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November 1, 2017

Rosemary Chiavetta, Secretatry
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street, 2nd Floor
Harrisburg, PA 17120

Re: **Proposed Rulemaking: Natural Gas Distribution Company Business Practices; 52 Pa. Code § 62.225, Docket No. L-2017-2619223**

Dear Secretary Chiavetta:

Attached for filing, please find PECO Energy Company's *Comments* to the Advanced Notice of Proposed Rulemaking Order. If you have any questions regarding this filing, please do not hesitate to contact me at 215.841.4220.

Sincerely,

Michael S. Swerling /adz

Michael S. Swerling
Assistant General Counsel

/adz

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Proposed Rulemaking: Natural Gas Distribution Company Business Practices; 52 Pa. Code § 62.225	: : :	**Docket No. L-2017-2619223**

COMMENTS OF PECO ENERGY COMPANY TO THE ADVANCED NOTICE OF PROPOSED RULEMAKING ORDER

I. INTRODUCTION

On December 14, 2014, the Pennsylvania Public Utility Commission (the "Commission") issued a Final Order in its *Investigation of Pennsylvania's Retail Natural Gas Supply Market* at Docket No. I-2013-2381742 ("Gas RMI Order").[1] The Gas RMI Order directed the Office of Competitive Market Oversight ("OCMO") to conduct an examination of system balancing practices, including tolerances and penalties. Subsequent to the Gas RMI Order, OCMO convened a collaborative stakeholder working group to review these business practices. As a result of OCMO's investigation, the Commission issued an Advanced Notice of Proposed Rulemaking Order on August 31, 2017 ("August 31 ANOPR").

PECO Energy Company ("PECO" or the "Company") appreciates the opportunity to provide comments regarding the Commission's proposals to improve the competitive marketplace by revising the rules for capacity assignment, penalties and imbalances. PECO's comments support the Commission's efforts to achieve fair and balanced retail competition, while protecting the integrity of natural gas distribution systems.

II. COMMENTS

A. *Uniform Capacity Costs For All Customers*

[1] See *Investigation of Pennsylvania's Retail Natural Gas Supply Market*, Docket No. I-2013-2381742 (Final Order entered on December 18, 2014).

According to the August 31 ANOPR, the existing capacity release model in Pennsylvania generally involves the release of capacity to Natural Gas Suppliers ("NGSs") at a system average cost. (ANOPR at 7). The Commission believes that this model could result in competitive market barriers, which prevent NGSs from: 1) creating new innovative product offerings; 2) undercutting the utility's price to compare ("PTC"); and 3) entering the market because the cost for capacity is untenable.

To remediate these possible outcomes, the Commission proposes to have natural gas distribution companies ("NGDCs") release capacity to NGSs at no charge. NGDCs would be permitted to recover the associated costs from all customers through a non-bypassable surcharge mechanism. Moreover, the Commission believes that its proposal would have the added benefit of reducing risks associated with non-payment by NGSs. PECO believes that this change is not necessary for the reasons described below.

1) Inability to create new innovative products.

No evidence was offered to support the conclusion that NGSs are unable to create new and innovative products as a result of paying for capacity released by NGDCs. For NGSs, this is a pass-through cost of doing business with their customers. Therefore, if an NGS is no longer required to pay the NGDC for capacity, there would be no resultant savings that could be redirected toward NGS products. The proposed enhancement would simply eliminate the need for NGSs to collect this operating cost from their customers. Accordingly, PECO does not see any basis for concluding that new/innovative products will be offered after NGS capacity costs are eliminated. Because this proposal will not facilitate new and innovative supplier offerings, it should not be implemented.

2) Inability to undercut the utility's PTC.

No evidence was offered to support the conclusion that capacity costs prevent an NGS from competing with (and successfully undercutting) an NGDC's PTC. Moreover, if this change were adopted, the capacity cost would need to be removed from the NGDC's PTC, which would have the overall effect of reducing the NGDC's PTC. NGSs would be left competing against the NGDC's commodity cost in the same manner that occurs today. Additionally, the NGDC's Gas Procurement Charge ("GPC") would need to be reduced to remove the working capital component associated with the capacity. Failure to do so would result in an overstated PTC because it would include a working capital cost component that no longer exists for suppliers. Implementing the proposed change without these provisions must be avoided. Otherwise, NGSs would inequitably receive compensation in an inappropriate manner. Because this proposal cannot achieve its intended result and will not benefit suppliers in competing against the PTC, it should be avoided.

3) Inability to enter the market due to the cost for capacity.

No evidence was offered to support the conclusions that NGS capacity costs prevent new suppliers from entering the marketplace, or that NGSs are required to pay for capacity upfront. As previously stated, capacity is a pass-through cost of doing business for suppliers. It is not an upfront capital cost needed to enter the marketplace. Moreover, NGSs pay for capacity the same way they pay for commodity, in the month after the costs are incurred (for example, March costs are paid in April). If an NGS collects capacity payments from its customers after remitting payment to the interstate pipelines, the NGS is subject to a working capital expense, not an advance payment. The cost of working capital is then included in the NGDC's PTC. Therefore, PECO does not agree that NGSs would be better situated to enter the marketplace by shifting these costs to all ratepayers. This proposal should not be adopted because it does not address a barrier to market entry.

4) Reducing risk associated with non-payment.

According to the August 31 ANOPR, the proposal to release capacity at no cost could position NGDCs to avoid a risk of supplier non-payment for capacity. This risk, however, does not exist for PECO as described in the August 31 ANOPR. Instead, once PECO releases capacity to a third-party supplier, the payment obligation exists between the receiving NGS and the interstate pipeline that originally provided the capacity. To mitigate the risk of non-payment, interstate pipeline companies require their recipients pass a stringent financial evaluation. For this reason, PECO's Gas Choice Program requires participating suppliers to pass an interstate pipeline creditworthiness evaluation before serving customers. Because nonpayment risk is assumed by interstate pipelines, PECO always receives credits for demand charges associated with capacity released to suppliers. Accordingly, this proposal should not be adopted because it would not alleviate any NGDC risk for non-payment of capacity costs.

B. Capacity Assignment From All Assets

According to the August 31 ANOPR, capacity must follow customers who shop, subject to system reliability requirements. 52 Pa. Code § 62.225(a)(1). NGDCs must release enough capacity to serve shopping customers in their service territories. NGDCs also must maintain enough capacity to serve non-shopping customers and comply with applicable Supplier of Last Report ("SOLR") obligations. The Commission acknowledges that NGDCs presently release capacity to NGSs. However, the Commission states that NGDCs do not release capacity from all of their assets (e.g., critical assets and 7c contracts). Furthermore, while acknowledging that "[t]here is no requirement that an NGDC release a full representative 'slice of the pie' of its assets to NGSs," the Commission believes that failing to do so provides NGDCs with a competitive edge. (August 31 ANOPR at 11-12). PECO does not believe that maintaining capacity associated with critical assets for reliability purposes presents NGSs with a market disadvantage for the following reasons.

1) PECO's Virtual Storage Program eliminates the need to release capacity from critical assets.

PECO has instituted a number of controls to prevent such a competitive disadvantage for suppliers. Specifically, retail suppliers are required to deliver a set amount of gas each month to their pool of customers: an Aggregate Daily Delivery Quantity ("ADDQ"). The ADDQ does not change for the calendar month, which allows suppliers to deliver known/fixed quantities of gas each day of the month. Additionally, during the winter peaking months (November-March), by design, NGSs' ADDQ requirements are capped equal to the Aggregate Daily Contract Quantity ("ADCQ"). The ADCQ is the amount of monthly firm transportation capacity that PECO assigns to NGSs so that supply can be delivered to shopping customers. This capacity stems from PECO's firm transportation contracts in quantities proportional to the NGS's pool of customers (as a portion of PECO's overall SOLR resources).

Because PECO does not release capacity from its on-system peaking facilities or its storage contracts, (so that PECO can meet all of its firm delivery requirements during the winter), NGS deliveries may not be sufficient to cover their customers' usage in the winter. To remediate this situation, PECO uses its storage and other assets to resolve all delivery imbalances (that do not negatively impact reliability) for each supplier during peak periods. Additionally, PECO allows NGSs to make up the difference by delivering gas to PECO during non-peak months, which can be used to meet storage refill requirements. This acts like a virtual storage program for suppliers allowing them to receive all the capacity needed to serve their customers.

2) NGDCs are required to release only enough capacity to follow NGS customers.

NGDCs are required to provide suppliers with enough capacity to follow shopping customers. In PECO's case, it releases the amount of capacity needed for each supplier to meet its ADDQ and ADCQ requirements. To the extent that NGDCs can release enough capacity (from non-critical assets) to follow NGS customers, NGDCs should not be required to provide virtual access to critical assets.

3) Access to critical assets must be reserved to NGDCs for reliability purposes

However, to the extent that the Commission is still interested in pursuing this approach, PECO offers the following specific concerns. In its August 31 ANOPR, the Commission envisioned NGDCs granting "virtual access" of critical assets to NGSs. (August 31 ANOPR at 13). Under this scenario, NGSs could use capacity from critical assets that remain under NGDC control. The Commission also made it clear that such virtual access should not violate reliability constraints and could be used by NGSs during non-peak periods (after first clearing availability with NGDCs).

PECO is concerned that virtual access could negatively impact reliability and, therefore, should be avoided. PECO uses its assets to provide valuable balancing services, managing its assets to address vast swings in demand annually, monthly, daily and intraday. To do this, PECO utilizes 5 intrastate storage contracts (two of which are 7c contracts), 12 transportation contracts and liquid natural gas ("LNG") and Propane peaking facilities – all of which are used to meet customer demand requirements ranging from as low as 90,000 dth (per day in the summer) to as high as 800,000 dth (per day in the winter) each year.

To ensure system reliability, the Company constantly reviews and manages weather conditions, customer usage trends, supply quantities that can be obtained from its contracts, amounts of natural gas withdrawals from its peak-shaving facilities, and the availability of spot market natural gas. Capacity assignments and storage assets have allowed PECO to manage vast swings in demand associated with these variables, so customers continue to receive reliable service during all periods.

More specifically, PECO's firm storage and transportation contracts with interstate pipeline companies are designed to address seasonal swings in demand, including but not limited to, design day projections. These resources also can react to intraday changes in projections and demand, resulting from variations in weather.

Additionally, PECO uses its LNG and Propane facilities to meet the peak day needs of its firm customers. These facilities must be managed in a very specialized manner. The amount of inventoried LNG and propane must be available to address customer demands throughout the entire winter heating season, including intraday swings and possible force majeure events, which could curtail the availability of natural gas on the interstate pipelines at any time. A decision to operate these facilities at any given time must be weighed against existing demand and potential future demand requirements. Any infringement upon these assets (virtual or otherwise) to address a temperature swing or force majeure event could cause PECO to fail in its statutory responsibility to act as the SOLR. Based on the Company's constant attention to and management of these factors and resources, PECO believes that access to critical assets should be reserved to NGDCs and should not be included in a virtual model.

C. Imbalance Trading

The August 31 ANOPR stated that limited and untimely communications result in supplier penalties, which could otherwise be avoided/mitigated. According to the Commission, imbalance trading (with enhanced communications between NGDCs and NGSs) could avoid/reduce penalties for over and under deliveries. PECO agrees that regular and timely communications can help suppliers mitigate penalties associated with over and under deliveries.

PECO utilizes imbalance trading as an effective tool for avoiding/mitigating delivery penalties. Moreover, PECO allows suppliers to trade confirmed deliveries among themselves to properly reconcile customer deliveries with usage (in accordance with their ADDQ requirements). According to Rule 10.12 of its Supplier Coordination Tariff:

> ***Trading of ADDQ Under-Deliveries and Over-Deliveries.*** *Offsetting ADDQ Under- and Over- Deliveries that are otherwise subject to penalty under Rules 10.8 and 10.9 and do not exceed five (5) percent of the Supplier's ADDQ may be traded between Suppliers as a means of eliminating those volumes from the calculation of the applicable penalty; provided, however, that such trade must occur within 24 hours of the day to which the offsetting under-delivered and over-delivered amounts apply; and provided further, that the Company shall assess to each NGS, and each NGS shall pay, a $0.025 per dth trading fee.*

PECO also permits NGSs to allocate delivered supply between the Company's Choice (Low Volume Transportation or LVT) and Transportation (High Volume Transportation or LVT) programs to reduce/eliminate penalties.

Regarding the Commission's request for enhanced communications to control imbalances, PECO's electronic bulletin board and its City Gate Solutions program allow NGSs to monitor and adjust their daily activities (in real-time) to avoid penalty provisions.

D. Penalties During Non-Peak Periods

According to the August 31 ANOPR, the Commission recognizes that penalties are a necessary market feature to help maintain system integrity and reliability. However, the Commission believes that a standard penalty calculation (as opposed to a static amount) for off-peak periods would reduce market participation barriers for NGSs. The Commission recommends that all NGDCs adopt the following UGI penalty model during off-peak periods:

The difference in price between the highest published index price for Texas Eastern M-3 and the lowest published index price for Texas Eastern M-2, as published in Platts' Gas Daily on the table "Daily Price Survey", but shall not be lower than $0.25/per Dth, applied to the difference between the DDR and the delivered volumes, plus all incremental costs incurred by Company as a result of the failure to deliver the DDR.

PECO supports using penalty structures that are market-based and that prevent opportunities for arbitrage. However, adopting a "one-size-fits-all" approach (such as the UGI model cited above) will not work for all NGDCs - each of which has unique operational and programmatic differences. If the penalty is not properly aligned with the specific Choice program, system balancing problems could result. For instance, during non-peak periods, an inadequately low penalty amount could result in too much gas being delivered on system. This could subject the NGDC (and its ratepayers) to unnecessary interstate pipeline penalties.

As previously stated, PECO establishes a set amount of gas each month to a supplier's pool of customers. The ADDQ does not change for the calendar month, which allows suppliers to deliver known/fixed quantities of gas each day of the month. It is easier for NGSs to comply with their ADDQ requirements during less volatile off-peak periods. Therefore, penalties should be the exception during non-peak periods. Additionally, PECO provides a 2 percent tolerance band (in which penalties will not be charged) for deliveries above/below the ADDQ (in non-peak months). Furthermore, PECO's LVT program penalty structure appropriately preserves system integrity as stated in Rule 10.9 of its Supplier Coordination Tariff:

Suppliers who fail to deliver the ADDQ established by the Company will be subject to the following penalty: a) if the under-delivery occurs in the months of April-October, a penalty equal to the lesser of $25 per dth or two hundred (200) percent of the mathematical average of the prices for delivered gas supplies published in Gas Daily for points located in Texas Eastern M-3 and Transco Z6 (non-NY) which are applicable to the calendar day in which the deficient deliveries were made; or b) if the under-delivery occurs in the months of

November- March, a penalty equal to the lesser of $50 or two hundred (200) percent of the mathematical average of the prices for delivered gas supplies published in Gas Daily for Texas Eastern M-3 and Transco Z6 (non-NY) which are applicable to the calendar day in which the deficient deliveries were made. The Supplier will also pay all costs incurred by the Company to obtain gas volumes needed to rectify the deficiency.

The Company shall waive imposition of the above penalty where the positive difference between the ADDQ and the amount delivered by the Supplier did not exceed two (2) percent of a Supplier's ADDQ, subject to the Supplier eliminating the deficient volume pursuant to a schedule directed by the Company.

These controls strike an appropriate balance between avoiding penalties for inconsequential errors and maintaining the integrity of the distribution system. Accordingly, this penalty structure should not be changed to one that does not address the Company's particular system requirements.

III. CONCLUSION

PECO appreciates the opportunity to comment on the Commission's Advanced Notice of Proposed Rulemaking Order and asks that these comments be favorably considered.

Respectfully Submitted,

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