



COMMONWEALTH OF PENNSYLVANIA
PENNSYLVANIA PUBLIC UTILITY COMMISSION
P.O. BOX 3265, HARRISBURG, PA 17105-3265

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October 3, 2008

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CORRECTED ORDER

I-00040103 F0002

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TO ALL PARTIES:

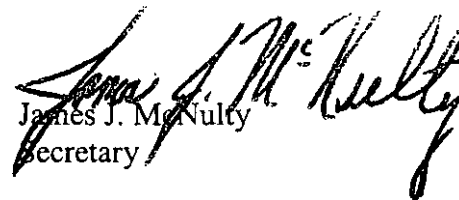
Investigation into the Natural Gas Supply Market: Report on Stakeholders' Working Group (SEARCH); Action Plan for Increasing Effective Competition in Pennsylvania's Retail Natural Gas Supply Services Market.

To Whom It May Concern:

This is to advise you that the Commission in Public Meeting on September 11, 2008 adopted an Order in the above entitled proceeding. Please replace the original Order sent to you inadvertently with the enclosed corrected Order

Thank you for your attention to this matter. We regret any convenience this may have caused you.

Very truly yours,


James J. McNulty
Secretary

Encls

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**PENNSYLVANIA
PUBLIC UTILITY COMMISSION
Harrisburg, PA 17105-3265**

Public Meeting held September 11, 2008

Commissioners Present:

James H. Cawley, Chairman
Tyrone J. Christy, Vice Chairman
Robert F. Powelson
Kim Pizzingrilli, Statement attached
Wayne E. Gardner

Investigation into the Natural Gas Supply
Market: Report on Stakeholders' Working
Group (SEARCH); Action Plan for Increasing
Effective Competition in Pennsylvania's Retail
Natural Gas Supply Services Market

Docket No. I-00040103F0002

**FINAL ORDER
AND
ACTION PLAN**

BY THE COMMISSION:

In its *Report to the General Assembly on Pennsylvania's Retail Natural Gas Supply Market (Report to the General Assembly)*, issued October 2005, the Pennsylvania Public Utility Commission (Commission) determined that effective competition did not exist in Pennsylvania's retail natural gas market. As a result of this determination, the Commission was required by law to convene the Natural Gas Stakeholders Group to explore avenues for increasing competition. See 66 Pa.C.S. § 2204(g) (relating to implementation; investigation and report to the General Assembly).

The purpose of this order is (1) to formally release the report documenting the work of the Natural Gas Stakeholders Working Group; and (2) to set forth and initiate an Action Plan that will increase effective competition in the retail market for natural gas supply services.

DISCUSSION

Background

As a result of the Commission's *Investigation into the Natural Gas Supply Market*¹, undertaken five years after the enactment of the *Natural Gas Choice and Competition Act (Act)* in 1999, the Commission determined that there was not "effective competition" in Pennsylvania's retail market for natural supply. *See Report to the General Assembly.*² For purposes of the report and this order, "effective competition" was defined as:

- Participation in the market by many sellers so that an individual seller is not able to influence significantly the price of the commodity.
- Participation in the market by many buyers.
- Lack of substantial barriers to supplier entry and participation in the market.
- Lack of substantial barriers that may discourage customer participation in the market.
- Sellers are offering buyers a variety of products and services.

Report to the General Assembly, p. 25.

The Commission's determination that effective competition did not exist was based on the lack of participation of an adequate number of natural gas suppliers and customers in the retail natural gas market, and the identification of substantial barriers in the market structure and operation that prevented or discouraged the participation of these groups in the market.

¹ Docket No. I-00040103.

² *The Report to the General Assembly* was released on October 6, 2006 and may be accessed at <http://www.puc.state.pa.us/PcDocs/570097.pdf>.

Because of the Commission's determination that retail competition did not exist, the *Act* required the Commission to convene an industry-wide stakeholders group to explore avenues, including legislative, for encouraging increased participation in Pennsylvania's retail natural gas supply market. *See* 66 Pa.C.S. § 2204(g) (relating to implementation – investigation and report to the General Assembly). The Natural Gas Stakeholders Working Group, subsequently christened "SEARCH³," first met on March 30, 2006.

Four subgroups were established to study related issues that had been identified in the *Report to the General Assembly* as being substantial barriers to competition. *See Report to the General Assembly*, pp. 67-69. Some issues were assigned to more than one subgroup so that certain aspects of the same issue could be examined from different perspectives. These subgroups with their assigned subject matter are listed below:

I. INTER-COMPANY ACTIVITY (IA) SUBGROUP

Issues assigned to the subgroup included: Security; Mandatory Capacity Assignments; Nomination and Delivery Requirements; Penalties For Non-Delivery; Purchase Of Receivables For Mass Market Customers; Supplier Tariff Requirements; Market Information; Switching Restrictions

II. CUSTOMER INTERFACE (CI) SUBGROUP

Issues assigned to the subgroup included: Pricing Information and Consumer Education; Seamless Move; Aggregation/Assignment; Supplier Consolidated Billing; Consumer Protection Rules; Barriers to Customer Participation; NGDC Consolidated Billing; Service To Low Income Consumers

³ SEARCH is an acronym for "Stakeholders Exploring Avenues for Removing Competition Hurdles."

III. COST OF SERVICE (CS) SUBGROUP

Issues assigned to the subgroup included: Costs of Retail Supply Service; Financial Incentives for Energy Efficiency; Purchase of Receivables for Mass Market Customers; Fixed Price Option

IV. COMPETITION MONITORING (CM) SUBGROUP

Issues assigned to the subgroup included: NGDC Promotion of Competition; Sustained Commission Leadership in Competitive Markets; Code of Conduct; NGDC Negotiated Supply Contracts; Aggregation/Assignment Programs

The subgroups were facilitated by Commission staff and involved stakeholders from all segments of the industry – residential, commercial and industrial customers, suppliers, natural gas distribution companies and pipelines⁴.

An additional subgroup was established after the collaborative began meeting. This subgroup examined issues relating to the possible abandonment of the merchant function by natural gas distribution companies and the development of a supplier of last resort model. Also, the working group, as a whole, discussed the various overlapping issues.

⁴UGI Utilities, Inc.; UGI Corporation; PECO Energy Company; Suburban Energy; Vectren Retail LLC; T.W. Phillips Gas and Oil Company; Stand Energy; Philadelphia Gas Works (PGW); PG Energy; Pepco Energy Services; Office of Consumer Advocate; NRG Energy Center – Pittsburgh; Shipley Energy; NiSource Corporate Services Company; MX Energy; Mack Services Group; Yvonne Zanos, Consumer Editor, KDKA; Independent Oil and Gas Association of Pennsylvania (IOGA-PA); Amerada Hess Corporation (Hess); Exelon Corporation; Energy Association of Pennsylvania (EAPA); Equitable Gas Company; Duke Energy; Dominion Peoples; Usher Fogel, Esq.; Constellation New Energy- Gas Division; Direct Energy; Linn Energy, LLC; National Fuel Gas Distribution Company; National Fuel Resources, Inc.; Columbia Gas of PA, Inc.; Industrial Energy Consumers of Pennsylvania (IECPA), *et al.*; ABARTA Oil & Gas Company; T and F Exploration, L.P.; Agway Suburban Energy; Dominion – Retail Inc.; The Peoples Natural Gas Company; PA AFL-CIO Utility Caucus; Agway Energy Services, LLC; Thermal Ventures II, LP; Pennsylvania Economic Development Association; Interstate Gas Supply, Inc.; Borough of Chambersburg, PA; South Jersey Energy Company; Exelon Business Services Company; National Energy Marketers Association; Texas Eastern Gas Transmission; and Columbia Gas Transmission. OSBA filed a statement that the lack of resources prevented its full participation in the working group.

SEARCH REPORT

The work of the subgroups was documented by Commission staff. Stakeholders were provided with interim summaries of the subgroups' discussions and were permitted to critique, revise and comment on the drafts. From these interim summaries, Staff prepared a final report on the activities of the SEARCH collaborative, which we are formally releasing with this order (*SEARCH Report*)⁵.

The *SEARCH Report* summarizes the work and discussions of the Stakeholders, devoting a section to each proposal, program, mechanism or practice that was examined. Each section defines the subject, states the positions of the participants, identifies the requisites for implementation, analyzes the impact on effective competition and discusses the disadvantages and costs of implementation. The report does not attempt to fully address all aspects of each issue that may have been raised during the working group discussions, and does not make any recommendation regarding the solutions presented. Instead, the *SEARCH Report* was written as a fair and neutral summary of the various barriers to market entry and participation for suppliers and of the possible solutions that might be implemented to increase effective competition in the retail market. In this order, we have cross-referenced applicable sections of the *SEARCH Report* in discussing the solutions that we have selected for further action.

ACTION PLAN

We have reviewed the *SEARCH Report* and have determined that, consistent with the pro-competition legislative policy embodied in the Act and the information contained in the *SEARCH Report*, our efforts to increase effective competition in the retail natural gas market should begin now and, furthermore, should be concentrated on changing the

⁵ The draft *SEARCH Report* was posted for public access on May 21, 2008 at <http://www.puc.state.pa.us/PCDOCS/1012492.doc>.

market structure and its operation to reduce or eliminate barriers to supplier entry and participation. In our judgment, increasing the number of suppliers and, in time, the variety of service offerings available in the marketplace would be expected to attract customers to the market.

In its *2005 Report to the General Assembly*, this Commission expressed its belief that “an integrated solution [to increase supplier and customer participation] that is developed by all interested parties and addresses all relevant substantive and procedural issues is preferable to a piecemeal approach to market climate improvement.” *Report to the General Assembly*, p. 69. We still believe this approach will provide the best possible solution.

Consistent with this approach, we are issuing this order that sets out an action plan to reduce barriers to entry and to change the structure and operation of the retail market in order to increase competition in natural gas supply. We have selected for action the programs, practices, rules and requirements whose modification would seem to offer the greatest potential to eliminate or reduce market barriers, and thereby increase supplier participation in the marketplace⁶.

The Action Plan will be implemented in two phases.

Phase 1 will address the matters that the Commission is able to implement immediately to facilitate the development of a competitive market. These matters include creation of the Office of Competitive Market Oversight within the Commission, the

⁶ In our judgment, customer participation will increase only if there are more suppliers offering a variety of products to attract customers to the market. For this reason, consumer information and education activities have been judged to be secondary matters that will be undertaken on an as needed basis, such as when changes are made to certain programs that could affect customer eligibility. Also, certain rule changes or new programs or policies that might increase customer participation, such as seamless moves, customer referral programs, and aggregation programs have not been recommended for implementation at this time. Discussion of these subjects may be found in the *SEARCH Report* at pp. 38-39, 39-43 and 55-58.

expansion of Purchase of Receivables programs, and the pursuit of legislative changes regarding capacity assignment/release.

Phase 2 will address those matters that require and are better handled by means of a rulemaking process before implementation. These rulemakings will address three (3) groups of issues: Natural Gas Distribution Company (NGDC) issues, Natural Gas Supplier (NGS) issues and business practices issues.

In the rulemaking regarding NGDC issues, the Commission will address rules for: Price to Compare formulation, reconciliation and quarterly adjustments, Purchase of Receivables Programs, mandatory capacity release and non-discrimination, and cost recovery of competition-related activities, and regulatory assessments.

In the rulemaking regarding NGS issues, the Commission will address rules for: creditworthiness of suppliers and reasonable security requirements.

Finally, in the rulemaking regarding business practices issues, the Commission will address rules for: standardization of NGDC system operating rules, specific operation rules regarding nomination and delivery requirements, tolerance bands and cash out/penalties, and standardization of electronic bulletin boards.

In terms of a time frame, in our opinion, a realistic time frame to complete this action plan would be two years from the date of this order. Also, we will accept the *SEARCH Report's* recommendation to conduct a formal milestone review to evaluate the Commission's progress in developing more competition in the retail market for natural gas supply in Pennsylvania. The review will be due five years from the entry date of this order.

PHASE 1 – MATTERS FOR IMMEDIATE COMMISSION ACTION

A. OFFICE OF COMPETITIVE MARKET OVERSIGHT

The subject of creating a Commission Office of Competitive Market Oversight (OCMO) to oversee the competition in the retail natural gas supply market was discussed by the SEARCH working group. The functions and activities of the OCMO would be necessarily broad in order to promote, facilitate, and guide the development of the retail market to achieve effective competition. The OCMO could act informally to facilitate disputes between a particular supplier and a NGDC, and also could intervene in a Commission proceeding, subject to due process requirements, to protect the public interest in regard to preserving, maintaining and increasing competition in the retail market. *SEARCH Report*, pp. 45-51.

As envisioned, the initial number of Commission staff permanently assigned to the OCMO would be small. As needed, other Commission staff could be temporarily assigned to the OCMO from the various bureaus depending on the circumstances. *SEARCH Report*, p. 49. Calling upon existing Commission staff to participate in proceedings for the purpose of advocating for the OCMO and the competitive market would not require additional resources, but rather a re-alignment of staff roles consistent with the objective of fostering competitive markets. *SEARCH Report*, p. 49.

In regard to the creation of the OCMO within the Commission, the NGDCs and NGSs disagree regarding the need for such an office and about its usefulness in promoting competition in the retail natural gas market. NGDCs state that Section 2204 (f) of the *Act* already provides for a company-specific collaborative process to discuss and resolve capacity and operational issues relating to customer choice. NGSs point out that the collaborative process can be cumbersome, and that those called pursuant to

Section 2204(f) do not offer a broad enough platform to resolve all types of competitive issues. *SEARCH Report*, p. 47.

Disposition

After review of the *SEARCH Report*, we find that it is in the public interest to establish an independent unit within the Commission to oversee the development and functioning of the competitive retail natural gas supply market. We have already expressed our intent to establish such an in-house unit in regard to the electric choice market in our Statement of Policy at 52 Pa. Code at § 69.1817 (relating to retail choice ombudsman). See *Policy Statement on Default Service and Retail Electric Markets*, Order adopted May 10, 2007 at Docket No. M-00072009.

In regard to the creation of such a unit, no change in legislation is necessary. Section 305(c) of the Public Utility Code authorizes the Commission to appoint, fix the compensation of, authorize or delegate such officers and employees as may be appropriate for the proper conduct of the work of the Commission. See 66 Pa.C.S. § 305 (c) (relating to director of operations, secretary, employees and consultants). Also, Section 308(f) allows the Commission to establish any additional bureaus that the Commission finds necessary to protect the interests of the people of Pennsylvania. See 66 Pa.C.S. § 308(f) (relating to bureaus and offices; other bureaus and offices). Accordingly, the Commission may establish an independent unit, and may direct and assign current staff to the unit on a permanent or temporary basis to perform certain duties and functions related to market monitoring and facilitation.

The Director of Operations is directed to take all necessary steps to establish an Office of Competitive Market Oversight. The Office shall be permanently staffed with necessary technical and administrative support staff. Other Commission employees may

be temporarily assigned to work for the OCMO on an as-needed basis. The Office shall be established and fully functional no later than Monday, January 5, 2009.

The OCMO will assume only advisory roles and informal mediation roles consistent with due process considerations that prohibit the co-mingling of advisory and prosecutory functions. One specific area of responsibility assigned to the OCMO is the mediation of disputes⁷ involving the release, assignment or transfer of capacity on a natural gas distribution company's system⁸.

B. PURCHASE OF RECEIVABLES PROGRAMS

Purchase of receivables was an issue that was considered by three of the subgroups as a means to increase supplier participation in the retail natural gas market. *SEARCH Report*, pp. 14-18. In a "Purchase of Receivables" (POR) program, the NGDC purchases a NGS's accounts receivable, most often at a discount. The discount may be attributable to uncollectible expense, *i.e.*, bad debt of the NGS's customers, and the NGDC's administrative costs for billing and collection. Purchase of receivables was also discussed as a means to satisfy security requirements for suppliers operating on certain NGDC systems. *SEARCH Report*, pp. 18, 20. Decreasing the security requirement for suppliers would remove a barrier to market entry for some suppliers and, thus, would increase supplier participation in the market.

The *SEARCH Report* recognizes that there are economic, legal and regulatory issues associated with mandating that NGDCs implement POR programs, and that establishing uniform rules to govern such programs would require further consideration

⁷ Requesting informal mediation by the OCMO will satisfy the due diligence requirement of the supplier meeting with the NGDC prior to filing a formal petition for Commission review of the company's capacity requirements. See 66 Pa. C.S. § 2204(d)(5)(ii) and § 2204(d)(6).

⁸ Note that the OCMO's authority to mediate disputes between NGDCs and suppliers involving capacity is not exclusive. A supplier may choose to file a formal complaint, with notice to the OCMO, and may request mediation by the Office of Administrative Law Judge's Alternate Dispute Resolution Mediator.

of the various options to accomplish such programs in a manner that is fair to all stakeholders. *SEARCH Report*, pp. 16 -18. However, it is clear that POR programs may be voluntarily implemented by NGDCs, subject to Commission approval. Columbia Gas voluntarily implemented a POR program whereby it purchases accounts receivable at a discount from suppliers operating in its service territory. *See Pennsylvania Public Utility Commission et al. v. Columbia Gas of Pennsylvania, Inc.*, Order entered October 27, 2005 at Docket Nos. R-00049783; R-00049783C0001; R-00049783C0002; R-00049783C0003; R-00049783C0004; R-00049783C0005; R-00049783C0007 at pp. 148-156 (Issues Specific to Rider PPS -Discount Rate for Purchase of Choice Receivables).

Also, as part of its policy statement on *Default Service and Retail Electric Markets*, the Commission determined that the public interest would be served by further consideration of a purchase of EGS receivables program. *See 52 Pa. Code § 69.1814* (relating to purchase of receivables); *Policy Statement on Default Service and Retail Electric Markets*, Order adopted May 10, 2007 at Docket No. M-00072009.

Disposition

The Commission agrees with the NGS comments that the use of POR programs can promote efficiencies, reduce costs to consumers and reduce barriers to market entry by alternative natural gas suppliers. The NGSs have long argued, and we agree, that the inclusion of billing and collection resources and costs in distribution rates provides an unfair subsidy in the provision of utility sales service and requires shopping customers to, in effect, pay twice for billing and collection. If this barrier to competition is reduced, the net result, for the benefit of consumers, is greater access to alternative supplier offers and competitive prices. At the same time, the Commission recognizes that any such program involves costs and risks that should be apportioned fairly between the NGDC and the NGS firms that participate in the program.

Moreover, this apportionment of costs and risks should also seek to eliminate redundancy in costs paid by NGS customers. For example, a NGDC's base rates contain costs for services related to bad debt and billing and collection. Because of this, a customer purchasing gas from a NGS is paying twice for bad debt and billing and collection service, once in NGDC base rates and again in NGS gas supply rates. The best way to prevent this situation, which will at the same time create a competitive marketplace, is by further unbundling the NGDC distribution rates and recognizing all of the costs related to gas supply service in the Price to Compare. For purposes of POR programs, the redundancy in cost situation affecting NGS customers may be prevented by requiring that the NGDC provide to the NGSs and its customers without additional charge those services that are already paid for in base rates, namely services related to bad debt and billing and collection.

In summary, while re-tooling the Price to Compare, in the long run, will assist in the establishment of a competitive retail market, we believe that properly designed purchase of receivables programs have a greater potential to immediately increase supplier participation in the market and, thus, would immediately increase "effective competition" in the retail market, which is the goal of this proceeding.

For this reason, by this order, we will encourage all NGDCs, who have not already done so, to file proposals to implement voluntary POR programs in their service territories. These proposals should be filed no later than December 31, 2008.

For those NGDCs that fail to file a proposed POR program by that date, the Commission will require each such NGDC to include, in its next base rate case or its next section 1307(f) gas cost proceeding, whichever comes first, fully allocated cost of service data by which the Commission can investigate the unbundling of natural gas procurement costs from base rates. In this fashion, the Commission will be able to investigate,

evaluate and decide whether further unbundling of natural gas costs is warranted for that NGDC.

PHASE 2 – RULEMAKING PROCEEDINGS

As mentioned earlier in this order, Phase 2 will address those matters that require and are better handled by means of a rulemaking process before implementation. These rulemakings will address three (3) groups of issues: NGDC issues, NGS issues and business practices issues.

A. RULEMAKING INVOLVING NGDC ISSUES

The rulemaking regarding NGDC matters will address the following issues which relate most directly to the duties, rights and obligations of NGDCs: reformulation of the Price to Compare, Purchase of Receivables programs, mandatory capacity release and assignment and NGDC cost recovery of competition-related expenses and regulatory assessments.

1. Reformulation of the Price to Compare

The Price to Compare (PTC) is the listed NGDC price for natural gas supply that consumers use to compare offers from alternative NGSs when shopping in the retail marketplace. The Commission's October 2005 *Report to the General Assembly* discussed two possible barriers⁹ to market entry and participation identified by suppliers that related to the NGDC's PTC for natural gas supply. *Report to the General Assembly*, pp. 53-61.

⁹ The *SEARCH Report* at pages 5-9 discusses these two subjects and the related issue of consumer education in regard to the pricing of natural gas supply at Section B (Price to Compare – Quarterly/Monthly Adjustments), Section C (Price to Compare - Consumer Education) and Section D (Gas Procurement Costs Contained within Base Rates).

The first barrier involved the costs that are incurred in the acquisition of natural gas supply, but that were excluded from the NGDC's PTC. Because the NGDC's PTC does not include all of the costs of gas supply acquisition, the PTC may present an artificially low price, making it difficult for the NGSs to compete against the NGDCs for customers. *Report to the General Assembly*, p. 60.

The second barrier identified by suppliers was the quarterly adjustment of the PTC pursuant to Section 1307(f). 66 Pa.C.S. § 1307(f). This adjustment creates a lag in recognizing increased gas costs so that consumers are confused as to the actual cost of the natural gas over time, and are lulled into thinking that the PTC is an annual fixed rate. In actuality, the NGDC's PTC represents a variable price with quarterly true-ups. *Report to the General Assembly*, p. 61.

The types of costs that should be recognized as gas procurement costs in a NGDC's PTC and the quarterly adjustment of the NGDC's PTC are complicated issues that were first considered in each company's restructuring filings. According to the *SEARCH Report*, the NGS community holds firm opinions that the current structure of annual rates based on least cost procurement strategies and reconciliation with interest shields the actual price to compare from consumers, thus making it difficult for NGSs to compete for customers based on price. *SEARCH Report*, p. 5.

The NGSs suggested that an option to address this problem would be directing 1307(f) NGDCs to file a fully allocated customer class cost of service study that removes rate base costs, and operation and maintenance expenses (related to natural gas procurement) from base rates, and creating a separate gas procurement surcharge to include these elements. In effect, through this process, the distribution rate would be unbundled. *SEARCH Report*, p. 8. The NGSs also suggest that the elimination of the reconcilable nature of the PTC would improve the competitive landscape by placing supplier of last resort (SOLR) service on the same platform as competitive alternatives.

SEARCH Report, p. 5. The NGSs also suggest that natural gas monthly prices be based on a monthly index such as the monthly New York Mercantile Exchange (NYMEX) or another financial index. *SEARCH Report*, pp. 3, 5 and 6.

The NGDCs do not oppose the development of a reasonable price to compare by shifting SOLR costs related to procurement from the distribution charge to gas costs so long as the costs can be tracked and recovered. The NGDCs state that some level of gas procurement costs currently in distribution rates may be necessary for NGDCs to maintain basic SOLR functions that benefit all customers, whether they are customers of NGS or NGDC commodity service. *SEARCH Report*, p. 9.

In contrast, consumers are understandably concerned about changes that might be made to the cost composition of the PTC, and the possible elimination of the 1307(f) reconciliation process. OCA stated that it must be made clear that only avoidable, or incremental procurement costs should be considered for inclusion in the PTC, and that including a wide range of costs in the PTC may simply artificially increase the cost to customers and not foster genuine competition. *SEARCH Report*, p. 8. In regard to the elimination of quarterly adjustments and reconciliation, OCA opposes frequent rate changes. *SEARCH Report*, p. 6.

Disposition

After review of the *SEARCH Report*, it is apparent that re-tooling of the PTC, in regard to its cost composition and automatic adjustment mechanism, is necessary to attract suppliers and increase effective competition in the retail natural gas supply market. Moving to a full market index rate or eliminating the reconciliation of gas cost rates for SOLR service would seem to be simple solutions that would immediately improve market opportunities for suppliers. However, implementing either could subject consumers to higher rates, and increased market volatility. The fairer method to establish

a “market” PTC relies on cost allocation whereby costs properly attributable to the procurement of the commodity -- natural gas and other services related to gas supply service are included in the PTC.

To accomplish this, regulations must be promulgated that, *inter alia*, identify categories of costs that are properly allocable to the procurement of natural gas, and require that only those categories of costs be reflected in the market PTC.

Additionally, although most cost components of the market PTC may be assumed to be stable over a finite time period, costs for procuring natural gas may vary greatly over that same period depending on the weather, the season, and any other occurrence that might affect amount of available natural gas supply. To account for this variability, a reconciliation and adjustment mechanism should be established that will re-set the market PTC at regular intervals to account for changes in gas costs. Finally, the calculation of the market PTC should be standardized to eliminate inconsistency between NGDC territories that has been identified as a barrier to the full participation of suppliers in the state retail market.

Because our ultimate goal is to establish a truly competitive retail natural gas market in Pennsylvania, we will direct that a rulemaking be initiated to reformulate the PTC and provide for its adjustment to account for fluctuations in gas costs. We will direct that the Law Bureau draft a proposed rulemaking order that: (1) identifies costs that will be taken into account in calculating a market PTC; and (2) addresses the adjustment of the PTC due to the reconciliation of gas costs. The proposed rulemaking order will also establish parameters for purchase of receivable programs. Commission staff from the Bureau of Conservation, Economics and Energy Planning and the Bureau of Consumer Services is directed to provide technical assistance to the Law Bureau and the Bureau of Fixed Utility Services (FUS) in this rulemaking as may be needed. We further direct that

the proposed rulemaking order be prepared to be acted upon no later than the end of the first quarter of 2009.

2. Purchase of Receivables

As explained earlier in this order, the Commission agrees with the NGS comments that the use of POR programs can promote efficiencies, reduce costs to consumers and reduce barriers to market entry by alternative natural gas suppliers. However, the Commission recognizes that any such program involves costs and risks that should be apportioned fairly between the NGDC and the NGS firms that participate in the program. The Commission also recognizes that Section 2205(c)(5) which prohibits mandatory prepayment to entities that use NGDC billing services may preclude mandatory POR programs.

Disposition

In addition to encouraging NGDCs to propose voluntary POR programs, the Commission will also include, in its rulemaking related to NGDC issues, uniform rules and guidelines for POR programs. The Commission has and will continue to review voluntary POR programs on a case by case basis but, in the long run, the industry and the market will benefit from regulations that will provide clear rules and guidance for POR programs on a statewide basis. While there is room for flexibility in our approach to what constitutes a fair and reasonable POR program, NGS suppliers who operate regionally and nationwide should not need to deal with POR contract terms that vary substantially among different NGDCs in Pennsylvania.

Therefore, the rulemaking on NGDC Issues will address, among other issues, the appropriateness of a discount on accounts receivables and parameters for its calculation, the effect of a POR program on the NGDC's uncollectible expense and the use of a bad

debt tracker. The overall goal is to establish reasonable and fair parameters for POR programs on a statewide basis. Again, we direct that a proposed rulemaking order be prepared so that the proceeding can be initiated no later than the end of the first quarter of 2009.

3. Mandatory Capacity Assignment

Section 2204(d)(1) of the Public Utility Code provides the NGDC with the option to release, assign or otherwise transfer capacity or Pennsylvania supply in whole or in part on a nondiscriminatory basis to suppliers or industrial customers on its system. 66 Pa.C.S. § 2204 (d)(1). The release, assignment or transfer of such capacity shall be on a nondiscriminatory basis and shall be at the applicable contract rate for such capacity. 66 Pa. C.S. § 2204(d)(1)&(3). Section 2204(d)(4) requires a licensed supplier to accept such release, assignment or transfer of capacity. 66 Pa.C.S. § 2204(d)(4). The issue is whether existing capacity assignment mandates should be modified. NGDCs assert that the mandatory assignment of capacity protects firm service for its SOLR customers while some NGSs see this requirement as a barrier to market entry. Other NGSs have concerns regarding the mechanisms for assigning capacity. This issue is discussed thoroughly in Section N of the *SEARCH Report* at pp. 31-34.

Disposition

The Commission understands the reason for mandatory capacity assignment as it ensures that SOLR service is continuous and reliable for the NGDC's customers. At the same time, the Commission can appreciate the suppliers' concerns about wanting the flexibility to purchase capacity on the pipeline as it suits the needs of their business operations. The Commission also recognizes the reality of the situation: (1) actual capacity release is a function of interstate pipeline tariffs, governed by the Federal Energy

Regulatory Commission; and (2) modifying the mandatory capacity assignment requirement requires legislative change.

However, because this issue has been identified as a barrier to competition by the suppliers, the ultimate solution may be to amend Section 2204(d)-(f) to lessen the control that a natural gas distribution company has over capacity on its system. Of course, such an amendment would need to be carefully crafted so as to ensure that system reliability is not put at risk for the sake of increased supplier participation. For this reason, we will direct the Director of Operations with the assistance of the Office of Legislative Affairs, the Office of Communications and other necessary legal and technical staff, to prepare a letter to the General Assembly recommending that a change be made in regard to Section 2204 and to prepare draft legislation amending this section.

The amendment of legislation is necessarily a protracted process, so it may not be an immediate solution. Therefore, in the interim, we will direct that the Rulemaking on NGDC Issues be drafted to include regulations to implement existing statutory requirements that the release, assignment or transfer of capacity by a NGDC shall be on a nondiscriminatory basis and shall be at the applicable contract rate for such capacity. 66 Pa. C.S. § 2204(d)(1)&(3). The proposed regulations will further define parameters for non-discriminatory assignment of capacity, the parameters for fair and reasonable contract rates, whether NGS firms can make alternative arrangements for needed capacity, and such other matters as are necessary to insure system reliability.

We also urge suppliers to use the existing remedies in Section 2204 to obtain some relief in regard to capacity management, and mandatory assignment of capacity. Section 2204(5)(i) of the *Act* permits a NGDC alone, or with one or more suppliers to voluntarily propose an alternative to capacity assignments, and Section 2205 (5) (ii) permits a supplier to petition the Commission for the authority to use alternate interstate storage or transportation capacity.

Section 2204 (f) requires that NGDCs provide for, and establish a working group of licensed natural gas suppliers having customers on the NGDC's system and representatives of residential, commercial and industrial customers (1) to meet on a scheduled basis and (2) to resolve operational and capacity issues related to customer choice. The Commission directs that each NGDC schedule a meeting for the first quarter in January 2009 for the purpose of discussing capacity in the context of system management. NGSs, regardless of whether currently active and serving customers on the company's system or not, shall be invited to the meeting.

Disputes involving capacity release that cannot be worked out in Section 2204(f) working groups¹⁰ may be resolved informally by the Office of Competitive Market Oversight (OCMO). Suppliers who are not able to come to agreement regarding capacity release with a distribution company may file an informal complaint with the OCMO for possible mediation. Alternatively, the supplier, with notice to the OCMO, may file a formal complaint with the Commission and request mediation by the Alternate Dispute Resolution Division in the Office of Administrative Law Judge (OALJ)¹¹. See the discussion of the creation of the Office of Competitive Market Oversight above at pp. 8-10. If an agreement cannot be reached, the supplier may file a formal petition with the Commission pursuant to review the capacity requirements pursuant to 66 Pa. C.S. § 2204(d)(5)(ii).

¹⁰ Section 2204(f) provides that the final determination of operational and reliability issues resides with the NGDC. 66 Pa.C.S § 2204(f).

¹¹ Requesting mediation from the OCMO or filing a formal complaint to be mediated by the OALJ is consistent with the statutory due diligence required of a supplier to meet and discuss possible alternatives with the distribution company prior to filing a Section 2204(d)(5)(ii) petition. See 66 Pa. C.S. § 2204(d)(5)(ii) and § 2204(d)(6).

4. NGDC Costs of Competition Related Activities

The physical venue for the retail natural gas market is the NGDC's transmission and distribution system as governed by the NGDC's operating rules and business practices and policies. Changes to the structure or operation of this retail market to lower or eliminate barriers to NGS entry and participation will necessarily result in costs to the NGDC.

The SEARCH group considered the issue of permitting NGDC recovery of costs related to the promotion of competition in the retail natural gas market. *See SEARCH Report* at Section E (relating to NGDC cost recovery), pp. 9-10. The *SEARCH Report* states that no legislative change is necessary to implement this cost recovery surcharge as it can be accomplished by a change to Commission regulations. *SEARCH Report*, p. 9.

Disposition

After review of the *SEARCH Report*, we find that the NGDCs should be able to recover *reasonable* costs that are *prudently* incurred in connection with the implementation of any changes designed to promote the development of effective competition in the retail market¹². Also, a surcharge mechanism¹³ that will ensure the recovery of these costs should have a positive effect on competition in that it would provide the funding needed by NGDCs to implement certain measures to increase competition in the natural gas supply market. *SEARCH Report*, p. 10. For these reasons, we believe that a surcharge with an automatic adjustment mechanism to recover these costs is in the public interest. Accordingly, we direct that issues related to NGDC recovery of costs attributable to the promotion of competition in the retail natural gas

¹² We note that these costs might also include those associated with increasing customer participation in the market such as modifications to NGDC billing systems or increased consumer education activities.

¹³ In accordance with 66 Pa.C.S. § 1408 (relating to surcharges for uncollectible expenses prohibited), except for universal service and energy conservation costs, the surcharge may not be used to recover costs related to uncollectible expenses.

market, including the establishment of a customer surcharge, be addressed in the rulemaking on NGDC Issues.

5. Regulatory Assessments

A NGDC cost that may be amenable to collection through a surcharge mechanism is regulatory assessments that are collected to support the regulatory activities of the Commission and the statutory advocates -- the Office of Consumer Advocate and the Office of Small Business Advocate¹⁴.

The current assessment process requires all regulatory costs allocated to the natural gas industry to be paid by the natural gas distribution companies. *See* 66 Pa.C.S. § 510 (relating to assessment for regulatory expenses upon public utilities); *Independent Oil and Gas Association of Pennsylvania v. PA PUC*, 804 A. 2d 693 (Pa. Cmwlth. 2000); appeal quashed 569 Pa. 508, 805 A. 2d 1212 (2000)(NGSs were not public utilities subject to regulatory assessments). The SEARCH participants considered an amendment to the Public Utility Code that would permit NGSs to be assessed for regulatory expenses based on commodity distribution throughput, but quickly rejected the idea as it could create another barrier to market entry and participation. *SEARCH Report*, p. 58. The discussion then turned to establishing an automatic assessment surcharge that would be used to recover assessments directly from consumers. This mechanism would allow NGDCs to recover these costs outside of a base rate case, similar to the way state taxes are collected from consumers. *SEARCH Report*, p. 58.

¹⁴ A full discussion of the SEARCH Group's work on the subject may be found in the *SEARCH Report* in Section X (relating to NGDC assessment surcharge) at pp. 58-59.

Disposition

While this proposal will not directly increase competition in the retail natural gas market, establishment of a surcharge with an automatic adjustment clause is in the public interest as it will lower regulatory expenses and litigation costs related to the assessment process and subsequent cost recovery from customers. For this reason, we will direct that the proposed rulemaking on NGDC issues include consideration of an adjustable surcharge mechanism to permit NGDCs to collect regulatory expenses directly from its customers. The proposed rulemaking should also consider cost recovery relating to NGDC assessments in support of the activities of the Office of Consumer Advocate (71 P.S. § 309-4) and the Office of Small Business Advocate (73 P.S. § 399.46).

The Commission is very much aware of consumer concerns about a company's recovery of costs outside of a base rate case. However, the establishment of a surcharge with an automatic adjustment clause that allows for the timely recovery of regulatory assessments which will include costs of the Commission actions to promote and facilitate natural gas competition can be a fair and efficient means to recover costs from stakeholders.

B. RULEMAKING ON NGS ISSUES

Section 2208(c) of the Public Utility Code establishes the security requirement for the issuance and maintenance of a NGS license. 66 Pa.C.S. § 2208(c)(1). The criteria that are to be used by the NGDC to set the amount and form of the security were established in each company's restructuring proceeding. The level of security is based on a formula that takes into account the NGDC's exposure to costs. For the retail supply market, this formula involves the peak day demand estimate for capacity, number of days' potential exposure in a billing cycle, and commodity estimates for quantity and

cost. Offsets to the amount of security that a NGS must provide may include calls on capacity, receivable purchases or receivable pledges. NGDC costs related to supplier default as set forth in Section 2207(k) of the Public Utility Code may also be taken into account when establishing the amount of security required. 66 Pa.C.S. § 2207(k).

SEARCH Report, pp. 18-19.

If a NGDC and NGS cannot come to a mutual agreement, the level or form of security is determined by criteria approved by the Commission. *See* 66 Pa.C.S. § 2208(c)(1). These criteria were established in the Commission's NGS licensing regulations and are to be used to determine security levels and acceptable forms for the security when voluntary agreement is not reached. *See* 52 Pa. Code § 62.111. Section 62.111(c) permits the use of the irrevocable letters of credit, corporate parental or other third party guaranty, and real or personal property. Personal property would include the use of escrow account or the pledge or purchase of receivables. 52 Pa. Code § 62.111(c).

SEARCH Report, pp. 18-19.

Also, an individual NGDC's security requirement, including the level of security, is subject to periodic review by the Commission. 66 Pa.C.S. §2208(c). *See also, UGI Utilities, Inc. – Gas Division v. PA PUC*, 878 A. 2d 186 (Pa. Cmwlth. Ct. 2005) appeal den. 586 Pa. 732; 890 A.2d 1062 (2005) (the Commission has discretion to approve criteria to be used to determine the financial security necessary based upon financial impact on the NGDC by a default by a NGS). Thus, a supplier is not without a remedy to address unreasonable security requirements of a NGDC on a case-by-case basis.

However, the *SEARCH Report*¹⁵ states that suppliers observe that the use of security instruments is not uniform among the companies and contend that this variability is a barrier to market entry and multi-system participation. Suppliers also raised concerns

¹⁵ This subject is fully discussed in the *SEARCH Report* in Section I (Creditworthiness/ Security) at pp. 18-21.

about the escalating cost of security to match the growth of their sales, and opined that there should be a limitation on the frequency of review of required security levels, with specific triggers for that review, such as a percentage change in pool size. *SEARCH Report*, p. 19.

Suppliers also view the NGDC's acceptance of only certain financial instruments as a barrier to market entry. Suppliers prefer to use corporate guarantees as the predominant practice. Further, to ensure fairness and remove a possible barrier for market entry, suppliers believe that specific criteria for acceptable financial instruments should be established in a regulation or order rather than permitting companies to set those through tariffs. *SEARCH Report*, p. 19.

Establishing standard language for the form of the financial instrument used for security and reasonable criteria for the amount of security should assist NGSs in obtaining security in an acceptable form and amount, while aiding the NGDC in collecting a claim against the security in the event of supplier default. North American Energy Standards Board (NAESB) forms and business practices could be reviewed for appropriateness to develop uniform language to address this issue. *SEARCH Report*, p. 21. Also, the use of a POR program should be examined as a way to reduce the level of required security, to lessen the need for frequent credit reviews and to ameliorate adjustments in security level that might normally be triggered by changes in a company's creditworthiness rating, which can occur for reasons unrelated to its immediate business interaction and relationships. *SEARCH Report*, p. 21.

Disposition

After reviewing the *SEARCH Report*, we believe that it is in the public interest for the Commission to initiate a rulemaking to address security requirements related to NGS licensing. The rulemaking will revise Commission regulations at Section 62.111

(relating to bonds or other security), and other related regulations in regard to the required level of security and the acceptable forms of security permitted to satisfy the statutory security requirement for licensing at 66 Pa.C.S. § 2208(c)(i)(relating to requirements for natural gas suppliers; financial fitness). The goal of this rulemaking will be to update the Commission's existing regulations regarding security requirements to better balance the ability of NGS firms to provide adequate security with the NGDC's risk of a supplier default.

The use of NGS accounts receivables in POR programs will be considered in regard to creditworthiness standards and as fulfillment of some part or all of security requirements. The rulemaking will also examine the adoption of standard language for the form of the financial instrument used for security and reasonable criteria for the amount of security. Finally, adoption of NAESB forms and business practices will be considered. We will direct that the Law Bureau and FUS to prepare a proposed rulemaking order on these issues to be acted upon at the December 4, 2008 Public Meeting.

C. RULEMAKING ON BUSINESS PRACTICE ISSUES

The physical venue for the retail natural gas market is the NGDC's transmission and distribution system as governed by the NGDC's operating rules, and business practices and policies. In the Commission's investigation into competition in the retail natural gas market, the suppliers identified certain of these NGDC operating rules and business practices as barriers to market entry and participation. *Report to the General Assembly*, pp. 50-52.

SEARCH participants examined the following NGDC operating rules, practices and policies related to the management of natural gas on the system: nomination and delivery requirements; tolerance bands related to balancing; and cash out/penalties. The

SEARCH group also examined the following subjects that were identified as barriers to full market participation by suppliers:

- the lack of uniformity in the operating rules between NGDC systems.
- the lack of uniformity in NGDC supplier tariffs.
- the lack of uniformity regarding electronic data transfer protocols.
- the lack of uniformity in regard to the existence and implementation of electronic bulletin boards.
- the lack of uniformity regarding creditworthiness and security.

A short summary of the group's discussions and possible solutions presented in the *SEARCH Report* for these identified barriers is presented below.

1. Standardization of NGDC System Operating Rules¹⁶

Differences among NGDC systems in regard to their organization and operation have been identified as a barrier to supplier entry and full participation in Pennsylvania's retail natural gas market. Interactions related to system operations (or asset management of natural gas supply) involve the exchange of information between NGSs and NGDCs. These interactions entail the day-to-day activities necessary to assure reliable delivery of natural gas to customers on the system.

Requiring all NGDCs to migrate to a preferred model for managing system assets would require comprehensive legislative changes and subsequent Commission proceedings to ensure due process related to property rights. However, certain business practices governing interactions between the suppliers and the NGDC can be tailored to operate within the preferred model. *SEARCH Report*, p. 13. This preferred model would streamline and/or standardize certain interactions between the NGSs and NGDCs involving gas supply management on the NGDC system. These best business practices

¹⁶ This subject is fully discussed in the *SEARCH Report* in Section G (Standardization of NGDC System Operations) at pp. 11-14.

could be defined and memorialized in a generic supplier's tariff or promulgated in Commission regulations. *SEARCH Report*, p. 13.

A subgroup of NGDCs and NGSs (including pipeline operators) considered the possibility of conforming NGDC-NGS business practices to those recommended by the NAESB. The NAESB subgroup reviewed each set of standards/business practices of each of these categories to determine if the standard or practice is already addressed by Pennsylvania rules, regulations and/or statute, is appropriate for consideration as a Pennsylvania business practice, may or may not be appropriate for Pennsylvania, or is not applicable. The members of this subgroup have differing levels of agreement as to whether certain standards or practices should be considered. This issue would require more exploration if it is to be pursued. *SEARCH Report*, pp. 13-14.

Standardizing some NGDC business practices through the adoption of NAESB practices could be implemented by a Commission rulemaking, or through the incorporation of NAESB practices by reference in a generic suppliers' tariff. Such changes to NGDC business practices would require less time to implement and would incur lower costs because of previous work on NAESB that has already been completed. *SEARCH Report*, p. 14.

2. NGDC Operating Rules

a. Nomination Rules and Delivery Requirements¹⁷

The type of relationship established between the NGDC and the NGS dictates the frequency of daily interactions involving information exchange on nominations and deliveries. In the partnership type of relationship, where a NGS is expected to manage supply, capacity and storage assets, information exchange is expected on a more routine

¹⁷ This subject is fully discussed in the *SEARCH Report* in Section J (Nomination and Delivery Requirements) at pp. 21-25.

and regular basis. In the situations where the NGDC acts as the parent and is expected to manage the array of assets, there is less required communication and hence, less interaction. *SEARCH Report*, p. 21.

Under a partner relationship, it is essential that the NGDC and NGS communicate in advance of each gas day cycle for nomination. The NGDC provides the NGS with outlooks for its customer pool, based upon weather forecasts and recent patterns of consumption activity. The NGS then utilizes that information together with its intelligence to formulate its gas day nomination. The timing for the main gas day nomination is different for each NGDC. *SEARCH Report*, p. 22.

Under wholesale rules established by North American Energy Standards Board (NAESB), four nomination cycles can be used to communicate information on gas required movement. In most cases, NGSs are only permitted to use the main cycle and can not make intraday nominations. Because these nomination periods could be used to adjust flows, the NGS is exposed to a greater risk of balancing penalty due to the mismatch of nominations and deliveries. At this time, no NGDC provides a NGS with the opportunity to use all of its nomination cycles. *SEARCH Report*, p. 22.

The *SEARCH Report* concludes that the elimination of inflexible or unreasonable nomination rules and delivery requirements¹⁸ that are not based on reliability concerns or physical NGDC system constraints would encourage supplier participation. The standardization of the rules for nomination and delivery requirements would lower operational costs for suppliers and facilitate supplier participation in multiple NGDC markets. *SEARCH Report*, p. 24.

¹⁸ For a more thorough explanation of how nomination rules and delivery requirements relate to tolerance bands and cash out/ penalties, see *SEARCH Report* at pp. 21-23.

To implement changes to nomination rules and delivery requirements and customer pooling or aggregation requirements, individual NGDC supplier coordination tariffs would need to be reviewed and amended. To establish uniform rules governing such matters, a Commission investigation could be undertaken. The uniform rules could be issued as a model supplier coordination tariff or promulgated in Commission regulations. *SEARCH Report*, p. 24.

b. Tolerance Bands¹⁹

Tolerance bands represent an operational flexibility accorded to transactions to accommodate the timeframes for actual movement of gas on a system or pipeline and the inherent measurement variations and recording lags associated with that movement. Simply put, a tolerance band is a range of acceptable values for the measured difference between the gas volume that is nominated to be delivered in a certain time frame on a NGDC's system and the gas volume that is actually delivered during that time frame by a NGS. Current Pennsylvania practice regarding tolerance bands, for both monthly and daily balancing programs run the spectrum from being based on tolerances of individual customers to being based on customer pools with bands of 2.5 percent up to 5 percent and 10 percent. *SEARCH Report*, p. 25.

In regard to tolerance bands, the *SEARCH Report* states that the adoption of wider tolerance bandwidths, along with other rules affecting system flow could lessen the possibility that NGSs operating on the system will incur penalties for imbalances. Broadening the tolerance bands to a reasonable width affords the NGS more flexibility in providing supply volume and in making business decisions in regard to the expansion of its sales and activities. The actual impact on effective competition will depend on the adoption of the proper system operations model and tariff design. *SEARCH Report*, pp. 27-28.

¹⁹ This subject is fully discussed in the *SEARCH Report* in Section K (Tolerance Bands) at pp. 25-28.

c. Cash Out/Penalties²⁰

Cash out is a term applicable to a settlement payment for gas purchased or sold between the NGDC and NGS in order to balance system supply. Penalties act as a deterrent to the NGS to manage its gas supply on the NGDC system so as not to fall outside the tolerance bands established to maintain system integrity. *SEARCH Report*, p. 28. The penalties are to compensate SOLR customers for use of their gas supply assets to balance the system. *SEARCH Report*, p. 28. According to the *SEARCH Report*, the goal of suppliers in proposing measures to reform cash out rules in NGDC supplier coordination tariffs is to decrease operational costs. Reforming cash out rules and other rules related to the management of supplier gas on the NGDC systems should increase supplier participation in the retail natural gas market. *SEARCH Report*, p. 29. Rules regarding cash out and penalties appearing in a NGDC's supplier coordination tariffs may be reviewed and amended as may be necessary by the Commission, after notice and opportunity to be heard. *SEARCH Report*, p. 29.

3. Standardization of Electronic Bulletin Boards²¹

Electronic Bulletin Boards (EBBs) are maintained by NGDCs and are accessed via a secure network/Internet connection by NGSs to post nominations and schedule deliveries of natural gas on the NGDC's system. Most NGDCs use a form of EBB, but there is little standardization of the format and operability. *SEARCH Report*, p. 29.

Suppliers believe the use of EBBs facilitate communications and enhance interactions between NGDCs and suppliers in regard to the movement of natural gas and delivery to customers which would allow for growth of supplier market share. Standardization of EBB format, content, functionality and use may also reduce errors.

²⁰ This subject is fully discussed in the *SEARCH Report* in Section L (Cash Out/Penalties) at pp. 28-29.

²¹ This subject is fully discussed in the *SEARCH Report* in Section M (Electronic Bulletin Boards) at pp. 29-31.

SEARCH Report, p. 31. Although EBBs may prove to be cost-effective in reducing errors, maintaining EBBs may be expensive. NGDCs would seek to recover costs through distribution rates. Also, the time lag in posting current information can be excessive so that the EBB can itself become a barrier to timely implementation of NGS-NGDC interactions. *SEARCH Report*, p. 31.

The suppliers offered a number of ideas related to best practices and standard content for EBBs. *SEARCH Report*, pp. 29-30. No change in legislation is necessary; rather, the requirement could be implemented as the result of a Commission investigation or through the rulemaking process. Cost issues could also be addressed in the same proceeding. *SEARCH Report*, pp. 30-31.

Disposition

The Commission directs that the Law Bureau and the FUS initiate a rulemaking on supplier coordination tariffs. The purpose of the rulemaking will be to revise and, when feasible, standardize supplier coordination tariffs and NGDC system operating rules, business practices, requirements, penalties and procedures to remove or reduce barriers to supplier participation in the retail natural gas market. Major issues that should be addressed include:

- The elimination or revision of inflexible or unreasonable nomination rules and delivery requirements²².
- The adoption of wider tolerance bandwidths, where justified, and the elimination or revision of other rules affecting system flow that do not negatively impact system reliability.
- The revision of unreasonable cash out rules and penalties.
- The adoption of best business practices related to information exchange and data transfer, including the possible standardization of NGDC business practices by the adoption of certain NAESB practices.

²² Data related to imbalance penalties, cash out penalties and system gaming that was filed by the PGW and Hess at this investigation docket in compliance with the Commission's order in *PA PUC, et al. v. Philadelphia Gas Works*, order entered September 28, 2007 at Docket No. R-00061931, pp. 126-127, shall be considered in this rulemaking.

The use and standardization of Electronic Bulletin Boards will also be addressed. The proposed rulemaking order should be completed so that it may be acted upon by the Commission no later than end of the first quarter of 2009.

FUTURE EVALUATION OF EFFECTIVE COMPETITION

The SEARCH Group studied two proposals that would allow for future evaluation and monitoring of competition in the retail natural gas market. The first proposal involves the establishment of a future milestone date where the state of competition in retail natural gas supply services market could be evaluated. The first evaluation was proposed to commence two to five years after implementation of the key measures that result from this collaborative. Alternatively, the Commission could direct that the follow-up evaluation be scheduled for a set number of years after its initial action resulting from this process. *SEARCH Report*, p. 59. The milestone review may be initiated by Commission order. *SEARCH Report*, p. 60.

This evaluation would be a more formal review and would supplement any day-to-day monitoring of competition by Commission staff. *SEARCH Report*, p. 59. The criteria for the evaluation would include the same criteria that the Commission considered in its October 2005 Report to the General Assembly: participation in the market by many buyers and sellers, the lack of substantial barriers to market entry for suppliers, the lack of substantial barriers that would discourage customer participation and the presence of sellers offering buyers a variety of products. *SEARCH Report*, p. 59. Not all issues that are being studied in this review need to be included in the evaluation. The scope of the evaluation should be decided after stakeholders gain experience with changes that were made as a result of this review. *SEARCH Report*, pp. 59-60.

The second proposal calls for the appointment of members of Commission staff to monitor competition and to address daily or on-going issues that arise affecting the above-mentioned criteria. *SEARCH Report*, p. 60. The appointment of these staff members should be made shortly after the conclusion of this review. Input from these staff members would be considered during the subsequent milestone evaluation. *SEARCH Report*, p. 60. See Section Y of the *SEARCH Report* at pp. 59-61 for further discussion of these proposals.

Disposition

The *SEARCH Report* rates the establishment of a future milestone review as having a moderate effect on the development of competition since it would give marketers a level of comfort that, if the changes made to the market as a result of this review are now insufficient, a forum will be provided for implementing additional measures as may be necessary. *SEARCH Report*, p. 60. We note that this retrospective review process should give the other stakeholders – customers, NGDCs and pipelines – the same level of comfort. Therefore, we will direct that such a formal review be scheduled five years from the entry date of this order.

At pages 9-10 of this order, *supra*, we directed that the Director of Operations take all necessary steps to create an in-house Office of Competitive Market Oversight, whose duties will include, *inter alia*, market monitoring and informal dispute resolution between suppliers and distribution companies. This Office will also be charged with conducting the future milestone review.

CONCLUSION

The purpose for convening the natural gas stakeholders was to explore avenues to increase competition in the retail natural gas supply market. The work of the group, as documented in the *SEARCH Report*, not only has provided us with possible solutions to increase supplier participation in the retail market, but also has demonstrated the commitment of all stakeholders to this goal.

We have developed an action plan that incorporates many of the solutions that were identified in the *SEARCH Report* that have the greatest potential to eliminate or reduce market barriers for suppliers. With this final order, we have set forth this plan and have set it in motion. We thank the stakeholders for their past assistance and for their continued participation as we move forward with this plan to improve market conditions for the benefit of all stakeholders consistent with the pro-competition policy goals embodied in the *Natural Gas Choice and Competition Act*; **THEREFORE,**

IT IS ORDERED:

1. That the *SEARCH Report* is adopted and issued for public release. The Report may be accessed at the PUC web page for the Natural Gas Stakeholders' Working Group: http://www.puc.state.pa.us/naturalgas/naturalgas_stakeholders_wg.aspx.
2. That the Law Bureau and the Bureau of Fixed Utility Services, with the assistance of other technical staff as may be required, prepare a proposed rulemaking order on **NGDC Issues** as set forth in this order. The proposed rulemaking order shall be prepared so that it can be acted upon no later than the end of the first quarter of 2009.
3. That the Law Bureau and the Bureau of Fixed Utility Services, with the assistance of other technical staff as may be required, prepare a proposed rulemaking order on **NGS Issues** related to creditworthiness standards and security issues as set forth

in this order. The proposed rulemaking order shall be prepared so that it can to be acted upon at the December 4, 2008 Public Meeting.

4. That the Law Bureau and the Bureau of Fixed Utility Services, with the assistance of other technical staff as may be required, prepare a proposed rulemaking order on issues related to **Business Practices** as set forth in this order. The proposed rulemaking order shall be prepared so that it can to be acted upon no later than the end of the first quarter of 2009.

5. That the Director of Operations is directed to take all necessary steps to establish an Office of Competitive Market Oversight. The Office shall be established and fully functional no later than Monday, January 5, 2009.

6. That the Director of Operations prepare, in consultation with the Law Bureau, a letter to the General Assembly requesting that the amendments to the Public Utility Code as set forth in this order be enacted.

7. That all jurisdictional natural gas distribution companies subject to the requirements of the *Natural Gas Choice and Competition Act* are directed to schedule a Section 2204(f) working group meeting for the first quarter in January 2009 for the purpose of discussing capacity in the context of system management.

8. That all jurisdictional natural gas distribution companies subject to the requirements of the *Natural Gas Choice and Competition Act*, who have not already done so, are encouraged to file proposals to implement a voluntary Purchase of Receivables programs no later than December 31, 2008. An original and 15 copies of the proposal shall be filed with the Secretary, Pennsylvania Public Utility Commission, P.O. Box 3265, Harrisburg, PA 17105-3265.

9. That a jurisdictional natural gas distribution company subject to the requirements of the *Natural Gas Choice and Competition Act* that does not offer or has not filed a proposed purchase of receivables program by December 31, 2008, shall include, in its next base rate case or its next section 1307(f) gas cost proceeding, whichever comes first, a fully allocated cost of service study by which the Commission can investigate the unbundling of natural gas procurement costs from base rates.

10. That the Secretary shall serve a copy of this order upon all jurisdictional natural gas distribution companies, licensed natural gas suppliers, the Energy Association of Pennsylvania, the Office of the Consumer Advocate, the Office of Small Business Advocate, the Office of Trial Staff and all other parties filing comments at Docket No. I-00040103.

11. That this docket be closed.

BY THE COMMISSION,



James J. McNulty
Secretary

(SEAL)

ORDER ADOPTED: September 11, 2008

ORDER ENTERED: September 11, 2008

**PENNSYLVANIA PUBLIC UTILITY COMMISSION
HARRISBURG, PENNSYLVANIA 17105-3265**

Investigation into the Natural Gas Supply Market: Report on Stakeholders' Working Group (SEARCH); Action Plan for Increasing Effective Competition in Pennsylvania's Retail Natural Gas Supply Services Market

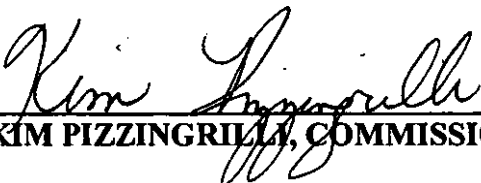
**PUBLIC MEETING
September 11, 2008
SEP-2008-LAW-0080*
Docket No. I-00040103F0002**

STATEMENT OF COMMISSIONER KIM PIZZINGRILLI

Today we are fulfilling another key obligation under the Gas Choice Act. The Commission is formally adopting and releasing the report documenting the work of the Natural Gas Stakeholders Working Group and setting forth the Commission's Action Plan to increase competition in the retail market for natural gas supply services.

The Action Plan represents a comprehensive strategy resolving many issues central to the successful implementation of the Act. I thank the SEARCH (Stakeholders Exploring Avenues for Removing Competition Hurdles) stakeholders and the Commission's team, which is comprised of representatives from nearly every PUC office and bureau, for the time and effort contributed to this project so far. We also appreciate the resources that will continue to be devoted as we implement our Action Plan by establishing an Office of Competitive Market Oversight and by promulgating a number of regulations. We look forward to the continued input of all stakeholders.

September 11, 2008
Date



KIM PIZZINGRILLI, COMMISSIONER