PENNSYLVANIA
PUBLIC UTILITY COMMISSION
HARRISBURG, PA 17105-3265

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

TESTIMONY OF INTERSTATE GAS SUPPLY, INC.

Interstate Gas Supply, Inc. ("IGS"), a licensed natural gas marketer in the Commonwealth of Pennsylvania, hereby submits the following written testimony in response to the above referenced investigation being conducted by the Pennsylvania Public Utility Commission regarding the state of the Natural Gas Supply Market in Pennsylvania and its Order, dated May 27, 2004 in the above referenced docket.

I. <u>Introduction</u>

Interstate Gas Supply, Inc. ("IGS") is a natural gas marketer and supplier of natural gas in the Commonwealth of Pennsylvania, and also conducts business of the same or similar nature in Ohio, Michigan, Kentucky and Illinois, either through its own efforts or through the efforts of a subsidiary corporation. IGS has over fifteen (15) years of experience in the natural gas marketplace, and was one of the original natural gas marketers in Ohio. Currently, IGS has limited its marketing efforts in Pennsylvania to Columbia of Pennsylvania's distribution system and territory. IGS also has customers behind Columbia of Ohio, Columbia of Kentucky, Dominion East Ohio, Vectren, Cincinnati Gas and Electric, Northern Illinois Gas Company ("Nicor"), and Michigan Consolidated Gas Company ("MichCon"). IGS has found, through its fifteen years in the natural gas marketplace, that overall competition has resulted in significant savings to residential, commercial and industrial consumers. For example, in Ohio, natural gas customers that have chosen IGS as their supplier have saved in excess of $46,000,000.00 between 1998 and April, 2004, compared to the incumbent utility. Additionally, over 1 million residential consumers currently participate in Ohio's Choice residential market and have selected a natural gas supplier that is not the incumbent utility company.[1]

II. Testimony

The Commission has requested testimony pursuant to its review of the state of natural gas competition in the Commonwealth of Pennsylvania. Specifically, the Commission has requested testimony on the following topics: (1) The assessment of the level of competition in Pennsylvania's natural gas supply service market; (2) The effect of the price of natural on competition; (3) the effect of consumer education on competition; (4) The effect of customer information/service on competition; (5) the effect of supplier financial security requirements on competition; (6) the effect of natural gas distribution company penalties and other costs on competition; and (7) Discuss any avenues, including legislative, for encouraging increased competition in Pennsylvania. IGS will address each topic in turn.

1. IGS' Assessment of the Level of Competition in Pennsylvania's Natural Gas Market.

From IGS' perspective, the competitive level of the Pennsylvania natural gas marketplace is encouraging. In Pennsylvania, IGS currently has customers only on the Columbia Gas of Pennsylvania ("CPa") system. With respect to CPa, IGS has a good working relationship with CPa and has found that CPa's approach to the competitive marketplace in Pennsylvania has encouraged and fostered competition. CPa's approach to the competitive marketplace is one of the reasons IGS chose to market on the CPa system.

While encouraging, the level of competition could be substantially improved. Specifically the level of competition can be increased through the purchase of receivables, minimizing the

[1] Public Utility of Ohio, *Natural Gas Customer Choice Program Customer Enrollment Levels*, July, 2004, available at www.puc.state.oh.us/PUCO/StatisticalReports/Reports.

purchase cost associated with purchasing receivables, eliminating excessive imbalancing fees by tying those fees to actual cost resulting from the imbalance, increasing consumer education and encouraging the utilities to embrace the programs and to communicate a positive message to consumers regarding choice. These issues will be addressed more fully in the following sections.

2. The Effect of the Price of Natural Gas on Competition.

The market price of natural gas continues to be volatile, although this has not always been the case. In the current market, which does not appear to be stabilizing anytime soon, the existence of a regulated price against which marketers have to compete, primarily with respect to residential customers, has a restrictive effect on competition. Whether or not marketers want to compete against a regulated price, in most markets it is or becomes the price to compare the marketer price against. A marketer’s fixed or variable price, which is a distinctly different product from a regulated price (which is adjusted periodically and has a prior period cost recovery factor imbedded in the formula to account for over and under estimations on the anticipated actual costs for the utility), is nonetheless compared to the regulated price by residential consumers. Since the regulated price is not and, by the nature of the formula utilized to calculated the regulated price, cannot be a reflection of the than current market prices marketers and the utilities pay for the natural gas commodity, marketers and ultimately residential customers are at a disadvantage. The disadvantage exists because a marketer might have a fixed price offer that would guaranty a customer a stable rate through what have become volatile winters, but if the rate is not below the then current regulated price, consumers will typically not make the change. The same is true with a variable price offer. Ultimately, to make the natural gas market competitive, artificial prices need to be removed from the equation.

3. The Effect of Consumer Education on Competition

One of the most significant factors that affects the success or failure of a competitive marketplace is consumer education and the utilities embracing competition. Consumer education in the form of mailers, seminars, informational sessions and information on websites is only a small part of what needs to occur for competition to be successful. In order for customers to know about, understand and ultimately make an educated choice about purchasing competitive services, the consumer must first know that competition exists. Beyond knowledge of the existence of competition, however, even more critical to its success is education of utility customer representatives that have contact with utility customers on the proper manner of consumers education. If the utility representatives do not know about competitive services and have not been properly trained on how to respond to inquires regarding competitive services, competition will not survive. If the utilities are not encouraged to create an atmosphere that nurtures and fosters competition when contacted by customers regarding competition, customers can be forever turned off to competition. Since the majority of residential customers have had only utility services, they will rely upon the utilities representations regarding competition when making a decision or forming an opinion regarding competition. If the utility has a negative position regarding competition, competition will fail. Therefore, it is critical that consumer education goes beyond mailers and seminars, but rather is embraced by the utilities from the perspective of the general public.

4. The Effect of Customer Information/service on Competition

Marketers rely upon customer information provided by the utility. In fact, the information provided by the utility related to customers is critical to marketers maintaining relationships within a specific utility area. Since the marketer does not read meters and does not provide invoices, the customer information gathered, recorded and provided by the utility to the marketer is essential. Additionally, since the utility has access to their entire database of current customer information, utilities that provide customer lists to marketers are even more desirable to marketers. IGS has found that utility provided lists are the single best resource for conducting marketing campaigns, and without the lists, enrollment and participation is significantly impacted. Permitting and even requiring utilities to provide the customer lists would significantly increase competitive interest. At this time CPa provides a list, for a fee, as well as Dominion. IGS is not aware if other utilities provide customer lists.

5. The Effect of Supplier Financial Security Requirements on Competition

Requiring a security deposit, if it is not based on definitive credit worthiness criteria, can have an anti-competitive effect. To foster competition, security deposit requirements should be related to credit concerns the utility establishes regarding financial stability. CPa requires a security deposit for a marketer to enroll customers on its system. IGS believes that the security deposit requirements behind CPa have been reasonable. However, it is IGS' understanding that not all security deposit requirements are as reasonable. A security deposit requirement should be tied to identifiable credit criteria that are clearly delineated. If a marketer can present financial statements that demonstrate an acceptable financial picture or has an S&P, Moody, or Dun & Bradstreet rating at an acceptable level, the security deposit requirement should so reflect. Additionally, various forms of security should be acceptable as collateral, including cash, letters of credit, parental guaranty based upon the creditworthiness of the parent, bonds, and other forms of similar collateral. By permitting various forms of collateral, marketers can more effectively maximize resources while meeting the credit requirements of the utilities.

6. The Effect of Natural Gas Distribution Company Penalties on Competition

Penalties associated with over and under delivery of natural gas can be a significant hindrance to competition for two reasons. First, excessive fees create financial risk that discourage a marketer from entering into a market. Second, excess penalties are often credited to the utility sales customers, subsidizing their commodity cost and contributing to an artificial price to beat. Generally, the fee assessed by a utility to a marketer for over or under delivering natural gas should be consistent and should reflect the actual costs incurred by the utility for the over or under delivery event. When a charge for over or under delivery is excessive and does not accurately reflect the economic impact associated with the event, it can be an anticompetitive factor. For example, in the summer months, over or under delivery is often neither beneficial to the marketer nor detrimental to the utility. However, a penalty may nevertheless be assessed by the utility for over or under delivery of natural gas. One utility charges a fee of $75.00 per mcf for failing to meet the daily base load requirements. Although IGS strongly supports base load nominations, an error in a daily nomination during a non-critical period should not result in a penalty of $75.00 per mcf, in addition to any actual costs incurred by the utility.

Although IGS recognizes that the amount of the over or under delivery penalty is intended to be a deterrent to marketers taking advantage of the system, when there is no advantage present, no actual damages to the utility and/or the incorrect nomination is inadvertent, a penalty is not necessary and deters marketers from entering the market. Since the utilities retain the right to charge actual expenses incurred by the utility for over or under delivery by a marketer, the penalty is unnecessary. Further, during non-critical days, such occurrence should not result in a penalty being assessed in addition to the actual expenses incurred by the utility, unless abuse has occurred. An abusive event can be tied to both frequency of failure to deliver base load amounts and the timing of the event. Regardless, the penalty should not be so restrictive that it deters a marketer from entering the marketplace.

7. Avenues for Encouraging Increased Competition in Pennsylvania

In responding to the previous six questions we have cited several ways to increasing competition, including removing or reducing artificial price signals, increasing consumer education but more importantly getting the utility onboard when communicating with customers, keeping financial requirements reasonable, and eliminating excessive penalties which are not cost based and subsidize utility sales customers. In addition to the foregoing, we will also discuss the positive attributes of purchasing receivables.

A. Purchase of Receivables

The purchase of receivables is a significant factor for IGS when deciding whether to compete in a market for a number of reasons. When a utility does not purchase receivables, the increased costs in time, money and lost opportunity associated with marketing to and maintaining residential customers behind a utility that does not purchasing receivables can and does reduce the marketer's desire to enter that marketplace.

With respect to the purchase of receivables, the time, capital/risk and opportunity costs all need to be considered by a marketer when deciding to enter a market.

i. Increased Time Costs.

With respect to the costs associated with increases in time to enter a market, participating in a program that does not purchase receivables necessitates a significant increase in development and implementation of software systems and infrastructure, IT maintenance and increased demand on IT professionals. When a utility does not purchase receivables, a marketer must track each individual residential customer account on an individual basis to ensure that timely and accurate information is being retained and communicated between the utility and marketer and, ultimately to the customer.[2] This requires an accounting and inventory software system that can communicate with the utility on a continuous basis to ensure that the information gathered by the utility is timely and accurately communicated to the marketer and that accurate and timely records of the same are being stored, maintained and communicated to the customer.

In essence, when a utility does not purchase the residential receivables, a marketer needs to have a software system that is capable of producing bill ready information and an accounting software system that can maintain each individual account with respect to natural gas supplied, invoiced, consumed, credits and payments, as well as age individual accounts.

Additionally, since the utilities do not typically operate on the same or even similar software systems, there are also time costs associated with ensuring that the software system that a marketer utilizes can communicate with the software system that the utility maintains. Since the utilities have already created such systems and need to bill the customer for the transportation charges regardless of who provides the commodity portion of the natural gas service, in many instances creation of such a system would not only take time but would be redundant.

The creation and implementation of a bill ready software system must be achieved before a marketer can enter a market where the utility does not purchase receivables. With the relatively short periods of time available to marketers with respect to marketing opportunities, given the need in most markets for marketers to compete against regulated prices that often do not reflect the than current market price of natural gas, the significant lead time required to enter a market when receivables are not purchased can and does deter market entrants. With the

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[2] This in part assumes that the utility is providing the customer with a consolidated bill that includes both the utility's charges as well as the marketer's charges. Although timely and accurate information is always necessary regardless of which entity is providing the monthly bill, when the billing is being provided by the utility and the receivable is being purchased by the utility, a marketer can more comfortably rely upon the aggregate information being provided by the utility on a monthly basis.

increased time investment associated with marketing and maintaining business on a utility system where the utility does not purchase the receivables, often for this reason alone marketers are inclined to dedicate their resources to markets where receivables are purchased by the utility.

ii. Increased Costs

As a continuation of the theme in the previous section, when a utility does not purchase receivables, in addition to the increased time necessary to develop, maintain and manage the software infrastructure, there is an associated increase in capital investment that is necessary to obtain and maintain such a system. Given the relatively small margins that a marketer can charge and remain competitive when offering products to customers, the significant capital expenditure associated with tracking, accounting for and collecting the receivables makes entry into such markets less palatable. With the significant costs associated with marketing, enrolling and maintaining a customer base, the increased costs associated with developing and maintaining a more substantial software system does not encourage marketers to enter the marketplace. When many utilities are willing to prepare and send the monthly customer invoice with the marketers charges included and maintain and collect the receivables, with little or no fee for that service, marketing behind a utility that does not purchase receivables becomes a more difficult and expensive proposition.

iii. Increased Risk

A third reason marketers are more inclined to invest resources in a market where the utility purchases receivables is the increased risk associated with collecting receivable. Given the small margin that is associated with natural gas accounts, if the marketer also had to dedicate resources to tracking, aging and collecting the receivables, along with the loss associated with uncollectable accounts, the desirability of the market is reduced. Additionally, given the significant financial investment that is required when the marketer is responsible for the receivables, a marketer is inclined to dedicate the resources to a market where receivables are not an additional risk and the receivable cost is a known factor.[3]

B. Fees Associated with Purchase of Receivables

The purchase of receivables by a utility encourages competition. IGS recognized that a utility that purchases receivables has the collection risk and that there is an associated cost. Although it is understandable that the utility does not want to assume the risk of collection without a mechanism in place to recover uncollectable receivables, it is imperative that the mechanism is based upon actual bad debt costs and does not encourage abuse and waste. Abuse and waste occur when a utility purchases receivables and the utility is not able to terminate service to a residential consumer that does not pay for the service. If the utility has purchased the receivable, the marketer will get paid regardless of the individual customer's failure to pay. Since the marketer will get paid regardless of payment by the individual consumer, even if the marketer is permitted to drop the individual customer from the program for non-payment, the marketer will not know that payment has not been made and will, therefore, not drop the customer for non-payment. If the utility is not permitted to terminate service, a customer could simply sign up with a marketer behind a utility that purchases receivables and never pay a bill, but continue to get service. Ultimately, the marketer will pay in increased receivable purchase costs. In fact, that appears to be the situation currently with CPa. Since CPa purchases receivables, IGS continues to supply natural gas to all of its residential customers, regardless of payment. Since CPa is restricted from terminating service to such customers, through no fault of

[3] Utilities that purchase receivables will do so for a specific percentage, typically between one and two percent, but can be as high as five percent, which is a defined percentage.

CPa, non-payment has increased to a level significantly above what has been IGS' experience with all other utilities. The system, ultimately, encourages a residential customer to sign up with a marketer and not pay his or her bill thereafter. The utility cannot terminate service and the marketer will not have knowledge that the individual customer has not paid and will not terminate the customer from the program. The result is higher costs to the marketer.

In order to reduce the cost associated with the purchase of receivables, it is essential that the utility be able to terminate service to a non-paying customer that has elected to purchase its natural gas from a marketer, and do so without first dropping the customer from the program. This will enable the utility to reduce bad debt and will ultimately reduce the charge associated with the purchase of receivables, while keeping consumers enrolled in the program.

Another issue regarding the purchase of receivables and, ultimately, increasing the level of competition in the natural gas market, is instituting a bad debt tracker. A bad debt tracker enables the utility to account for uncollectable debt and to pass the cost associated with bad debt to all natural gas consumers equally, regardless of whether they are with the utility or a marketer. Where a bad debt tracker has been instituted, some utilities are able to purchase the receivables for no fee, or a much lower fee of between one and two percent (1%-2%). This enables the utility to purchase the receivables and does not disadvantage sales or transportation customers, treating all customers equally. By doing this, there is no charge to the marketer and 100% of the marketers revenue is paid to the marketer, and the utility is made whole for bad debt. Also, it creates a more competitive market because customers that have chosen to use a natural gas supplier for the commodity portion of their service are not treated differently than those that have remained with the utility for all services.

III. Conclusion

IGS is encouraged by the level of competition in Pennsylvania and anticipates increasing its marketing efforts in Pennsylvania. IGS would be inclined to market behind additional Pennsylvania utilities if the issues addressed herein were standardized throughout the utilities. When the utility purchases receivables at a cost-reflective level, is flexible on penalties and ties penalties to critical periods and has reasonable security requirements, IGS is more eager to enter the market. Pennsylvania has benefited its residents and businesses by permitting and encouraging competition in the natural gas market and should continue to create an atmosphere that fosters competition. Competition benefits consumers, stimulates growth and creates savings. IGS thanks you for this opportunity to address the Commission.

Respectfully submitted,

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