
2002	84	7	13	78
2003	78	4	4	78
2004	78	8	4	82
2005	82	2*	3*	81*

*As of May 12, 2005.

3. Buyers/Shopping Customers

a. Consumer Education

The Commission was a partner in the Utility Choice program, a consumer education program, overseen by the Council for Utility Choice (CUC). In addition to the Commission, the CUC also is made up of consumers, small-business and utility representatives, and representatives from the Governor's Advisory Commission on African American Affairs, the Governor's Advisory Commission on Latino Affairs, and the Pennsylvania Rural Development Council. The Utility Choice program, which ended at the end of 2004, educated Pennsylvania consumers about natural gas, electric and local telephone competition, and the opportunity to buy services from alternative suppliers.

The two-year natural gas consumer-education program was funded by $2.4 million in assessments from the following NGDCs: Columbia; Dominion; Equitable; NFG; PG

Energy; UGI-Gas; PECO; Penn Fuel Gas/North Penn; T.W. Phillips; and Valley Cities. The amount of the assessment was based on the number of customers for each company.

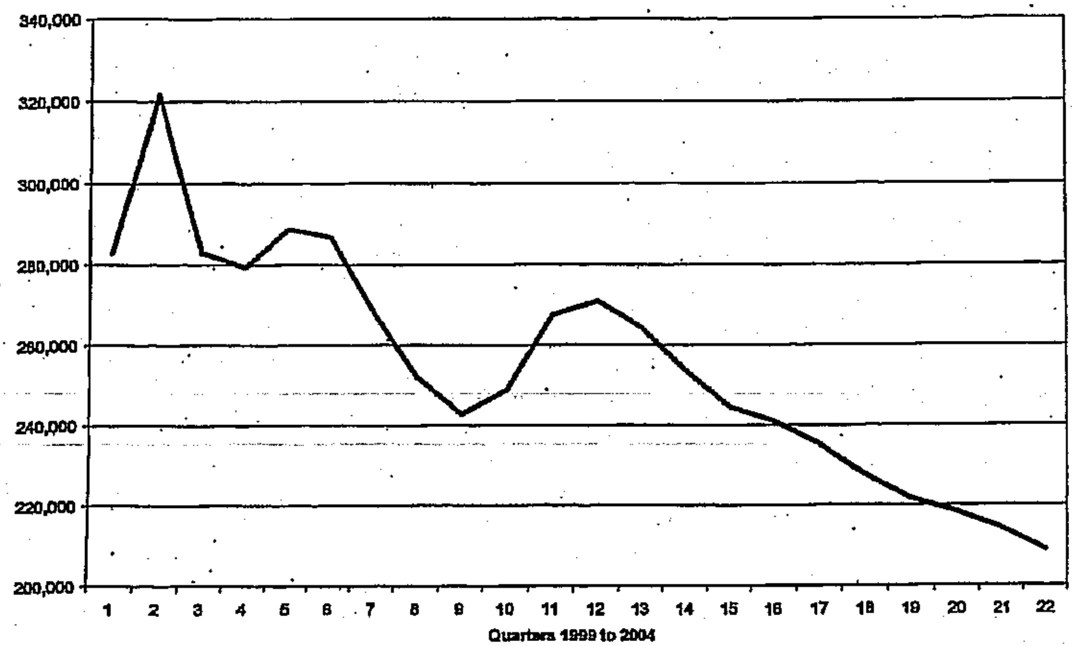
Three surveys were completed that measured the effectiveness of the Natural Gas Choice consumer education program. The most recent survey was conducted in August 2004 (1,205 respondents statewide were surveyed with a margin of error of plus or minus 2.8 percent). According to the August 2004 survey results, 55 percent of gas customers were aware that they are allowed to choose their own supplier of natural gas, and 16 percent have shopped for a different supplier of gas. Fifty-eight percent of gas customers said they did not have enough information to make a decision about participating in the Natural Gas Choice program. Nineteen percent of gas customers wanted more information about rates and savings, and 10 percent wanted more information about competing suppliers.

A survey in March 2001 revealed 71 percent awareness, and a survey in February 2003 yielded a 62 percent awareness level (although Philadelphia residents were not included). Not accounting for the fact that Philadelphia residents were included in only one of the three surveys, 63 percent of the surveyed consumers were aware of Natural Gas Choice and their ability to participate in the program.

b. Number of Customers

The <u>total</u> number of customers obtaining natural gas supply from NGSs was at an all time high in the second quarter of 1999. That high mark was 321,539, or about 11% of the total number of just under 2.8 million customers. By the fourth quarter of 2004, that number had fallen to 208,849, or about 7% of the total number of just under 2.8 million customers. This decrease in customer numbers is depicted in the following graph.

Number of Customers Shopping by Quarter



Of the nine NGDCs, three had fewer customers participating. Three had more customers participating. One had the same number of customers participating. Two NGDCs did not respond.

Looking just at the residential marketplace, one NGDC had the same number of residential customers participating between 1999 and 2004. Three NGDCs had decreasing numbers of residential customers shopping. Two NGDCs had no residential customers shopping. Three NGDCs did not respond.

The OCA also keeps records of the number of residential customers that are shopping for natural gas. As shown in the following table, the total number of residential customers shopping in October 1999 was 253,734. By April 2005, this number had dropped to 177,534. The most recently available figure on the number of residential customers obtaining supply from NGSs was 174,141 as of July 1, 2005. August 2005.[40]

[40] OCA's shopping statistics for residential natural gas customers for the month of August 2005 may be

Number of Residential Customers Shopping by Date (Source: PA OCA's Natural Gas Shopping Statistics)								
	Oct-01	Apr-02	Oct-02	Apr-03	Oct-03	Apr-04	Oct-04	Apr-05
Columbia	111,914	109,000	92,760	86,974	80,715	77,754	78,058	74,492
Dominion Peoples	114,747	112,989	102,607	95,725	90,393	87,609	84,285	79,481
Equitable	27,071	24,366	22,997	21,591	20,646	20,359	19,510	18,836
NFG	0	0	0	0	0	0	0	0
PECO	2	8	794	1,235	1,594	1,704	1,720	1,777
PG Energy	0	0	0	0	0	0	0	0
PGW	0	0	0	0	0	0	0	0
PPL Gas	0	0	0	0	0	0	0	0
TW Phillips	0	0	0	0	0	0	0	0
UGI		1,251	1,876	4,186	3,683	3,081	2,951	2,948
Valley Cities, NUI	0	0	0	0	0	0	0	0
TOTAL	253,734	247,614	221,034	209,711	197,031	190,507	186,524	177,534

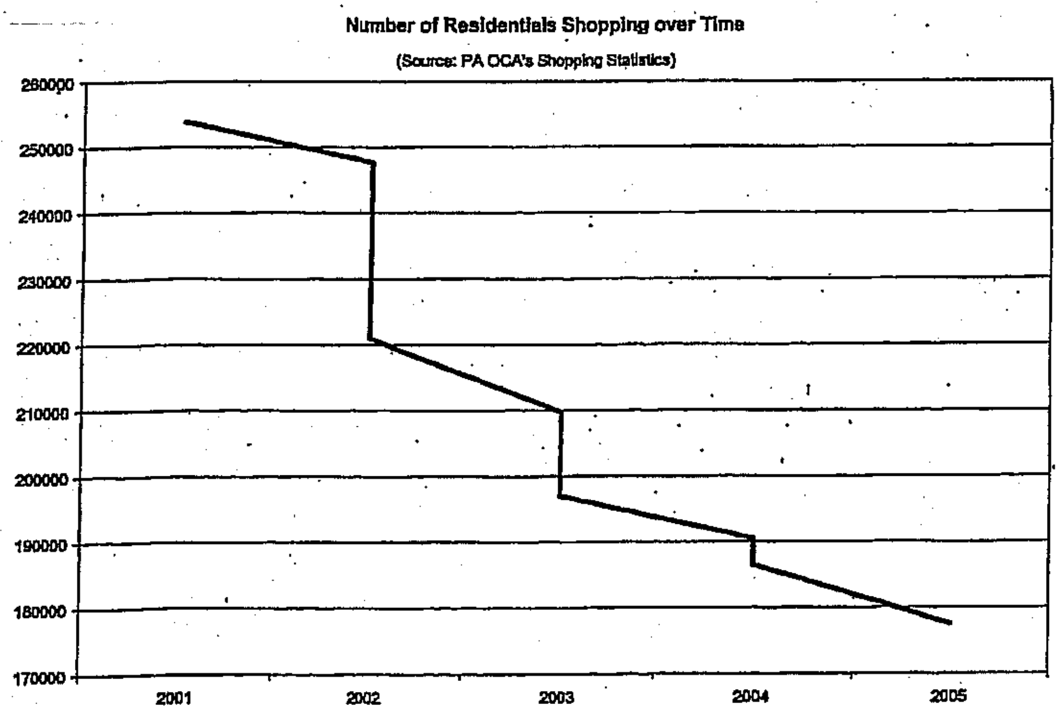
According to the OCA[41], nearly all the residential customer switching has occurred among the customers of three western Pennsylvania-based companies – Columbia, Dominion Peoples, and Equitable. This fact is demonstrated from the above chart. The reason for this, the OCA believed, is that those three companies already had substantial retail choice "pilot" programs ongoing well before the 1999 legislation was passed. During those pilot programs, customers who switched from their utility to an alternative gas supplier were exempted from paying the 5% gross receipts tax on their monthly gas bills.

accessed at http://www.oca.state.pa.us/cinfo/gstats0705.pdf.

[41] OCA Comments, pp. 3-4; OCA Testimony, Tr. 61-62.

The OCA also states that when the Competition Act was passed, however, this advantage was lost because the gross receipts tax was eliminated on all natural gas service.[42] There has been virtually no retail competitive activity for residential customers in most of the remaining natural gas service territories. Even among the three western Pennsylvania gas utilities, the number of customers served by alternative suppliers has decreased by about 20% since the beginning of 2001.

This data is shown in the following graph.



The data responses show that, with respect to residential volumes, one NGDC had a decrease in residential volume. One had the same volumes. Two NGDCs had zero

[42] *Id.*

residential volumes flowing through competition. Five other NGDCs did not respond to the data request.

Customer participation in the market is of course dependent on the willingness of suppliers to extend service offers to customers. NGSs may find residential customers unattractive to serve because of acquisition costs, load factors, credit risk, and other reasons[43] unrelated to requirements for market participation.

4. Possible Effect of External Forces on Pennsylvania's Retail Market

Regardless of how "effective competition" is defined, or the economic model being used, it is a difficult task to analyze the change in the levels of competition over time. There are macro-economic changes in the wholesale market that trickle down and affect the retail market. An example of these changes would be the increased wholesale price and volatility in the wholesale natural gas markets caused by an increase in total US-wide demand, without an attendant increase in supply.[44] In fact, this supply/demand imbalance has become great enough in today's wholesale market to induce interest in the construction of liquefied natural gas facilities that would provide for the importation of natural gas from around the world.[45]

Moreover, weather can affect the wholesale, and consequently, the retail market price. Weather changes over time. Change occurs from day-to-day, week-to-week, and

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[43] OCA Comments, pp. 5-6.

[44] During the 1999-2000 price spike, the Commission observed a number of failures and exits by long-time gas marketers. Such occurrences are generally symptomatic of a rising wholesale market where extensions of credit are not as freely available in sufficient amount to cover price escalations.

[45] A good overview of Liquified Natural Gas and related issues is given in *Chemical & Engineering News*, April 25, 2005, Volume 83, Number 17, pp. 19-22. This article may be found at www.pubs.acs.org/cen/coverstory/83/8317LNG.html *See also* various FERC filings for *Dominion Cove Point LNG, LP*, FERC Docket No. RP05-213-000.

year-to-year. Cold winters cause much larger price movements, than warmer winters. Similarly, the increasing reliance on natural gas for electric generation has affected the wholesale marketplace.[46]

Other events may have affected the development of competition at the retail level, including, most significantly, the impact of Enron's bankruptcy on the wholesale and retail marketplaces.[47] For example, Enron's bankruptcy may have affected the financial community's view of marketing and trading companies in general which in turn resulted in a contraction of credit for these entities and a loss of market liquidity. Consequently, the number of traders and the volume of financial and physical natural gas transactions may have been reduced. Also, commodity price and market volatility may have increased due to the increasing participation of non-gas related entities in the NYMEX[48] natural gas market.

By itself, or in combination with other macro-issues, these wholesale market concerns could have affected the level of competition in Pennsylvania's retail natural gas supply market from 1999 to 2004. Without further study, it is difficult to draw any definitive conclusions regarding which, if any, of these factors had a material impact on the development, or disintegration, of this competitive retail market.

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[46] *Testimony Regarding Diversification of Power Generation Resources* by Sonny Popowsky, Consumer Advocate of Pennsylvania, before the U.S. Senate Energy and Natural Resources Committee, March 8, 2005, found at: http://www.nasuca.org/Sonny%20Popowsky%20%20Senate%20Energy%20Testimony%203-8-05.pdf.

[47] *See, e.g.*, University of Pennsylvania, Research, Business Section: *After Enron, Who Else Goes Down, and When?*, dated December 5, 2001, found September 8, 2005 at http://www.upenn.edu/researchatpenn/article.php?170&bus.

[48] NYMEX – New York Merchantile Exchange NYMEX is the world's largest physical commodity futures exchange and the preeminent trading forum for energy and precious metals. Transactions executed on the NYMEX avoid the risk of counterparty default because NYMEX clearinghouse acts as the counterparty to every trade. The NYMEX pioneered the development of energy futures and options contracts 26 years ago as a means of bringing price transparency and risk management to this vital market..

However, it is important to note that the preceding discussion is meant to provide a perspective on the other forces[49] that may have affected, and may continue to affect Pennsylvania's retail natural gas market. These forces are not within the authority, or the direct control of the Commission or the market participants, and as such, for purposes of this investigation, have not been incorporated into our analysis regarding the level of competition in the statewide retail natural gas market.

B. Barriers to Supplier Entry and Participation

In their comments, reply comments and testimony, the majority of commenters (other than NGDCs) accepted as a given that there is not "effective competition" in Pennsylvania's natural gas industry and identified barriers to supplier participation in the market. In so doing, the commenters also offered suggestions that could be implemented to increase competition. Only EAP and the NGDCs indicated that "effective competition" as envisioned in Chapter 22 existed in the retail natural gas market, and that no changes needed to be made to the legislation.

1. Security Requirements.

A number of commenters identified high security requirements for licensing as a barrier to market entry for suppliers. Section 2208(c)(relating to financial fitness) of the Public Utility Code[50] requires that in order to obtain or maintain an NGS license, a supplier must furnish a bond or other security in a form or amount as determined by the NGDC. Section 62.111 of the Commission's regulations carries out this statutory requirement, and dictates that:

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[49] Commenters have also discussed the possible negative effect of these and other outside influences on competition in the gas supply market. *See* IOGA Comments, p. 3; OCA Comments, p. 5-6; UGI Comments, p. 3.
[50] 66 Pa. C.S. §2208(c).

The amount of the security should be reasonably related to the financial exposure imposed on the NGDC or supplier of last resort resulting from the default or bankruptcy of the licensee. At a minimum, the amount of security should materially reflect the difference between the cost of gas incurred and the supplier's charges, if any, incurred by the NGDC or supplier of last resort during one billing cycle;

52 Pa. Code §62.111(c)(1).

The regulation also allows a variety of security instruments to be used to satisfy the requirement including bonds, irrevocable letters of credit and for companies with annual operating revenues less than $1 million, real or personal property that meet certain criteria. 52 Pa. Code §62.111(c)(2)(3).

In reviewing the record in this Investigation, the Commission found that security issues were of high importance to both NGDCs and NGSs. Accordingly, we will discuss many of the NGS and NGDC comments herein.

Numerous commenters claimed that the high security amounts and the limited forms of security accepted by NGDCs (bonds and irrevocable letters of credit) acted as a barrier to market entry by suppliers.[51] Interstate Gas Supply comments that security requirements not based on definitive credit worthiness can have an anti-competitive effect, and states that if a marketer can provide financial statements that demonstrate an acceptable financial picture or an S&P, Moody, or Dun & Bradstreet rating at an acceptable level, the security requirement should be reduced.[52]

NEMA contends that financial security requirements should be designed to provide the NGDC with reasonable compensation in the event of supplier default.[53]

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[51] Shipley Comments, pp. 5-7; Utilitech Comments, pp. 1-2.

[52] Interstate Gas Supply Comments, p. 5.

[53] NEMA Comments, p.7.

Requirements should reflect reasonable costs of securing supplies during reasonable weather conditions.[54] Companies with certain S&P or Moody ratings should already meet reasonable standards.[55] Direct Energy states that suppliers with high credit ratings should be permitted to provide reduced security.[56]

In their Joint Reply Comments, Suppliers note that in keeping with the current statutory scheme, either the NGS or the NGDC should be able to propose an adjustment to the actual exposure based on the level of risk of the supplier actually defaulting.[57] In other words, the Commission's regulations should have a two-tiered structure: the first tier should be based on actual exposure.[58] In the second tier, actual exposure can be adjusted based upon the individualized risk or lack of risk factors depending on the case.[59] If the NGS can show it is a low risk, it can have a lower requirement; if the NGDC can show the NGS is a higher risk, the NGS would need more security. Under this system, the Commission would be the final arbiter of any dispute and should monitor security requirements to ensure fairness and uniformity.[60] Such a system assumes that any NGS meeting the same requirements will be required to post the same amount of security per customer.[61] Interstate Gas Supply agrees that credit criteria [security] should

[54] *Id.*

[55] *Id.*.

[56] Direct Energy Comments, pp. 6-7.

[57] Suppliers' Joint Reply Comments -- Shipley, Shell Energy, Dominion Retail, Direct Energy Services, Interstate Gas Supply (Suppliers' Joint Reply Comments), p. 9.

[58] Suppliers' Joint Reply Comments, p. 9.

[59] *Id.*

[60] Suppliers' Joint Reply Comments, p. 9.

[61] *Id.*

be standardized across the board and be based upon the financial strength of the individual supplier.[62]

Shipley comments that security requirements should be "bi-lateral" and based on the level of NGS revenue that the NGDC is holding.[63] Allowing marketers to pledge their accounts receivable balances to the NGDC would help in reducing the security requirement under the NGDC's tariffs.[64]

Interstate Gas Supply states that other types of collateral should be permitted as security.[65] In their Joint Reply Comments, the Suppliers advocate that an NGDC should not be permitted to require only a single form of security or a non-industry standard form.[66] At a minimum, NGDCs should be required to accept industry standard bonds, letters of credit, cash collateral or corporate guarantees (from entities with investment grade debt ratings).[67]

The NGSs also voiced their opinions that there should be greater options in providing security. Marketers should be allowed to issue bonds, letters of credit on a variety of other sources.[68] Others should be able to meet the financial standard with, for

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[62] Interstate Gas Supply Testimony, Tr. 39.

[63] Shipley Comments, p. 7.

[64] Mack Service Group Comments, p. 3.

[65] Interstate Gas Supply Comments, p. 5.

[66] Suppliers' Joint Reply Comments, p. 9.

[67] *Id.*

[68] Shipley Testimony, Tr. 50.

example, cash, letters of credit, parental guarantees or a reasonable bonding requirement.[69]

Security requirements should be transparent. They should be non-discriminatory and based on realistic calculations of true exposure that utilities face.[70]

Because the amount and form of security is determined by the NGDC against whom the NGS competes, security requirements not based on definitive credit worthiness can have anti-competitive effects.[71] Also, security requirements that varied among NGDCs discouraged suppliers from broader participation in the market.[72]

EAP continues its support of individual NGDC security requirements.[73] Dominion Peoples claims that its financial security requirements have not drawn any complaints and are not negatively affecting competition[74]. Security requirements are designed to protect customers and to ensure that the NGS is financially sound to secure supply for the load it has committed to serve.[75] They also safeguard the NGDC (and ultimately the NGDC's customers) from having to bear the cost of an insolvent NGS's abandoning its obligations.[76]

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[69] NEMA Comments, p. 7; Direct Energy Comments, p. 7. A "parental guarantee" is a promise by a parent company to pay some debt, or to perform some legal duty in case of failure of another who is liable for the debt or performance of the duty. *Blacks Law Dictionary,* (West 8th ed. 1999) p. 724 (def. of 'guaranty').

[70] Shipley Testimony, Tr. 50.

[71] Interstate Gas Comments, p. 5.

[72] Suppliers' Joint Reply Comments, pp. 2-3.

[73] EAP Comments, pp. 12-13.

[74] Dominion Peoples Comments, p. 13.

[75] *Id.*

[76] Dominion Peoples Comments, p. 13.

Summation

An NGDC has the authority to establish the amount and the form of security an NGS must provide not only to operate on the NGDC's system, but also to maintain its license as a natural gas supplier in this Commonwealth. *See* 66 Pa. C.S. § 2208(c). To the extent that NGDCs require security in a form, or in an amount so excessive that it makes it burdensome for a supplier to maintain its license or participate in the NGDC's marketplace, existing security requirements may be anti-competitive and according to suppliers acts as a market barrier to entry.[77] Also, the varying and multiple security requirements among NGDCs increase the cost of doing business for a supplier who wishes to operate in more than one NGDC service territories and thus, represents a significant barrier to supplier entry into, and participation in the retail natural gas market on a statewide basis.

2. Capacity Assignment.

Section 2204 (d)(1) of the Competition Act allows the NGDC the option to release, assign or otherwise transfer capacity or Pennsylvania supply in whole or in part on a nondiscriminatory basis to licensed NGSs or industrial customers on its system. 66 Pa. C.S. §2204 (d)(1). Section 2204(d)(4) requires a licensed NGS to accept such release, assignment or transfer of capacity. 66 Pa. C.S. §2204(d)(4).

According to OCA, the capacity assignment provisions of the Competition Act addressed two important concerns:

[77] In *Petition of Shipley Energy Co. for a Modification of Security Requirement,* Order entered July 9, 2004 at Docket No. P-0032045, p. 16, the Commission determined that Shipley had not met its burden of proving that UGI's security amount constituted a barrier to competition. It is noted, however, that the Commission did reduce the amount of security that UGI could request from the supplier, calculating the security amount using a 30-day billing cycle and the average gas cost for the two coldest months of two consecutive years. Order at pp. 13-14. The Commission's order was affirmed on appeal by Commonwealth Court. *See UGI Utilities, Inc. v. Pa. PUC,* 878 A.2d 186 (Pa. Cmwlth. 2005). UGI filed a petition for review with the state Supreme Court on August 8, 2005 at Docket No.655 MAL 2005.

(1) to ensure suppliers had adequate and reliable resources to deliver gas to the NGDC to serve customers and

(2) to ensure that NGDCs did not incur and remaining sales customers did not have to pay for "stranded" interstate pipeline costs associated with customers who migrated to service by an alternate supplier. The capacity assignment ensured both reliability and fairness to customer choice participants and consumers who remained with the utility.

OCA Comments, p. 10.

Many commenters have identified the assignment to suppliers of pipeline capacity as a barrier to market entry. EAP indicates that the capacity assignment provisions are necessary to maintain reliability.[78] UGI states that it has not assigned gas supply assets to NGSs to date. However, UGI states that the rules allowing NGDCs to assign pipeline transportation and storage capacity to NGS are necessary to avoid creating stranded costs and to provide for reliable service.[79]

Texas Eastern, the only pipeline company to participate in this Investigation, states that the most significant development at FERC is Order 637 issued on Feb. 9, 2000. Order 637 provided for increased pipeline services in the secondary market, market segmentation and capacity release, all of which have increased the value of primary transportation.[80]

Texas Eastern comments that continued reliable natural gas service is dependent on continuing contractual dedication of capacity, especially capacity at specific points that are operationally important (points of input, quantities of gas, and pressure) to

[78] EAP Comments, p. 6.

[79] UGI Comments, p. 9.

[80] Texas Eastern Comments, p. 4.

NGDC systems. Without access to the requisite firm upstream interstate pipeline capacity, there can be no assurance of continued reliable service.[81]

Also Texas Eastern comments that capacity should be adequate to cover peak days and average day deliveries, to preserve historical reliability and supply diversity, and to meet on a firm basis, new market demands.[82] Providers of service to firm load should be required to hold firm capacity with firm receipt points and firm delivery points sufficient to meet their peak day requirements.[83]

Texas Eastern comments that the supplier of last resort ("SOLR") should be given a clear signal that the costs of acquiring pipeline capacity and other assets on a firm basis sufficient to meet its obligations will be fully recoverable. Texas Eastern supports building additional pipeline capacity.[84] The SOLR must have contractually held non-recallable firm capacity at primary delivery points and primary receipt points as well as sufficient supply to meet customer needs.[85] SOLR must be able to meet obligations, and demonstrate a pre-existing capability to cover potential failures of the market.[86] There must be sufficient economic incentives for SOLRs to perform the standby supplier function for the entire period required to serve the market.[87]

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[81] Texas Eastern Comments, pp. 7-8.

[82] *Id.*

[83] *Id.*

[84] Texas Eastern Comments, p. 5.

[85] Texas Eastern Comments, p. 11.

[86] *Id.*

[87] *Id.*

OSBA states that as long as an NGDC will function as SOLR for priority customers, it will need to have sufficient capacity to serve both sales and transportation customers.[88]

Suppliers, however, oppose mandatory capacity assignment. They assert mandatory assignment of pipeline capacity by certain NGDCs is often excessive and/or unusable or too costly to serve retail customers. NGSs believe they should have the sole option of deciding whether or not to take assignment of upstream capacity.[89]

An NGDC has no incentive to reduce or reform contracts and the marketers are forced to pass the costs of the capacity to customers. According to New Energy, "mandatory assignment may be the primary reason that natural gas choice has not occurred in small commercial and residential markets."[90]

OSBA points out, however, that Section 2204(e), 66 Pa. C.S. §2204(e), allows NGSs to provide their own capacity, but the NGDCs have entered into new contracts to serve all priority customers and NGSs have agreed to continue to take capacity assignments.[91]

In regard to mandatory capacity assignment, OCA states that most Pennsylvania choice programs require a mandatory pro rata assignment of interstate pipeline capacity by NGDCs to NGSs as customers migrate to choice. OCA states that mandatory pro rata assignment of capacity may prevent third party suppliers from minimizing transportation costs and thus being able to compete effectively with NGDCs. When capacity is

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[88] OSBA Comments, pp. 6-7.

[89] Dominion Retail Comments, p. 10.

[90] New Energy Comments, p. 8.

[91] OSBA Comments, p. 7.

assigned to an NGS on a pro rata basis, the cost of capacity assigned to the NGS is the same as the cost to the NGDC and thus, the NGS's costs for assigned capacity is fixed. Without this assignment, the NGS might be able to acquire cheaper capacity on its own.[92] OCA states that the mandatory capacity assignments under Section 2204(d) that require suppliers serving priority customers to take mandatory capacity assignment for three years should be kept in place. OCA also states that there should be a pro-rata share of capacity costs.[93]

OCA continues that the natural gas supply service provided by NGDCs against which third parties must compete consists of two cost components: gas supply commodity charges and demand (or capacity charges). Demand charges reflect the costs associated with reserving interstate pipeline capacity and storage capacity used to move that gas to the NGDC city gate. One way for the NGS to compete is to utilize its interstate pipeline capacity in a more efficient manner than the NGDC and achieve a lower per unit cost for delivered gas supplies.[94]

OCA also states that NGSs may also compete by offering natural gas service under different terms and conditions than the NGDC--such as a fixed rate for a longer period of time. An NGS might also compete by combining different services, like natural gas and electricity. However, current fixed price services are priced substantially above the current Price To Compare ("PTC")[95] so they are unattractive to consumers. Also,

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[92] OCA Comments, pp. 15-16.

[93] *Id.*

[94] *Id.*

[95] Commenters have used different terms for the NGDCs' commodity price of natural gas. To eliminate confusion, the term "Price to Compare" or "PTC" is used in this report.

there is no evidence that bundled services are being offered in Pennsylvania on terms attractive enough to induce customers to switch.[96]

NGDCs take issue with the failure of NGSs to use Commission proceedings to address the capacity assignment issue as provided for in the Competition Act. T.W. Phillips points out that no NGS has taken advantage of the opportunity to petition the Commission pursuant to Section 2204(d)(5)(ii) to prevent capacity assignments and authorize use by supplier of alternate capacity when it has been shown to be comparable, particularly in terms of reliability. Also, no NGS has intervened in any Section 2204(e) proceeding, wherein an NGDC must obtain Commission approval in advance of its acquiring any new or renewed firm transportation or storage service capacity that is used to maintain service to their customers. T.W. Phillips states that it has made several of these filings since 2000 and no supplier has intervened.[97] EAP claims that the NGSs' criticisms and refusal to take advantage of existing statutory avenues for providing alternate capacity, rest on their desire to replace firm interstate services with inferior substitutes.[98]

Summation

The position of the NGDCs is that firm capacity is essential to ensure reliability of service for customers. However, NGS have identified mandatory capacity assignment as a substantial barrier to supplier participation in the retail natural gas supply services market here in Pennsylvania. While it may be argued that the suppliers have cast some doubt on their willingness to risk their own capital to ensure delivery capability to their own markets by not intervening in Commission proceedings to challenge the renewal of

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[96] OCA Comments, p. 17.

[97] T.W. Phillips Comments, p. 6.

[98] EAP Comments, p. 6.

capacity contracts, mandatory capacity assignment remains, from the suppliers' perspective, a barrier to market participation that should be addressed. Notwithstanding the identification of capacity assignment as a market barrier, the issue must be carefully considered, especially in regard to SOLR service where it is of vital importance that service be continuous and reliable.

3. Nomination and Delivery Requirements

Some NGDCs have nomination and delivery requirements[99] that align with the interstate pipelines; others do not. The varying rules regarding nomination and delivery create a barrier for a supplier that wants to serve over a number of territories.[100] Wholesale suppliers are reluctant to deliver in certain NGDC territories.

Shipley comments that tariffs in the western part of the state are more conducive to competition. A uniform set of rules that track the nomination requirements of interstate pipelines should be established. Also penalties for imbalance should be cost-based.[101]

Although Interstate Gas Supply strongly supports base load nominations, an error in daily nomination during a non-critical period should not result in excessive penalties.[102] Since the utilities retain the right to charge actual expenses incurred by the utility for over or under delivery by a marketer, the penalty is unnecessary.[103]

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[99] Nomination is defined as "the estimated volume that a customer informs the utility or marketer they will use or deliver for a specific gas day." Deliveries requirements are the "transportation volumes that are confirmed by the pipeline company for delivery to the customer at the delivery point and consumed by the customer." *See* MidAmerican Energy, *Industry Terms and Definitions for Customer Choice*, found May 12, 2005 at https://www.midamericanchoice.com/html/industryterms2.asp.

[100] Shipley Comments, pp. 8-9.

[101] *Id.*

[102] Interstate Gas Comments, pp. 6-7.

In their Joint Reply Comments, the Suppliers state that the Commission should also look at nomination and delivery rules across the NGDCs with the goal of creating uniformity and fairness. Because market based penalties can insure delivery, fair and flexible nomination rules will not necessarily allow suppliers to harm NGDCs.[104]

Although not strictly related to delivery requirements, Dominion Retail indicates that the purchase of imbalance gas, monthly/daily cash outs and storage gas in place should simply be priced at the then-current market, rather than under complicated and unpredictable pricing schemes presently used by NGDCs.[105] Pooling requirements are cumbersome and act as a barrier to competition.[106]

Summation

Suppliers have identified the varying nomination and delivery requirements established by NGDCs as a barrier to entry, and participation in multiple NGDC markets. The Commission recognizes that nomination rules and delivery requirements are essential to ensure system reliability and that the NGDC system operational requirements may vary because of physical difference among the systems. However, inflexible or unreasonable nomination and delivery requirements may be anti-competitive, and as such, represent a barrier to supplier entry and broader supplier participation in the retail natural gas market. In considering this issue, the purpose of these requirements must be weighed against their impedance of broader supplier participation in the statewide market.

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[103] *Id.*

[104] Suppliers' Joint Reply Comments, p. 7.

[105] Dominion Retail Comments, pp. 3-4.

[106] Amerada Hess Comments, p. 10.

4. Penalties for non-delivery

Penalties for non-delivery of gas are required to preserve reliability on the system, and to avoid cost shifting to sales customers.[107] In its reply comments, Columbia defends its $75 per MCF for non-delivery. Columbia submits that the charge serves as a reasonable and important disincentive for non-deliveries or under-deliveries to residential customers, and it is necessary because of the drastic consequences of non-delivery or under-delivery. During recent years, gas prices have neared this level in other markets, tempting NGSs to re-route supply to those markets.[108]

Suppliers have mentioned penalties as a barrier to market entry and participation and suggested solutions to make penalties fairer:

- Penalties in supplier tariffs should be cost based.[109]
- Uniform penalties should be established across all NGDCs.[110]
- A band of tolerances over/under should be considered before a penalty takes effect.[111]
- Significant penalties should attach only during periods of critical gas supply.[112]

Alternatively, OSBA suggests a two-tier penalty structure for non-delivery could be adopted, with the higher penalty applicable only in the case of gaming.[113] EAP

[107] UGI Comments, p. 14.

[108] Columbia Comments, p. 3.

[109] Shipley Comments, p. 8; New Energy Comments, pp. 8-9.

[110] OSBA Comments, pp. 5-6.

[111] Dominion Retail Comments, p. 8.

[112] Amerada Hess Comments, p. 8.

[113] OSBA Comments, pp. 5-6.

opposes the proposed two-tiered no fault penalty system as unworkable because one would have to adjudicate intent or fault.[114]

Summation

Excessive penalties have been identified as a barrier to market participation by some suppliers. The rationale for assessing penalties for non-delivery and under-delivery is to deter gaming or arbitrage type behavior among suppliers. However, penalties that are in excess of reasonable costs expended by the NGDC may be anti-competitive and according to suppliers, present a barrier to supplier participation in an NGDC's territory. Varying penalties among NGDC systems also discourage a supplier from operating in more than one NGDC service territory and thus, the lack of a uniform penalty system acts as a barrier to suppliers who wish to participate in the retail market on a statewide basis.[115]

5. Price to Compare ("PTC") and Section 1307 Adjustment

Suppliers have identified two possible barriers to market entry and participation in regard to the pricing of natural gas by the NGDC. The first barrier involves the types of costs that have been omitted from an NGDC's PTC. The second barrier involves the quarterly adjustment of the PTC under the Section 1307(f) adjustment mechanism. These issues are discussed separately below.

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[114] EAP Comments, p. 13.

[115] In *Shipley, infra.*, the Commission also directed that penalty charges should not be included in calculations of security amounts. Order at p. 11. *See* 52 Pa. Code §62.111 (relating to bonds or other security).

a. Fully Loaded PTC

The initial PTC was developed for each NGDC in the context of its restructuring proceedings.[116] Under Section 2203(3), 66 Pa. C.S. §2203(3), each NGDC was directed to address unbundling of commodity, capacity, balancing and aggregator services.

Suppliers identify the existing PTC as a barrier to market entry and supplier participation. At present, an NGS must compete with a price that reflects fully loaded gas costs against an NGDC's price that by rule reflects only an NGDC's pure gas costs; non-gas costs have been excluded.[117]

Suppliers argue that the PTC should include all costs related to gas supply function.[118] A fully loaded PTC rate would reflect uncollectible expenses, and the administrative cost of acquiring and administering PTC gas supplies.[119] The PTC must capture all the costs incurred in selling natural gas: the supply costs, the accounting costs, the regulatory costs, all of the overhead costs associated with selling the product, i.e., all

[116] Application of Columbia Gas of Pennsylvania for Approval of a Restructuring Plan, Docket No. R-00994781; Application of Peoples Natural Gas Company for Approval of a Restructuring Plan, Docket No. R-00994782; Application of PG Energy, Inc. for Approval of a Restructuring Plan, Docket No. R-00994783; Application of Equitable Gas Company for Approval of a Restructuring Plan, Docket No. R-00994784; Application of National Fuel Distribution Corporation for Approval of a Restructuring Plan, Docket No. R-00994785; Application of National Fuel Distribution Corporation for Approval of a Restructuring Plan, Docket No. R-00994785; Application of UGI Utilities Inc. for Approval of a Restructuring Plan for its Natural Gas Division, Docket No. R-00994786; Application of PECO Energy for Approval of a Restructuring Plan for its Natural Gas Division, Docket No. R-00994787; Application of Penn Fuel Gas, Inc. for Approval of a Restructuring Plan, Docket No. R-00994788; Application of Carnegie Natural Gas Company for Approval of a Restructuring Plan, Docket No. R-00994789. On December 1, 1999, after its acquisition of Penn Fuel Gas and PFG Gas, PPL Gas filed an application for a restructuring plan at Docket No. R-00994788.

[117] Shell Energy Comments, p. 4.

[118] Dominion Retail Comments, pp. 2, 10-11.

[119] UGI Comments, p. 16.

customer care costs, including bad debt and customer care migration expenses.[120] These costs, which are currently bundled in the distribution rate, should be split out and should be recovered in the Section 1307(f) adjustment mechanism. In other words, proper unbundling should be performed to reflect these costs in the PTC.[121]

In regard to charges that belong more appropriately in the PTC rather than the distribution rate, more costs should be included in the PTC than in the base rate. OCA's concern is that the non-gas costs will wind up in both the PTC and the distribution rates, and OCA wants to prevent customers from paying for those same charges twice.[122]

One NGDC, Dominion Peoples, does not oppose the idea of a fully loaded PTC, but argues that these costs which are currently included in distribution rates must be done in the context of an NGDC base rate case..[123] UGI, however, claims that a rulemaking could flesh out the details of a fully loaded PTC pursuant to 66 Pa. C.S. §2203(3).[124]

b. *Section 1307(f) Adjustment Mechanism*

Suppliers have identified the quarterly adjustment of an NGDC's PTC using the Section 1307(f) process as a market barrier for both suppliers and customers.

Under Section 1307(f)(1)(ii), an NGDC may file a tariff with the Commission that provides for regular adjustment, but not more frequently than monthly, to its rates for

120 Shell Energy Testimony, Tr. 44; Direct Energy Comments, p. 5.

121 Shell Energy Testimony, Tr. 45.

122 OCA Testimony, Tr. 78-79.

123 Dominion Peoples' Reply Comments, pp. 5-6.

124 UGI Comments, p. 16.

natural gas sales. In Section 1307, "gas costs" are defined as the "direct costs" paid by an NGDC for the purchase and delivery of natural gas to its system in order to supply customers and may include costs paid under agreements to purchase natural gas, costs paid for transporting natural gas to its system, costs paid to storage service from others, all charges, fees, taxes and rates paid in connection with such purchase, pipeline gathering, storage and transportation and costs paid for employing futures, options and other risk management tools. 66 Pa. C.S. §1307(h) (relating to definition).

As to being anticompetitive, the suppliers explain that the Section 1307 adjustment mechanism has a detrimental effect on marketing.[125] The mechanism creates a lag so that customers are never really aware of the true cost of gas that they use. For example, an NGS gave an example where one NGDC made an interim adjustment to its gas cost rate, lowering it by $2.00 per MCF. The timing coincided with Shipley's offer of a fixed rate for one-year. Customers chose to receive service from the NGDC because the rate looked like the better deal, but ended up paying more when the NGDC increased its gas cost significantly during the heating season. Shipley's one-year contract price was $7.25 while the NGDC charged $7.46 and then $8.33 during the heating season.[126]

At present, customers only see an artificial price that does not change often. Consequently, the price of the forecasting error, *i.e.*, the 4% interest rate that customers pay to NGDCs on under collections, is hidden from customers who pay it.[127] The quarterly adjustment perpetuates the myth that the NGDC is supplying a fixed price service. The use of the adjustment mechanism creates a price that is a projection of future gas prices, is reconcilable on a dollar for dollar basis, and most certainly is not a

[125] Shipley Comments, p. 9.

[126] Shipley Comments, pp. 2-3.

[127] Suppliers' Joint Reply Comments, pp. 2-3.

fixed price, but rather a variable price.[128] The price never represents in a current period the actual price a customer pays for a given volume of gas.[129]

Thus, NGSs believe the PTC, as adjusted quarterly through the Section 1307(f) process fails to send the proper price signals to customers. To encourage competition in Pennsylvania, customers should be able to see and respond to price signals. Utility pricing must be able to fluctuate with current market conditions and do so on a timely basis.[130]

Moreover, suppliers state that they are disadvantaged in their marketing efforts because the PTC is presented to the market as an annual gas cost, which implies that it is fixed for one year, but in reality, it is a variable rate.[131] This means the average PTC is at least $1/MCF too low and the NGSs are competing against an artificially low price. NGDCs should explain that their PTC is not fixed and if gas costs are adjusted upward upon reconciliation, the consumer will pay more later.[132]

NGSs also assert that by underestimating their gas costs NGDCs can create below market PTCs. In fact, suppliers argue that there is an incentive to under-collect PTCs because NGDCs are allowed to collect interest from customers on under recoveries.[133]

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[128] *Id.*

[129] *Id.*

[130] NEMA Comments, pp. 3-4.

[131] Dominion Retail Comments, p. 2.

[132] Dominion Retail Comments, p. 3.

[133] Shipley Comments, p. 9.

More importantly, they argue that economic prudence demands that the NGDCs err, if at all, by underestimating those gas costs to avoid the 6% over collection penalty.[134]

OCA and the NGDCs oppose changing the PTC rate to a monthly adjustable rate. OCA states that the intent of the Competition Act was to provide benefits to consumers by introducing retail choice to Pennsylvania, not to harm them by increasing natural gas cost rates and volatility or diminishing service and reliability.[135]

EAP argues that the current statutory system of annual purchased gas cost rates with quarterly adjustments reflects a reasonable balance among the possible approaches. In theory, there are a range of possible ways to establish an initial PTC rate, and its adjustments. However, no evidence was presented during the Investigation that a change to the quarterly adjustments would provide a benefit to consumers.[136]

T.W. Phillips points out that NGDCs are subject to annual gas cost purchase proceedings and are required to use least cost procurement strategies to procure supply so that annual purchased gas cost proceedings assure competitive gas costs for purchases of merchant service. Also, T.W. Phillips states that no regulatory protections are available to gas supply customers from NGSs.[137]

Suppliers have offered numerous suggestions to address their concerns regarding the Section 1307(f) process. Chief among these is the monthly adjustment of an NGDC's PTC so as to more closely reflect the market price of natural gas supply.[138] In its

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[134] Shell Energy Comments, pp. 3-4; Suppliers' Joint Reply Comments, p. 4.

[135] OCA Comments, p. 6.

[136] EAP Reply Comments, p. 7.

[137] T.W. Phillips Reply Comments, p. 5.

[138] Shipley Comments, p. 6; Shell Energy Comments, pp. 3-4; NEMA Comments, pp. 3-4; Dominion

comments, NEMA acknowledges that the law requires a fixed rate option if adjustments are made on a less than quarterly basis. 66 Pa. C.S. §1307(f) (1)(ii). NEMA opposes this because the addition of a fixed rate price will confuse consumers.[139] On the other hand, UGI suggests that NGDCs could voluntarily offer a non-reconcilable fixed rate option as it would more closely resemble NGS monthly offerings.[140] OCA opposes the idea of monthly adjustments of PTC to market.[141]

Other suggestions from suppliers include the following:

- The NGDCs would post a rolling twelve-month average market price with the monthly PTC.[142]
- NGDC system sales of supply gas could be made non-reconcilable.[143]
- NGDCs could move to a monthly price system that would require only minimum reconciliation.[144]
- The Commission could create incentives for the NGDCs to minimize price lags by limiting under/over collection adjustments to no more than .25 /MCF. [145]
- PTC should be market-based and tied to a published and credible index such as the NYMEX that closes at least one month in advance of the current month.[146]

Retail Comments, p. 9; Suppliers' Joint Reply Comments, pp. 5-6.

139 NEMA Comments, pp. 3-4.

140 UGI Comments, p. 14.

141 OCA Comments, pp. 6, 23.

142 Shipley Comments, p. 9.

143 Dominion Retail Comments, pp. 2-3.

144 Dominion Retail Comments, p. 6.

145 *Id.*

146 OCA opposes the idea of using another index like the NYNEX index to make the adjustment. OCA Testimony, Tr. 77.

This would permit suppliers to market against a known formula and allows utilities time to prepare to allow for customer migrations.[147]

- The Section 1307(f) adjustment process should provide over- or under-collections or other supply related costs that are attributable to the period prior to migration to avoid any potential double charging or recovery of such charges.[148]

Summation

While Pennsylvania's retail natural gas market was implemented in accordance with the Competition Act, the resulting competition may be best described in traditional economic terms as a "price leader" type of oligopoly where the actions of one seller influence the price and the subsequent actions of other sellers in the market. In this instance, the NGDC establishes the PTC -- the benchmark price against which NGSs are obliged to compete. When the PTC is adjusted, the suppliers must adjust their price to compete against that NGDC. The existence of such an oligopoly situation alone supports the conclusion that effective competition does not exist in the retail natural gas market.

Because the NGDC's PTC does not include all of the costs of gas supply acquisition, the PTC may represent an artificially low price, making it difficult for NGSs to compete against the NGDCs for customers. Moreover, the quarterly adjustment of the PTC through the Section 1307(f) process creates a lag in recognizing increased gas costs so that customers are confused as to the actual cost of natural gas over the long run. The customers believe to their detriment that the NGDCs are offering an annual fixed rate when it is really a variable cost service with quarterly true-ups. These practices involving

[147] NEMA Comments, pp. 3-4.

[148] *Id.*

natural gas pricing make it difficult for suppliers to compete against the NGDCs for customers.

Accordingly, the manner in which the PTC was formulated and is adjusted to correct over- or undercollections through the Section 1307(f) process constitutes a barrier to supplier participation in the retail natural gas market. The PTC and the quarterly adjustment mechanism should be re-examined to encourage increased competition.

C. Barriers to Customer Participation

Commenters have raised several issues that might represent barriers to customer participation in the retail natural gas service supply market. Chief among them is the NGDC's PTC rate and Section 1307(f) quarterly adjustment mechanism that insulates customers from knowing the actual cost of gas and perpetuates the notion that the NGDCs are offering an annual fixed rate for natural gas supply.[149]

Suppliers believe that the current system masks the price of gas so customers have no good information on which to base decisions on their consumption. The suppliers make reference in footnote 1 of their Joint Reply Comments to Report of the Government Accounting Office "Electricity Markets: Consumers could benefit from Demand Programs but Challenges Remain," (August 2004, GAO-04-844) from http://www.gao.gov/new.items/d04844.pdf. The report finds that one of the most significant hindrances to demand programs in electric markets is regulated prices that mask market costs from customers.[150]

[149] In *Dominion Retail, Inc. v Pa. PUC*, 831 A. 2d 810 (Pa. Cmwlth. 2003), Commonwealth Court affirmed the Commission's order that Equitable's fixed sales service (FSS) Rate does not have to be reconciled under Section 1307(f), 66 Pa. C.S. §1307(f). Rate FSS is available for residential and small business customers and provides them with the option of locking in the price for natural gas service for one year.

[150] Suppliers' Joint Reply Comments, pp. 2-3.

To encourage competition in Pennsylvania, NEMA suggests that customers should be able to see and respond to price signals. Utility pricing must be able to fluctuate with current market conditions and do so on a timely basis.[151]

NEMA also suggests that besides more accurate and immediate information about market price, customers need additional consumer education regarding the benefits of shopping for alternative suppliers. NEMA also believes that NGSs should be involved in developing educational messages about the availability of natural gas supply through alternative suppliers.[152] Dominion Peoples disagrees, and states that although the initial education program was successful, there are diminishing returns from further large scale campaigns.[153]

Dominion Retail comments that customer enrollment should be more uniform and efficient to allow for customers to change suppliers.[154] Direct Energy supports providing advance information about contract renewals to customers so they can make informed decisions about selecting a new supplier but would eliminate the 60- and 90-day notice requirement.[155]

In addition to consumer education, some suppliers would like to be more involved in customer care service, especially in providing seamless service transfer when a customer moves. Currently, NGSs are not allowed to continue serving customers through

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[151] NEMA Comments, pp. 3-4.

[152] NEMA Comments, p. 6.

[153] Dominion Peoples Comments, pp. 10-11.

[154] Dominion Retail Comments, pp. 9-10.

[155] Direct Energy Testimony, Tr. 29-30.

the move process, and are not allowed to act as the agent for the customer in contacting the NGDC and arranging for the move and continuation of the NGS's service. Shipley explains that ten percent of its customers move every year.[156] Value may be added to the contract by insuring a customer a seamless transfer of service to a new home.[157]

Summation

According to suppliers, the lack of accurate and immediate information about the true costs of natural gas (price signals) acts as a barrier to broader customer participation in the natural gas supply marketplace. Also, the inability of a supplier to continue a contract with a customer who moves during the term of a contract may also represent a barrier to customers' continuing participation in the market.

Convincing evidence has not been offered that lack of general consumer education programs about choosing an alternative supplier presents a barrier to customer participation in the retail market. However, the need for additional consumer education along with other customer service and information issues may need to be re-visited depending on changes that are made to the statewide retail market to increase supplier participation and competition.

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[156] Shipley Testimony, Tr. 47.

[157] Shipley Testimony, Tr. 48.

VI. FINDINGS

Consistent with Section 2204(g), the Commission presents the following findings:

(1) The Pennsylvania natural gas industry was restructured in accordance with the Natural Gas Choice and Competition Act, 66 Pa. C.S. §§2201, *et seq.*

(2) Since the enactment of the Competition Act, there has been little to no change in the throughput of competition volumes. In 1999, approximately 50% of the gas flowing in Pennsylvania was under a competitive tariff. In 2004, the volume was approximately 47.5%.

(3) Early in 1999 the average number of NGSs serving in each NGDC territory was just over 20. That number has dropped to 10 NGSs per NGDC in the fourth quarter of 2004.

(4) The number of customers obtaining supply from alternative natural gas suppliers was at an all time high in the second quarter of 1999. That high mark was 321,539. By the fourth quarter of 2004, that number had fallen to 208,849.

(5) Although there are levels of competition on three NGDC systems in western Pennsylvania, this competition pre-dates the Competition Act and came about as a result of Commission-approved pilot programs on those systems. Since 2001, competition on these three systems has decreased by 20 percent.

(6) NGS security requirements are established by each natural gas distribution company and differ between companies. 66 Pa. C.S. §2208 (c)(i).

(7) According to suppliers, the amount or form of security required by an NGDC acts as a substantial barrier to entry and participation by an NGS in an individual NGDC service territory.

(8) According to suppliers, the differing security requirements among NGDCs act as a substantial market barrier to NGS entry, and participation in marketing natural gas supply service in multiple NGDC service territories.

(9) Penalties for non-delivery or under delivery of natural gas by a NGS vary by NGDC and for the most part, these penalties are not cost-based.

(10) According to suppliers, the differing penalties among natural gas distribution companies act as a substantial barrier to NGS entry and continued participation

in marketing retail natural gas supply service in multiple NGDC service territories.

(11) Capacity assignment to NGSs is mandatory under 66 Pa. C.S. §2204 (d)(4)) and according to suppliers, acts as a barrier to supplier participation.

(12) An NGDC's Price to Compare ("PTC") establishes the retail market price for natural gas against which NGSs must compete for customers and sales in the NGDC's distribution territory. A change in an NGDC's PTC causes a change in the retail market price of gas against which suppliers must compete for sales and customers.

(13) NGDC's gas rates are adjusted on a quarterly basis, pursuant to 66 Pa. C.S. §1307(f), and subsequently lags behind the true cost of natural gas.

(14) An NGDC's natural gas distribution rate includes costs of natural gas supply procurement that should be recognized in the NGDC's PTC.

(15) Customers are not provided with accurate or timely information regarding the true cost of natural gas supply service because of the price lag associated with quarterly true-ups pursuant to the Section 1307(f) adjustment mechanism and the omission of some natural gas commodity procurement costs from the PTC. These commodity procurement costs are instead included in the NGDC's distribution rate.

(16) There is not "effective competition" in Pennsylvania's retail natural gas supply service market on a statewide basis.

VII. CONCLUSION

In this report, the Commission has adopted what it believes is a reasonable and workable definition of "effective competition" for this Investigation. It is a descriptive definition that lists certain aspects of the market structure and operation that are indicia of "effective competition" in that market:

(1) Participation in the market by many sellers so that an individual seller is not able to influence significantly the price of the commodity;
(2) Participation in the market by many buyers;
(3) Lack of substantial barriers to supplier entry and participation in the market; and
(4) Lack of substantial barriers that may discourage customer participation in the market.

Using this definition as a standard and giving appropriate weight[158] to the data, the comments and testimony submitted by participants, the Commission made sufficient findings regarding the realities of Pennsylvania's retail natural gas supply service market:

- The record demonstrates a lack of participation by many natural gas buyers and sellers in the retail natural gas supply services market on a statewide basis.
- The record indicates that natural gas distribution companies tend to act as price leaders in their respective service territories because many customers are not aware that the commodity price of natural gas, i.e. the Price to Compare or PTC, is a quarterly reconcilable price, based on projections, rather than a fixed annual price.
- According to suppliers, substantial barriers to entry in the retail natural gas supply market exist because of differing security requirements among natural gas distribution companies.
- According to suppliers, substantial barriers to entry and continued participation by natural gas suppliers in the retail natural gas service supply market exist as the result of the omission of procurement costs from the natural gas distribution company's commodity price of natural gas (PTC).

[158] The statistical data submitted by NGDCs demonstrates low numbers of suppliers actually participating in Pennsylvania's retail market. Because a competitive market needs to attract and retain competitors, it is appropriate to give additional weight to the comments and the testimony of suppliers regarding the existence and magnitude of barriers that have caused them to make business decisions to forgo the Pennsylvania market. *See* IV. (f): "Methodology," *supra.*, pp. 26-27.

- According to suppliers, substantial barriers to supplier participation in the retail natural gas supply market exist because of penalties placed on suppliers that vary among natural gas distribution companies systems and that are not cost-based.
- The regulatory lag in the establishment and implementation of quarterly price adjustments by natural gas distribution companies tends to mask the current market price of natural gas.
- The marketplace lacks accurate and timely price signals; as a result, the market cost of natural gas supply service offered by natural gas distribution companies is not communicated immediately to customers.

Based on the factors we have adopted to consider whether "effective competition," exists for purposes of Section 2204(g), these findings support the ultimate conclusion that there is a lack of "effective competition" in Pennsylvania's retail natural gas supply market at this time.

In light of this conclusion, pursuant to 66 Pa. C.S. §2204(g), the Commission determines that there is a need to convene the Stakeholders to consider an integrated solution to enhance competition in the statewide retail natural gas supply services market. The Stakeholders shall examine the below listed issues and other relevant matters that are identified in this report or by Stakeholders, and make recommendations regarding any changes that need to be made to the market's structure and operation to encourage increased participation by NGSs and customers. These issues include:

A. SECURITY. Excessive security and restrictive forms of security accepted by NGDCs and lack of uniformity of security requirements hinder supplier entry and market participation.

B. MANDATORY CAPACITY ASSIGNMENTS. Mandatory capacity assignment acts as a market barrier.

C. NOMINATION AND DELIVERY REQUIREMENTS. Restrictive nomination and delivery requirements that varied among NGDCs discourage supplier participation in the market.

D. PENALTIES FOR NON-DELIVERY. Excessive penalties and lack of uniformity between NGDC systems act as barriers to supplier participation in the statewide retail market.

E. PRICE TO COMPARE. Inclusion of all costs related to natural gas supply procurement as a means of increasing supplier participation in the statewide retail market.

F. PRICING INFORMATION AND CONSUMER EDUCATION. Lack of timely price signals act as a barrier to customer participation. Additional consumer education may be needed in light of changes that may be made to the market.

G. SEAMLESS MOVE: Lack of portability of competitive supply service for a retail customer moving from one location to another within the same service territory discourage customer participation.

H. RECEIVABLES FOR MASS MARKET CUSTOMERS. Institution of a reasonably priced NGDC "purchase of receivables" policy as an interim mechanism to promote choice for customers. Use of a "bad debt tracker" to ensure NGDC recovery of bad debt expense in conjunction with purchase of receivables.

I. ACQUISITION COSTS FOR MASS MARKET: Use of Opt-Out Municipal Aggregation, increased availability of customer lists and customer assignment programs to lessen the high cost to NGSs of acquiring mass market customers.

J. SUPPLIER CONSOLIDATED BILLING: Availability of Supplier Consolidated Billing as an important tool for advancing NGS-customer relationships.

K. SUPPLIER TARIFF REQUIREMENTS: Uniform supplier tariff rules, including those provisions related to customer enrollment, to encourage supplier participation statewide.

L. CONSUMER PROTECTION RULES. Revision of some requirements, particularly customer notice requirements, that create additional costs for NGSs.

M. NGDC CONSOLIDATED BILLING: Exclusive NGDC consolidated billing limitations restrictions NGSs in their ability to communicate effectively with consumers.

N. NGDC PROMOTION OF COMPETITION: Use of incentives for NGDC incentives to promote competition with a corresponding ban on the marketing of SOLR service by NGDC.

O. SUSTAINED COMMISSION LEADERSHIP IN COMPETITIVE MARKETS: The need for a supplier Ombudsman to increase Commission responsiveness to supplier issues.

P. NGDC NEGOTIATED SUPPLY CONTRACTS: Possible elimination of special negotiated contracts or agency agreements between customers and NGDCs.

Q. MARKET INFORMATION: The cost for daily consumption information and data accuracy issues and availability of daily customer usage or utility operating and transportation discount information create barriers for NGS participation.

R. CODE OF CONDUCT: Lack of reporting, auditing or enforcement of the Code of Conduct, especially in regard to certain communications between an NGDC and its unregulated affiliates.

S. SWITCHING RESTRICTIONS: Lag in NGDCs implementation of customer switching suppliers.

T. SERVICE TO LOW INCOME CONSUMERS. Remove of obstacles to provide competitive retail service to low income customers.

Also, the Stakeholders shall recommend any legislative amendments, if any, that need to be made regarding the Natural Gas Choice and Competition Act and the Public Utility Code and revisions that should be made to applicable Commission regulations to facilitate their recommendations to enhance competition in the statewide retail natural gas supply services market.

The Commission acknowledges that it may already have the legal authority to implement some of the solutions that have been proposed commenters in this investigation, such as the recognition in the distribution company's PTC of all natural gas procurement costs in a NGDC base rate case[159] and the further unbundling of specific services such as billing or metering through a rulemaking.[160] However, based on past experience, the Commission believes that an integrated solution that is developed by all interested parties and addresses all relevant substantive and procedural issues is preferable to a piecemeal approach to market climate improvement.

The Commission anticipates that the first stakeholder meeting will be held this Fall 2005 and that the group's work will be completed by the end of 2005.

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[159] 66 Pa. C.S. §2203 (11).

[160] At present, the Commission may address unbundling of other services only through the rulemaking process. 66 Pa. C.S. §2203(3)(relating to standards for restructuring the natural gas industry). Because rulemakings can be a two year process, it may be possible for the stakeholders to agree to the use of a different, more expedient Commission proceeding that would still afford all parties due process.

APPENDIX

Investigation into Competition in the Natural Gas Supply Market,
Order entered May 28, 2004 at Docket No. I-00040103

PENNSYLVANIA
PUBLIC UTILITY COMMISSION
Harrisburg, PA 17105-3265

Public Meeting held May 27, 2004

Commissioners Present:

Terrance J. Fitzpatrick, Chairman
Robert K. Bloom, Vice Chairman
Glen R. Thomas
Kim Pizzingrilli
Wendell F. Holland

Investigation into Competition in the Natural Gas Supply Market

Docket No. I-00040103

ORDER

BY THE COMMISSION:

Section 2204(g) of the Natural Gas Choice and Competition Act requires the Commission to initiate an investigation or other appropriate proceeding to determine whether effective competition for natural gas supply services[1] exists in the Commonwealth.[2] The proceeding must be launched five years after the effective date of the Natural Gas Choice and Competition Act. The Act became effective July 1, 1999.

[1] The term "natural gas supply services" is defined as (1) the sale or arrangement of the sale of natural gas to retail gas customers; and (2)services that may be unbundled by the Commission under section 2203(3) (relating to standards for restructuring of the natural gas utility industry.) 66 Pa. C.S. §2202.

[2] **§ 2204(g) Investigation and report to General Assembly**
Five years after the effective date of this chapter, the commission shall initiate an investigation or other appropriate proceeding, in which all interested parties will be given a chance to participate, to determine whether effective competition for natural gas supply services exists on the natural gas distribution companies' systems in this Commonwealth. The commission shall report its findings to the General Assembly. Should the commission conclude that effective competition does not exist, the commission shall reconvene the stakeholders in the natural gas industry in this Commonwealth to explore avenues, including legislative, for encouraging increased competition in this Commonwealth.
66 Pa. C.S. § 2204(g).

Thus, we must initiate our investigation on, or shortly after July 1, 2004 to comply with the directive of the General Assembly. With this order, we initiate this investigation.

The purpose of the investigation is to determine the level of competition that exists currently in the natural gas supply service market in Pennsylvania. A party that wishes to submit written testimony shall file ten copies of his or her written testimony at this docket with the Commission's Secretary no later than Friday, August 27, 2004. An electronic copy of the testimony on a diskette must also be provided so that testimony can be posted at the Commission's website.

Parties are asked to address the following topics in their written testimony:

1. The assessment of the level of competition in Pennsylvania's natural gas supply service market.
2. The effect of the price of natural gas on competition.
3. The effect of consumer education on competition.
4. The effect of customer information/service on competition.
5. The effect of supplier financial security requirements on competition.
6. The effect of natural gas distribution company penalties and other costs on competition.
7. Discuss any avenues, including legislative, for encouraging increased competition in Pennsylvania.

Note that the list of topics is not all inclusive. Other topics that are relevant to assessing competition in the Pennsylvania natural gas supply service market may also be addressed.

Additionally, the Commission will direct all natural gas distribution companies and licensed natural gas suppliers to provide the information requested in Annex A. The receipt of this current and historical data should provide a more accurate and complete picture of competition in the Pennsylvania market.

Following receipt of the written testimony, the Commission will hold an *en banc* hearing to further explore the level of competition in Pennsylvania. The *en banc* hearing will be held on September 30, 2004. The Commission will issue a Secretarial Letter addressing further procedural details for this hearing on or before September 10, 2004. The Commission wishes to remind interested parties are invited to contribute other relevant data and statistics related to this investigation; **THEREFORE,**

IT IS ORDERED:

1. That an investigation into competition in Pennsylvania's natural gas supply service market is initiated.

2. That a copy of this order shall be served upon all Pennsylvania natural gas distribution companies, the Philadelphia Gas Works, the Office of Consumer Advocate, the Office of Small Business Advocate, all licensed natural gas suppliers, the Energy Association of Pennsylvania, the Independent Oil and Gas Association and the Industrial Energy Consumers of Pennsylvania.

3. That a person wishing to submit written testimony addressing the issues presented in this order shall do so no later than August 27, 2004. An original and ten (10) copies of the written testimony and one diskette containing an electronic version of the written testimony shall be filed with the Commission's Secretary. Testimony should be addressed to James J. McNulty, Secretary, Pennsylvania Public Utility Commission, P.O. Box 3265, Harrisburg, PA 17105-3265.

5. That the natural gas distribution companies, the Philadelphia Gas Works, and the natural gas companies shall file the answers to the questions appearing in Annex A shall be filed no later than August 27, 2004. An original and ten copies of the answers

and an electronic version of the answer on a diskette shall be filed with the Commission's Secretary.

6. That an *en banc* hearing will be held on September 30, 2004. The Commission will issue a Secretarial Letter addressing the procedural aspects for this hearing on or before September 10, 2004.

7. That the contact persons for this investigation are: Robert Bennett, Fixed Utility Services at 717- 787-5553 (robennett@state.pa.us) and Patricia Krise Burket, Assistant Counsel at (717) 787-3464 (pburket@state.pa.us).

8. That this Order shall be published in the *Pennsylvania Bulletin* and that the Order and the written testimony submitted shall be posted at the Commission's website at www.pucpaonline.com.

BY THE COMMISSION:

James J. McNulty,
Secretary

(SEAL)

ORDER ADOPTED: May 27, 2004

ORDER ENTERED: May 28, 2004

ANNEX A

Natural Gas Distribution Companies

Each natural gas distribution company is directed to provide specific information about its system.

(1) For each quarter of the years 1999 to 2004, provide the following:
  (a) Number of natural gas suppliers operating on its distribution system;
  (b) Number of residential, industrial and commercial customers purchasing gas from alternative suppliers;
  (c) Volume of natural gas transported on its distribution system;
  (d) Volume of natural gas transported for suppliers on its distribution system.
  (e) Numbers of customer complaints/disputes regarding slamming or unauthorized change of supplier; changing a supplier; selecting a supplier; confusion regarding a bill on which charges appear for natural gas from an alternative supplier, error in billing for a supplier; and any other issue competition-related issue.

(2) Provide the following information about security requirements that natural gas suppliers are required to maintain for licensure (66 Pa. C.S. § 2208(c)(1)(i)):
  (a) Security requirement as posted in the distribution company's initial supplier tariff.
  (b) Each change that was made to this security requirement to date.

Natural Gas Suppliers

Natural gas suppliers are directed to provide specific information regarding sales volume and customer number. For each of the quarters of the years 1999 to 2004, provide the following:

(1) Number of customers (by class) for each distribution system on which the supplier operates.
(2) Volume of natural gas delivered to customers (by class) on each system on which the supplier operates.
(3) Numbers of customer complaints/disputes regarding slamming or unauthorized change of supplier; changing a supplier; selecting a supplier; confusion regarding a bill on which charges appear for natural gas from an alternative supplier, error in billing for a supplier; and any other issue competition-related issue.