

Prepared Comments of
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before the

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Introduction

Chairman Godshall, Chairman Preston, members of the Committee, I appreciate the opportunity to update you on the status of competitive natural gas markets in Pennsylvania. While competition is not increasing as quickly as we would like in the natural gas market, the Pennsylvania Public Utility Commission (PUC) remains committed to fostering the market and making improvements so that natural gas competition will succeed in the Commonwealth.

Background

Competition for natural gas supply has existed in Pennsylvania since 1999, when the Legislature enacted the Natural Gas Choice and Competition Act. Prior to the Competition Act, customers' gas was supplied and delivered by the local distribution company. With the restructuring of the natural gas industry, local distribution companies were required to unbundle their services into two parts: (1) the regulated distribution of gas, which the local distribution company continues to provide; and (2) the gas supply, which is open to competition.

As with the restructured electricity market, natural gas customers can only shop for the supplier of the commodity. They are still captive customers of the local distribution company for the delivery of their gas. This means that regardless of which customers ultimately purchase their gas from, the local distribution company is still responsible for safe and reliable gas delivery and responding to service interruptions and

outages. While the local distribution company usually collects a distribution charge from customers that reflects the cost of pipeline maintenance, billing, and customer service, it is prohibited from making a profit on the gas commodity itself.

If customers do not shop for a competitive natural gas supplier, they receive default supply service from their local distribution company. Under default supply service, customers pay a supply charge composed of a Purchased Gas Cost Factor (reflecting the cost of the physical gas), a Gas Procurement Charge (reflecting administrative costs for the utility to buy gas supplies), and a Merchant Function Charge (reflecting the utility's uncollectible accounts associated with gas supply service). Combined, these charges equal the "price to compare," which may be used as a benchmark for comparing default service with service from a competitive supplier.

The PUC's Role

The Competition Act required the PUC to issue a report to the General Assembly assessing the level of competition in the natural gas market five years after the effective date of the Act. In the October 2005 report, the PUC found that effective competition did not exist in Pennsylvania's retail gas market.¹ The PUC concluded that the number of suppliers and buyers in choice programs across the state was insufficient for effective competition and that the marketplace lacked accurate and timely price signals. The report noted that suppliers felt there were substantial barriers to market entry because of the

¹ *Report to the General Assembly on Competition in Pennsylvania's Retail Natural Gas Supply Market*, from the Into the Natural Gas Supply Market, Docket No. I-00040103 (Oct. 2005).

local distribution companies' differing and unnecessarily high security requirements, excessive and varying penalties for non-delivery, differing nomination and delivery requirements, and misleading price comparisons.

To address the issues identified in the report, the PUC convened a stakeholder group to explore avenues for encouraging increased competition in the retail natural gas supply market. The PUC directed this stakeholder group, known as SEARCH (Stakeholders Exploring Avenues for Removing Competition Hurdles), to develop recommendations for changes to the market structure to increase competition. Over the course of three years, SEARCH conducted an investigation involving stakeholders from all segments of the industry, including residential, commercial, and industrial customers, suppliers, local distribution companies, and pipeline companies.

PUC's Action Plan

On September 11, 2008, the PUC adopted a Final Order and Action Plan, based on recommendations from the SEARCH process. The Action Plan identified various measures that the PUC should take to reduce barriers to entry and change the structure and operation of the retail market to promote competition in natural gas supply. Since September 2008, the PUC has been working to implement the measures identified in the Action Plan.

As a first step in the Action Plan, the PUC formed the Office of Competitive Market Oversight (OCMO) within the Commission. OCMO was created to provide an

informal forum for addressing obstacles encountered by suppliers and for resolving disputes that arise between suppliers and local distribution companies. Since its creation, OCMO has met with natural gas stakeholders to develop interim guidelines governing the marketing practices of natural gas suppliers and has worked with individual suppliers to address concerns that have arisen in the market, including the sharing of customer information between suppliers and utilities and the accurate and consistent presentation of prices in marketing materials, disclosure statements, and bills.

Rulemaking 1: Promotion of Competitive Retail Markets

The PUC also proposed three rulemakings in its Action Plan. The first rulemaking, initiated in December 2008, changed the requirements for marketer licensing and revised the consumer protection guidelines in the purchase of receivables programs.² Specifically, the rulemaking proposed to allow marketers to use accounts receivables in purchase of receivable programs to fulfill some or all of their security requirements. The rulemaking also specified certain language for the financial instruments used for security and developed reasonable criteria for local distribution companies to use in setting the amount of security a supplier must have to maintain its license. These revisions sought to better balance the ability of suppliers to provide adequate security to maintain its licensed status with the local distribution company's risk of financial loss in the event of supplier default.

² In these programs, the local distribution company purchases the receivables from suppliers, making the local distribution company responsible for billing the customer, collecting payment, and then reimbursing the marketer, even if the customer does not pay.

After reviewing comments, the PUC adopted a final rulemaking on these issues on June 16, 2010. The Independent Regulatory Review Commission (IRCC) approved the rule on November 4, 2010, and the final regulations became effective on January 1, 2011.

Rulemaking 2: Competitive Supplier Licensing

The second rulemaking proposal, issued in March 2009, reformulated the “price to compare” used by consumers to determine whether prices from competitive suppliers are better than the price for default service from the local distribution company. This change was designed to promote competition by providing consumers with more accurate and up-to-date information about the rate they would pay a supplier compared to the rate offered by the local distribution company.

The rulemaking also proposed to make permanent rules for establishing voluntary purchase of receivables programs and set guidelines to ensure that the release, assignment, or transfer of capacity to competitive suppliers is non-discriminatory as to availability and price. Additionally, to ensure that local distribution companies are able to recover costs related to improving the competitive market, the rulemaking proposed changes to the handling of the recoverable costs related to competition activities and regulatory assessments.

After reviewing comments, the PUC adopted an advance notice of final rulemaking in August 2010 and, due to substantial changes from the proposed rule to the final rule, the PUC solicited further comments. After reviewing these comments, the

PUC adopted a final rulemaking order in February 2011. The rule was then reviewed by the IRCC, and after certain revisions, the PUC adopted a revised final rulemaking order in June 2011.

Rulemaking 3: Business Practices

The third rulemaking, released for comment in April 2009, establishes a common set of business practices for local distribution companies in an effort to attract more supplier participation in the competitive market. These standards are designed to govern the business relationship between local distribution companies and competitive suppliers with respect to financial transactions, communications, and data exchange.

The proposed rulemaking directs local distribution companies to submit standard coordination tariffs and implement uniform operational rules for the management of gas on the system, particularly with respect to imbalance trading, tolerance bands, cash out and penalties, nominations and capacity. The rulemaking also establishes a working group to develop and implement communications standards. The use of a common set of business practices and supplier coordination tariffs will not only facilitate the entry and participation of more competitive suppliers in the retail natural gas supply market, but will also increase efficiency in industry operations.

The PUC is currently in the process of finalizing this rulemaking, which should be completed within the next few months.

Today's Market

The passage of the Competition Act has not generated the levels of competition in Pennsylvania's natural gas market that the PUC envisioned. Pennsylvania has seen success on the commercial and industrial side of the market, though few natural gas suppliers are marketing to residential customers. While there are over 100 natural gas suppliers licensed to do business in Commonwealth, as of July 2011, only 11 suppliers are making competitive offers to Pennsylvania's residential customers.

Based on the most recent statistics published by the Office of Consumer Advocate, only 8 percent of residential customers have switched to a competitive natural gas supplier.³ While this number is certainly low, it does represent a slight increase from the past two years, where residential shopping numbers remained around 7 percent. It is possible this uptick is related to a renewed interest in competition spurred by the recent expiration of rate caps in the restructured electricity market. With so many of Pennsylvania's electric customers saving money by choosing an alternative generation supplier, gas consumers may try to realize similar benefits by switching to a competitive natural gas supplier.

The PUC intends to take advantage of any renewed interest in competitive markets to encourage growth in the natural gas market. The PUC is making progress on the Action Plan's last rulemaking and hopes to issue a final rule within the next few months.

³ PA Office of Consumer Advocate, *Pennsylvania Natural Gas Shopping Statistics* (July 1, 2011) (http://www.oca.state.pa.us/Industry/Natural_Gas/gasstats/gstats0711.pdf).

This rulemaking will make some of the largest adjustments to the market structure that the PUC has undertaken to date. I am confident that the issuance of this final rule will create a more level playing field for suppliers and remove some important barriers to market entry. Hopefully, this last round of rule changes will have a positive impact on the natural gas market and trigger robust competition.

As part of our ongoing efforts to grow the market, the PUC is also in the process of creating a page on its website to provide information on natural gas choice. This webpage will assist consumers in understanding how to compare prices and shop for natural gas supply. Through our efforts with www.PAPowerSwitch.com, the PUC has discovered the importance of providing a central resource for customers to gain access to information about shopping for an alternative supplier and realizing the benefits of competitive markets.

Despite these efforts by the PUC, there is no denying that competition in the natural gas market is lacking. And, with gas prices as low as they are, it is even more difficult for suppliers to break into the market.

However, the PUC is steadfast in its commitment to competitive markets. I believe that competition produces greater efficiency, more innovative product offerings, and generally lower prices for consumers. With this in mind, the PUC will continue to strive for a more fully competitive natural gas market.

Thank you again for the opportunity to speak about this important issue. I am happy to answer any questions you may have.