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FILE NO: 7638/02

ORIGINAL

August 27, 2004

Re: <u>Investigation into Competition in the Natural Gas Supply Market</u>
<u>Docket No. I-00040103</u>

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2004 AUG 27 PM 4: 23
PA PUC
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James J. McNulty, Secretary
Pennsylvania Public Utility Commission
P. O. Box 3265
Harrisburg, PA 17105-3265

Dear Mr. McNulty:

Enclosed for filing are an original and ten copies of the Comments of Amerada Hess Corporation in the above-referenced matter, together with a diskette containing an electronic version of the comments.

Regarding the three categories of information in Annex A to the Commission's May 28, 2004 Order that natural gas suppliers were directed to file with the Commission, Amerada Hess respectfully declines to provide the data requested until such time as a Protective Order is entered. All of the requested information is competitively sensitive and capable of being used for anticompetitive purposes. In private sales discussions and public advertising, competitors may use the customer complaint/dispute/inquiry information to disparage their rivals, possibly with misleading interpretations of the data and yet bolstered by the credibility of the Commission's website as its source. Two of the most closely guarded competitive secrets in the industry are the numbers of customers and volumes of gas delivered by an NGS in each NGDC system. Such information should be obtained in aggregate form from each NGDC, which can readily provide the information in a competitively neutral fashion. If each natural gas supplier is required to provide such data, the information should be filed under seal and maintained in confidential non-public folders only for the Commission's use.

Very truly yours,

DOCUMENT FOLDER

RHOADS & SINON LLP

By: James H Cawley
James H. Cawley

Enclosures
cc: Patricia Krise Burket, Esquire, Law Bureau
Robert Bennett, Energy Manager, Bureau of Fixed Utility Services

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Before The
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

Comments of Amerada Hess Corporation

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DOCKETED
SEP 23 2004

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August 27, 2004

Introduction

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

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

A. Volumetric tolerances

B. Cashout and penalty rates

C. Pooling regulations and imbalance trading

D. Telemetry utilization and cost

E. Data accuracy, availability and timeliness

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

Overview

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

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

Comments

Affiliate Standards of Conduct

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

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

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

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

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

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

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

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

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

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

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

Agency Programs

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

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

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

Operational Rules

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

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

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

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

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

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

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

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

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

Performance Based Rates

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

Conclusion

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

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

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

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

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

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

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

EXHIBIT A

PA Utility Comparison

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

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August 27, 2004

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James J. McNulty, Secretary
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Commonwealth Keystone Building
400 North Street – Filing Room (2nd Floor)
P.O. Box 3265
Harrisburg, PA 17105-3265

Re: Investigation into Competition in Natural Gas Supply Market; Docket No. I-00040103; **TESTIMONY OF SHIPLEY ENERGY COMPANY**

Dear Secretary McNulty:

Enclosed for filing with the Commission are the original and ten (10) copies of the written testimony and a diskette containing an electronic version of the written testimony of Matthew Sommer on behalf of Shipley Energy Company in the above-captioned matter.

If you have any questions regarding the enclosed information, please do not hesitate to contact the undersigned.

Very truly yours,

Todd S. Stewart
Counsel for Shipley Energy Company

TSS/tap
Enclosures

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MAILING ADDRESS: P.O. BOX 1778 HARRISBURG, PA 17105

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BEFORE THE
PENNSYLVANIA UTILITY COMMISSION

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

TESTIMONY OF MATTHEW SOMMER
ON BEHALF OF SHIPLEY ENERGY COMPANY

Dated: August 27, 2004

Q. Please state your name for the record.

A. My name is Matthew Sommer.

Q. By whom are you employed and in what capacity.

A. Shipley Energy Company as a Business Manager.

Q. What is the purpose of your testimony in this proceeding?

A. The purpose of my testimony is to respond to the Commission's Order initiating this investigation, in which the Commission asked Commenters to address seven listed topics and any additional issues that the witness believed to be relevant to the competitive state of the natural gas market in Pennsylvania, including suggesting ways by which the Commission might improve the competitiveness of those markets.

Q. What is your assessment of the level of competitiveness and competition in the natural gas supply market in Pennsylvania?

A. Shipley has been able to offer value to customers, both in the UGI and Columbia gas markets, by providing one-year fixed price contracts, which over the course of the contract, have provided savings to those customers over what they would have paid if they had remained on Supplier of Last Resort ("SOLR") service. Consequently, Shipley has been able to gain a foothold in both of those NGDC service territories. Nonetheless, for a variety of reasons that I will discuss below, Shipley's ability to garner additional customers has been hampered, and Shipley continues to face NGDC rules and behavior that negatively impact its ability to continue to serve its customers.

Shipley's over-all assessment is that the market is far less competitive than it otherwise could be. For instance, Shipley is the only NGS currently serving residential customers on the UGI system and is one of a very few suppliers serving customers on the Columbia system. Nonetheless, if the Commission is willing to invest the effort in making the changes within its aegis, and in championing some additional changes in the General Assembly, there is a good chance that the present situation can be turned around. Some positive changes would be to allow NGSs to provide services that only NGDCs may currently provide and to remove some of the other remaining barriers to competition. The one issue that has perhaps had the largest impact, but which the Commission may not be able to change on its own, is the negative impact of the translation of §1307(f) pricing mechanism into the price to compare.

Q. What affect, if any, does price have on natural gas competition?

A. Over the past several years, for a variety of reasons, wholesale natural gas prices have been trending upward, which can make it difficult to attract and retain customers. This difficulty is compounded by the fact that there is a built-in lag in the adjustment of gas cost rate prices that SOLR customers face, and against which NGSs compete. Coupled with the incentive that NGDCs have to continually under collect those charges, and the price differential can appear to be significant. SOLR customers, may not even be aware of the increasing price, and because of the way gas cost rates are translated into the price to compare, customers are almost never aware of the true cost of the gas that they use. When coupled with the fact that NGDCs change their prices quarterly, and sometimes more frequently while the price to compare remain static, it only adds more confusion. Moreover, such adjustments have the potential to be somewhat arbitrary, and therefore highly detrimental to a NGSs continuing ability to compete.

By way of example, last year, one of the two NGDCs in whose service territories Shipley competes, made an interim adjustment to its gas cost rate and lowered it by over $2.00 per mcf. The timing of the interim adjustment was such that the information became available to the public at about the same time that Shipley was marketing its new price for contract renewals for the coming year. The NGDC's adjustment had the affect of making Shipley's offer look highly unattractive even though it was likely that before, or during the winter heating season, the NGDC would have to increase the gas cost rate significantly; which it did. The result was a loss of customers that returned to POLR service and unwittingly paid more for their gas than they would have if they had remained with Shipley -- these customers could have locked-in a one year fixed price from Shipley of $7.25 mcf for service beginning in September of '03, but instead returned to the SOLR provider and ultimately paid as much as $7.46 and then $8.33 mcf during the heating season.

The gas cost rate-pricing mechanism can have a severe and negative impact on a NGS's ability to do business. Even the ordinary quarterly adjustment process makes it very difficult for suppliers to make offers of a fixed price over a one (1) year period -- which is what customers want -- because at some period in the course of the year it is possible that the NGSs price may exceed the NGDCs GCR. Nonetheless, over the long term, the NGS will almost always save the customer money. Depending on the timing, however, the competitive price may not appear to be so competitive.

Q. Has consumer education had any effect on competition?

A. From a marketers perspective, there can never be too much consumer education on the benefits of competition, so long as there are NGSs out there willing to serve customers in any particular service territory, because hardly anything is more frustrating to customers who want to choose than to have no competitive alternatives available. In general, however, Shipley believes that there should be a variety of means of communications to customers.

Q. How have customer information and customer service rules impacted competition?

A. Shipley believes that customer service/information rules can be modified to increase competitive opportunities. In particular, Shipley believes that NGSs such as Shipley should be able to provide seamless service to customers. That is, if Shipley is contacted by a customer who currently does not have gas service but who lives in area served by a natural gas distribution company, Shipley should be able to sign up that customer as a supply customer and then interface with the appropriate natural gas distribution company to have the customer connected to the supply system and make all of the arrangements necessary to provide service to that customer. In addition, Shipley should have the ability to provide that customer with a single bill that would include both its charges and the natural gas distribution company charges. By allowing the NGS to be the sole interface with the customer for all services related to gas supply, Shipley would have the same competitive opportunity that the NGDCs have in marketing their SOLR service. It is only when all such barriers to competition are removed, and the NGSs are allowed to compete on an even playing field with the NGDCs, that NGSs will be able to meaningfully penetrate the market and provide the benefit of competition to customers. The same would hold true for other services, which could be unbundled from the distribution rate including meter reading and any other similar services.

Q. What effect do NGDC supplier security requirements have on Shipley's ability to compete?

A. As the Commission is probably aware, Shipley just completed a litigated matter before this Commission where Shipley challenged the level of financial security imposed upon it by one of the NGDCs in whose service territories it operates. UGI's tariff required that any NGS, including Shipley, would have to provide financial security of $1,200.00 per residential customer. While Shipley was otherwise happy to serve as many residential customers as possible, the geometrically expanding financial security requirements made any increase in customers disproportionately more costly to Shipley. That is, because of the combination of a high level of security, and a requirement that allowed Shipley to provide that security only in the form of a Letter of Credit, increasing customer counts dramatically increased the negative impact on Shipley's credit availability which negatively impacted all of its businesses. In short, imposing high levels of financial security, that are not reasonably related to the exposure that the NGDC might face in the event of a bankruptcy or default of the NGS, poses a very real barrier, not only to initial entry into the market but also to expansion of customer base. In Shipley's case, which the Commission did rectify, UGI was imposing a financial security requirement that was in excess of three (3) times the annual commodity charges to the typical residential customer. While it is true that the annual carrying cost for credit instruments may not be, in and of themselves, a significant barrier to entry, that is not the only issue. High security requirements coupled with draconian forms of security can impose severe restrictions on the ability or desire of NGSs to enter into a particular service territory. NGDCs do have the ability bi-annually to propose adjustments to security requirements as well. Shipley believes that any such adjustments should be transparent and should apply equally to all NGSs, unless there is some NGS-specific change. That is, if an NGDC chooses to have a per-customer security requirement, which appears to be the most appropriate, that security requirement should be based upon transparent market and consumption data that apply generally, as opposed to a black box, supplier specific, security requirement which is unverifiable and potentially discriminatory and/or anti-competitive.

Moreover, in today's economic climate, it is important to recognize that utilities are not immune from financial difficulties. To the extent that NGDCs bill on behalf of suppliers, the NGDC can hold significant amounts of NGS revenue. Under such circumstances, security requirements should be bilateral and based upon the level of NGS revenue that the NGDC holds during the peak billing months of the year.

Q. What affect have natural gas distribution company penalties or other costs had on competition?

A. The penalties alone, even though they are potentially significant and are almost never cost based, are not the only problem involving NGDC rules. The rules upon which the penalties are founded also require critical examination. In particular, some NGDCs have nomination and delivery requirements that align closely with the requirements of the interstate transmission pipelines, while other NGDCs have requirements which do not. More often than not, this latter group require the NGSs to deliver with absolute perfection or face significant and drastic penalties. As significant as these nominations requirements may be, the problem is exacerbated when an NGS serves across multiple territories where the rules differ. These varying nomination and delivery requirements across NGDC service territories create a second barrier to entry. Specifically, and particularly in the residential market, the more diverse the rules are across NGDCs service territories, the more likely that mistakes will be made because of confusion on the part of either of the NGS or its wholesale suppliers. In Shipley's own experience, it has had difficulty in finding wholesale suppliers who are willing to deliver gas to it in certain NGDC service territories because the rules are so different from industry standards, which increases the possibility of penalties and the financial risks associated with them. In many cases these rules may differ from the rules that the NGDC applies to its own gas supply operations. Choice markets are more competitive in the Western part of the state, and although the tariffs in those markets could be improved as well, they appear to be more appropriate as models for how to promote competition that could be better adopted for statewide use. Shipley suggests that the Commission examine these rules, with the goal of creating a set of rules that are as similar as possible and which track the nomination requirements of the interstate pipelines. However, Shipley believes that penalties for imbalance in particular, should be cost-based.

Q. Are there any things that the Pennsylvania Public Utility Commission could do to encourage competition in Pennsylvania?

A. Yes. In addition to the items that I have discussed above, which include: 1) allowing NGSs the ability to sign up new customers and contact the NGDC on behalf of the customer to arrange for new service; 2) allowing NGSs to provide a single bill; 3) requiring reasonable and transparent security requirements; and, 4) creating consistency in rules including reasonable penalty structures across service territories. Shipley believes that one additional critical item which must be addressed is the treatment of gas cost rates, their inclusion in the price to compare, and the effect of the adjustment mechanism. As the Commission is well aware, in today's economic climate there is an incentive for natural gas distribution companies to under-collect gas cost charges from their customers. This incentive arises from the interest which NGDCs are allowed to collect from customers in addition to the actual gas charges, when NGDCs under-collect. This incentive has the effect of creating a perpetual lag in gas cost charges so that gas cost charges are not reflective of the actual cost of gas in the period in which they are collected. Moreover, when a customer wants to switch from SOLR service to service by a competitive provider, they must continue to pay these costs for the next year, making the switch to competition very difficult and very difficult to explain to customers.

There are several potential solutions to this problem, including a re-examination of the make-up of the price to compare, with the possibility of adjusting it without regard to the gas cost charges, and instead relying on a market based mechanism. Similar to proposals in the electricity markets, NGDC's could be required to adjust the price to compare monthly to account for experienced gas costs. Such an adjustment would send the appropriate price signals to consumers and would allow NGS to compete against a more realistic market-based price. Such a mechanism would go a long way toward eliminating the negative impact of the collection lag. Under such circumstances, the price to compare could be stated as two prices: 1) the current month's market-based price; and, 2) a rolling twelve-month average market price. In any event, it is clear to Shipley that until customers are able to compare NGS prices to NGDC prices on a more equivalent basis, SOLR service from the NGDC is likely to retain a competitive advantage over NGS service.

Shipley believes that the Commission also should consider mandatory customer assignment programs, similar to those used in the electric markets, if these suggestions fail to produce the desired results and in those NGDC service territories where shipping remains low or non-existent. Such programs can introduce customers to the market and overcome the inertia which has so far prevented many from choosing, even where doing so would have saved them money.

Q. Does this conclude your testimony?

A. Yes, it does.

AFFIDAVIT

I, Matthew Sommer, am Business Manager for Shipley Energy Company and am authorized to make this affidavit on behalf of Shipley Energy Company . I hereby verify that the statements contained in the foregoing document are true and correct to the best of my knowledge, information and belief. I understand that false statements therein are made subject to the penalties of 18 Pa. C.S. §4904, relating to unsworn falsification to authorities.

DATED: 8/20/2004

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August 27, 2004

DOCUMENT FOLDER

ORIGINAL

James J. McNulty, Secretary
Pennsylvania Public Utility Commission
Post Office Box 3265
Harrisburg, PA 17120

Re: Investigation Into Competition in the Natural Gas Supply Market; Docket No. I-00040103; **Dominion Peoples' Testimony and Answers to Annex A Questions Addressed to NGDCs**

Dear Secretary McNulty:

Enclosed for filing with the Commission are an original and ten (10) hard copies and diskettes containing electronic versions of the following documents:

(1) The Prepared Direct Testimony of William E. McKeown, Director, Pricing and Regulatory Affairs, The Peoples Natural Gas Company, d/b/a Dominion Peoples; and

(2) Dominion Peoples' Answers to the Questions Appearing in Annex A to the Commission's May 28, 2004 Order in the above-captioned docket.

Also enclosed are two additional hard copies of each of these documents. Please date stamp them and return them to us via our courier.

Thank you for your attention to this matter.

Very truly yours,

Lillian S. Harris

LSH:tlj
enclosures
cc: William E. McKeown
Susan G. George
Joseph Gregorini

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

PREPARED DIRECT TESTIMONY
OF
WILLIAM E. McKEOWN, DIRECTOR,
PRICING AND REGULATORY AFFAIRS,
THE PEOPLES NATURAL GAS COMPANY, d/b/a
DOMINION PEOPLES

Dated: August 27, 2004

Dominion Peoples' Statement No. 1

Q. Please state your name and business address.

A. My name is William E. McKeown. My business address is 625 Liberty Avenue, Pittsburgh, PA 17222.

Q. By whom are you employed and in what capacity?

A. I am employed by The Peoples Natural Gas Company d/b/a Dominion Peoples ("Dominion Peoples") as Director, Pricing and Regulatory Affairs.

Q. Please describe briefly your educational background and work experience.

A. I was graduated from The Pennsylvania State University in 1978 with a Bachelor of Science Degree in Business Administration. I earned a Master of Business Administration Degree from Duquesne University in 1983. I have attended in-house training courses on economic evaluation and the ratemaking process. I also have attended the American Gas Association course on gas rate fundamentals.

Prior to my employment with Dominion Peoples, I was employed by Consolidated Natural Gas Service Company, Inc. ("Service Company"). Beginning in September, 1978, I was employed as an auditor in the Internal Auditing Department. In October, 1980, I transferred to the Service Company's Rates and Certificates Department. I held various positions of increasing responsibility within that Department. During that time, I supervised the preparation of cost of service studies for Hope Gas, Inc. and CNG Transmission Corporation, and supervised the preparation of supporting data for the filing of rate proceedings for Hope and CNG Transmission before the West Virginia Public Service Commission and the Federal Energy Regulatory Commission ("FERC"), respectively. In

August, 1987, I joined Dominion Peoples as an Assistant Director, Rates, and was appointed to the position of Director, Rates and Regulatory Affairs on January 1, 1991. In that position, I was responsible for the management of the rate functions, including general rate increase proceedings, 1307(f) proceedings, special rates and special studies, and involvement at the FERC. I was also responsible for managing the development of and support for all of Dominion Peoples' Public Utility Commission-approved rates for Pennsylvania supply, delivery, and other services.

Subsequently, in November, 1997, I became Executive Assistant to the President. In that position, I was responsible for financial planning, company operating and capital budgets, gas requirements planning and forecasting, and strategic analysis. On March 30, 1999, I was appointed Director, Regulatory PGA Accounting, Pennsylvania Representative. In this position, I was responsible for managing the recovery of natural gas costs by all of the local distribution companies in the CNG system and for acting as Dominion Peoples' primary regulatory liaison with this Commission. I was appointed to my current position on January 1, 2000. My responsibilities include managing rate functions for system LDCs in Pennsylvania and West Virginia, coordinating all of the system's LDCs' activities before the FERC, and requirements planning for all of the LDCs.

Q. What is the purpose of your testimony in this proceeding?

A. The purpose of my testimony is to respond to the Pennsylvania Public Utility's Commission's ("PUC or Commission") inquiry regarding whether effective competition for natural gas supply exists in the Commonwealth. In its Order entered on May 28, 2004, *the Commission initiated an investigation pursuant to Section* 2204(g) *of the*

Natural Gas Choice and Competition Act ("the Act"). In the Order, the Commission asked the parties to address several specific topics in their written testimony and invited parties to address other topics that are relevant to assessing competition in the Pennsylvania natural gas supply market. While I cannot speak for the other Natural Gas Distribution Companies ("NGDCs") or Natural Gas Suppliers ("NGSs"), my testimony informs the Commission of Dominion Peoples' experience with natural gas supply competition in Dominion Peoples' certificated territory. I will describe the steps that Dominion Peoples has taken to address retail choice and identify a few potential measures that, if employed, Dominion Peoples believes could strengthen competition in natural gas supply markets in the Commonwealth.

Q. What do you mean by "steps that Dominion Peoples has taken"?

A. At the threshold, I note that the Act was designed to allow retail gas customers to choose among NGSs and NGDCs for natural gas supply. At the same time, however, the Act did not address the customers' choice of NGDCs; it preserved NGDCs' tariff rate schedules, and riders incorporated into tariffs, and policies or programs existing on the effective date of the Act.

Turning to your specific question, although the Act became law on June 22, 1999, Dominion Peoples began a process in 1984 to give its ratepayers the opportunity to choose their NGSs and to use Dominion Peoples' transportation service to deliver the customers' gas. The first step in that process was the unbundling of Dominion Peoples' bundled sales rates into transportation and natural gas cost components. Our initial effort began in 1984, and was addressed exclusively to our largest industrial customers. For three years thereafter, we unbundled all of our sales rates and introduced separate rates for standby and storage services. As that was occurring, more and more of our industrial and larger commercial customers began to shift from sales service to transportation service.

In 1989, we began to allow NGSs and marketers to pool or aggregate customer supplies on our systems, so that they could serve groups of customers as efficiently and economically as possible. Then, in 1992, we eliminated the so-called "volumetric threshold" from our tariff that has made the availability of Dominion Peoples' transportation service dependent upon the amount of gas that a customer consumed each year. As a result of that change, we made transportation service available to all of our customers, including our smallest ones. In 1997, we introduced our Energy Choice Program, a comprehensive and continuing effort to educate our residential and small commercial customers on their opportunity to choose an NGS and to encourage NGSs to make their services available to those customers. In effect, our Energy Choice Program brought Dominion Peoples into compliance with the customer choice and other provisions of the Act two years before it became law.

Q. Was that the end of the process for Dominion Peoples?

A. No. In our 1307(f)-1998 natural gas cost recovery proceeding, the Commission directed Dominion Peoples to address certain "restructuring issues" in our 1307(f)-1999 proceeding. Those "restructuring issues" included Dominion Peoples' plans for maintaining or abandoning the provision of retail service, including plans with respect to our renewal or termination of interstate transportation and storage contracts, our obligation to serve, metering and billing services, standby service, storage service, and recovery of stranded natural gas costs. In anticipation of having to satisfy that directive, Dominion Peoples, in late 1998, invited a cross-section of natural gas industry stakeholders to participate in what we refer to as the "Peoples Collaborative," a series of meetings among the stakeholders in which we discussed and tried to reach agreement on critical restructuring issues. We were aware, when we began the Peoples Collaborative, that the Pennsylvania General Assembly was considering comprehensive restructuring legislation -- what became the Act -- that would likely require Dominion Peoples to file a separate restructuring case with the Commission in 1999.

Q. What was the outcome of the Peoples Collaborative?

A. The Peoples Collaborative produced a formal settlement among seven of the participants. that provided a framework for the manner in which Dominion Peoples addressed certain issues in its 1307(f)-1999 proceeding. Most significant of those issues were Dominion Peoples' future obligation to serve and the manner in which it would satisfy that obligation through the reservation and assignment of natural gas supply assets. These are two of the critical issues that were addressed by the Act.

Q. What happened next?

A. Peoples filed its 1307(f)-1999 case on April 1, 1999, and a significant part of that case was addressed to the restructuring issues identified by the Commission in our 1307(f)-1998 case, as refined by the efforts of the Peoples Collaborative. Many of the entities that participated in the Peoples Collaborative also participated in Dominion Peoples

1307(f)-1999 proceeding. They included the three public advocates, a group of Dominion Peoples' largest industrial customers, two major natural gas marketers that were operating on Dominion Peoples' system and that were participating actively in Dominion Peoples' Energy Choice Program, and the Independent Oil and Gas Association of Pennsylvania, a trade association that represents both marketers and Pennsylvania natural gas producers.

Q. How was Dominion Peoples' 1307(f)-1999 proceeding resolved?

A. Dominion Peoples' 1307(f)-1999 proceeding was resolved via a settlement that was approved by the Commission. The Settlement Agreement included the following issues that also are raised by the Act: 1) action on Dominion Peoples' then-existing interstate pipeline capacity contracts; 2) balancing; 3) Dominion Peoples' reservation and assignment of gas supply assets; and 4) Dominion Peoples' obligation to serve.

Q. You mentioned previously that the Act became law in June, 1999. What was Dominion Peoples' response to it?

A. When the Act became law, the Commission issued an order adopting various filing requirements for NGDCs. On August 2, 1999, Dominion Peoples filed its testimony and related documentation in response to the Commission's July 15, 1999 Order directing that submission. The filing included Dominion Peoples' "Restructuring Plan" and two tariff supplements, the first of which governed rates, terms and conditions of Dominion Peoples' services to what are defined as "retail gas customers" in the Act and a second tariff supplement that contained the rates, terms and conditions of Dominion Peoples' services to what are defined as "NGSs" by the Act. As to the former, almost all of the rates, terms and conditions that appeared in Dominion Peoples' retail tariff exhibit had already been approved by the Commission and appeared in Dominion Peoples' then-effective tariff. As for the latter tariff supplement, Dominion Peoples noted in its filing that it had included most of the contents of the rates, terms and conditions in its contracts with suppliers or as part of operating rules that it expected NGSs to honor.

Q. What was the outcome of Dominion Peoples' Restructuring Proceeding?

A. Dominion Peoples was able to reach a comprehensive settlement of its Restructuring Proceeding with the three public advocates, Peoples Industrial Intervenors, TXU Energy Trading Company, Statoil Energy Services, Inc., Columbia Energy Services Corporation and CNG Retail Services, Inc. Statements of non-opposition to the comprehensive settlement also were filed by T.W. Phillips Gas & Oil Company, Enron Energy Services, Inc., Independent Oil and Gas Association of Pennsylvania, and PECO Energy Company. The Commission entered an Order approving Dominion Peoples' Restructuring Settlement on January 31, 2000. The tariff terms and conditions established in Dominion Peoples' Restructuring Proceeding have not changed significantly since that time. The vast majority of the tariff language that was agreed to then remains in place today.

Q. Can you summarize your testimony to this point?

A. Yes. Through a series of actions that started in 1984, Dominion Peoples already had addressed and resolved many of the issues that NGDCs were directed to address in the restructuring cases that were spawned by the Act. Those issues included the unbundling of rates, choice of gas commodity suppliers for all customers regardless of size or customer classification, open access to natural gas suppliers and marketers, consumer education, obligation to serve, and reservation and assignment of natural gas supply assets. As a result, the focus of Dominion Peoples' Restructuring Proceeding was necessarily narrower than it might have been for other NGDCs. Dominion Peoples resolved all "pending" restructuring issues through the settlement reached with all parties, as described above.

Q. How is the remainder of your testimony organized?

A. My testimony tracks the seven topics identified in the Commission's request for written testimony in its May 28, 2004 Order. The last section of my testimony addresses other issues relevant to assessing competition in the Pennsylvania natural gas supply service market. In addition, I would note that Dominion Peoples has today filed answers to the questions that the Commission addressed to NGDCs in Annex A to its May 28, 2004 Order.

ASSESSMENT OF THE LEVEL OF COMPETITION IN PENNSYLVANIA'S NATURAL GAS SUPPLY MARKET

Q. What is Dominion Peoples' assessment of the level of competition in Pennsylvania's natural gas supply market, at least as it applies to Dominion Peoples?

A. In 1986, we had less than 100 commercial and industrial customers who were using unbundled transportation service in purchasing their supplies on the open market. Shortly after the Act became law in 1999, we had about 128,000 residential, commercial and industrial transportation customers purchasing their supplies on the open market.

That represented more than 1/3 of Dominion Peoples' customers and about 2/3rds of Dominion Peoples' volumetric throughput. As of today, we have about 96,000 residential, commercial, and industrial transportation customers, which represents about 27% of our market. Volumetrically, transportation today still represents greater than 50% of our total throughput.

Dominion Peoples considers choice to be a success on its system. We have seen, however, a decline in the number of transportation customers since 1999; Dominion Peoples attributes this decline to several factors. We believe that customer participation in choice is derivative of NGS participation and activity. There are fewer NGSs operating in Dominion Peoples' certificated territory today than in 1999 and 2000. In 1999, there were 37 suppliers, whereas today there are 20. While it is difficult to pinpoint the reasons for the decline, Dominion Peoples can identify at least two possibilities, including the general winnowing out of some new entrants in the gas supply business and, to a lesser extent, the legislative change that leveled the playing field for NGDCs and NGSs on the application of the Gross Receipts Tax to sales of natural gas.

Q. Could you explain what you mean in more detail?

A. We believe that, as with any normal business cycle, the Pennsylvania natural gas supply market is in the process of maturing. It experienced the usual influx of new entrants when the Act presented new opportunities for marketers and heightened consumer interest in choice. As with other business sectors, some NGSs were better at the gas supply business than others. We believe that the decline in the number of suppliers is attributable at least in part to this natural business phenomenon. One aspect of this was that some marketers may not have been able to adjust to the marked natural gas price spikes in recent years.

In addition, when the Act was under consideration there was a built-in advantage for NGSs over NGDCs in marketing gas to consumers because the Pennsylvania Gross Receipts Tax was not applicable to sales of natural gas by NGSs, but it was applicable to NGDCs' gas sales. The General Assembly eliminated the 5% disparity for NGSs by repealing the Gross Receipts Tax for sales of natural gas.

THE EFFECT OF THE PRICE OF NATURAL GAS ON COMPETITION

Q. Do you have an opinion about whether the price of natural gas has been a significant driver in Pennsylvania's natural gas supply market?

A. We believe that the price of natural gas has had an effect on competition, and I make the following general observations in that regard. Since 2000, we have seen natural gas prices double from historical levels and, correspondingly, that is the timeframe when we have seen the greatest number of transportation customers return to Dominion Peoples' sales service and NGSs exit the gas supply market on our system. We have little doubt that there is a direct relationship between these events. Having so stated, Dominion Peoples believes that NGSs would be in a better position to inform the Commission about their experience in this regard.

THE EFFECT OF CONSUMER EDUCATION ON COMPETITION

Q. Do you have an opinion about the effect of consumer education on competition?

A. In order to jumpstart our Energy Choice Program, in 1997, we undertook a significant consumer education effort to familiarize our customers with the opportunity to choose and the mechanics of how to choose an alternate gas supplier. In addition, in response to the provisions in the Act, the Commission also required additional consumer education measures to be undertaken by NGDCs in 1999 and thereafter.

Dominion Peoples undertook a consumer education campaign that appears to have been quite effective, but we believe that there are diminishing returns to be gained from further large-scale consumer education campaigns. In short, Dominion Peoples' customer base is well aware of the opportunity to choose, based upon the extensive consumer education campaign that Dominion Peoples undertook in the late 1990's, and while Dominion Peoples continues to provide consumer education on customer choice, the vast majority of its customers are aware of the opportunity to choose and how to undertake it.

THE EFFECT OF CUSTOMER INFORMATION/SERVICE ON COMPETITION

Q. In your opinion, what has been the effect of customer information/service on natural gas supply competition?

A. My first observation is that the NGDC's service should not have an effect on whether a customer chooses an alternate supplier. This is because the NGDC is always in the picture as the distributor of the gas supply that is acquired from an NGS. So the NGDC's service should not really impact the customer's decision to choose or not to choose an alternate gas supplier.

As for the customer service being provided by the NGS, I would note that the customer always receives gas regardless of whether the customer's gas supplier is meeting its supply obligation into the pool. Whether the NGS is actually delivering enough natural gas supply to the NGDC's system to cover its contractual obligations is essentially invisible to the end-user. Obviously, the NGS would have a balancing obligation with the NGDC, but as for the end-user, the service "inadequacy" -- that is, the under-delivery by the NGS -- would not be a service issue that would impact the end-user's choice of that supplier in most instances.

There may be other "service" issues, like problems with billing or other matters where the NGS is dealing directly with the customer, that may impact the customer's decision on whether to choose an alternate gas supplier, but because we do not get involved with those matters, Dominion Peoples does not have an opinion about them. We believe that NGSs would be in a better position to testify about that point. It is important to recognize, however, that Dominion Peoples provides billing services for NGSs that choose not to undertake that function. We believe that this has helped NGSs to stay in business by avoiding the costs of establishing and managing customer billing systems.

As for customer information, to Dominion Peoples' knowledge, the restrictions on the ability to disseminate customer information that the Commission has employed does not seem to be an impediment to natural gas supply competition. There may be more information that an NGS may desire regarding customer usage that could aid the NGS in performing its gas supply planning and thereby reduce its costs, but as for the customer information requirements that the Commission currently has in place, Dominion Peoples does not perceive them to be a detriment to natural gas supply competition in Pennsylvania. Furthermore, early on, the Commission recognized the need to make information about prices available to customers. In Dominion Peoples view, this was right on target. Making information available to customers through various sources such as unbundled NGDC prices and price-to-compare data has greatly helped competition in Pennsylvania and is essential to a successful choice program.

THE EFFECT OF SUPPLIER FINANCIAL SECURITY REQUIREMENTS ON COMPETITION

Q. Do you have an opinion on how Dominion Peoples' supplier financial security requirements have affected NGS competition in Dominion Peoples' certificated territory?

A. Yes. I would begin by noting that Dominion Peoples' financial security requirements for NGSs have not changed since Dominion Peoples' Restructuring Settlement in early 2000. As you will recall, that settlement was either supported or not opposed by the vast majority of NGSs operating on Dominion Peoples' system at that time. Further, to my knowledge, no NGS has complained to the Commission regarding Dominion Peoples' supplier financial security requirements in the past 5 years. So, I would say that the supplier financial security requirements on our system are not negatively affecting natural gas supply competition.

Obviously, the security requirements are designed to ultimately protect the customers. They are employed to ensure that an NGS is financially able to secure adequate supply to serve the load it commits to serve. They also serve to safeguard the NGDC (and ultimately the NGDC's customers) from having to bear the cost of an insolvent NGS's abandoning its obligations.

THE EFFECT OF NGDC PENALTIES AND OTHER COSTS ON COMPETITION

Q. Do you have an opinion about the effect of Dominion Peoples' penalties and other costs on natural gas supply competition?

A. While I know that the Commission requested that the written testimony submitted in response to its Order address this topic, Dominion Peoples has had limited experience in this regard. Dominion Peoples has imposed some penalties on NGSs over the course of refining its Energy Choice Program, but to my knowledge no NGS has left Dominion Peoples' certificated territory as a result of having incurred penalties. Dominion Peoples has received some negative feedback from NGSs regarding our imbalance charges, but in my opinion, elimination of the penalties applied for failure to deliver adequate gas supplies is not a viable option. These supply-related penalties help to deter gas suppliers from breaching their obligation to supply sufficient gas supplies for transportation customers in their pools, which negatively impacts system reliability. My previous comments regarding consumer protection apply equally here, and I will not repeat them.

AVENUES FOR ENCOURAGING INCREASED NATURAL GAS SUPPLY COMPETITION IN PENNSYLVANIA

Q. Do you have any thoughts on possible measures that may encourage increased natural gas supply competition in Pennsylvania?

A. Yes. First, let me say that we believe energy choice is working in Pennsylvania. Generally, customers understand their options, but unfortunately, at this time, there are not many marketers participating for the smaller volume customers. As I mentioned previously, we at Dominion Peoples believe that customer participation in natural gas choice is directly related to the number of participating NGSs. Increased natural gas competition can be achieved by finding ways to encourage NGS participation. Perhaps the best way to identify these measures is to look at other natural gas choice programs, find those that are successful, and examine the reasons why they are successful.

Q. Have you found any other successful natural gas choice programs?

A. Yes, right next door in Ohio. Natural gas choice participation on Ohio's two largest natural gas distribution companies is quite successful. At Columbia Gas of Ohio (Columbia), 540,000 of Columbia's 1.35 million customers (or 40%) are participating in natural gas choice. At Dominion East Ohio, (DEO), 598,500 of DEO's 1.16 million customers (or 52%) are participating in natural gas choice. Further, DEO currently has about 45 NGSs that provide supply service to these customers.

We examined the program of our affiliate, DEO, compared it to the Dominion Peoples' program and even received some feedback from a few NGSs participating on the DEO system. First of all, understand that many administrative aspects of the DEO and Dominion Peoples programs are essentially the same. For example, we both utilize the same gas nominations system and customer billing system. Therefore, we concluded that the administrative aspects of our natural gas choice program, such as gas supply nominations, volume tracking, balancing reporting, and the manner in which customer enrollment data is transferred, should not be a deterrent to NGSs.

We did, however, determine that certain unique aspects of the DEO program likely contribute to the higher levels of NGS participation in DEO's program. The common thread among these is that they help to lower an NGS's overall operating and customer acquisition costs. They are:

1) Purchasing of NGS Receivables by DEO and Bad Debt Cost Tracker -- The primary business focus of NGSs is to acquire and supply gas on behalf of customers. In situations where an NGS serves hundreds and perhaps thousands of customers, such as in the residential and small commercial markets, "credit and collection" related activities could be a significant cost component. The Public Utility Commission of Ohio (PUCO) addressed this issue by requiring NGDCs to purchase the "receivables" from the NGS. When purchasing the receivables, the NGDC remits to the supplier a percentage of the amounts billed on behalf of the NGS regardless of whether the customer pays the full amount of the bill. Additionally, the PUCO permits some of the NGDCs to recover both utility- and supplier-related bad-debt costs from all ratepayers through a tracker. Combined, these two items serve to greatly reduce and stabilize the collection costs for the NGS while making natural gas choice available to a much broader group of customers regardless of the customer's ability to pay. Dominion Peoples believes that a bad debt tracker would enable Pennsylvania NGDCs to purchase gas suppliers' receivables in the same way as permitted in Ohio.

2) Municipal Aggregation with Optional Opt-Out Provisions – State law in Ohio permits customers within a given municipality to be aggregated so that, combined, they can receive natural gas supply service from a single NGS. This law also requires that customers be provided with the option of opting out of a particular municipal aggregation pool. This allows the natural gas consumers located in member municipalities to negotiate the best rates in the aggregate. Also, the potential to combine hundreds and thousands of residential and small commercial customers into

a buying pool is very attractive to NGSs and greatly reduces customer acquisition costs.

3) Market Size Opportunities – The customer bases of DEO and Columbia -- the two most successful programs in Ohio -- are significantly larger than the customer bases of the NGDCs in Pennsylvania. As I previously stated, both DEO and Columbia have in excess of 1,000,000 customers in Ohio. The larger natural gas utilities in Pennsylvania have from 250,000 to 500,000 customers. Obviously, marketers see a benefit in the opportunity to accumulate a significant number of customers. Our experience is that only 30% to 60% of the customer base will choose an alternate supplier because of customer indifference, inertia and the like. In smaller markets, like in Pennsylvania, the marketer may not see enough potential to spend the time and money to accumulate a small number of customers. A solution may be for an NGDC in Pennsylvania to exit the merchant function, an event that would potentially enable NGSs to accumulate a critical mass of customers.

Q. Does this conclude your testimony?

A. Yes.

Thank you very much.

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

Dominion Peoples' ANNEX A Responses

(1) For each quarter of the years 1999 – 2004, provide the following:

(a) Number of natural gas suppliers operating on its distribution system;
(b) Number of residential, industrial and commercial customers purchasing gas from alternative suppliers;
(c) Volume of natural gas transported on its distribution system;
(d) Volume of natural gas transported for suppliers on its distribution system.

RESPONSE:

Refer to the attachment and the file labeled Response No. 1 (a – d).xls.

DOMINION PEOPLES
Investigation into Competition in the Natural Gas Supply Market
Data Request No. 1 (a) - (d)

		Natural Gas Supply Customers									Total System Throughput
		Number of Suppliers	Residental		Commercial		Industrial		Total		
			Customers	Volumes	Customers	Volumes	Customers	Volumes	Customers	Volumes	
1999	1st Qtr	35	115,749	6,197,820	13,158	6,328,149	203	4,752,743	129,110	17,278,712	29,510,350
	2nd Qtr	34	114,949	1,948,038	13,122	2,133,031	204	4,097,370	128,275	8,178,439	11,976,084
	3rd Qtr	37	114,395	808,706	13,025	1,098,985	205	4,555,104	127,625	6,462,795	8,096,165
	4th Qtr	37	115,324	3,715,024	12,841	4,007,971	202	5,519,374	128,367	13,242,369	20,661,630
	Total			12,669,588		13,568,136		18,924,591		45,162,315	70,244[illegible]
2000	1st Qtr	37	123,021	5,988,052	12,719	5,966,338	206	6,229,671	135,946	18,184,061	29,872,499
	2nd Qtr	36	123,449	1,907,738	12,440	1,967,509	214	4,716,587	136,103	8,591,835	12,084,396
	3rd Qtr	36	119,978	935,284	11,561	1,080,312	202	4,243,847	131,741	6,259,444	8,065,625
	4th Qtr	33	113,795	3,588,026	11,256	3,300,587	173	4,482,406	125,224	11,371,019	19,323,103
	Total			12,419,100		12,314,746		19,672,511		44,406,358	69,345,623
2001	1st Qtr	27	109,837	6,630,740	9,908	4,582,804	191	4,013,864	119,936	15,227,409	31,708,370
	2nd Qtr	27	108,197	2,305,923	9,858	2,335,586	197	3,430,543	118,252	8,072,052	13,650,443
	3rd Qtr	26	112,356	793,458	10,322	906,521	203	3,459,568	122,881	5,159,547	7,037,507
	4th Qtr	24	113,269	2,624,174	10,785	2,479,142	195	3,811,586	124,249	8,914,901	14,711,826
	Total			12,354,295		10,304,053		14,715,561		37,373,909	67,108,146
2002	1st Qtr	22	111,542	5,681,829	10,541	5,056,354	189	4,370,968	122,272	15,109,151	27,996,211
	2nd Qtr	25	105,536	2,149,901	10,142	2,325,960	203	3,953,741	115,881	8,429,602	13,690,168
	3rd Qtr	25	99,769	700,163	9,721	981,332	208	3,481,749	109,698	5,163,243	7,100,294
	4th Qtr	24	97,205	3,037,359	9,361	2,991,915	188	4,387,336	106,754	10,416,610	19,164,396
	Total			11,569,252		11,355,560		16,193,794		39,118,606	67,951,[illegible]
2003	1st Qtr	23	95,082	5,926,544	8,971	5,443,895	175	4,317,943	104,228	15,688,382	33,905,958
	2nd Qtr	23	92,070	1,627,866	8,594	1,804,078	169	3,715,072	100,833	7,147,016	12,301,068
	3rd Qtr	23	90,097	654,235	8,327	782,941	173	3,735,901	98,597	5,173,077	7,430,263
	4th Qtr	24	88,640	2,547,942	8,238	2,637,606	177	4,684,893	97,055	9,870,441	18,447,837
	Total			10,756,586		10,668,521		16,453,809		37,878,916	72,085,126
2004	1st Qtr	19	87,173	4,980,405	8,037	4,851,058	174	5,208,920	95,384	15,040,383	32,161,140
	2nd Qtr	20	85,437	1,502,725	7,942	1,664,768	174	4,076,971	93,553	7,244,465	12,576,901
	Total			6,483,130		6,515,827		9,285,891		22,284,848	44,738,041

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

Dominion Peoples' ANNEX A Responses

(1) For each quarter of the years 1999 – 2004, provide the following:

(e) Number of customer complaints/disputes regarding slamming or unauthorized change of supplier; changing a supplier; selecting a supplier; confusion regarding a bill on which charges appear for natural gas from an alternative supplier; error in billing for a supplier; and any other issue competition-related issue.

RESPONSE:

Refer to the chart below. Dominion Peoples did not track NGS related customer complaints during 1999. NGS related customer complaints are tracked in total and not by the requested categories. During 2000 and 2001, NGS related customer complaints were not tracked by quarter.

	1999	2000	2001	2002	2003	2004
1st Quarter				52	14	5
2nd Quarter				9	17	6
3rd Quarter				6	11	3
4th Quarter				5	6	
Total	Not available	52	48	72	48	

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

Dominion Peoples' ANNEX A Responses

(2) Provide the following information about security requirements that natural gas suppliers are required to maintain for licensure (66 Pa. C.S. section 2208(c)(1)(i)):

(a) Security requirement as posted in the distribution company's initial supplier tariff.

(b) Each change that was made to this security requirement to date.

RESPONSE:

(a) Refer to the attachment and the file labeled Response No. 2 _ DP Tariff Sheets.doc.

(b) There have been no changes to the security requirement terms and conditions since initially implemented on March 3, 2000.

RULES AND REGULATIONS

5. Billing and Payment (continued)

Charges previously billed to the NGS by the Company, for which payment has not been received by the Company by the due date, will be assessed a late-payment charge of two percent (2%) per month on the unpaid balance.

If the Company has not received payment from the NGS for any services or charges, including late-payment charges, within fifteen (15) days of the statement date, the Company may deduct this unpaid amount from any payments accruing to the NGS under any agreement between the NGS and the Company or take gas in kind from the NGS in satisfaction of obligations and/or terminate the agreement with the NGS upon ten (10) days written notice to the NGS.

6. Creditworthiness

The Company shall not commence service or continue service to the NGS if the NGS fails to meet the creditworthiness criteria outlined in this Section.

The Company will base its creditworthiness evaluation on the financial information provided in response to the "Financial Information" and "Certificate" sections below.

a. Financial Information - In consideration of the opportunity to supply gas to the Company's ratepayers and in order for the Company to accept the NGS as the supplier of gas to ratepayers of the Company, the NGS must provide the following financial information, provided, however, that such financial information will not be required by the Company if the NGS has obtained a Natural Gas Supplier License from the Commission within one year prior to the date it submits an application to the Company for approval to become a NGS of gas to ratepayers of the Company and that such information has been provided to the Company:

   The NGS shall provide the following financial information:

   i. Financial statements, annual report or Form 10-K for the most recent fiscal year-end.
   ii. Current interim financial statements.
   iii. Listing of parent company, affiliates and subsidiaries.
   iv. Any reports from credit reporting and bond rating agencies which are available.
   v. A bank reference and at least two trade references.

b. Certificate: The NGS shall deliver a certificate of a duly elected officer or authorized representative certifying the following:

   i. The NGS is not operating under any chapter of the bankruptcy laws and is not subject to liquidation under any state law.
   ii. The NGS is not subject to the uncertainty of pending or threatened litigation in state or federal courts or regulatory proceedings which could (1) cause a substantial deterioration in its financial condition, (2) cause a condition of insolvency, or (3) endanger its ability to exist as an ongoing business.
   iii. The NGS does not have outstanding lawsuits, actions or judgments, which, individually or in the aggregate, could jeopardize its ability to remain solvent.

RULES AND REGULATIONS

6. Creditworthiness (continued)

iv. The NGS has the power and authority to transact the business it transacts and proposes to transact, has obtained and holds a Natural Gas Suppliers License from the Commission and is in good standing in each jurisdiction in which such qualification is required by law, other than those jurisdictions as to which failure to be in good standing would not, individually or in the aggregate, reasonably be expected to jeopardize its ability to transact the business it transacts or to remain solvent.

v. The NGS has no delinquent balances outstanding for billings made previously by the Company or its affiliate, and the NGS must have paid its account in the past according to the established terms and not made deductions or withheld payment for claims not authorized by contract.

c. The NGS has a continuing obligation to notify the Company in writing, within two business days, of the occurrence of any event which would render the NGS unable to provide the certificate required in paragraph (b) of this "Creditworthiness" section, as of the date such event occurred and within two business days of any other significant deterioration of its financial fitness or creditworthiness. The NGS shall also provide the Company a copy of the financial statements as specified in paragraph (a) of this "Creditworthiness" section upon request by the Company.

d. Evaluation Process to Determine Financial Fitness:

To the extent the Company determines that the NGS's financial condition under paragraph (a) is questionable or the NGS cannot supply the certificate required under paragraph (b) above, the Company will require one of the following forms of security or credit enhancements of the NGS if the NGS's financial condition or certification do not meet the Company's creditworthiness standards:

i. A security deposit equal to the maximum daily consumption of the ratepayer(s) served by the NGS times $3.00 per Mcf times 60 to be deposited into an interest bearing escrow account; or

ii. A payment in advance equal to the maximum daily consumption of the ratepayer(s) served by the NGS times $3.00 per Mcf times 60; or

iii. A standby irrevocable letter of credit drawn upon a bank acceptable to the Company; or

iv. A guarantee by a person or another entity which satisfies the credit appraisal; or

v. Such other security as is mutually acceptable to both the Company and the NGS.

All information submitted or provided to the Company will remain confidential and be used solely for the purpose of evaluating the financial fitness or creditworthiness of the NGS. The Company reserves the right to reevaluate financial fitness or creditworthiness when information received by the Company indicates that the financial condition of a previously approved NGS has deteriorated

RULES AND REGULATIONS

7. **Bonding Requirement**

In addition to any creditworthiness requirements as set forth in Rule 6, the Company also requires that the NGS post a performance bond or any other security suitable to the Company, to cover any costs associated with the NGS prematurely discontinuing service to customers or the NGS default of payments of Commission imposed financial penalties and restitution to customers. The amount of the performance bond or other security shall be equal to $2 times the volumes the NGS is expected to serve during the month of January. The level of the bond shall be recalculated annually.

The bonding requirement will be waived for that portion of the NGS's load used to serve Non-Priority One ratepayers whose annual consumption is 300 Mcf or more, but in such circumstance, the Company shall not be responsible to provide those ratepayers service as supplier of last resort and the Company shall have none of the obligations arising under Section 2207(a) and (k) of the Public Utility Code. The Company may waive the bonding requirement related to delivery failure for the NGS that demonstrates to the Company's satisfaction that it will assign the gas supply contract to the Company in the event of a default. With regard to the latter, the Company, in its sole discretion, which shall not be unreasonably exercised, may waive the bonding requirement related to delivery failure if the NGS assigns its gas supply contracts acquired for purposes of serving its customers on the Company's system (and if applicable, any related financial risk management contracts) to the Company in the event the NGS prematurely discontinues service to its customers. Such waiver shall be subject to the following conditions:

a. The NGS's supplier agrees to assign applicable gas supply to the Company.

b. The Company is satisfied with the relevant contract assignment language and applicable reasonable terms and conditions.

c. The Company is satisfied with the NGS's supplier's credentials or the security of supply;

d. The NGS agrees to reimburse the Company for any losses the Company suffers as a result of agreeing to the assignment of contracts, including, but not limited to, losses from a differential in the assigned gas prices and the NGS's contracted price with its customers and losses resulting from the NGS's supplier refusing to assign the relevant gas supply

8. **Procedures when a NGS Exits the System** (C)

NGSs may not exit the Company's system except during the period between April 1 and August 31. The NGS shall not exit the Company's system without first providing two months notice to the Company. Upon the NGS's exit from the Company's system, the Company will serve the NGS's former customers at the Company's supplier of last resort rates, or at the agreed-to NGS price for the remainder of the billing cycle if the NGS discontinues service prior to the beginning of the next billing cycle. Any differences between the cost incurred by the Company and the NGS's price shall be recovered from the NGS . Any capacity or supplies previously assigned to the NGS will revert to the Company, including gas held in storage. If the NGS had used capacity not assigned by the Company to bring gas on to the Company's system, then the NGS agrees to offer to assign said capacity, including gas held in storage, to the Company, which the Company may, at its sole discretion, accept or reject.

Balancing for NP-1 and P-1 pools of both interstate and local supplies for the exiting NGS's final month of service shall be performed in accordance with the "Monthly Balancing" provisions under Rate NP-1. No imbalance price multipliers will be applied. Remaining on-system storage balances for exiting NGSs, not used to offset final imbalances, shall be subject to the buyback provision under Rate P-1.

ORIGINAL

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Investigation into the Competitiveness of the Natural Gas Supply Market **Docket No. I-00040103**

COMMENTS OF

DOCUMENT FOLDER

Louis D. D'Amico
Executive Director
on behalf of
Independent Oil and Gas Association
Of Pennsylvania

RECEIVED
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Introduction

When the Natural Gas Choice and Competition Act was signed into law in June 1999, the Independent Oil and Gas Association of Pennsylvania (IOGA) was optimistic about the future of competition in the natural gas supply market. There were concerns by many of us that certain provisions of the Act and the conservative, "go-slow" approach would not yield all the results that were intended.

IOGA has long advocated a free market approach to the natural gas business. We were not driven only by the altruistic realization that competition was good for consumers, but by the recognition that it was good for producers also – a true win-win situation.

When IOGA was formed as the Pennsylvania Natural Gas Associates in 1979, the nation had experienced the second "oil shock" in the aftermath of the Iranian revolution. Producers were then optimistic about the changes brought about by the Natural Gas Policy Act toward a total deregulation of gas prices at the wellhead.

The Pennsylvania natural gas producing industry would not have benefited, however, if the Pennsylvania PUC had not made the first steps toward a competitive marketplace by allowing industrial and commercial markets to transport third party gas supplies on utility pipeline systems. The PUC actions changed the traditional relationship between the Local Distribution Companies (LDCs) and local producers of natural gas. Likewise, actions by the Federal Energy Regulatory Commission had the same effect.

Prior to these actions producers were "trapped" with one and only one practical market in any given area. We could sell our gas to a regulated monopoly at whatever

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price that entity chose to offer. With interstate pipelines exiting the merchant function and LDCs transporting gas, our gas production could be sold to multiple customers at market-based prices. These deals could be made directly between producer and customer, or through an independent marketer.

The evolution brought on by FERC's unbundling of the interstate pipeline merchant function from the delivery function led to a true wholesale market for the natural gas commodity. Every player – producer, consumer, and merchant – could see a true market-based price for the commodity at Henry Hub in Louisiana. The value of gas to the Pittsburgh market, for example, would be a city gate price equal to the Henry Hub price plus the cost of transportation to the city gate.

IOGA believes that transparency of prices through a national market best approaches the definition of pure competition, assuming all else is equal. Unfortunately, this is false assumption.

CURRENT STATE OF COMPETITION

A quick review of the percentage of customers on each LDC (or "NGDC" under the Gas Competition Act) who have taken advantage of the freedom to choose a provider is sufficient to judge the success or failure of customer choice in Pennsylvania. Add to that review an examination of how many marketers are active on these systems, and how large a percentage of each LDC's residential choice participation is dominated by the utility's "independent" affiliate, it becomes quite clear that the results under the Act have not met the hope and expectation.

We are sure it can be argued, and will be argued quite piously by the NGDCs and their affiliates, that the failure is a result of customers' total delight and satisfaction with their utility supplier and/or its affiliated supplier. Perhaps I am somewhat cynical, but I seriously doubt the truth of that contention.

Where are all the marketers? Why have they not been aggressively pursuing residential customers? Why aren't customers shopping for natural gas? ***WHAT COMPETITION?***

HOW DID WE GET HERE?

The failure of FERC to take the action(s) required to create a viable pipeline capacity market to compliment the free market of the commodity gas is certainly one cause of the lack of success of customer choice. FERC remains bound to the traditional regulatory method or model of pricing capacity. A century of familiarity, habit and self-perpetuation in the regulatory game may be responsible. Perhaps fear of the unknown or unseen problems that could occur if the FERC ventured outside of its comfort zone may be a reason. Perhaps the resistance of the various players – attorneys, rate consultants, FERC's staffers – has held up this logical next step. Or finally, perhaps FERC's detour to electric competition placed gas too far on the back burner to proceed.

The implosion of Enron and difficulties to the entire energy trading market as a result of this implosion certainly has been damaging to Choice. Price volatility resulting from this, as well as price speculation and the disappearance of the infamous "gas bubble," have also been factors damaging to Choice.

Price transparency is a good thing, but it also has a drawback. Because market clearing prices are so transparent, competition forces buy/sell margins to decline quickly. For the consumer and producer, this is the beauty of competition. For the middle man – marketer or broker – thin margins force extreme efficiencies, shake-outs, or other efforts to gain a competitive edge. Many marketers and brokers took perilous positions in the financial marketplace, gambling on derivatives or other speculative hedging positions that were aggravated by price volatility.

These, however, are national problems not specific to Pennsylvania's Act. There are problems that this Commission and the General Assembly could address and fix if they are of the mind to do so. These are Pennsylvania-specific problems relating to Customer Choice, utility regulation and free markets.

There are several problems in Pennsylvania's Customer Choice model. Like FERC, the regulatory players in and around the Commission have never fully understood or dealt effectively with free market players in a regulated environment. One glaring example was the Commission's insistence that NGSs should shoulder a portion of the cost of operating the Commission. Although the law was specific in establishing that NGSs were not to be treated as utilities for any reason, the Commission apparently had difficulty grasping this concept, and the valid reasons the marketing community had for opposing the Commission's position – until an IOGA funded lawsuit successfully overturned the Commission's effort in Commonwealth Court.

There are other problems with the Pennsylvania model that various commenters will address, I am sure. However, there is one overriding concept that the legislation ignored which ultimately will doom Customer Choice to failure until it is indeed addressed.

Competition must be fair. That is a pretty simple statement. Every player must operate on a "level playing field," a concept and term thrown about often during the collaborative effort to draft the Act. As basic as this principle is, and as widely touted as it was during the collaborative process, there remains one problem – the 800 pound gorilla of a problem with the Pennsylvania model.

There can be no fair competition between an unregulated NGS and a regulated monopoly. A monopoly cannot, nor will not, ever accept a level playing field and fairly compete with any other supplier on its system.

The same can be said about an unregulated affiliate of the incumbent utility. The opportunity for "mischief" between the two entities is too tempting and too easy

to disguise. The myth that some effective "China Wall" is or can be erected between these entities is just that – a myth. There are too many anecdotal stories from customers and marketers about "sweetheart" deals between sister companies and between the sales and delivery functions within the utility. Proving the existence of these special deals is next to impossible. A customer receiving a special deal on transportation is not going to jeopardize his advantage by providing the Commission or another supplier with written support to prove the deal's existence. It is clearly not in the customer's best interest to do so.

There is also a cross subsidy problem in which employees of the regulated monopoly are actually providing services to the nonregulated affiliate at ratepayers' expense. On the other hand, the NGS must actually pay its staff out of any meager profit it he can make on supplying gas.

The utilities may also leverage their regulated delivery systems to "extort" or extract concessions and financial benefits from the producing community. IOGA members are currently experiencing this from two separate NGDCs. Further discussion of these types of efforts must be avoided at this time due to potential legal action that may be forthcoming.

The cold reality of the situation is that as long as the utilities continue to serve customers through their regulated activities and/or "compete" with NGSs through their unregulated affiliates, their will never be true competition and Choice in Pennsylvania.

Respectfully submitted,

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