Testimony of William Barkas, Manager of Regulatory Affairs, Dominion Retail, Inc.
before the
House Consumer Affairs Committee – October 27, 2011

Good morning. My name is Bill Barkas and I am a Manager of Regulatory Affairs for Dominion Retail. We serve approximately 128,000 natural gas customers, and over 300,000 electricity customers in Pennsylvania. We have participated in the natural gas market since the beginning of Choice, starting with the pilot programs that preceded statewide Choice. Right now we serve customers in the service territories of Peoples Natural Gas, Equitable Gas Company and Columbia Gas Company.

Thank you for providing us with this opportunity to share with you with our views on natural gas competition and our recommendations for what we can do to make the markets more competitive on a statewide basis. As you know, the natural gas market for residential and small commercial customers was opened to customer choice by the *Natural Gas Choice and Competition Act ("Choice Act")*, in 1999. (66 Pa. C.S. § 2201, *et seq.*) Unlike the electricity markets, however, which were opened to competition a year earlier, there were no rate caps in the gas markets that prevented suppliers from making offers to customers. Moreover, while the residential and small commercial customer natural market has been growing over the past 12 years, the shopping statistics have remained significantly lower than those of the electricity markets. State wide, on average, only about 8% of residential customers buy their natural gas from a Natural Gas Supplier ("NGS"). It is NGSs who provide competitive natural gas service.

The Choice Act contains a provision that required the PUC to look at the competitiveness of the natural gas market in 2005, and the PUC did just that. The result is what

has come to be known as the SEARCH process. While that effort took several years, it has produced some changes to the market structure, including a set of regulations that recently were re-submitted to the Independent Regulatory Review Commission ("IRRC"). That rulemaking, titled *Natural Gas Distribution Companies and Promotion of Competitive Retail Markets*, Docket No. 2008-2069114 (Final Rulemaking Order entered February 23, 2011)("Rulemaking"), addresses several important concepts. It is Important that you understand, however, that the Rulemaking does not resolve the issue that is addressed in the proposed legislation. To make sure you understand the difference, I thought I would spend some time explaining what the PUC has done so far, and what remains to be done.

I. Rulemaking

First let me talk about the Rulemaking, it addresses five specific subjects:

1) Establishing permanent rules for purchase of receivable programs;
2) Ensuring that the release, assignment and transfer of pipeline and storage capacity by a utility is nondiscriminatory and fair;
3) Addressing the recovery of the costs of competition related activities by utilities;
4) Addressing a utility's ability to recover the costs of their regulatory assessments under an automatic adjustment surcharge; and,
5) Reformulation of the Utility's "price to compare" ("PTC") to better reflect all costs related to natural gas supply and procurement.

I will talk about each of these in a little more detail.

1. Purchase of Receivables. The Rulemaking establishes final requirements for purchase of receivables ("POR") programs, seeking to standardize those programs across gas utility service territories. Under the Choice Act, gas utilities are required to bill the gas charges for NGSs operating on their system. A Purchase of Receivables programs, POR, allows the gas

utilities to buy the receivables that they are billing—at a discount. That means that the gas utilities continue to bill and collect for NGSs like they do today, but they get to charge the NGS for the service in the form of a discount. That discount is calculated to protect the gas utility from the risk of the receivable becoming uncollectible. All of the major gas utilities have or shortly will have a voluntary POR program.

2. **Assignment or Transfer of Pipeline and Storage Capacity.** Another subject addressed by the Rulemaking is the release, assignment or transfer of capacity. Under the Choice Act, 66 Pa. C.S. § 2204(d), the gas utilities are permitted to assign to NGSs, the pipeline and storage capacity that they purchase. This capacity allows the gas utility to deliver gas from the gas fields into their service territories, or to store it close by. These assets, when used by the gas utility, are paid for by customers through rates. Capacity assignment is when the use of that pipeline or storage capacity is transferred to the NGS. The assignment also comes with a price tag. The PUC's Rulemaking recognizes that there may be some problems with amounts of capacity assigned and the price at which it will be assigned, and seeks to ensure that this assignment is done on a nondiscriminatory and competitively neutral basis.

3. **Cost of Competition.** With regard to the NGDC's cost of competition related activities, the PUC asserted its belief that it would not be appropriate to have an automatic adjustment clause for recovery of education and other costs associated with competition, such as computer system upgrades and the like. The PUC is amenable to allowing utilities to recover such costs through base rates or otherwise as necessary, but not through an automatic surcharge.

4. **Regulatory Assessment Recovery.** The Rulemaking rejects requests for a surcharge to recover regulatory assessments. These assessments are provided for in the Public

Utility Code and are the basis of the PUC's funding. It appears that the PUC may believe that 66 Pa. C.S. § 510 must be changed to make this sort of recovery possible.

5. **Price to Compare.** The Price to Compare (also referred to as the "PTC") is the "rate" or "price" that customers are told to use as a benchmark when evaluating an NGS offer, to see if the economics are to the customer's liking. Each gas utility prints the price to compare on its customers' bills each month and it is listed on shopping guides that are published to help customers make "informed" choices. The problem is that the Price to Compare, today, is not at all comparable to the prices offered by NGSs, such as my company. The Price to Compare is a prediction by the gas utility, and is based upon what the gas utility expects gas to cost in the next 3 months. One major problem with the Price to Compare is that it does not include all of the costs that utilities incur to provide default service. This discrepancy is one of the items the PUC is trying to correct in its rulemaking. When the Rulemaking is effective, it will require the gas utilities to include in the calculation of the Price to Compare, recovery of the money that the gas utilities spend to provide default gas service. Remember, default service is the sale of the commodity to customers who don't choose a supplier.

In particular, the Rulemaking has provisions that are intended to remove all identifiable natural gas procurement costs from the base (delivery) rates of the Natural Gas Utilities, where those costs presently are recovered. This process of removing charges from one rate and moving them to another is often referred to as "unbundling." See, 66 Pa. C.S. § 2203(3).

Gas utilities currently recover most of the costs associated with buying natural gas through their distribution (delivery) rates. This present practice has as least two negative effects: 1) it charges those procurement costs to all customers, even though all customers, and

particularly shopping customer, do not cause those costs; and, 2) it distorts the true cost of gas (makes it appear to be less expensive than it really is) by not recovering the costs associated with procuring gas from the customers who use the gas. These procurement costs include supply management expenses such as bidding, contracting, hedging, credit risk management costs and administration and general expenses associated with buying gas. It also includes other administrative costs such as, education, regulatory, litigation, tariff filings, working capital, information system and taxes.

As part of its deliberations on the PTC, the PUC did take the rather significant step of requiring gas utilities to include the reconciliation amount, or e-factor as it is officially known, in the Price to Compare. The e-factor is sometimes referred to as the over/under collection mechanism. The legislation that we are supporting depends on the inclusion of the e-factor in the price to compare, to be effective. My colleague will address this subject in more detail.

II. Statutory Proposals.

We are supporting three modifications to the natural gas provisions of the Public Utility Code.

1. The first change is to build on the PUC's proposed regulation requiring the e-factor to be included in the price to compare, and to make the PTC even more market relevant so that it is more comparable to NGS prices. Once the PUC's Rulemaking is effective, this pricing disparity will be the largest remaining systemic barrier to competition. It is simply too difficult to explain the gas utilities' current cost recovery mechanism PTC to customers in way that allows a valid comparison to an NGS price, which is typically an all-inclusive, fixed rate. This lack of comparability leads to confusion and customer mistrust of marketers.

2. The Second proposed change is to eliminate what is known as the Migration Rider. The Migration Rider requires the gas utility to continue to charge customers the e-factor, even after the customer no longer takes gas service from the utility. The logic is that because the e-factor calculation spreads the collection of any difference between the price of gas at the time the customer used it, and the amount the customer was charged at the time he or she used the gas over a 12 month period, if a customer leaves, they should have to pay the e-factor for 12 months to make sure the gas utility is made whole. This extra amount (it can be a refund as well) is known as the Migration Rider charge, and under present law, if a customer leaves the supplier of last resort, or default service that is provided by the gas utility, and takes service from an NGS, the Customer must continue to pay this extra amount for up to a full year after they leave. For most customers, the Migration Rider charge shows up as a new line on their bill and makes it look like they are being penalized for shopping, even though they had been paying the charge all along and simply did not know it.

Because our proposal will shorten the reconciliation to a one month backward look, we believe that the utilities will be able to recover their gas costs on a present basis and will no longer need a Migration Rider charge. It should be obvious why the Migration Rider charge makes competition difficult, customers simply don't understand, and often are not willing to accept a "new" charge for shopping.

3. The final significant change is to remove a provision of the Choice Act that would require any utility that trues-up its over/under balance on a monthly basis to also have an annual fixed priced product that is reconciled. A reconciled or trued-up rate is bad enough, as I discussed previously, because it will cause a lag in recovery of costs, but an annual fixed price that is reconciled will be even worse than the quarterly rate we have today. This provision

simply makes no sense in today's market and should be eliminated. The main reason is that most NGSs offer annual fixed rates that are not reconciled. The fixed price product is being provided by the market already, and in a manner that customers understand—all in. There is no reason to confuse customers by requiring a 1 year product that may appear to be a fixed price, when it really is not.

I hope I have helped further your understanding of what we think is needed to make the natural gas markets more competitive, and I invite any questions you might have.