

Testimony of Matthew Sommer, Vice President, Shipley Energy Company, before  
the House Consumer Affairs Committee -- October 27, 2011

Good Morning, my name is Matt Sommer and I am Vice President of Natural Gas and Electricity for Shipley Energy Company, a supplier of natural gas to nearly 20,000 residential, commercial, and industrial customers of Columbia Gas of PA, UGI, and PECO. We have been active in these markets since the passage of the Natural Gas Choice and Competition Act and I appreciate the opportunity to speak to you today.

I am here to talk to you about improving the competitiveness of the natural gas markets in Pennsylvania for residential and small commercial customers. As you have heard, those markets have been open to competition for over 11 years, but the level of shopping still lags far behind electricity markets that, for the most part, have been competitive only for a few years. At a time when production of Marcellus Shale natural gas is expanding greatly in Pennsylvania, it would only make sense if residential and small business customers could better avail themselves of competitive pricing for natural gas purchases.

As my colleague discussed, there are certain precursors to competitive energy markets, many of which are being addressed by the PUC. However there remains one major stumbling block to natural gas competition that the PUC can't fix – the ability to make an apples to apples price comparison between the utility's price to compare and the supplier's offering. The reason why such a comparison is not possible has everything to do with the way that utilities are required to recover costs from customers through rates. I will try to explain how this current process creates a problem and then explain why our proposal will solve the problem.

**I. The Problem – Utilities do not charge the exact price of the gas at the time the customer uses the gas.**

It surprises many people to learn that the price they pay for gas can be changed, even a year after they used the gas, were billed for the gas, and paid for the billed gas! It also surprises people to learn that they can be charged six percent interest on the amount that the utility undercharged, and that it will take a full year to pay it back. The reason is a little complicated but stems from the requirement that natural gas utilities recover their gas costs on a dollar for dollar basis. That means that they have a right to collect the full amount they spend on gas, and only as much as they spend. If a natural gas utility collects too much, it must pay the money back with 8% interest, and if it collects too little – which is most often the case – it must collect more from the customers later, and must charge the customers 6% interest. This process is required by Section 1307(f) of the Public Utility Code. The extra amount that a utility must charge, or refund, is called the e-factor adjustment. You heard Bill Barkas talk about the fact that the price to compare presently does not reflect the fact that customers don't pay the true amount for the gas they use at the time they use it. And that is part of the problem. The other part of the problem is that the e-factor adjustment can often be a big number.

Gas utilities may adjust the c-factor, this is the gas cost charge, on a quarterly basis. What that means is that they look at the amount of gas they already have already purchased, and how much gas they expect to purchase in the future based upon how much customers are expected to use, and they figure in the price they expect to pay for the gas they need to buy, and based on all of that, the gas utility projects the price for the next 3 months. This projected price is called the c-factor.

The gas utilities also may adjust the e-factor quarterly, the e-factor looks backward and is intended to recover the dollars (or pay back the dollars) that result from the gas utility's prediction of future prices and consumption having been off the mark, or imprecise. However, the e-factor is always calculated to recover any balance over the next 12 months. When the PUC's regulations are final, the c-factor and e-factor will both be part of the price to compare.

It may be helpful to give you an example, so assume I am an XYZ default service gas customer. (This discussion is only about the gas costs, and does not address the delivery charges.) On January 15, I receive my gas bill from XYZ, they charge me \$5 per mcf and I use 20 mcf. So the commodity portion of my bill is \$100 ( $\$5 \times 20$ ). But, let's say for the sake of this example, that XYZ actually paid \$6/mcf for the gas. That means they estimated a dollar less per unit than the gas actually cost. So now there is an unrecovered balance of \$20 ( $\$1 \times 20$ ). That means I still owe \$20 ( $\$1/\text{mcf}$ ) for each mcf of gas I used in January, but I don't even know it until March (the end of the quarter). If January's scenario were to repeat itself each month for the next quarter, the unrecovered balance will grow to \$60. By the way, as this balance is growing, don't forget that I am being charged 6% interest on the balance, as required by Title 66. So, at the end of the quarter, XYZ says, "we need to true-up our e-factor". They do the math something like this, except they do it for all customers at one time—"this guy uses about 20 mcf per month, that equals 240 mcf per year, and he has an unrecovered balance of \$60 for the first quarter, so we divide the \$60 by the 240 mcf/per year, and we get .25/mcf." So, starting the next quarter, XYZ adds \$0.25 more to my e-factor charge. If this happened every quarter, you can see how the balance could get large. Another problem is that takes 2 or three months for the price signal, the \$1 price increase, to reach me. It also makes the gas I buy from XYZ look cheaper than it really is, and if I am like most customers, when I get my bill and see the e-factor adjustment, I won't know that it was for gas I already used.

Representative Payne is proposing to take the \$20 balance from the January bill, and divide it over the 20 mcf that I would be expected to use in the following month, and increase my e-factor adjustment for next month by only \$1/mcf. The balance would be retired by the end of the next month. That means better cash flow for the Gas Utility, since customers pay their outstanding amounts sooner, and it also means that I pay less interest. Another benefit is that my total price of gas at the time I use it more closely matches the full price XYZ paid for the gas. Under this proposal, XYZ also would be able to adjust my c-factor charge upwards if they believed that the

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As my colleague discussed, there are certain precursors to competitive energy markets, many of which are being addressed by the PUC. However there remains one major stumbling block to natural gas competition that the PUC can't fix – the ability to make an apples to apples price comparison between the utility's price to compare and the supplier's offering. The reason why such a comparison is not possible has everything to do with the way that utilities are required to recover costs from customers through rates. I will try to explain how this current process creates a problem and then explain why our proposal will solve the problem.

**I. The Problem – Utilities do not charge the exact price of the gas at the time the customer uses the gas.**

The problem is clear, and it starts with the way the e-factor is calculated. The calculation seeks to recover any over/under collection over a 12 month period and delays the collection up to three months. This stretched out and delayed collection tends to layer over/under collection balances on top of one another so that over time, the balance can grow quite large—due largely to the huge incentive to be under-collected. And while it is true that the dollar amount of the adjustment is changed quarterly, the calculation is still determined to recover the balance over the next 12 months.

## **2. The Solution**

Rep. Payne's legislative proposal does not change the fundamental concept that gas utilities make no profit on selling the gas commodity, which is why this reconciliation process is required. Rather, Representative Payne is proposing that the e-factor, the over/under collection charge, be adjusted on a monthly basis, so that the balance remains manageable and so that the balance can be collected in a single month. It also keeps the recovery of gas costs more current so that the resulting price to compare is more market relevant. Specifically, the calculation would seek to recover, in the coming month, the amount of over/under collection from the past month. This makes the e-factor more current, which means that the rate a customer pays on a monthly basis looks more like a market price and lessens the chance that a customer will have to pay interest on under collections, or that a gas utility will have to pay interest on an over collection—which at 8% is a pretty hefty penalty.

This change also will help to eliminate another problem called the Migration Rider, which allows gas utilities to collect the e-factor charge from customers for up to a year after they switch to a competitive supplier. As part of this change we are also proposing that gas utilities adjust their c-factor and the resulting PTC on a monthly basis – to further the goal of keeping the rate market relevant.

increased prices would continue. And lastly, this means that the price to compare ends up being that much more accurate when it is compared to a gas supplier's offer. So, customers can more easily shop competitively.

We looked at the e-factor adjustments for two gas utilities, as examples, and found that over the past 7 ½ years, the two gas utilities' e-factors were, on average, 10% of the actual gas costs. That means that customers were almost always being charged less than the actual cost of the gas at the time they used the gas. As a consequence, when a supplier such as my company makes an offer to a prospective customer, that customer will compare my price to a gas utility's Price to Compare, and the Price to Compare will appear to the customer to be lower than it should be, possibly 10% lower. The actual prices could be closer or further apart – but the problem should be obvious – if my price can beat the gas utility's actual cost, without Rep. Payne's legislation, how do I explain to the customer that switching to my service will save him or her money? The answer is that it is very difficult. The reason is that my price almost always looks higher than the utility's price, even though it not higher most of the time, and the customer does not know that the comparison with the utility's price is a false comparison – it is like comparing apples to oranges. Let me say this again – the customer does not realize that the price comparison, my price versus the PTC, is false.

In order for competition to work, customers need to know how to compare prices. Moreover, prices that are distorted cannot form the basis of an informed shopping decision. These same customers wouldn't drive into a gasoline station and fill their vehicle without knowing the price before the nozzle is put into the car, and they shouldn't be expected to buy natural gas without knowing the true and full cost at the time of consumption.

Making sure that the price to compare includes all the costs of providing the service, as the PUC has proposed in its regulations, is a good start, but it will only go so far. The distorting effect of large e-factors must be removed from the equation. An artificial 10% price differential is an almost impenetrable barrier to real competition.

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The goal here is for a customer who wants to shop to be able to easily look at an offer from a competitive supplier and compare that offer to a gas utility's price to compare, as an apples to apples comparison and without significant costs or fees that the customer does not see and that could impact the price looking forward. Allowing for simple apples to apples review based on one's gas utility bill and a gas supplier's offer is, we believe, a small, yet reasonable change to the Utility Code. We think our proposal will address this problem in a manner that is fair to utilities, to customers and to suppliers.

I welcome your questions and thank you for this opportunity.