BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Investigation into Competition	:	Docket No. I-00040103
in the Natural Gas Supply Market	:	

COMMENTS OF THE
OFFICE OF CONSUMER ADVOCATE

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APPENDIX A

I. INTRODUCTION

On May 28, 2004 the Commission entered an Order opening an Investigation into Competition in the Natural Gas Supply Market. ("May 28 Order"). This investigation was launched in accordance with Section 2204(g) of the Natural Gas Choice and Competition Act ("Act") which requires the Commission to initiate an investigation or other appropriate proceeding to determine whether effective competition for natural gas supply services exists in Pennsylvania. 66 Pa.C.S. §2204(g). The Act requires the Commission to conduct such an investigation five years after the effective date of the Act and to report its findings to the General Assembly. *Id.*

The Act was passed in 1999 and required each Pennsylvania Natural Gas Distribution Company ("NGDC") to open up its service territory to natural gas supply retail choice. Prior to passage of the Act, retail choice was only available to residential and small commercial customers through pilot programs in the service territories of several NGDCs in western Pennsylvania. Natural gas transportation programs for industrial and large commercial customers had generally been available in all of the NGDC service territories throughout the Commonwealth for many years prior to the Act. The Office of Consumer Advocate ("OCA") has generally been supportive of making retail choice available to residential customers and was an active participant in all of the NGDCs' restructuring proceedings that took place during 1999 and 2000.[1]

The 1999 natural gas legislation came on the heels of, and was in large part based on, the legislation passed by the General Assembly in 1996 to restructure the Pennsylvania electric industry. In both cases, a major thrust of these restructuring statutes was to "unbundle"

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[1] Pursuant to Section 2212 of the Act, retail choice did not have to be offered in the service territory of Philadelphia Gas Works ("PGW") until September 1, 2003. The OCA was an active participant in the restructuring proceeding of PGW during 2002 and 2003.

the rates of our electric and natural gas companies so that retail customers would have greater access to competitively priced electric generation and natural gas commodity service. Significantly, in both cases, retail customers retained the option of continuing to purchase electric generation ("Provider of Last Resort") or natural gas commodity service ("Supplier of Last Resort") from their incumbent electric or natural gas distribution company. To the extent that unregulated suppliers were able to offer electric generation or natural gas commodity service on more attractive terms, retail customers were free to select one of those suppliers, and the incumbent utility was required to distribute the unregulated supply service to the customer through its regulated electric distribution lines or natural gas pipes.

It is important to consider that the Commission is undertaking this review during a period of significantly increased wholesale natural gas prices and price volatility compared to the 1998-1999 period when retail gas competition was adopted and implemented. Natural gas was trading at the Henry Hub at approximately $2/MMBtu in 1999, yet has fluctuated widely up to $10/MMBtu in January 2001, down to slightly over $2/MMBtu again in January 2002 and then a steady increase to over $5/MMBtu in 2004. Natural gas traded on the spot market in the second half of 2000 at a price that was more than four times higher than the 1998 and 1999 prices. Most observers predict that natural gas prices will remain relatively high and that spot market prices will average over $5/MMBtu for the long term. This significant increase in spot market natural gas prices has impacted retail natural gas competition, particularly for residential and small commercial customers, and should be taken into account in the Commission's evaluation and recommendations for the future of natural gas competition in the Commonwealth.

The OCA has been closely following the development of retail choice for natural gas supply in Pennsylvania by compiling natural gas shopping statistics and preparing shopping guides to assist customers in making informed choices about their natural gas supply service. In reality, despite some early interest in retail choice, the vast majority of residential natural gas customers in Pennsylvania continue to purchase their natural gas supply from their incumbent NGDC. The following chart sets forth the number and percentage of residential natural gas customers who were being served by Natural Gas Suppliers ("NGSs") as of July 1, 2004:

PA Gas Switching Statistics as of 07/01/04			
Company	**Total Residential Customers**	**Residential Customers Served by Alternative Suppliers**	**Percent of Residential Customers Served by Alternative Suppliers**
Columbia Gas	343,706	74,918	21.8
Dominion Peoples	329,091	86,614	26.3
Equitable Gas	240,660	19,902	8.3
National Fuel Gas	199,904	0	0
PECO Gas	418,168	1,732	0.4
PG Energy	140,530	0	0
PGW	481,000	0	0
PPL Gas	65,796	0	0
TW Phillips	55,437	0	0
UGI Gas	268,391	2,995	1.1
Valley Cities	4,655	0	0
Totals	**2,547,338**	**186,161**	**7.3**

As shown in this chart, nearly all of the residential retail choice activity has occurred among the customers of three western Pennsylvania-based NGDCs – Columbia,[2] Dominion Peoples, and Equitable. A primary reason for this appears to be the fact that these companies already had substantial retail choice "pilot" programs ongoing well before the 1999 Act was passed. During those pilot programs, customers who switched from their NGDC to an alternative gas supplier were exempted from paying the then-applicable 5% gross receipts tax on their monthly gas bills. In the 1999 legislation, however, this advantage was eliminated because

[2] In addition to serving customers in western Pennsylvania, Columbia also serves customers in several counties in southcentral Pennsylvania.

the General Assembly eliminated the gross receipts tax on ***all*** natural gas service, including gas supply service provided by the NGDC.

As explained below, the results of the implementation of retail choice for residential customers has been mixed. There has been virtually no retail choice activity for residential customers in the natural gas service territories in the eastern part of Pennsylvania. Even among the three western Pennsylvania gas utilities, the number of customers served by NGSs has decreased by about 20% since the beginning of 2001.

In general, residential customers have been and likely will continue to be slow to change to alternative suppliers for many reasons. There are customers who are unwilling or reluctant to make any change, and others who may believe that the savings on the bill would be too small to undertake the complicated comparisons and choice. Furthermore, there are relatively few natural gas suppliers actively marketing to residential customers – even in those NGDC service territories with higher shopping levels. In some NGDC service territories there are no marketers making offers at all. In those service territories where there is retail choice activity, the level of supplier interest has been hard to retain from year to year during the period that retail choice has been in effect. Marketers have moved in and out of the residential market and some have abruptly exited the market. This lack of consistent options in this market has made it difficult to educate consumers about making choices and has made it difficult to realize the potential benefits of natural gas customer choice.

Even in those service territories where there has been some level of retail choice activity for residential customers, it is not clear whether those consumers are receiving significant sustained benefits. In those service territories where there has been substantial numbers of residential customers participating in retail choice, the trend appears to be toward those customers returning to their NGDC for natural gas supply service.

The OCA would note that the relatively low numbers of Pennsylvania residential customers who have opted to take natural gas supply service from an alternative supplier is also a reflection of how difficult it is for many residential customers to shop for natural gas supply service. Customers must first make a determination of what they are paying for that portion of their natural gas supply service that is subject to competition, *i.e.*, the "price to compare." Even though the price to compare is generally available from the NGDC, or from other sources such as the OCA Shopping Guides, it is still no easy task for a typical residential customer to make a comparison of an NGS offer when the NGDC's price to compare changes on a quarterly basis. This is especially true when it can take up to 45 days or more for a switch to an alternative supplier to take place. In the interim, a quarterly update by the NGDC could turn what looked like a good deal into a bad deal before the term of the new contract with the NGS even commences. Such situations lead to customer confusion and frustration with the retail choice process. Such problems are not as prevalent in the electric choice programs, since the electric generation "price to compare" is set on an annual basis and has generally been determined well in advance. This makes it easier for customers to shop and make meaningful comparisons to offers in the competitive market. In addition, electric distribution company generation rates are not reconcilable for over- and under-recoveries and are not subject to migration riders as is the case for natural gas supply service.

Furthermore, it is not clear that there is substantial interest on the part of NGSs to serve residential customers in Pennsylvania. NGSs may find that residential choice customers are difficult to serve for a myriad of reasons, including acquisition costs, load factors, credit risk, and other reasons. This may be particularly true for low-income and payment troubled customers.

With this background, the OCA submits that the focus of this investigation should not be solely on efforts to increase the level of retail choice activity in Pennsylvania. While encouraging the benefits of increased retail choice is an important goal in this investigation, it is equally important to ensure that consumers are not made worse off by the single-minded pursuit of this goal. The intent of the Act was to provide benefits to consumers by introducing retail choice to Pennsylvania, not to harm them by increasing natural gas cost rates and volatility or diminishing service and reliability.

The OCA strongly urges the Commission to steer away from proposals for residential customer choice that would increase costs to the customers as a means of encouraging switching. These models offer little in the way of positive benefits for consumers and treat switching as an end, rather than as a means to lower rates and reliable service.

Many customers have already made their choice, and that choice is to continue to purchase natural gas supply from the incumbent NGDC. Since this is currently the vast majority of residential customers in Pennsylvania, it is essential that the Commission ensure that NGDCs continue to provide safe, adequate and reliable natural gas sales service at the lowest cost possible. Furthermore, the Commission should continue to urge utilities to engage in purchasing practices that will enable NGDCs to provide some price stability that will assist customers in budgeting their household expenses. Stability in rates and customer bills will lead to better payment practices and fewer uncollectibles.

As subsequently discussed, there are several things that could be done to improve the operation of Pennsylvania's natural gas choice programs that reflect Pennsylvania's five-year experience, as well as the experience in other states. These measures could increase the potential for residential consumer benefits from these retail choice programs. However, the emphasis should remain on maintaining least-cost, reliable service for all customers, including those customers that continue to receive natural gas supply service from their NGDC.

II. RESULTS OF GAS RETAIL CHOICE FOR RESIDENTIAL CUSTOMERS IN PENNSYLVANIA

A. Summary Of Current Retail Activity In Pennsylvania.

In Pennsylvania, natural gas customer choice results in the individual NGDC service territories have been mixed. In some NGDC service territories, there is currently no retail choice activity for natural gas supply service. In those areas, there are no customers participating in customer choice programs, and no suppliers appear to be soliciting customers (T.W. Phillips, NFGD, PPL, PG Energy, PGW). However, in certain other NGDC service territories, there is some participation in customer choice programs. (Columbia, Dominion Peoples, Equitable, UGI and PECO). However, several of these companies have choice programs that have very low levels of participation. For example, to OCA's knowledge, only one supplier is soliciting residential customers in UGI's service territory, and only a few thousand customers have elected to purchase service from that supplier.

Several NGDCs in the Commonwealth initially experienced significant levels of participation in their customer choice programs. In the early stages of customer choice, Dominion Peoples, Columbia and Equitable had participation rates of up to 30 percent of their residential customers. However, today, those participation levels have declined significantly as have supplier marketing efforts.

For example, as of July 2002, the rate for residential customers ("price to compare") of Columbia Gas of Pennsylvania ("Columbia") was 47.03 cents per ccf. There were four NGSs making offers to residential customers for both fixed price and variable price products at that time. There was only one variable price offer being made at the time that was less than Columbia's price to compare. The fixed rate offers were for a term of 1 or 2 years and reflected a higher price than Columbia's price (which is subject to change four times per year). This premium varied from two cents to ten cents per ccf for the fixed rate NGS offers. For Dominion Peoples' customers, there were two NGSs offering services to residential customers, but the price premium for fixed rate offers for that service territory was significantly above the Dominion People's quarterly price to compare. There was only one marketer seeking residential customers in the service territories of Equitable Gas and UGI, and none for National Fuel Gas, PECO Gas, PG Energy, PPL Gas, TW Philips.

In December 2002, this pattern was replicated, with the exception of one NGS seeking PECO Gas residential customers, but at a significantly higher price for monthly variable service. At that time, the prices offered by three of the four NGSs to Columbia's residential customers were higher than Columbia's price to compare even for variable rate offers and much higher for fixed rate offers.

In early 2003, the Commission reported that there were 78 licenses issued to NGSs. Only a handful of those were actively serving residential choice customers. The most recent information in the OCA's Natural Gas Shopping Guide issued in August 2004 shows that there are four NGSs still making offers to residential customers in Columbia's service territory, one for Dominion Peoples, one for PECO Gas, one for UGI Gas, and none for Equitable Gas, National Fuel Gas, PG Energy, PGW, PPL Gas, or T.W. Phillips. With respect to the Columbia service territory, several offers for variable rate products at less than the current Columbia Gas price to compare are available and three of the four NGSs are offering a fixed price service at less than the current price to compare. However, the scope and variety of these pricing options from multiple marketers are not available in any other NGDC service territory for residential customers. There is currently no information that has been compiled in Pennsylvania that sets forth the level of customer savings that has come about as a result of retail choice.

It is clear that widespread competition for natural gas service is not available to most of Pennsylvania's residential customers and that only residential customers in Columbia's service territory have routinely been offered more than one alternative natural gas supply service in the past five years. Most residential natural gas customers continue to receive natural gas supply service from their NGDC and have not been offered lower prices or alternative services by retail natural gas suppliers.

B. Terms and Conditions Of Retail Choice Programs In Pennsylvania.

Many of the natural gas supply offers made to residential customers, especially those made most recently during the periods of high natural gas price volatility in the wholesale markets, have been more expensive than the price to compare offered by the incumbent utility. In particular, fixed price offers have often carried a significant premium over the current price to compare. During the periods where this pattern has not been in effect, *i.e.*, when natural gas suppliers were able to provide a product that offered savings to residential customers, there was generally greater shopping activity.

Although the customer choice programs operated by each Pennsylvania NGDC differ with respect to specific terms and conditions, there are features generally common to all of the programs. Pursuant to the provisions of the Act, NGDCs assign a *pro rata* share of the interstate pipeline capacity they reserve to alternative suppliers. Suppliers use the assigned capacity to deliver a specific quantity of gas, as determined by the NGDC, to the NGDC on a daily basis. The base rates charged by the NGDC for distribution service to choice customers are the same distribution charges assessed to customers electing to purchase their natural gas supply service from the NGDC.

The capacity assignment provisions contained in the Act were intended to address two important concerns: (1) to ensure that suppliers had adequate and reliable resources to deliver gas to the NGDC to serve its customers; and (2) to ensure that NGDCs did not incur, and remaining sales customers did not have to pay, for "stranded" interstate pipeline costs associated with the customers who migrated to service by an alternative supplier. The capacity assignment feature ensured reliability and fairness to both customer choice participants and customers remaining on the NGDC's sales service.

Pennsylvania has adopted a reasonable set of consumer protection policies and programs to accompany the move to retail natural gas competition. The Commission's regulations require natural gas suppliers to disclose key terms and conditions to new customers, establish procedures to assure customer authorization and prevent slamming, regulate key consumer contract terms, and establish criteria for licensing of natural gas marketers. However, contrary to the approach used in retail electric competition, the financial assurance or security imposed on retail natural gas marketers is reflected in individual NGDC tariffs and policies and not subject to a statewide approach as part of the Commission's licensing process. Pennsylvania's overall consumer protection policies and programs have prevented many of the incidents prevalent in other states of marketing abuse and allegations of deceptive marketing practices.

However, two incidents should be borne in mind by the Commission as it considers proposals to reform or make changes in the Commonwealth's retail natural gas competition policies. First, the failure of Titan Energy, a supplier that declared bankruptcy and abruptly exited the retail market in 2000, resulted in numerous customer complaints. Second, NewPower obtained Columbia Energy's retail customers in late 2000 when Columbia Energy withdrew from the market. Some of NewPower's practices caused numerous customer complaints to be filed concerning its customer notification and billing practices. NewPower later declared bankruptcy and exited the market, causing additional customer confusion and complaints.

The inception of customer choice also was accompanied by the development and funding of a statewide consumer education program. In February 2000, the Commission ordered a gas education program at a cost of $1.2 million per year for two years, with an additional option for a third year, paid for by an assessment on NGDCs. The lack of widespread marketing activities, however, resulted in a lower level of activity compared to the roll out of electric choice and some of the natural gas education program funding was subsequently used to focus on the reality of higher natural gas customer bills and how to conserve energy to lower bills rather than how to shop. A customer survey done in early 2003 documented that 62% of Pennsylvania's households were aware of natural gas customer choice. A December 2003 survey documented a slight reduction in this awareness, down to 55%. The final year of the gas choice education assessment was eliminated. The funding has primarily been used over the last year to educate customers about high natural gas bills, payment plan options, and how to access programs to either reduce or help pay bills for qualified customers. The OCA has agreed with this approach.

III. <u>Comparison of Retail Choice In Pennsylvania To Programs In Other States</u>.[3]

A. <u>Introduction</u>.

As of January 2004, twenty-one other States and the District of Columbia had legislation or regulatory programs in place that allow some or all of the jurisdiction's residential customers to purchase natural gas supply from an alternative gas supplier. Most states have not adopted statewide retail choice programs, but instead are in the process of phasing in or allowing pilot programs, some of them very large. In general, residential and small commercial customer migration to alternative suppliers has not grown during the 2003-early 2004 period. According to the Energy Information Administration,[4] enrollment in customer choice programs increased by less than 1 percent in 2003, although the number of eligible customers increased by nearly 4%. Nationally, 13% (4 million) of eligible customers participated in state customer choice programs in 2003. Most of the participating customers are in Ohio and Georgia. Approximately half, or 30 million of the approximately 60 million residential customers in the U.S., have access to a customer choice program.

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3 The OCA was assisted in the preparation of this portion of its comments and the attached Appendix A by Consumer Affairs Consultant Barbara Alexander and Natural Gas Industry Consultant Jerome Mierzwa. Both of these consultants are familiar to the Commission, having testified on behalf of the OCA in numerous proceedings involving restructuring and natural gas issues. The data and information cited in this Section and in Appendix A has been gathered by Ms. Alexander and Mr. Mierzwa as a result of their examination of the retail choice programs in other jurisdictions that they have done as part of this investigation as well as work performed on behalf of other clients. The data and information reported here was gathered by Ms. Alexander and Mr. Mierzwa from available public sources and through informal discussions with participants in the retail choice programs in other jurisdictions, including natural gas distribution company personnel, natural gas marketer personnel and regulators.

4 EIA, Retail unbundling—U.S. Summary, available at http://www.eia.doe.gov/oil_gas/natural_gas/restructure/state/us.html

The level of marketer activity throughout the country has decreased in the last year. The number of marketers licensed to serve residential customers has dropped from 165 to 121 and the number of those marketers who are actively seeking residential customers (*i.e.*, making offers to new customers) has dropped from 159 to 92.[5]

B. Overview Of Retail Choice Programs In Other States.

Pennsylvania's residential customer shopping rates in general reflect the experience in most states, *i.e.*, a few retail choice programs have resulted in shopping rates over 20%, but most states and in most programs, the experience mirrors the lower shopping rates in the eastern Pennsylvania NGDC programs. The states that have experienced sustained levels of significant residential customer migration are several programs in New York, Ohio, and Georgia, which are discussed in more detail in Appendix A, attached hereto. A more extensive discussion of the Illinois experience is also included because of its persistent issues relating to supplier marketing practices and affiliate conduct. The District of Columbia customer choice program for its only NGDC, Washington Gas, currently has a 14% participation rate among residential customers (18,000 customers), with four alternative suppliers offering options to the NGDC "price to compare," down from a high of over 25,000 participants in 2002.[6] Maryland's customer choice participation rate varies dramatically from 4.3% for Columbia Gas residential customers to 21.3% of Washington Gas' residential customers as of March 2004.[7] Michigan's retail customer choice programs are in effect for all major NGDCs. Statewide, approximately

5 *Id*

6 http://www.dcpsc.org/hottopics/gas.ppt

7 http://www.psc.state.md.us/psc/gas/gasenrollmentrpt.htm

250,000 customers are served by alternative natural gas suppliers, but as of December 2002, only 11% of Michigan residential customers who were eligible to shop had selected an alternative natural gas supplier.[8] Certain states that allow customer choice have virtually no participation by residential customers (New Jersey, Massachusetts, West Virginia, New Mexico, Montana). Iowa and California have abandoned choice, at least for residential customers.

In developing its Comments in this investigation, the OCA examined in detail the natural gas retail choice programs in several other states. A summary of these programs is attached hereto and marked "Appendix A."

C. Limitations To Residential Retail Choice.

It is important to recognize that the prices charged for natural gas supply by NGDCs in Pennsylvania are still carefully regulated by the Public Utility Commission, as they are in most jurisdictions. Each NGDC must make an annual filing to determine its purchased gas cost rate. In that filing, the company must demonstrate that it is pursuing a least cost gas procurement strategy. That is, it is purchasing gas in the wholesale market at the lowest reasonable price in order to provide its customers with reliable service. 66 Pa.C.S. §§1307(f), 1317, 1318. Moreover, the NGDCs make no profit on the sale of the gas commodity. They simply pass through the wholesale gas costs to retail customers on a dollar for dollar basis, with no markup. The NGDCs make their profit elsewhere – through the regulated return on their investment in gas pipes and other facilities that are used to serve their customers.

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8 See http://www.cis.state.mi.us/mpsc/gas/choicestat.htm. Michigan's approach to the establishment of natural gas supply pricing for NGDCs (who remain the supplier of last resort for all customers) is to emphasize price stability and the PSC has established Fixed Cost Purchasing Guidelines. See the 2003 Annual Report at http://www.cis.state.mi.us/mpsc/reports/annual/2003/CED.htm.

For an NGS to win customers, the NGS has to offer some value to the customer, such as lower prices or long-term fixed price contracts. Since NGDCs are already supposed to be buying and selling the lowest cost gas available, with no profit margin, it is not surprising that very few marketers have been able to come into Pennsylvania, or elsewhere, and offer savings to residential customers off of the regulated retail utility price. Unfortunately for the marketers, they are operating in the same volatile, escalating wholesale natural gas market in which the utilities are buying their gas. In addition, marketers face additional costs in order to acquire customers and earn a profit on the sale of the gas.

Given the inherent difficulties in earning profits, many marketers are unlikely to pursue small commercial or residential customers. The comments that follow are based on the OCA's observations of the choice programs in Pennsylvania and discussions with numerous interested parties in other jurisdictions, including local gas distribution companies and alternative suppliers. The OCA looks forward to reviewing the comments and answers to the Commission questions that will be provided to the Commission by Pennsylvania NGDCs, NGSs and other stakeholders. Review of these comments will help inform the further comments that the OCA hopes to present at the Commission's *en banc* hearing on September 30, 2004.

In general, the natural gas supply service provided by NGDCs against which third-party suppliers must compete consists of two cost components: gas supply commodity charges and demand (or capacity) charges. Gas supply commodity charges are the costs associated with purchase of the commodity itself. Demand charges reflect the costs associated with reserving interstate pipeline transportation and storage capacity utilized to move that gas to the NGDC citygate. In the natural gas commodity market, NGDCs and suppliers face the same wholesale market conditions for natural gas. This is significant because the costs of acquiring commodity represent approximately 75 percent of an NGDC's cost of natural gas supply service. One way for an NGS to compete with an NGDC for natural gas supply service is to utilize its interstate pipeline capacity in a more efficient manner than NGDCs and achieve a lower per unit cost for delivered gas supplies. Most of the Pennsylvania retail choice programs, however, require mandatory *pro rata* assignment of interstate pipeline capacity by NGDCs to NGSs as customers migrate to choice service. It appears that mandatory *pro rata* assignment of capacity may prevent third-party suppliers from minimizing transportation costs and thus being able to compete effectively with NGDCs. When capacity is assigned to an NGS on a *pro rata* basis, the cost of the capacity assigned to the NGS is the same as the cost to the NGDC. Thus, the NGS's costs for the assigned capacity are fixed. In the absence of mandatory *pro rata* assignment, presumably a marketer would arrange for a capacity portfolio to serve all of its customers – not just the newly acquired choice customers – and therefore could possibly obtain some savings in capacity costs. Thus, one way that a marketer can serve customers at rates less than the NGDC would be to obtain such savings on capacity costs, since the marketer and the NGDC both purchase commodity supply in the same competitively-priced wholesale markets.

It must be noted, however, that the purpose of the Pennsylvania Act's provision for *pro rata* assignment of capacity was to ensure that the NGDC did not have, and the NGDC's customers did not have to pay for, stranded capacity costs as customers migrated to retail choice programs. The OCA submits that this key provision of the Act has worked reasonably well in not imposing additional costs on customers who choose to remain with the NGDC as full sales service customers.

NGSs may also compete by offering natural gas supply service under different terms and conditions than the NGDC – such as a fixed rate for a longer period of time.

Currently, all Pennsylvania NGDCs adjust their purchased gas cost rates on a quarterly basis. Some customers may prefer to have a fixed rate contract for service for a period of one year or longer in order to better budget household expenses. Theoretically, NGSs may also compete with NGDCs by combining different services (*e.g.*, natural gas and electric service). However, as discussed above, current fixed price services offered by NGSs are priced at a substantial premium over the NGDCs' quarterly rates and are therefore not attractive. Nor is there any evidence that bundled services are being offered in Pennsylvania on terms that are attractive enough to induce customers to switch to an alternative provider.

D. Features Of Other Retail Choice Programs That May Merit Consideration.

The OCA has examined several other retail choice programs in other jurisdictions, including those states reporting the highest level of choice activity. In discussions between the OCA's consultants and participants in the Ohio choice programs, including marketers, it was indicated that the Ohio programs' lack of mandatory capacity assignment, which allows suppliers to seek lower cost transportation arrangements, is an attractive feature for marketers. However, discussions with marketers in other jurisdictions suggest that marketers either favor mandatory capacity assignment or don't find such provisions problematic. It should be noted that in a capacity constrained region, such as eastern Pennsylvania, the lack of capacity assignment can hinder customer choice development. Furthermore, in programs such as Columbia Ohio's, stranded costs are created as customers migrate from Columbia Ohio to an alternative supplier. These stranded costs are partially paid for by remaining sales customers through their gas cost rate and by choice customers through balancing charges.

Marketers participating in the Ohio choice programs also found the purchase of their receivables by the NGDC at reasonable discounts (*e.g.*, one percent) to be an important, positive feature of the Ohio programs. Without this feature, marketers found they had little leverage to collect from certain customers. In Pennsylvania, Columbia does purchase supplier receivables; however, the discount appears to be very high compared to other programs – five percent. Dominion Peoples does not offer to purchase supplier receivables. Of course, the purchase of receivables by the utility must be done in a manner that does not increase rates for remaining default service customers or reduce consumer protections for affected ratepayers.

Another feature of the Ohio program that makes it more attractive than Pennsylvania is the size of the relative markets. Dominion East Ohio and Columbia Ohio each serve well over a million potential choice customers. Because suppliers have limited resources, promotional and advertising dollars are targeted towards larger markets. While no bright line test exists, this suggests that for some Pennsylvania NGDCs, there may simply not be enough customers in their individual service territories to generate supplier interest.

Suppliers also favored consistency between NGDC programs and noted that program fees discourage competition. With respect to program consistency and fees, the choice programs in Pennsylvania are similar to those in Ohio.

Suppliers noted other areas of the Pennsylvania program that they felt hindered their ability to participate in the market. Suppliers indicated that it is difficult for them to obtain the specific customer consumption information necessary to efficiently arrange for gas supplies to serve customers. In New York, authorized suppliers are able to obtain customer consumption history through the NGDCs' web sites (with customer consent). Such information is not as readily available for Pennsylvania customers.

IV. RECOMMENDATIONS

A. Introduction

With the exception of the unique Georgia Atlanta Gas Light program, which is discussed in Appendix A, Pennsylvania's natural gas customer choice programs have generally mirrored experiences in other states. Many states have struggled to get retail choice programs for smaller customers off the ground. The current regulatory structure, wherein unregulated suppliers compete with a natural gas distribution company that is charging only the passed-through cost of a least-cost gas supply, provides a limited opportunity for profit. The OCA submits, however, that the solution to this problem is not to artificially increase the prices charged by the regulated utility. That would leave most customers worse off than they would have been if there had been no restructuring of the natural gas industry at all. Where states have had some modest success with retail choice programs, there may have been incentives provided to encourage participation by customers and suppliers alike, some of which may have an adverse impact upon those customers who remained with the incumbent gas utility.

Furthermore, it is not clear that Pennsylvania could replicate those features of the retail choice programs, such as Ohio, which have been conducive to fostering retail choice activity. For example, marketers have found it easier to enter a larger market such as Columbia Ohio and Dominion East Ohio, both of whom have over one million retail customers. Pennsylvania gas utilities, by comparison, have much smaller customer bases. Pennsylvania utilities, for the most part, also lack available on-system storage that could be assigned to alternative suppliers. This was one feature of the Dominion East Ohio program that marketers found attractive.

The most significant impediment to the development of residential customer choice is the lack of marketing activity and the inability to offer savings. These factors are unlikely to change in the near term where wholesale natural gas prices remain very high and very volatile.

The level of shopping and relative lack of alternative suppliers marketing to residential customers suggests that a robust retail competitive market simply may not develop for most residential customers. The success of natural gas restructuring, however, should not be judged solely on the level of retail choice activity that is occurring. There were other benefits delivered by the Act, including elimination of the gross receipts tax on all natural gas service, the development or expansion of universal service programs in all NGDC service territories, and the modification of the 1307(f) process to allow greater use of financial instruments and natural gas price risk management tools to assist NGDCs in reducing gas cost volatility to provide more stability in purchased gas cost rates.

The OCA submits that the Commission should not make changes to the customer choice programs simply for the purpose of increasing the level of retail choice activity. Many customers have already made a choice, and that choice is to stay with their incumbent natural gas utility. The customer choice program should not be redesigned in a way that imposes additional costs on customers or that increases NGDC rate volatility to the point that customers are forced to switch to alternative suppliers.

B. **Recommendations**

1. **The Commission Should Not Undertake Any Changes To Customer Choice Programs That Would Result In Increased Costs For Customers Who Choose To Remain With Their NGDC Or That Would Reduce System Reliability Or Quality Of Service.**

One of the choices that customers were given by the Act was the choice to remain as a sales service customer of their NGDC. Therefore, the Commission should ensure that these customers are not harmed by any actions taken to promote retail choice activity. The goal of this investigation should be to ensure that consumers are provided with the opportunity to receive reliable natural gas service at the lowest reasonable cost. Since most Pennsylvania natural gas customers are purchasing their natural gas supply from their NGDC, it is essential that care is taken not to increase costs for that supply. Existing program features, such as mandatory *pro rata* assignment of capacity may make it more difficult for marketers to serve residential customers, but they also help to reduce the potential for stranded costs. The OCA submits that with natural gas costs at near-historic highs, this is not an appropriate time to saddle ratepayers with additional costs.

The current program designs also reflect the General Assembly's intent that the NGDC must act as supplier of last resort in the case of supplier default. Therefore, capacity that is assigned to an NGS is recallable if the NGS fails to deliver the requisite supplies and choice customers are returned to the NGDC. This feature ensures that all customers – both choice customers and sales customers – are receiving safe, reliable and adequate service without any duplication of natural gas supplies or stranded cost. The Act specifically requires the Commission to adopt and enforce standards to ensure the continuation of the safety and reliability of the natural gas supply and distribution service for all retail customers. 66 Pa.C.S.

§2203(1). The OCA submits that the Commission should not approve any program design modifications that would reduce the level of reliability.

Similarly, the purchase of receivables may be viewed by marketers as a positive aspect of a choice program. However, such a provision should only be implemented under reasonable terms and conditions that do not cause the NGDC to incur additional costs that would have to be passed on to ratepayers and that do not reduce consumer protections for affected ratepayers.

2. NGDCs Should Be Encouraged To Continue To Develop Purchasing Strategies To Minimize The Volatility In Purchased Gas Costs, Consistent With The NGDC's Least Cost Gas Obligation.

Since most natural gas customers in Pennsylvania remain SOLR customers of the NGDC, either through affirmative choice or as a result of a lack of competitive options, it is essential that NGDCs continue to fulfill their role as SOLR by providing safe, reliable, reasonably-priced service at the least cost possible. By statute, NGDCs' natural gas supply costs must be consistent with a "least cost fuel procurement policy." 66 Pa.C.S. §1318. When the Natural Gas Choice Act was passed in 1999, the Public Utility Code's definition of recoverable "natural gas costs" was modified to include "futures, options and other risk management tools." 66 Pa.C.S. §1307(h). This expresses the clear intent of the General Assembly that NGDCs should be able to engage in natural gas price risk management activities in order to reduce the volatility in purchased gas costs. The OCA submits that a well-designed gas procurement program, that includes a portfolio of fixed-price purchases, indexed purchases and financial risk management tools can help to stabilize an NGDC's purchased gas cost rate. Less volatile rates will make it easier for consumers to plan their household budgets from month-to-month and lead to improved collections for the utility.

Further statutory authority for implementation of hedging strategies and gas cost risk management programs is found in other parts of Chapter 13 of the Public Utility Code. In approving natural gas supply costs, the Commission must determine whether the utility "is pursuing a least cost fuel procurement policy, consistent with the utility's obligation to provide safe, adequate and reliable service to its customers." 66 Pa.C.S. §1318(a). One of the Commission's tasks during the annual review of purchased gas costs is to examine the utility's Reliability Plan and Supply Plan that is submitted as part of the 1307(f) filing. 66 Pa.C.S. §1317(c).

Specific findings required to be made under Section 1318 of the Public Utility Code include that the utility has taken all "prudent steps necessary to negotiate favorable gas supply contracts" and taken "all prudent steps necessary to obtain lower cost gas supplies on both short-term ***and long-term*** bases both within and outside the Commonwealth." These statutory directives indicate that an NGDC should not rely simply on short-term wholesale market purchases to serve its customers, but should also be seeking to take longer-term positions to guard against excess price volatility. The OCA supports the efforts of NGDCs to engage in hedging activities and the development of natural gas price risk management plans that will minimize volatility in purchased gas cost rates and provide more stability to customers' bills. The Commission should encourage utilities to engage in such activities, especially during this period of extreme volatility in the wholesale gas markets.

Finally, the Act prohibits the development of a month-to-month price change unless the NGDC also offers a 12-month fixed rate option. At this time, the OCA does not support any change in this statutory directive. The OCA is concerned that in times of volatile gas costs, monthly changes to purchased gas cost rates would leave customers even more unable to budget household expenses since they would not know what gas prices are from one month to the next.

V. CONCLUSION

The Office of Consumer Advocate appreciates the opportunity to present these Comments to the Commission as it considers the future of the natural gas retail choice program in Pennsylvania. The OCA looks forward to working with the Commission and other stakeholders on these important issues.

APPENDIX A

SUMMARY OF RETAIL CHOICE PROGRAMS IN OTHER JURISDICTIONS[1]

1. New York

The New York Public Service Commission ("NY PSC") has strongly supported the move to retail natural gas competition and instituted retail choice programs in the service territories of each natural gas distribution company. New York has not adopted comprehensive gas restructuring or retail competition legislation, but has adopted a statewide set of consumer protection policies that are applicable to both electric and natural gas marketers licensed by the Commission. Pursuant to the NY PSC's Gas Policy Statement issued in 1998 (and amended in 1999)[2] gas utilities are required to unbundle their rates and limit their acquisition of new capacity contracts, shifting to short-term and citygate arrangements for capacity necessary for system operation and reliability. While the NY PSC initially anticipated that the natural gas distribution utilities would exit the merchant function within a relatively short time, this has not occurred.

As of May 2004, 13.7% of residential customers were served by an alternative gas supplier – which represents a 2.1% participation rate decrease in the last 12 months. Another

[1] The OCA was assisted in the preparation of this Appendix by Consumer Affairs Consultant Barbara Alexander and Natural Gas Industry Consultant Jerome Mierzwa. Both of these consultants are familiar to the Commission, having testified on behalf of the OCA in numerous proceedings involving restructuring and natural gas issues. The data and information cited in Appendix A has been gathered by Ms. Alexander and Mr. Mierzwa as a result of their examination of the retail choice programs in other jurisdictions that they have done as part of this investigation as well as work performed on behalf of other clients. The data and information reported here was gathered by Ms. Alexander and Mr. Mierzwa from available public sources and through informal discussions with participants in the retail choice programs in other jurisdictions, including natural gas distribution company personnel, natural gas marketer personnel and regulators.

[2] New York PSC, Policy Statement Concerning the future of the Natural Gas Industry in New York State and Order Terminating Capacity Assignment, Case 97-G-1380, November 3, 1998. The Commission clarified some aspects of this order in April 1999.

significant decrease in shopping levels occurred in early 2003.[3] The degree of residential customer shopping varies significantly among the various natural gas distribution companies, with the largest numbers reported for Keyspan Energy Delivery of New York and Niagara Mohawk Power Co. Most gas distribution utilities in New York are governed by multi-year performance plans that address the distribution and, in some case, the gas supply portion of customer bills. Each of these plans contains a Service Quality or Customer Service performance mechanism with established baseline performance standards and automatic penalties (in the form of reduced earnings) for the failure to achieve the minimum standards during the term of the plan and a company-specific low-income bill payment assistance program funded through distribution rates.

For example, National Fuel Gas Distribution Corp. ("NFGD-NY"), an upstate utility, operates under a multi-year rate plan that the Commission recently extended until December 2004.[4] As of May 2004, 41,300 residential customers were served by alternative suppliers in NFGD-NY's retail choice program.

The New York and Pennsylvania programs differ in two significant respects. First, in the New York program there is a mandatory release of capacity unless the supplier can demonstrate they have comparable capacity during the five winter months. Second, each New York natural gas distribution company operates under individually negotiated "backout credits." In New York, backout credits are provided as a discount to the distribution charges of a choice customer. This provides customers with an incentive to switch to an alternative supplier. The

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[3] The New York PSC publishes Gas Retail Access Migration statistics on its website: http://www.dps.state.ny.us/Gas_Migration.htm

[4] New York PSC, Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of National Fuel Gas Distribution Corp., Case No. 00-G-1858, September 18, 2003., available at: http://www.dps.state.ny.us

amount of the credit is intended to reflect the average cost savings – in administrative and general expense, cash working capital and other expenses – experienced by a natural gas distribution company when a customer switches. It is uncertain whether the natural gas distribution company cost savings are greater than the additional costs associated with administration of the choice program. It was thought that this payment of a backout credit would enable a marketer to more effectively compete in the customer choice program. In New York, the backout credit approach was established after the programs were initially in place, but has not resulted in any significant increase in participation levels.

In New York, alternative suppliers can access customer consumption data through the Company's web site if they have the customer's account number. This system assumes that the supplier has the customer's account number by means of a customer consent process. However, the supplier's access to any other individual account information, such as payment history, requires specific customer consent for that purpose that is transmitted to the NGDC.

There is no migration rider in New York so that under/over collections do not follow customers who shop and then return to the incumbent utility. This policy leaves open the possibility that marketers could game the system by soliciting new customers or returning customers to the natural gas distribution company at certain opportune times, depending upon the level of the utility's over/under-collection factor. Furthermore, such a policy also could result in pressure by alternative suppliers to oppose any effort by the natural gas distribution company to manage its gas portfolio to smooth price volatility since larger over- and under-collections present more opportunities for marketers.

Under the statewide minimum consumer protection rules adopted by the Legislature in 2002, suppliers can initiate disconnection of service for nonpayment of the competitive gas supply portion of the bill. However, such an option carries with it the obligation by the supplier to offer payment arrangements, honor medical emergencies, and generally duplicate the terms of service and obligation to serve of gas utilities. While it is not a requirement that the utility purchase the supplier's receivables, some utilities do so.

Access to capacity remains a significant issue under the New York programs. This is particularly the case in the New York City area where capacity is fully subscribed. In that situation, there is no incentive for the local natural gas distribution company to give up capacity, particularly when the supplier could then use such access to enter other markets.

A large concern for utilities is the risk that a supplier will file for bankruptcy, an event that has occurred in several upstate New York programs. Customers who prepaid the supplier or who had paid cash deposits lost not only the benefit of their contractual price, but the prepayments and deposits that the supplier had collected. Utilities are concerned that once a supplier files for bankruptcy, they cannot get back assigned capacity or gas that may be in storage unless the bankruptcy court specifically approves the transaction.

One of the most successful (but still very small) New York programs is that of Orange and Rockland ("O&R"). In that program, O&R purchases the supplier's receivables and promotes competitive choices when the customer contacts the utility's phone center for any purpose. Switching customers are guaranteed savings of seven percent for the first two months, but the savings are not guaranteed beyond two months. The customer's natural gas supply charges then reflect the marketers' contract offer for the balance of the contract period. O&R is provided an incentive to promote customer switching through an incentive program that provides it with an increased return on equity if it is able to achieve a certain customer choice participation levels.

2. Ohio

Ohio has adopted a statewide retail choice program for natural gas service and aggressively pursued it. Initiated in the late 1990's, these programs have expanded in two of the four investor-owned gas utilities. Customer migration rates and supplier marketing activity is fairly robust in the Columbia Gas of Ohio ("Columbia Ohio")[5] and Dominion East Ohio Gas ("Dominion East Ohio") programs. While the pace of migration of customers to the choice program has slowed over the past year, 52% of Dominion East Ohio's residential customers and 39% of Columbia Ohio's residential customers are currently served by an alternative supplier. Other gas utilities have lower participation rates: Vectren – 23.8%; Cincinnati Gas and Electric – 7.9%.[6] This relatively high shopping level may increase since the Ohio Legislature has adopted a municipal aggregation program for natural gas that is similar to that in place for the Ohio retail electric competition program.

By way of background, the choice programs of both Dominion East Ohio and Columbia Ohio share certain common features. Neither program includes mandatory capacity assignment provisions. Both utilities require daily deliveries by suppliers based on the estimated requirements of their customers as determined by the distribution utility. Both programs provide for the purchase of alternative suppliers' receivables. However, the Public Utilities Commission of Ohio ("PUCO") permits the recovery of these costs by the natural gas distribution companies through an uncollectibles tracking mechanism.

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[5] The Public Utilities Commission of Ohio publishes "apples to apples" price comparison charts for each gas utility and updates these charts monthly. The July 2004 Apples to Apples chart for Columbia Ohio indicates 8 marketers offering a variety of fixed and variable rate plans for residential customers: http://www.puco.ohio.gov/Puco/ApplesToApples/NaturalGas.cfm?doc_id=479

[6] The Public Utilities Commission of Ohio publishes Customer Enrollment Levels for Natural Gas customer choice programs: http://www.puco.ohio.gov/Puco/StatisticalReports/Report.cfm?doc_id=1176

In the Columbia Ohio program, the utility elected to maintain pipeline capacity sufficient to serve all of its sales and choice customers. Thus, stranded costs were incurred as customers migrated to choice. These stranded costs are recovered from all sales and choice customers. Certain features of the stranded cost recovery mechanism resulted in an increase in the gas cost rates for remaining sales customers, thus enabling alternative suppliers to compete more easily. There were a number of other unique features of the Columbia Ohio program, established through a number of stipulations, which render difficult to pursue as a model. For example, stranded costs were partially offset by the crediting of certain FERC Order 636 transition costs and by significant interstate pipeline refunds. In Pennsylvania, Order 636 transition costs have been completely collected by Pennsylvania NGDCs, and no significant pipeline refunds are anticipated in the near future. Therefore, such an approach would not be available in Pennsylvania.

In the Dominion East Ohio program, the utility did not maintain pipeline capacity to serve choice customers. It maintained capacity sufficient to serve only sales customers (plus certain transportation customer balancing requirements). Dominion East Ohio has been able to adjust its pipeline capacity entitlements to essentially eliminate stranded costs. To maintain system reliability, Dominion East Ohio requires alternative suppliers to demonstrate that they have reserved capacity comparable to that reserved by Dominion East Ohio for the five winter months. System reliability is also maintained by the structure of the program. Alternative suppliers are assigned or allocated on-system and pipeline storage sufficient to meet 50 percent of their customers' design peak day demands. This storage reverts back to Dominion East Ohio if a supplier defaults. Thus, one-half of the reliability risk of supplier default is eliminated. On-system storage represents 34 of the 50 percent assigned to alternative suppliers, and is a key factor in Dominion East Ohio's ability to operate its choice program. Most Pennsylvania NGDCs, however, do not have on-system storage.

Initially, retail choice customers in Ohio enjoyed savings. These savings were largely attributable to the fact that customers executed fixed price contracts prior to a period of unprecedented gas price increases. The most recent data available (June 2004) shows that during the term of Dominion East Ohio's choice program, which was initiated in 1997 as a pilot program and expanded system wide in 2000, customer net savings have totaled $13 million. The OCA does not have recent dollar estimates for the Columbia Ohio program.

The unprecedented recent increases and volatility in gas prices have had a significant impact on competitive supplier offerings in Ohio, and elsewhere. Prior to the price increases and volatility, marketers routinely offered fixed price arrangements that were competitive with the gas distribution utility's offering. Now fixed price offerings are rare, and those that are available are at prices well in excess of the utility's price. These offerings can be compared on the PUCO's web site. It is uncertain at this time whether this significant change in supplier offerings in Ohio will affect participation levels.

In summary, with the exception of Georgia, which mandated that the natural gas distribution company exit the merchant function, Ohio has the highest customer choice participation rates in the country. The OCA's review of the two largest retail choice programs in Ohio – Columbia Ohio and Dominion East Ohio – reveals several features that marketers have found attractive and may have helped to increase choice participation rates. These features include the lack of mandatory capacity assignment with, instead, a requirement that the marketer utilize comparable capacity to serve choice customers during the five winter months. In addition, the large size of the markets served by Ohio natural gas distribution companies, several larger than one million potential customers, allows marketers to make more efficient use of their advertising and marketing budgets. The purchase of receivables by the natural gas distribution company was another feature that some marketers cited as favorable. Also contributing to the initial success of the choice programs in Ohio was the initial savings that choice customers realized when they switched to fixed price contracts during the run-up in natural gas costs that occurred in 2002-2003. With fewer and fewer marketers willing to offer fixed price contracts without a large premium, however, those types of savings are no longer achievable.

3. Illinois

Illinois has not adopted comprehensive retail gas competition legislation, but the Commission has approved a variety of pilot programs for residential customers. According to a July 2004 report issued by the Illinois Commerce Commission,[7] two natural gas utilities operate approved retail access programs for smaller customers: Nicor Gas and Peoples Gas Light ("PGL"). Participation limits exist for both utility programs, but Nicor's program was expanded to permit choice for all of its two million customers as of March 1, 2002. A total of 152,000 residential customers and 57,000 small commercial customers were served by alternative suppliers in these programs as of December 2003. While residential customer participation increased by over 40% in Nicor's service territory in 2003, participation in the PGL's program dropped by over 20%. In part this was due to the exit from the market by Nicor Energy in early 2003, a major supplier in both pilot programs, and the change in the state tax law that eliminated the tax advantage associated with sales by non-utility suppliers. The Illinois Commission's Report points to the smaller service territory, the imposition of a switching fee, and the

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[7] ICC, Annual Report on the Development of Natural Gas Markets in Illinois, July 2004, available at http://www.icc.state.il.us/ng/docs/040708garpt.pdf

participation limits of the PGL program as potential barriers to more extensive participation by alternative suppliers.

In 2003 the Illinois Legislature adopted the Alternative Gas Supplier Law, and pursuant to that statute, the Commission adopted rules[8] and now certifies all gas suppliers who seek to provide service to residential and small commercial customers. Currently, ten suppliers are licensed for the two utility gas choice programs. These regulations require suppliers that market to residential and small commercial customers to post a security bond in the amount of $150,000 and require the marketer to certify that “it will offer to reimburse its Illinois residential and small commercial customers for the additional costs those customers incur to acquire natural gas as a result of the applicant’s failure to comply with a contractual obligation to supply such energy.” 83 Ill.Adm.Code §551.80. The amount of this obligation must be contained in an unconditional guarantee or payment bond in an amount not less than the amount of gas the marketer expects to schedule over the next 12 months times the 12-month average citygate gas price.

The Illinois programs have also been marked by allegations of marketing abuse and violation of consumer protection laws. The Illinois Citizens Utility Board (“CUB”) has filed a class action lawsuit against Nicor Solutions’ “fixed bill” program,[9] alleging that it is deceptive because it promises the customer a fixed bill even if gas prices go up, but the resulting price is set at such a high level that most customers lose money compared to actual utility prices. The price that the customer will be charged under the “fixed bill” program is not stated in its

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8 Illinois Administrative Code, Title 83, Part 551, effective January 1, 2004, contains consumer protection requirements as well as licensing requirements.

9 Nicor Solutions uses the same logo as the natural gas utility, Nicor Gas, and sends out its promotional materials in the Nicor Gas bill.

literature, but is customer-specific and reflective of the day the customer signs up for the program.[10]

The largest marketer in the PGL program is Peoples Energy Services. This marketer was also sued by CUB and recently fined $40,000 by the Commission for misleading advertising.[11] While appearing to offer a locked-in or fixed price for natural gas, the terms of the contract actually allowed the gas supplier to raise its rates based on market conditions and the quoted cents per therm did not reflect other recurring monthly fees (such as a monthly fixed charge and a "balancing" charge). Furthermore, the contract imposed an early termination fee of several hundred dollars if a customer attempted to leave the marketer and return to the utility. The Illinois Commission is now examining the sales practices of other gas marketers.

4. Georgia

Georgia has taken the most drastic approach of any state in its move to retail competition for natural gas service. This market model has not been adopted in any state for either electric or natural competition.[12] First, under the Georgia approach, all customers had to choose an alternative natural gas supplier and those who did not choose were assigned to an alternative supplier. Second, Atlanta Gas Light, the distribution utility was completely removed from any retail relationships and has no retail obligation to serve. Rather, customers are billed directly by the marketer for both unregulated natural gas commodity charges and regulated distribution charges. Third, Georgia's natural gas marketers can disconnect service for

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10 Article may be found at http://www.lexis.com/research/retrieve/frames?_m=bfcb4a13804bc970b4af18f7c4050627&csvc=bl&cform=bool&_fmtstr=FULL&docnum=1&_startdoc=1&wchp=dGLbVlz-zSkAz&_md5=a582a2e75481fa08ffbc11d23ea6d994

11 http://citizensutilityboard.org/pdfs/NewsReleases/20040721_GasMarketers.pdf

12 While the Texas electric competition model requires the retail energy provider to assume full billing and collection responsibility with their customers, there is a "default provider" that is obligated to serve customers under the Price to Beat rates for a transition period.

nonpayment of any portion of the bill, thus preventing the customer from obtaining natural gas service from any default provider or competitive supplier until the bill is paid or the marketer has agreed to payment terms. Fourth, the market model did not originally contemplate or provide for any "provider of last resort," but such a service was adopted as part of the 2002 reforms mandated by the Legislature. The Georgia program has faced significant controversy, customer complaints, and substantial intervention and reform by the state Legislature.

Retail competition for natural gas suppliers and customers at Atlanta Gas Light (AGL), the state's largest investor-owned natural gas utility, began November 1, 1998 under the 1997 Natural Gas Competition and Deregulation Act.[13] The Act and the Georgia Public Service Commission ("Georgia PSC") implemented a competition model (sometimes referred to as the Single Retailer Model) in which the retail customer receives natural gas service and bills from the gas marketer and has no interaction with the local distribution utility. The Act required that when certain market conditions were met, all customers who had not yet chosen a competitive supplier would be assigned to a competitive supplier based on the market share obtained by the suppliers in the first several years of the program. In late 1998 and early 1999 there was not much activity by customers to choose a natural gas supplier. Customers were then told in early 1999 that there was a deadline for choosing a marketer or they would be assigned to a marketer. As a result of this approach, many customers signed up for competitive providers by the fall of 1999. That left only 280,000 customers that had to be assigned a marketer because 1.1 million had already chosen a marketer.

This astounding migration during the first year of the program was due in part to the massive marketing campaigns by various marketers (coupled by upfront prizes and give-aways, such as the $50 promised by SCANA, and a free month of natural gas by Peachtree) and

13 http://www.psc.state.ga.us/gas/sb215.htm

in part due to the controversy and outrage expressed by customers against Atlanta Gas Light (the distribution utility) who had recently initiated a new rate design approach for charging for natural gas distribution service that shifted cost recovery to low users. By the fall of 1999, AGL was completely removed from the retail natural gas business and every retail customer had chosen or been assigned to a competitive marketer.

At the time of the most intense marketer activity during 1999 there were 24 licensed suppliers seeking retail customers. This high point has subsequently declined. By January 2004, the number of marketers actively seeking customers had fallen to nine.

In spite of the relatively large number of active marketers in the Georgia retail market, it appears that the bulk of customers were being served by only a few marketers. A study conducted by Ken Costello of the National Regulatory Research Institute on behalf of the Georgia PSC in 2002 found that four marketers served nearly 90 percent of the natural gas market in Georgia.[14] The study characterized the Georgia market as highly concentrated where conditions are conducive to the exercise of market power and found that the Georgia market has features that may be conducive to behavior by marketers that lie contrary to consumer interests.

The Georgia Public Service Commission ("Georgia PSC") received 15,281 complaints against marketers in the late 1999 and early 2000 period: 2,039 about billing, 179 about service, and 13,063 alleging deceptive marketing, primarily slamming. According to the Georgia PSC's Consumer Affairs office, natural gas complaints went from a pre-deregulation low of 208 for the first six months of 1998, to a post-deregulation high of 8,596 for the first six months of 2001, a 40-fold increase in customer complaints.[15]

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[14] The competitiveness of the Georgia Deregulated Gas Market; Ken Costello, Senior Institute Economist; the National Regulatory Research Institute; January 2002

[15] Interview with Phil Nowicki, Georgia PSC, November 28, 2001.

The Commission initially licensed natural gas suppliers without any investigation into their ability to conduct large scale billing and customer service programs and did not obtain security bonds or other financial security as a hedge against marketer failure or loss of customer deposits and prepayments. Nor did the Commission establish basic contractual disclosure requirements until late in 2002 and, as a result, marketers were not required to inform new customers in writing of the material terms of their agreement or provide a copy of any contractual agreement. The Commission has not regulated the deposit and credit practices of marketers, although there appears to be an unwritten rule that marketers have an "obligation to serve" in that they cannot deny an individual natural gas service, but can, based on unregulated credit evaluation criteria, demand a deposit.

Most importantly, the natural gas marketers can disconnect service for nonpayment of the bill. The marketer must issue a notice and only AGL can actually physically disconnect (and reconnect) the service. The disconnection activity was very slow in the early days of this program due to the massive billing failures and billing errors. Once marketers began to more routinely issue timely bills in early 2001, the pace of disconnections increased markedly. This occurred at the same time that customers were seeing the true effect of the large bills from the winter of 2000-2001, one of the coldest on record in the Atlanta area. The impact of the cold weather on those customers who had entered into variable rate contracts exacerbated the higher prices reflected on their bills due to increased usage. The Commission halted disconnection of service in the winter of 2000-2001, but when the moratorium was lifted in April, record numbers of disconnections occurred. As a result, over 125,000 disconnections occurred in the summer and fall of 2001, and as of the end of November approximately 50,000 residential customers remained disconnected.[16]

While only AGL can physically disconnect a customer, the prior AGL practice of attempting to contact the customer at the premises and potentially negotiating a payment plan or accepting payment has ended. AGL field personnel act as merely agents of the marketers, none of whom are required to contact the customer and seek to avoid disconnection of service. Furthermore, once disconnected, only AGL can reconnect the customer and the backlog of those disconnected in early 2002 was estimated to take eight weeks to resolve given the available AGL resources devoted to this task.

In the fall of 2001, in the face of mounting criticism and public complaints about the natural gas program, Governor Roy Barnes announced the formation of a Natural Gas Consumer Protection Task Force and stated that he is "strongly persuaded that the state needs to take steps to protect the individual consumer of natural gas." He cited the high prices currently charged by natural gas marketers and the record number of disconnections that had occurred. At the time that the Task Force made its final recommendations to the Governor in January 2002, the Governor proposed legislation to correct some of the defects in the natural gas program identified by the Task Force. During the following legislative session, an attempt to "re-regulate" natural gas was defeated. However a significant package of reforms was adopted in the Natural Gas Consumers' Relief Act (HB 1568). The final version of the legislation adopted a "Consumer Bill of Rights" and a mandatory requirement that the Commission appoint a Provider of Last Resort. The Consumer Bill of Rights and the resulting PSC regulations have resulted in

[16] Quinn, "Funding Elusive for Natural Gas Safety Net," The Atlanta Journal-Constitution, November 21, 2001. Note: The Georgia PSC obtains monthly reports on disconnection activity from AGL, but does not publish this information on a regular basis.

enhanced regulation of marketer billing and contract procedures. The legislation also requires the Commission to supervise the quality of service provided by Atlanta Gas Light to the marketers in the form of timely meter readings and switching procedures.

These consumer protection reforms adopted in 2002 have had an impact on customer complaints. In contrast to the high complaint ratios of over 1,000 per month in late 2000 and 2001, the PSC Gas Marketer Scorecard reflects a reduction in complaints during 2003 and 2004 to date, now averaging 150-200/month. However, billing complaints are still the largest complaint category.

The statutorily mandated Provider of Last Resort program requires the chosen marketer (selected by a bidding process) to serve two groups of customers: consumers who meet the definition of low income as established by the Georgia Department of Human Resources (Group 1) and consumers who are unable to obtain service from another marketer and do not meet the criteria for low income (Group 2). Under the rates approved by the Commission for the marketer selected in June 2002 (SCANA)[17], low income customers will pay about $0.22 per therm over the wholesale price of natural gas with a $4.95 monthly charge, low income seniors (not required by the legislation, but offered by the winning bidder) will pay $0.20 over wholesale and a $4.95 monthly charge, and other high risk customers (those unable to obtain service from another marketer, but who are not certified as low income) will pay $0.36 over wholesale with a $11.95 monthly charge. Pursuant to the provisions of the new legislation, the Universal Service Fund (collected from all market participants) will support the POLR's uncollectible expenses associated with this service for at least the low income customers.

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[17] Georgia PSC selects SCANA to Be the Regulated Natural Gas Provider Established by the Natural Gas Consumers' Relief Act (HB 1568) and Takes Other Actions, June 18, 2002, available at www.psc.state.ga.us .