BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Investigation of Pennsylvania's Retail Natural Gas Supply Market	: :	**Docket No. I-2013-2381742**

COMMENTS OF THE
OFFICE OF SMALL BUSINESS ADVOCATE

I. INTRODUCTION

On September 12, 2013, the Pennsylvania Public Utility Commission ("Commission") issued an Order in the above-captioned matter initiating a formal investigation ("Investigation") into the current status of Pennsylvania's retail natural gas market to assess whether effective competition exists and make recommendations for improvements to ensure that a properly functioning and workable competitive retail natural gas market operates in the state.[1] The Order indicates that the investigation will proceed in two phases. The first phase will assess the status of the current retail gas market and explore what changes are needed to allow customers to best realize the benefits of choice.[2]

The Office of Small Business Advocate ("OSBA") submits the following general comments as well as responses to the Commission's specific questions pursuant to the Order.

II. GENERAL COMMENTS

The underlying premise of the Investigation appears to be that ratepayers always save money by shopping. The OSBA is not aware of any empirical evidence addressing the question of whether retail natural gas customers who currently shop are paying lower prices, on average,

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[1] *Investigation of Pennsylvania's Retail Natural Gas Supply Market*, Docket No. I-2013-2381742 (Order entered September 12, 2013) at 2.

[2] *Id.* at 3.

than customers who do not shop. Moreover, in the absence of forced switching, there will always be a potentially large percentage of customers who will exercise their right to shop and not switch, *i.e.,* they will make a rational choice to forego "introductory" savings of a few dollars per month so as to avoid the need to constantly monitor renewal offers. In the OSBA's view, it is likely that many of these customers rely on the Commission to ensure that utility gas supply rates are just and reasonable.

It may be advisable, prior to implementing a policy goal that necessitates expending significant resources on increasing retail shopping rates, to engage in such analysis, if none in fact already exists, to confirm the Commission's apparent underlying premise that customers will consistently fare better if they shop. The OSBA acknowledges, however, that such an analysis would be difficult given the variability of purchased gas cost ("PGC") rates from quarter to quarter, due both to the volatility of gas prices and the operation of the current gas cost reconciliation mechanism.

III. RESPONSES TO QUESTIONS

1. *What is the current status of retail natural gas competition for customers, by class and by service territory, and for NGSs? For each such customer class and service territory, how accessible are competitive suppliers?*

The OSBA will defer to the natural gas distribution companies ("NGDCs") to provide current shopping statistics for each of their territories.

2. *Are currently effective NGDC rates properly structured to reflect the separation between the costs of the NGDC's role as a distribution utility and its role as a Supplier of Last Resort (SOLR)?*

In the OSBA's view, the currently effective NGDC rates are structured properly to reflect cost differences, since each NGDC now applies a merchant function charge ("MFC") and gas procurement charge ("GPC") to non-shopping customers. While an NGDC's MFC and GPC will need to be updated in a Section 1307(f) proceeding and/or base rates case (as required by statute), the existing *rate structure* is sufficient to separate delivery and SOLR costs.

However, the OSBA retains a concern that the existing PGC pricing mechanism does not provide a rational and understandable price signal for competition. PGC rates are highly variable, and the rates contain a muddle of current period costs and prior period reconciliation. Regarding rate instability, the OSBA notes that in the electric industry in Pennsylvania, electric generation suppliers ("EGSs") generally support a policy of pricing default electric service at or near spot market prices, in order that such prices: a) reflect "prevailing market prices"; and b) are sufficiently unstable so that EGS offers may be more attractive. In the natural gas arena, PGC rates generally remain in effect for a 3-month period, and are inherently unstable, often exhibiting large swings in the middle of winter periods.[3] And yet this price instability in PGC rates has not led to significant market penetration by natural gas suppliers ("NGSs"). It may be that NGSs are not able to offer more stable and therefore more attractive rates (given the weather sensitivity of demand for natural gas), or it may be that the instability in PGC rates makes it all but impossible for customers to price shop for a full winter of service. If higher shopping rates are the goal, it is possible that competition would benefit from a more stable and predictable Price To Compare ("PTC"), by giving the NGSs a clearer price target.

Current PGC pricing and reconciliation is complex and confusing, and includes the following curious attributes. First, the "C-Factor" component of PGC rates, per long-standing Commission policy, does not reflect only the current cost of gas, but also includes some of the prior period revenue-cost variances. While this approach may have made some sense in pre-

[3] The correlation of PGC rates with spot market prices is presumably not that high, due to effects of hedging and reconciliation.

competition days for auditing purposes, it has been an anachronism for more than a decade. The OSBA would recommend that the C-Factor component of PGC rates include only the best estimate of the current period cost of gas, excluding prior period revenue-cost variances.

Second, a migration rider is mandated by statute, though it has not been consistently applied in Pennsylvania. If the migration rider were to be implemented sensibly, it would reflect only prior period variance recovery, and would apply only to customers who took PGC service during the period when the variance was built up. In the OSBA's view, neither of these conditions is consistently applied in Pennsylvania.

Furthermore, despite the mandated migration rider, the Commission has determined that the PTC shall include the E-Factor charge. Thus, a customer that opts to shop will not see a utility bill reduction equal to the PTC, which is understandably confusing. A better approach would be to require NGDCs to report their PGC prices on bills, with current period and prior period charges separately shown, and include a note indicating that if the customer chooses to shop, it will continue to incur the E-Factor charge (or credit) for a period of up to 12 months.

3. *Does the existing market design of NGDCs serving as the SOLR present barriers that inhibit customer choice or prevent suppliers from fully participating in the retail market?*

No. However, gas supplies cannot be delivered absent pipeline capacity. At present, NGSs are required to take mandatory capacity assignment from NGDCs when supplying customers, which is appropriate and necessary in order to avoid "stranded" capacity costs as customers shop. As a result of mandatory capacity assignment, NGSs can only compete against gas *commodity* costs, not capacity charges. The OSBA would oppose any alternative to the current practice of mandatory capacity assignment.

4. Should NGDCs continue in the role of SOLR?

Yes. The OSBA believes that gas commodity prices for gas traded on the interstate pipeline system are transparent and highly competitive. It is unlikely that independent NGSs can consistently or materially beat NGDCs in purchasing gas in these markets over time, if for no other reason than NGSs would need to make a profit on commodity sales while NGDCs are not permitted to mark-up commodity costs. Moreover, in the past when the Commission has invited the NGSs to present credible alternatives to the NGDC as SOLR, *e.g.,* the Philadelphia Gas Works ("PGW") Supply Collaborative, the NGSs did not even propose that they replace the NGDC as SOLR.[4] If the supplier proposals presented in the PGW Supply Collaborative are any indication, the OSBA is not confident that NGSs present a credible alternative to the NGDC as SOLR.

5. Are there enhancements and updates to the current SOLR model that would further improve the state of competition within the retail natural gas market?

a. Are there opportunities through the potential restructuring of the SOLR model and retail gas market to encourage expansion of natural gas distribution facilities into areas of the Commonwealth that do not currently have access to natural gas facilities?

b. Are there changes to the retail natural gas market that the Commission can undertake de novo through regulation or policy that would promote retail natural gas competition?

c. Are there changes to the retail natural gas market that the Commission can undertake de novo through regulation or policy that would remove barriers to retail natural gas competition?

d. What legislative changes should be made to further improve the retail natural gas market in Pennsylvania?

To the extent this question relates to the expansion of distribution systems to provide access to more supplies, the OSBA believes that ratepayers can benefit from the introduction of more gas *producers* into the market. The OSBA would support the elimination of regulation and

[4] *Pa. P.U.C. v. Philadelphia Gas Works*, Docket No. R-2008-2073938.

NGDC policies that discourage the economic interconnection of new local producers. While at this time, the OSBA cannot cite any specific examples of NGDC policies that discourage the entry of new producers, the following issues may bear investigation:

- Some NGDCs offer discounted distribution rates to customers who might otherwise bypass their distribution systems. While this policy benefits distribution ratepayers by retaining some margin from these customers, it may also serve to discourage the development of some new supply sources.
- NGDCs may impose unreasonably high tariff charges on gas suppliers who use the distribution systems to access the interstate markets.

To the extent this question relates to expansion to serve more gas consumers, the OSBA is unsure how current SOLR regulations affect distribution system expansion. Customer contribution policies can inhibit economic expansion of the distribution grid, and the OSBA generally supports efforts such as the UGI GET Gas pilot to address those issues as long as they meet reasonable economic criteria.

6. *Are there outcomes from the Commission's recently completed electric RMI that would be applicable and useful to implement in the retail gas market? To the extent possible, please provide comments on the following topics:*
    a. *Seamless Move*
    b. *Accelerated Switching Timeframes*
    c. *Standard Offer Program*
    d. *Low-income customer shopping*
    e. *Expanded Consumer Education about shopping*
    f. *Any additional RMI initiative that would translate well to the retail natural gas market*

Provided that the costs are reasonable, the OSBA has no objection to more seamless moves, accelerated switching, and expanded education. However, it does have concerns about a standard offer program. It is unclear, given the unstable nature of PGC rates, whether a standard offer program would provide a consistent, predictable benefit to ratepayers, and whether NGSs would be willing to participate (including responsibility for costs) in such a program without being able to quickly opt in and out each time the PGC rate changes.

7. *To take advantage of the opportunity that is present through the Marcellus Shale resource, should NGDCs and NGSs be encouraged to explore opportunities with natural gas exploration and production companies?*

In the OSBA's view, producers do not need any assistance from regulated NGDCs. Moreover, an NGDC/producer alliance could result in a conflict of interest in connection with an NGDC's responsibility to procure gas supply in a least cost manner. To the extent that NGSs want to work with producers, they are free to do so.

8. *Recognizing that the Commission withdrew the proposed rulemaking addressing NGDC business practices at Docket No. L-2009-2069117 and committed to commencing a new proposed rulemaking on these issues, please provide comments on the continued need to address standardized supplier tariffs and business practices with regard to imbalance trading, tolerance bands, cash out and penalties, nominations and capacity.*

The OSBA takes no position at this time with regard to standardized supplier tariffs and business practices. The OSBA does note that NGDC practices in this respect vary substantially from utility to utility, and that standardizing the various approaches would likely be a complex undertaking.

IV. CONCLUSION

In view of the foregoing, the OSBA respectfully requests that the Commission proceed with the Investigation consistent with the OSBA's comments.

Respectfully submitted,

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