

**BEFORE THE PENNSYLVANIA
HOUSE CONSUMER AFFAIRS COMMITTEE**

Comments of

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**Regarding
Informational Meeting
Recovery of Purchased Gas Costs**

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Good morning Chairman Godshall, Chairman Preston and members of the House Consumer Affairs Committee. I am Terry Fitzpatrick, President & CEO of the Energy Association of Pennsylvania (“EAP”), a trade association whose members include all of the larger natural gas utilities, also known as natural gas distribution companies (“NGDC”), operating in the Commonwealth of Pennsylvania.¹

I appreciate this opportunity to comment on the proposed changes to Section 1307 of the Public Utility Code submitted by Dominion Retail, Inc., Shipley Energy Company and Interstate Gas Supply, Inc., which I shall refer to as the “Gas Marketer Group”, and to answer your questions.

In brief, my comments will cover the following points:

- EAP and its gas utility members support the promotion of retail gas markets in a manner that is fair and balanced to all customers, and which recognizes the important role gas utilities play in ensuring the reliable deliveries of gas to their smaller residential, commercial and industrial customers.
- Gas utilities do not “compete” with gas marketers, and instead procure natural gas supplies for those customers who do not switch. Gas utilities recover associated gas supply costs from those customers without a profit or mark-up.
- The issues addressed in the proposed amendments to Section 1307, namely how gas utilities should recover over and under collections of gas costs and whether certain gas supply-related costs should be removed from base rates and recovered from customers receiving their gas supply service from gas utilities, are being addressed in a pending final rulemaking of the Pennsylvania Public Utility Commission that reflects the results of a broad stakeholder review process.
- The proposed changes seek to promote retail markets in ways that are at odds with the stated goals of minimizing price volatility and permitting price comparisons.

EAP and its NGDC members are familiar with the issues raised by this proposal, namely the reconciliation of utility purchased gas costs (“PGC”) and the nature of the costs that should be recovered through utility PGC rates, because they have been the topic of extensive examination by a wide body of stakeholders before the Pennsylvania Public Utility Commission

¹ EAP’s NGDC members include: Columbia Gas of PA; Equitable Gas Company; National Fuel Gas Distribution Corp.; PECO Energy Company; Peoples Natural Gas Company LLC; Philadelphia Gas Works; UGI Central Penn Gas, Inc.; UGI Penn Natural Gas, Inc.; UGI Utilities, Inc. – Gas Division and Valley Energy, Inc.

("PUC" or "Commission"),² and have most recently been addressed in a final PUC rulemaking order that is currently undergoing final review in the regulatory review process, including reviews by the Independent Regulatory Review Commission ("IRRC") and this committee (the "Promoting Retail Markets Order").³

As I will explain, EAP believes the proposed amendments to Sections 1307(f) and (h) will not achieve their stated purposes of "making accurate price comparisons possible" and minimizing rate volatility. Moreover, the proposal is at odds with the PUC's determination, in its recent Promoting Retail Markets Order. In that rulemaking Order, the PUC stated that "the quarterly adjustments already provided for in existing regulations will adequately mitigate large reconciliation swings due to the seasonal nature of gas sales and that any over/under collection balance will remain relatively small by comparison to overall gas costs."⁴ The PUC's Promoting Retail Markets Order already mandates a process for shifting gas supply-related costs from base rates to a surcharge on PGC customers, and it is not clear if the proposed revisions to Section 1307(h)'s definition of "natural gas costs" is seeking to duplicate the PUC's determination, or to require an overly broad shifting of costs that would unfairly burden PGC customers.

I. BACKGROUND

Before turning to the specifics of the proposed legislative changes, I think it would be helpful to the members of this committee to briefly review the current responsibilities and obligations of the Commonwealth's NGDCs, and the role they play in ensuring that natural gas supplies are available for their residential, commercial and industrial customers.

NGDCs primarily perform two functions. First, they distribute natural gas to end use customers through a pipeline system they have constructed and continue to operate and maintain. The rates charged for this gas delivery service are determined in PUC rate proceedings. The management of these systems may require the use of upstream interstate pipeline and storage services to balance gas deliveries to the NGDC's distribution system with system use.

Second, NGDCs continue to have a statutory obligation to serve residential and smaller volume commercial and industrial customers ("core market customers")⁵ as the supplier-of-last-resort ("SOLR"). These obligations extend not only to those PGC customers who do not switch,

² This extensive stakeholder process is referred to as the "SEARCH" process, and included some or all of the Gas Marketer Group members. SEARCH is an acronym for "Stakeholders Exploring Avenues for Removing Competition Hurdles."

³ *Natural Gas Distribution Companies and the Promotion of Retail Markets*, Docket No. L-2008-2069114, Final Rulemaking Order entered February 23, 2011.

⁴ Promoting Retail Markets Order, pp. 24-25.

⁵ Such customers are also sometimes referred to as "mass market customers".

but also to those core market customers who do switch and purchase their natural gas supply services from gas marketers.

Through the enactment of the Natural Gas Choice and Competition Act (“Choice Act”) the right to shop for natural gas supply service was extended to all customers, including core market customers. The General Assembly further made the fundamental policy decision to allow core market customers to continue to receive PGC service, i.e. gas supplies from the SOLR (currently the gas utility) under the existing PGC process with slight modifications. Under this statutory PGC process, gas utilities make annual PGC filings with the PUC that involve two reviews. There is a review of projected gas supply plans and costs for a future twelve-month PGC period, and a projected rate is developed to recover the projected costs using assumptions about expected customer usage and weather conditions. There is also a review of historical PGC decisions regarding gas cost procurement, and to the extent the natural gas costs are found to be prudently incurred, the gas utility is permitted to recover the difference between the PGC revenues it collected during the historic period and its prudently incurred historical PGC costs through a so-called “E-Factor” component of its projected PGC rates. The E-Factor can be a positive or negative number.

To minimize the potential size of E-Factor adjustments, the PUC is authorized to permit NGDCs to implement quarterly adjustments to their PGC rates,⁶ subject to review in their annual PGC filings. The current statute also provided for the possibility of monthly adjustments, but only where the gas utility offers customers an annual fixed price option, so that they could avoid the potential volatility of monthly adjustments. All NGDCs, however, are subject to PUC regulations that require quarterly adjustments for significant variations between projected and actual PGC revenues and costs, and which permit, but do not require, quarterly adjustments for smaller variations.

The Choice Act also mandated that core market customers leaving PGC service should continue to pay the E-Factor for a period of twelve months to prevent cost shifting to other PGC customers, because the E-factor is collecting or refunding costs incurred to provide service to the customer before the customer left PGC service. This payment is commonly known as a “migration rider”. Most or all NGDCs also have so-called “reverse migration riders” which exempt customers returning to PGC service from paying or receiving the E-Factor for twelve months because they were not receiving PGC service when the variance between actual PGC revenues and costs was being incurred. The current proposal which eliminates both the migration rider and the reverse migration rider would result in an inappropriate cross-subsidization of costs between shopping and non-shopping customers, create the potential for stranded costs to be paid by PGC customers, and create customer confusion.

⁶ Previously, only annual adjustments were permitted unless, upon being notified of a significant change in gas costs, the PUC specifically authorized an interim adjustment.

II. PROPOSED CHANGES TO THE RECONCILIATION PROCESS

The supplier proposal would amend the current statutory scheme and mandate monthly reconciliations BUT would not achieve the stated purpose of “making accurate price comparisons possible” or minimizing rate volatility. The PUC, as quoted above, appropriately concluded that its existing quarterly PGC rate adjustment rules do not create a barrier to retail competition.

Core market customers do not favor volatile prices, as price volatility makes it harder for them to budget for gas costs, and, accordingly, most gas marketers offer customers annual fixed price contract options. However, where customers wish to compare such offers to a PGC rate, there is an obvious tension between more frequent PGC rate adjustments as proposed here and less frequent PGC adjustments. As recognized by the Commission, more frequent adjustments would make comparisons more difficult whereas less frequent adjustments make comparisons easier.

The issue of monthly PGC adjustments was extensively vetted during the SEARCH process and the Commission’s pending rulemaking proceeding. After assessing the information provided by many parties, the PUC appropriately concluded that the current system of requiring quarterly adjustments for significant changes struck the appropriate balance between more frequent PGC adjustments which make it more difficult for customers to weigh the benefits of fixed price offers, and concerns about the customer confusion purportedly created by E-Factor adjustments. As the PUC recognized, and as the evidence shows, annual E-Factor adjustments are such a small component of PGC rates under the current quarterly adjustment system that they cannot seriously be considered to be a barrier to competition. Further, for the reasons I explained previously, concerns about the E-Factor allegedly causing PGC rates to distort current market conditions is not a valid concern because most PGC costs and gas marketer supply costs do not reflect current short-term market prices; instead, they reflect the costs of a portfolio of gas supply assets priced at differing levels over time.

I would also note that, if a monthly reconciliation process attempted to reconcile all imbalances incurred in one month over the next month alone, as opposed to over a twelve-month period, much greater volatility in PGC rates would result because of the highly seasonal nature of gas usage. Gas costs are recovered through volumetric rates, and gas usage is highest during the winter months when gas is used for heating purposes. If reconciliations occurring during a winter month had to be recovered over a subsequent spring month when anticipated sales volumes are much smaller, the monthly adjustment could cause a significant change in gas prices.

It is not clear if the supplier proposal is intended to require or encourage reconciliation on a month to month basis. If this is the intent, I do not believe it would be good public policy to artificially promote the benefits of gas marketer fixed price service offerings by causing excessive and unnecessary PGC price volatility for PGC customers. If the intent is to have monthly reconciliation amounts recovered over longer terms, then I would agree with the Commission's conclusion in the Promoting Retail Markets Order that the existing quarterly adjustment rules strike the appropriate balance between providing customers with a relatively stable PGC price and the goal of minimizing the size of annual E-Factor adjustments. I would also note that however reconciled, monthly PGC rate adjustments will increase NGDC administrative costs by requiring the calculation, filing and dissemination of additional rate adjustments and by increasing call center volume that usually results when rate adjustments occur.

The Committee should be aware that many NGDCs in New York have monthly PGC rate adjustments. However, these rate adjustment mechanisms are part of a larger array of regulatory policies that permit the recovery of stranded costs created by retail shopping, and hence, they are not directly comparable to policies adopted in Pennsylvania as part of the Choice Act which, amongst other things, were designed to avoid the creation of stranded costs.

III. PROPOSED CHANGES TO THE DEFINITION OF NATURAL GAS COSTS

After gathering facts through the SEARCH process, the PUC has determined in its Promoting Retail Markets Order that NGDCs must remove administrative and other costs related to certain gas supply functions from base rates, and recover such costs through surcharges that would only be assessed to customers receiving PGC service. The Promoting Retail Markets Order also specifies a process for such rate adjustments to be performed. The goal of these proposed rate adjustments is to make the PGC service offering more comparable to those of gas marketers.

EAP is challenging the total removal of gas supply-related costs from base rates in the regulatory review process because, as discussed above, certain gas supply activities are associated with the SOLR function and should not be avoidable, because they benefit both PGC customers and customers who choose to switch. In addition, other gas supply assets may be used to balance system deliveries with customer usage, which also benefits all customers. In response, the PUC has informed the IRRC that costs related to the administration of firm storage and transportation need not be removed from NGDCs' base rates, but concerns remain about recovering other SOLR-related or system balancing costs from PGC customers alone.

Since the PUC is already addressing the issue of how PGC-related acquisition costs should be recovered, it is not clear why the Gas Marketer Group's proposed revisions to Section 1307(h) are necessary. If the wording is intended to remove all gas supply costs from base rates and to place all such costs on PGC customers, even though a significant portion of such costs are for the benefit of core market customers served by marketers, then the Gas Marketer Group is proposing an even broader inappropriate cross-subsidization of shopping core market customers by PGC customers than the proposed rules currently under scrutiny before the IRRC.

Similarly, EAP is concerned with the addition of the words "lost and unaccounted for gas" to Section 1307(h)'s definition of natural gas costs. Lost and unaccounted for gas represents the difference between gas that is delivered into the system and metered gas deliveries, and can reflect leaks, meter errors, or other factors. These factors are applicable to all customers, and not just PGC customers. The costs of lost and unaccounted for gas attributable to PGC customers is already recovered through PGC rates, and the costs of lost and unaccounted for gas applicable to other customers, including all transport customers served by gas marketers, are already recovered through rate mechanisms applicable to such customers. Adding the words in question to Section 1307(h) is likely to lead to confusion as to whether all of an NGDC's lost and unaccounted for gas must be recovered from PGC customers alone, a result which would create cross-subsidization and be patently unfair.

IV. CONCLUSION

EAP members fully support the promotion of competitive retail gas markets in a manner that is fair and balanced among all customers, and gas utilities have actively worked with the PUC and gas marketers to address legitimate concerns and to explore avenues to promote retail markets. EAP does not believe, however, that competitive retail markets should artificially be stimulated by placing inappropriate burdens on gas customers who elect not to switch after shopping or who cannot shop or elect not to shop. For the reasons stated above, EAP does not believe that the Gas Marketer Group proposed legislative revisions would promote retail markets in a fair manner which would protect and benefit gas customers.

