Before The
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Investigation into Competition in the Natural Gas Supply Market
Docket Number I-00040103

Comments of Amerada Hess Corporation

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Introduction

Pursuant to the order in Docket No. I-00040103 issued by the Pennsylvania Public Utility Commission ("Commission" or "PUC") on May 27, 2004, Amerada Hess Corporation ("Hess") hereby submits comments on the state of competition in the Pennsylvania natural gas market. Over the past five years, for the most part, the natural gas market in the Commonwealth of Pennsylvania ("Pennsylvania" or "The Commonwealth") has been open to competition and customers have been able to reap the benefits of that competition. Nevertheless, over that period, Hess and other market participants have seen a number of lessons learned based on extensive experience within Pennsylvania and in other states on the East Coast of the United States. Hess urges the Commission to give careful consideration to the comments submitted in this investigation in order to improve the natural gas programs based on best practices in and around Pennsylvania.

Hess and other marketers have a strong interest in supplying and marketing natural gas service to commercial and industrial ("C&I") customers in the Commonwealth. However, in order to ensure that this market offers sufficient opportunity to enough marketers to provide for a robust competitive market, a number of barriers must be removed, particularly with regard to enforcement of the Standards of Conduct and utility Agency Programs. Moreover, there are a wide variety of operational best practices identified for implementation. These best practices will be outlined further throughout these comments, and will address such areas as:

A. Volumetric tolerances

B. Cashout and penalty rates

C. Pooling regulations and imbalance trading

D. Telemetry utilization and cost

E. Data accuracy, availability and timeliness

Hess appreciates the Commission's attention to these important issues and looks forward to working with the Commission, the Consumer Advocate, the Office of Small Business Advocate, utilities, and other market participants to improve conditions in the Pennsylvania natural gas market for the ultimate benefit of Pennsylvania's natural gas customers.

<u>Overview</u>

As one of the largest competitive suppliers of natural gas in the Commonwealth, as well as in many other states on the East Coast, Hess speaks from experience in terms of the various issues we will outline throughout these comments. Hess has found that while the Pennsylvania market has offered opportunity for customers to shop for competitive natural gas supply, there remains a number of impediments to market growth, and marketers have found it inefficient to operate within a number of local distribution company ("LDC" or "utility") territories. C&I customers in particular have displayed a growing interest in shopping for natural gas supply and Hess has developed strong, long-term relationships with its customers over the past five years. Customers have benefited from competitive prices, as well as a number of services provided by natural gas suppliers that were not previously available through monopoly utility service. For example, suppliers now offer a number of pricing options, including fixed pricing, that give customers a wide variety of options to best fit their individual business needs.

Nevertheless, despite the obvious advantages of competition for customers, there remain a number of substantial issues in the competitive market. Many of the issues Hess will outline below result in barriers to entry for new marketers, an inability for marketers that currently serve in some utility territories to remain in those territories or to enter other LDC territories, and operational inefficiencies, all of which translate into increased costs for customers. As the next logical step in this investigation Hess respectfully requests that the Commission initiate a process in which market participants would work together to delve further into these issues; identify solutions; and implement changes to mitigate and/or eliminate these barriers and operational issues in order to enhance the competitive natural gas market in the Commonwealth. It is only through the efforts of all interested parties, in cooperation with the Commission that a robust competitive market can and will be established.

Comments

Affiliate Standards of Conduct

One of the most significant barriers faced by marketers in Pennsylvania is the advantage utility affiliates have over unaffiliated natural gas suppliers. Although the Commission has worked diligently to establish a set of well-crafted Affiliate Standards of Conduct ("Standards") designed to prevent utility affiliate advantages, Hess has serious concerns about the effectiveness of these restrictions largely because they do not include adequate reporting, audit or enforcement measures necessary for ensuring compliance. The Commission should require effective reporting and scrutiny, beyond the simple filing of a log for those utilities with affiliated suppliers. Of particular interest should be when the LDC has considerable discretion in the administration of its programs and instances when the affiliate has a much greater market share within its affiliated LDC's territory than in other LDCs areas where it operates. Examples of these discretionary programs would include: decisions on when to release capacity to a marketer; daily balancing requirements that can be waived; requiring gas to be brought in on certain pipelines and not accepting deliveries on other pipelines; decisions on when to interrupt interruptible customers; decisions when to recall released capacity; or decisions on who to give discounted transportation rates. These and other discretionary decisions that certain LDC's have can significantly affect any marketers' costs to serve its customers and can be implemented in a way that gives preference to an LDC's affiliate.

The Standards are also deficient, and must be improved upon in order to ensure that discretionary programs, such as those referenced above, are not implemented in a manner intended to benefit the LDCs affiliates, because they lack restrictions on sharing of information by suppliers with their affiliated LDC's. Section B(8) of the Standards restricts the LDC's from sharing customer proprietary information with their affiliated suppliers, but there is no restriction on the suppliers sharing information with their affiliated LDC. Without such a two-way restriction, the affiliated suppliers are free to supply information to their affiliated LDC having the potential to improperly affect operational decisions of the affiliated LDC, or inappropriately influencing the LDC's decision to take action on the above referenced discretionary programs, in such a way that it specifically benefits the affiliated supplier.

Although the Standards specifically prohibit utilities from offering preferential treatment to customers of their affiliates over customers of unaffiliated suppliers, a particular area of concern is the LDC's discretionary granting of distribution rate discounts. The Binding Interim Standards provide as follows:

> If an natural gas distribution company provides a distribution service discount, fee waiver or rebate to its favored customers, or to the favored customers of its affiliated natural gas supplier, the natural gas distribution company shall offer the same distribution service discount, fee waiver or rebate to other similarly situated customers. Offers shall not be tied to any unrelated service, incentive or offer on behalf of either the natural gas distribution company or its affiliated natural gas supplier...[1]

These standards are currently in effect and are mirrored in the Proposed Rulemaking Order for Permanent Standards of Conduct published April 17, 2004 in the Pennsylvania Bulletin.[2]

It is important that an effective reporting and enforcement mechanism be provided so that customers of the LDC are not left with the perception that greater discounts are available if they purchase gas from the LDC's affiliate. As stated in the Binding Interim Standards, utilities are required to <u>offer, and not simply make available upon request,</u> distribution service discounts to similarly situated customers. To our knowledge, there is no way for a customer or supplier to insure that this occurs because some LDCs require customers to sign a confidentiality agreement regarding their distribution charges. Customers are also disadvantaged by

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[1] Binding Interim Standards of Conduct Pursuant to 66 Pa. C.S. § 2209(a), Annex A at § B(7), Docket No. M-00991249 F0004, Final Order entered March 30, 2000.
[2] Proposed Rulemaking, Permanent Standards of Conduct, Docket No. L-00030162, 34 Pa. B. 2071 (April 17, 2004), Annex A (proposed 52 Pa. Code Ch. § 62.142(a)(7)).

confidentiality as they are unable to determine whether they are in fact receiving the rates that other similarly situated customers have received.

It is not clear why this information should not be publicly available since any discounts should be applied uniformly. However, if the Commission deems there to be a valid business reason, then, at a minimum, LDCs should be required to:

A. Define the criteria to be used in determining whether customers are similarly situated with one another; and

B. Report all discounts granted, as required in the Standards, but also identification of the marketer serving the discounted customer, and certification that all similarly situated customers have been proactively offered the same discount.

Agency Programs

Another concern similar to affiliate abuse is the operation of Equitable Gas Company's Agency Program. Through its Agency Program, Equitable is able to offer discounted distribution rates to customers if Equitable is faced with the prospect of losing the customer's business to another utility. Hess is aware that Equitable offers these discounts due to the competition they face from other LDCs that are building distribution pipelines to directly compete for the same customer. The lack of defined franchise territories is the largest contributing factor in this competitive situation among utilities and is a model nearly unique to Pennsylvania as compared to other states on the East Coast. However, within the confines of this current model, the Agency Programs have not only allowed LDCs to compete with one another for distribution services, but they have also resulted in unfair competition between LDCs and the marketers serving customers on their distribution systems.

For example, Hess has been faced with competition from Equitable Gas as Equitable has attempted to compete with efforts by People's Gas to build pipelines to serve Equitable's customers. Hess has no quarrel with Equitable's right under its Agency Program to offer discounted distribution rates in order to counter the offers made by a competing LDC in its territory. However, the Agency Program tariffs are written with such vague language as to the purpose of the program and the types and levels of discounts that can be offered, that Equitable is free to offer not only discounted *distribution* rates, but discounted *commodity* rates as well. Such offerings do not serve merely to provide a competitive edge against the competing LDC, but also provide a decided advantage against marketers serving customers in Equitable's territory. Hess has faced situations in which a customer was offered discounts only if a bundled supply was purchased from the utility. This requirement is inappropriate and flies in the face of the letter and spirit of the Standards of Conduct, particularly as these Agency Programs exist outside the bounds of the Standards' coverage. If the discount applies to distribution rates then it should be available whether the customer purchases the commodity from the utility or a marketer. Any discount on commodity in all likelihood is being subsidized by other customers through the operation of the utility's gas cost recovery mechanism.

Hess respectfully requests that the Commission require Equitable to revise its Agency Program tariffs to limit agency program discounts to discounts on distribution rates only and to expressly prohibit utilities from discounting commodity rates, which results in increased costs to other customers.

<u>Operational Rules</u>

There are a number of operational issues that need to be addressed in various LDC programs throughout the Commonwealth. While these issues are too numerous and detailed to include in this document, we will provide an overview of some of the issues with an example. In addition, in order to better illustrate the wide variance in operational rules from one utility to another in Pennsylvania, attached as Appendix A is a comparison of each LDC on the issues outlined below.

Volumetric tolerances. Each LDC establishes a tolerance band within which marketers must balance their customer pools in order to avoid penalties. Tolerance bands that are too restrictive not only act as an overly conservative means of managing marketer behavior, but also unfairly penalize marketers that *do* perform well by any other standard, but cannot possibly predict customer consumption within the percentage established by the LDC tariff. Hess contends that LDCs cannot predict consumption, and therefore balance, as well as they are requiring marketers to do. Moreover, penalties outside these tolerance bands should be based on market rates with <u>reasonable</u> multipliers to prevent gaming of the system and significant penalties only during periods of critical gas supply concern.

For example, Equitable provides a very small tolerance band, only 2.5%, for imbalances. Best practices would dictate a tolerance band of +/-10%.

Cashout and penalty rates. Outside the tolerance bands established by the utilities, imbalances are cashed out to balance the marketer's pool to zero. Cashout prices and penalties must be fair so that amounts to deter gaming do not become punishments for reasonable marketer performance. For example, Columbia Gas of Pennsylvania ("CPA") uses an average of 10 consecutive days of the high/low prices in *Gas Daily* or else the high/low of the LDC's commodity price, for cashouts of overdeliveries/underdeliveries, respectively. The LDCs should cash out imbalances within the tolerance band of +/-10% at 100% of the Gas Daily Average ("GDA") at the appropriate index for that pool's area. Outside the tolerance band, a multiplier of 90%/110% for overdeliveries/underdeliveries of the GDA at index is adequately punitive, except during critical periods.

Pooling regulations and imbalance trading. While most utilities balance all customers on the same monthly schedule so that all customers within an LDC's territory are permitted to imbalance trade with one another, UGI balances its customers on varying monthly schedules and utilizes more than 20 different pools. This large number of pools, which are not permitted to trade with one another, allows UGI to collect cash out penalties regardless of whether its overall system was negatively affected. That is, the UGI system as a whole may have been in balance and therefore not incurred any costs, but due to individual pool imbalances that cannot be netted, UGI is collecting penalties without offering any reasonable method for those penalties to be avoided. This cumbersome and inefficient system also acts as a barrier to entry for new marketers with a small number of customers who do not have adequate customer diversity within any one pool to be able to avoid costly penalties and cashouts. This practice gives larger established marketers an unfair competitive advantage. The separate pooling within the interruptible pool should be eliminated and all customers should be put into the same operating pool. Of the forty-six utilities in whose territory Hess operates, UGI is the only one that has this segmentation of customers.

Telemetry utilization and cost. Implementation of telemetry for the reading and transmission of customer consumption data is imperative to ensure accurate balancing and billing. Use of this technology assists in keeping customer natural gas costs down. Marketers serving customers behind CPA have complied fully with the metering requirements imposed by CPA and yet telemetry has still not been implemented. This technology is particularly important in the CPA territory as Operational Matching Order ("OMO") customers must have deliveries matched to customer consumption in order to avoid penalties. Without telemetry, accurate matching is extremely difficult if not impossible to achieve. The Commission should require LDCs to install telemetering equipment for all customers where the daily balancing of deliveries and usage is required by the LDC because this technology facilitates the acquisition of accurate consumption information thereby permitting marketers to effectively balance customer pools and reduce costs associated with cashouts and penalties.

Data accuracy, availability and timeliness. Accurate and timely data is extremely important if a marketer is to effectively balance customer pools and keep costs at a minimum both for itself and for the customers. Hess has experienced difficulties with several utilities in terms of the amount of time it takes to get consumption and other customer data from the LDCs so as to ensure that data received is accurate. Moreover, automation improvements are needed in automating the transmission of data between LDCs and marketers.

On certain LDC's, data is frequently inaccurate when reporting Hess' imbalance position for the month. Very often, we do not discover the error until after the expiration of the trading period so that we are unable to make the correct trades to avoid penalties. In addition to the penalties incurred due to this inaccurate data, additional negative monetary impacts occur when we are forced to buy or sell gas at unfavorable prices in order to balance the pool unnecessarily due to faulty data. These costs unavoidably factor into customer prices. Procedures should be put in place to ensure that marketers are not penalized when bad data is supplied by the LDC.

Hess can provide additional specific examples of each of the above and would gladly discuss these details with staff and any interested parties. In an effort to improve the competitive market in Pennsylvania, Hess requests that the Commission establish working groups among all interested parties with the goal of streamlining and improving the operating rules in each utility.

Performance Based Rates

There is no current incentive for LDCs to work cooperatively with marketers to facilitate an efficient robust competitive market; but it should be their duty to do so. Hess proposes that the Pennsylvania LDCs be rated by marketers and transportation customers on areas such as those raised herein. LDC's receiving low ratings would be identified for Commission overview of their program. This type of incentive would encourage greater cooperation between LDCs and marketers to resolve the issues outlined in these comments as well as many others. The ultimate beneficiaries of these improvements would be the natural gas customers of Pennsylvania.

Conclusion

For the reasons cited above, Hess requests that the Commission take the following actions:

A. Initiate a process in which market participants can work together to delve further into the operating issues identified above; identify solutions; and implement changes in order to enhance the competitive natural gas market in the Commonwealth;

B. Put in place adequate reporting and monitoring requirements to ensure that the Standards of Conduct are complied with, particularly that all discounts offered to customers of LDC affiliates are offered to similarly situated customers of non-affiliated marketers;

C. Invalidate the confidentiality provisions of LDC contracts with customers to the extent that they prohibit discussion of distribution rate discounts. In the alternative, require LDCs to define the criteria for determining whether customers are similarly situated, to report all discounts, and to certify that all similarly situated customers have been offered the same discount;

D. Require Equitable to revise its Agency Program tariff to limit agency program discounts to discounts on distribution rates only and expressly prohibit Equitable from discounting commodity rates; and

E. Implement a system for marketers and transportation customers to rate each LDC regarding the implementation of its transportation program in order to provide guidance to the Commission as to where a program review would be appropriate. This rating system would also provide an indirect incentive to the LDC to develop and implement its program in a reasonable manner.

The Commonwealth of Pennsylvania has made progress toward its goal of a robust competitive natural gas market and should be commended for taking an interest in the current state of the market five years after its inception. There is still much work to be done in order to fully provide the benefits of competition to the natural gas customers of Pennsylvania. Nevertheless, the issues Hess has outlined, and the solutions we have suggested are easily addressed with the support of the Commission and the cooperative efforts of all market participants, most particularly the LDCs and the natural gas suppliers, both existing and those interested in commencing service to Pennsylvania customers. Hess looks forward to further discussions with the Commission, its staff and these market participants to resolve the issues we have raised in these comments.

EXHIBIT A

PA Utility Comparison

Utility	Balancing Type (Daily, Monthly, Both)	Cash Out/In Methodology	Imbalance Trading	Imbalance Fees	Telemetry	Storage	Pool vs Direct Serve	Pool Tolerance
Columbia of Pennsylvania	Monthly	Lowest/highest Gas Daily tiered	Limited - following month	\$0.07/Mcf - \$500 Max	Few customers	No	Both	Total of customers' chosen tolerances w/in each pool
Dominion Peoples	Monthly, Daily Choice	Lowest/highest price utility paid	Yes-limited trade partners	\$0.04/Mcf - \$100 Max	Some customers	Yes	Both	3.5% of supply
Equitable	Monthly	Lowest/highest price utility paid	Yes	\$0.01/mcf	No	No	Both	2.5% of total pool consumption
PECO	Both	Short: PECO sales rate per dth when out of tolerance; Long: Carries over with tiered penalty	Yes - 300 dth min per day	None	All customers	No	Direct	Daily Long: greater of 10% or 50 mcf of customer's TCQ; Daily Short: greater of 10% or 100 mcf of customer's TCQ after bank has been fully utilized; Monthly Tolerance: sum of customer's TCQ
Penn Fuel	Both	Lowest/highest Gas Daily tiered	No	N/A	All customers	Yes	Pool	Daily: based on 5% of deliveries (Penalty: \$0.25/dth); Monthly: pool cashed-out to 0 at end of month
PG Energy	Both	Tiered: Short - Based on LDC average commodity costs for gas; Long - Based on customer sales rate	No	N/A	All customers	Yes	Direct	Daily: based on +/- 2.5% of customer usage; Monthly: Based on 2.5% of contracted monthly mcf
UGI	Both	Average of Henry Hub index plus LDC Transport Rate at tiered levels	Limited to pool with same cycle end dates	\$0.25/mcf	Most customers	No	Direct	Daily: based on No Notice Allowance purchased by customers; Monthly: based on 10% of pool deliveries
Valley Cities	Daily/Nov. - Mar. & Monthly/Apr. - Oct.	Tiered: Based partly on Valley Cities cost of supply and published price from Nat. Gas Week for TGPL and Tetco	Yes	None	All customers	No	Pool	Daily: from Nov. - Mar. must be within -2.5% and +10% of usage; throughout the year, pool is cashed-out to 0 at end of month