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VIA E-FILING

Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
P.O. Box 3265
Harrisburg, PA 17105-3265

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

Dear Secretary Chiavetta:

Enclosed for filing please find a copy of the comments of the UGI Distribution Companies, comprised for purposes of this filing of UGI Utilities, Inc. – Gas Division; UGI Penn Natural Gas, Inc. and UGI Central Penn Gas, Inc., in the above-captioned proceeding.

Please feel free to contact me with any questions.

Very truly yours,

Mark C. Morrow

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Counsel for the UGI Distribution Companies

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 THE
UGI DISTRIBUTION COMPANIES**

I. INTRODUCTION

The UGI Distribution Companies ("UGI"), comprised for purposes of this filing of UGI Utilities, Inc. – Gas Division; UGI Penn Natural Gas, Inc. and UGI Central Penn Gas, Inc., appreciate this opportunity to submit comments in response to the Commission's Advance Notice of Proposed Rulemaking Order ("ANOPR") entered on August 31, 2017 in the above docket, and published in the September 16, 2017 edition of the *Pennsylvania Bulletin.* These comments are meant to supplement those filed by the Energy Association of Pennsylvania ("EAP"), of which UGI is a member, at this docket.

The ANOPR describes the Retail Market Investigation Stakeholders Group ("RMI Stakeholder Group"), of which UGI was an active participant, conducted pursuant to the Commission's December 18, 2014 Order in its *Investigation of Pennsylvania's Retail Natural Gas Supply Market*, Docket No. I-2013-2381742 (Order entered September 12, 2013) ("RMI Order"), as well as other past Commission initiatives designed to promote retail choice. It then proposes a number of changes to the Commission's regulation at 52 Pa. Code §62.225 addressing release, assignment or transfer of capacity "to improve the competitive market by revising how capacity is assigned and addressing related issues including penalties and imbalance trading." ANOPR p.1. Some of the suggested changes are modeled on the practices of certain identified Commonwealth natural gas distribution companies ("NGDC").

Briefly, UGI believes some of the revisions proposed in the ANOPR are workable and may have merit, while others, as proposed, may not. In some instances, a proper evaluation of the merits may require more information. Thus, while UGI believes the Commission appropriately decided to proceed with an advance notice of proposed rulemaking, UGI believes the Commission should explore and receive further stakeholder input concerning the ANOPR proposals before proceeding with a proposed rulemaking.

In this regard, UGI would note RMI Stakeholder Group wisely included a Commissioner-directed introductory briefing process for participating Commission staff by stakeholder groups which, in the case of NGDCs, included detailed presentations concerning the composition of their individual gas supply portfolios, customer choice program designs and characteristics of the wholesale gas market areas they operate in. These presentations showed the distinctly differing wholesale market conditions and supply characteristics of Commonwealth NGDCs. In particular, there are significant differences between the western part of the Commonwealth, where on-system storage and local production are significant sources of supply and interstate pipeline capacity resources are abundant, and the eastern part of the Commonwealth where these conditions do not prevail. UGI's presentation (the "UGI RMI Presentation") is attached in Appendix A hereto.

The NGDC presentations and the subsequent RMI Stakeholder Group did not, however, address some of the specific proposals set forth in the ANOPR, and did not delve into the details of the NGDC examples cited. UGI's comments below have accordingly been based, in part, on independent research it has conducted in response to the ANOPR, and the Commission should consider whether a technical conference might be appropriate to permit stakeholders to better understand the cited NGDC policies, and examine how and if they could be translated into a statewide norm.

UGI would also remind the Commission of the comments it and other NGDCs filed in December of 2013 in response to the RMI Order. As UGI's comments noted, NGDC and electric distribution company ("EDC") operations differ substantially because of the differing physical characteristics of electricity and gas, and the differing regulatory regimes and wholesale markets they operate in. These differences make it much more difficult for NGDCs to adopt uniform retail choice policies than it is for EDCs to do so.

The December 2013 comments also highlighted the differences between EDC and NGDC provider-of-last-resort and supplier-of-last-resort ("SOLR") responsibilities respectively. Specifically, NGDCs like UGI do not have SOLR responsibilities for the larger volume transportation customers on their distribution systems. These larger volume customers procure and schedule their own upstream gas supplies, often through Commission-licensed natural gas suppliers ("NGS"), but do not necessarily have the right to obtain gas supply service from their NGDC in the case of an upstream supply failure. UGI generally refers to such customers as "Transportation Customers." UGI does have statutory SOLR responsibilities, however, with respect to its smaller volume customers, who (a) often use gas for essential human needs, (b) often do not have daily metering capabilities, (c) have a statutory right to procure natural gas supply service from NGDCs (or other designated SOLR provider) and to leave and return to such SOLR service on short notice if they elect to procure natural gas supply service from a NGS and (d) often need to be served by gas supply assets that require long-term contractual commitments. UGI refers to such customers as "Core Market Customers" and those Core Market Customers who elect to procure natural gas supply service from a NGS as "Choice Customers." Other NGDCs may refer to such customers using different terms such as "priority one customers." As a result of the differing characteristics and applicable NGDC legal responsibilities for these customer groups, NGDCs appropriately often have substantially differing tariff rules for Transportation Customers and Choice Customers, and in general UGI would note that discussions of retail market rules and the Commission's regulations should, as appropriate, recognize this important distinction. As the data submitted by the NGDCs in response to the RMI Order indicated, there is already a robust and long-standing retail market serving Transportation Customers, and UGI believes the Commission's desire to improve retail markets should largely be focused on rules pertaining to Choice Customers and the subset of NGSs, which UGI refers to as "Choice Suppliers", serving this retail gas market segment.

II. <u>COMMENTS</u>

A. *<u>Uniform Capacity Costs for All Customers</u>*

The ANOPR notes that most NGDCs release gas supply assets to Choice Suppliers and generally require the NGS to pay the costs of the released assets, but notes:

> *the Peoples Natural Gas Company (Peoples) releases capacity assets to the NGS like all other NGDCs, but instead of the NGS paying for it, all customers pay the average system cost of capacity (regardless of their participation within the market). While mathematically this difference is identical (i.e., the NGDC's cost of capacity is reimbursed by either customers or NGSs in full), this structure could offer a benefit to all market participants. Therefore, the Commission proposes that the Peoples' approach to capacity payment should be replicated across the Commonwealth.*

ANOPR, p. 8. The ANOPR suggests that this approach could benefit the market by reducing collection risk to NGDCs and reduce risk to NGSs because they would have to recover fewer costs from their customers. It suggests that customers would benefit because this change might encourage more NGSs to enter the market.

UGI believes the ANOPR's proposal could work on its system, but would have to be modified to address the treatment of secondary market revenues to prevent unfair cost-shifting and double recovery by Choice Suppliers, particularly in the wholesale market conditions prevailing in the eastern part of the Commonwealth.

Under current Federal Energy Regulatory Commission ("FERC") policies, shippers who contract for firm pipeline or storage capacity must pay demand charges designed to recover the bulk of the interstate pipeline or storage facility cost, regardless of usage, and smaller variable rates reflective of usage and designed to recover pipeline or storage variable costs. Such rates are often referred to as "straight fixed variable rates". To help offset the fixed demand charge component of straight fixed variable rates, the FERC permits primary firm customers to release capacity to secondary users using the FERC's capacity release mechanism designed to promote transparency (through posting requirements) and efficiency (through rules designed to make sure that assets become available to secondary shippers who value them most through the bidding process). Such capacity may also be bundled with commodity and sold in such secondary markets through so-called "off-system sales." FERC also permits capacity to be released outside the normal posting and bidding process to an asset manager who will pay a fee to the releasing party and will in turn seek to maximize the value of the asset in ways that the releasing party perhaps could not do itself. Exceptions to bidding, posting and maximum price rules are also provided for state-approved customer choice programs. When capacity is released under the FERC's capacity release mechanism, the secondary shipper must meet the pipeline's credit requirements, and pays the applicable demand and variable charges to the pipeline, with such payments being credited against the primary shipper's bill. In UGI's experience pipelines have never decreased secondary shipper payment credits to UGI as a result of a secondary shipper's refusal or inability to pay billed charges to a pipeline.

In order to encourage NGDCs to maximize secondary market revenues derived from gas supply assets procured to serve Core Market Customers in accordance with the least cost procurement standard specified in Section 1318 of the Public Utility Code, 66 Pa.C.S. §1318, the Commission, through precedent established in annual Section 1307(f) purchased gas cost ("PGC") proceedings, has established cost sharing mechanisms whereby NGDCs generally retain a portion of such secondary revenues, and flow the remaining portion of such revenues to PGC customers. In both the case of Peoples and UGI (and to UGI's understanding all other NGDCs in the Commonwealth) 25% of secondary revenues are generally retained and 75% flowed back to PGC customers. However, in the case of releases to Choice Suppliers, UGI, and UGI believes Peoples as well, does not apply the sharing mechanism to releases of gas supply assets to Choice Suppliers, and all revenues received from such releases, as well as bundled sales, are flowed back to PGC customers. Choice Suppliers may then use the assets, or their functional equivalent, to either serve the Choice Supplier's customers or for secondary market transactions to maximize the value of the gas supply assets in the secondary market. The value they receive from such secondary market transactions may then be reflected in the prices of their product offerings.

Under UGI's sharing mechanism, 75% of the revenues derived in secondary markets from the use of gas supply assets not released or transferred to Choice Suppliers are flowed back to PGC customers. However, it is UGI's understanding from research conducted in response to this ANOPR that Peoples flows 75% of the revenues derived in secondary markets from the use of gas supply assets not released or transferred to Choice Suppliers <u>to PGC and Choice</u>

Customers alike. Thus, Choice Suppliers on the Peoples system receive the full benefit of secondary market revenues derived from core market gas supply assets released or sold to Choice Suppliers at zero cost, while the Choice Customers served by such Choice Suppliers also receive sharing mechanism credits derived from core market gas supply assets retained and used to serve PGC customers alone. UGI believes this may reflect that on the Peoples system, such secondary market revenues are not significant. On the UGI system, however, such revenues are more significant and thus applying this aspect of the Peoples rate design to UGI as proposed in the ANOPR could result in cost shifts inconsistent with the statutory least-cost fuel procurement standard applicable to UGI's SOLR responsibilities.

Specifically, UGI's sharing mechanisms credited approximately $8.7 million in 2014, $13.7 million in 2015, $6.8 million in 2016 and $8.4 million in 2017 to PGC customers. These numbers reflected 75% of the secondary market revenues UGI was able to realize from PGC assets which *were not released to Choice Suppliers and not paid for by Choice Customers*.

These numbers reflect the fact that in the market area of the Commonwealth in which UGI operates, secondary markets can place considerable value on released gas supply assets. In the production area of the Commonwealth in which Peoples is located, however, secondary markets generally do not carry a high value. Evidence of this dichotomy is reflected in slides 9-11 of the UGI RMI Presentation, and in the following testimony submitted by Peoples' Director of Gas Supply in its most recent PGC proceeding at Docket No. R-2017-2586310:

CAPACITY RELEASES.

A. The Company views capacity release primarily as a mitigation measure through which it can recapture a portion of the capacity reservation costs that it pays to the pipelines from replacement shippers who may be interested in buying the capacity when the

Company does not need it. As a general matter, however, Peoples historically has not had a lot of surplus capacity for release purposes and does not expect to have a lot in the future because it has assembled and will continue to have a highly-efficient capacity portfolio. Peoples uses transportation capacity during the summer months to meet its non-heating load and to fill storage. During the winter months, Peoples uses firm transportation capacity in conjunction with storage withdrawals to meet higher cold weather demands and Peoples has contracted for firm transportation services accordingly. Therefore, most of the capacity the Company has under contract is used year-round, adjusts seasonally to match the Company's load profile, or is capacity that may be needed in order to meet unexpected daily and seasonal demands. Moreover, as a general rule, when Peoples does not need all of the capacity it holds, the market generally does not need the capacity either, and the Company can recover only a fraction of its costs through a release.

In light of the above, to the extent the Commission wishes to proceed with the ANOPR's proposal to recover the costs of gas supply assets released, transferred or sold to Choice Suppliers from customers, UGI believes that the Commission should require that sharing mechanism credits resulting from assets paid for and used by PGC customers alone should be credited to those customers alone and not to Choice Customers as well.

Turning to other aspects of the ANOPR's proposal, UGI believes the Commission should clarify that the cost recovery mechanism it has proposed would, like Peoples' rate mechanism, be a PGC rate subject to the reconciliation, adjustment and interest recovery/refund provisions applicable to such rates or a functionally equivalent rate. In addition, UGI believes the wording of Commission's regulation at 52 Pa. Code 62.225 should be modernized to reflect the diversity of potential Commission-approved gas supply arrangements and sources, including the use of functionally equivalent supply arrangements where actual gas supply contracts cannot be assigned or transferred for legal or reliability reasons.

Finally, UGI believes the Commission's regulations should not mandate a particular Choice program design, but should instead provide the Commission with the flexibility to do so. This would give the Commission the flexibility to permit variations if it encounters conditions it did not anticipate or expect.

Specifically, UGI would propose the following modifications, shown in red, to the revisions to 52 Pa. Code §62.225(a) proposed in the ANOPR:

§ 62.225. Release, assignment or transfer of capacity.

(a) A<u>[n]</u> NGDC <u>**or a city natural gas distribution operation**</u> **[holding contracts for firm storage or transportation capacity, including gas supply contracts with Commonwealth producers or a city natural gas distribution operation]** <u>**with natural gas supply assets acquired to meet SOLR or other Commission-approved obligations**</u> may release, assign, **[or]** transfer <u>**or sell the gas supply assets or their functional equivalent**</u> **[the capacity or Commonwealth supply]**, in whole or in part **[associated with those contracts],** to licensed NGSs or large commercial or industrial customers on its system.

* * * * *

(3) **[A]** <u>**At the Commission's direction**</u>, <u>**a**</u> release, assignment, **[or]** transfer <u>**or sale under this section to a licensed NGS serving customers for which the NGDC has a SOLR obligation may be made at no or a reduced cost to the NGS so long as the NGDC is able to fully recover costs not recovered from the NGS on a full and timely basis through Section 1307(f) rates or**</u>

their functional equivalent, and any secondary market revenues derived from the gas supply assets acquired to meet SOLR obligations that are not so released, assigned, transferred or sold, subject to any Commission-approved incentive sharing mechanism, are credited to the customers who pay the for the costs of such assets through their Section 1307(f) purchased gas cost rates [must be based upon the applicable contract rate for] [of capacity or Pennsylvania supply**] [and] [shall** be subject to applicable contractual arrangements and tariffs. **Capacity or Pennsylvania supply costs shall be charged to all customers as a non-bypassable charge based on the average contract rate for those services]**.

While, with the above changes, UGI believes the ANOPR's capacity proposals could be workable, UGI believes the potential benefits from the proposed change cited by the ANOPR may be overstated and need to be weighed against the cost of implementation.

Specifically, the ANOPR suggests a primary benefit to the proposed capacity cost recovery mechanism proposed in the ANOPR would be that the NGDCs and their PGC customers would experience a reduced risk of potential NGS payment default. However, for that portion of gas supply assets released through the FERC capacity release mechanism, UGI is already protected from potential NGS default by interstate pipelines' rules imposing credit and performance assurance requirements on secondary shippers. The effectiveness of those mechanisms is evidenced by the fact that UGI has not experienced any instances where its interstate pipeline or storage charges have not been reduced as a result of a secondary shipper's inability or unwillingness to pay. Similarly, with respect to other sales made by UGI to Choice Suppliers to provide gas supply assets or their functional equivalent that may not be released through the FERC capacity release mechanism, UGI has also been able to rely on its ability to withhold the scheduling of deliveries for non-payment and its own financial security requirements to similarly avoid any losses.

The ANOPR also suggested that its proposed cost recovery mechanism would be of benefit to NGSs, and thus the market, since NGSs would not have to pay for capacity costs up front and wait for cost recovery from their customers. The ANOPR suggests this could entice more NGSs to enter the market and offer innovative services. UGI believes there are several factors which the Commission should consider before drawing this conclusion.

First, under the Peoples tariff quoted in the ANOPR, Choice Suppliers are still responsible for interstate pipeline and storage variable charges, and thus will still presumably have to continue to meet applicable pipeline or storage providers' financial security requirements.

Second, Choice Suppliers are already not disadvantaged by customer non-payments when competing with SOLR service because the Commission already requires NGDCs to add a Merchant Function Charge, reflective of NGDC PGC uncollectible costs, to their price to compare, thereby removing any advantage to SOLR service resulting from the recovery of PGC uncollectible costs through distribution base rates.

Third, to the extent the ANOPR is suggesting the carrying costs a Choice Supplier might experience between the time it pays for gas supply assets and the time it collects revenues from its customers is a barrier to retail choice, this risk has also already been minimized on many NGDC systems through the adoption of Purchase of Receivable ("POR") programs in accordance with the Commission's regulation at 52 Pa. Code §62.224.

Fourth, to the extent the ANOPR is suggesting Choice Suppliers face a risk of mispricing their products so that revenues do not recover costs and a profit, presumably this risk would remain with respect to the remaining commodity and other costs Choice Suppliers would still have to recover through the prices they charge for their retail market products.

Fifth, to the extent the ANOPR is suggesting the Choice Suppliers would gain a competitive advance as compared to SOLR service because their product offerings would no longer have to reflect the costs of charges for gas supply assets released, assigned, transferred or sold by NGDCs, presumably NGDC prices-to-compare would also have to be adjusted to reflect that the associated gas supply assets costs can no longer be avoided by shopping, thereby placing Choice Supplier service offering prices back into the same relative position when compared to SOLR service prices-to-compare.

Finally, UGI questions whether the attraction of Choice Suppliers with more limited financial means would be beneficial to the retail markets. Choice Suppliers with more limited financial means might be more vulnerable to failure if they misprice their products or cannot otherwise fulfill their obligations, and such failures could cause potential Choice Customers to view retail markets with more skepticism.

B. *Capacity Assignment From All Assets*

The ANOPR correctly notes that there are categories of assets, such as so-called Section 7(c) contracts subject to FERC jurisdiction, that cannot be released due to legal constraints, and other assets where physical release may not be appropriate for operational or reliability reasons. It then suggests that in such instances a virtual release might be appropriate. However, the ANOPR's discussion of virtual releases on page 13 suggests a misunderstanding of what a virtual release is and thus appears to be proposing a solution that would not be practical or workable on all NGDC systems.

In the market area of the Commonwealth in which UGI operates, it is not reasonable and prudent to assume that substitute gas supplies could be procured at reasonable cost during peak conditions if certain key gas supply assets ("Reliability Assets") unexpectedly became unavailable. The ANOPR appropriately recognizes there can be such Reliability Assets, but mistakenly appears to assume that these assets can be released if there are appropriate contractual restrictions on their use or similar restrictions can be imposed through issuance of operation flow orders ("OFO"), and suggest on page 13 that physical releases with such restrictions would amount to a "virtual release". This is not accurate.

A contractual restriction only gives a NGDC the right to sue for damages in civil court or to seek specific performance, neither of which will provide the required gas delivers on short notice necessary to fulfill SOLR obligations. In this regard, claims for civil damages may be of no concern to an insolvent or bankrupt Choice Supplier. Similarly, the right to issue an OFO does not ensure the delivery of the required gas supplies on short notice to meet SOLR obligations. Instead, it only enables a NGDC to issue penalties or deny future service for violating OFO restrictions. Once again, OFO penalties or the denial of future service may be of little or no concern to an insolvent or bankrupt Choice Supplier, or one that decides for other business reasons to cease doing business on UGI's system or in the Commonwealth.

Defining which gas supply assets should be Reliability Assets has sometimes been an issue of contention, and the answers can obviously differ significantly between NGDCs depending on their mix of gas supply assets and the prevailing market conditions of the geographic area they operate in. Certainly the issue of whether storage capacity should be deemed a Reliability Asset has been the topic of discussion and litigation on certain systems, including UGI's. In such proceedings, UGI has been able to demonstrate that it needs to retain storage capacity, but has been able to work with Choice Suppliers and public parties to reach mutually acceptable solutions that enable Choice Suppliers to achieve the secondary market revenues they might obtain from a release of storage and associated inventories, while not actually releasing such storage. See UGI RMI Presentation, pp. 12-13.

Specifically, in lieu of releasing storage capacity and transferring associated inventories, UGI makes bundled city gate sales to Choice Suppliers during the winter at summer index prices, thereby enabling them to realize the seasonable price benefit between winter and summer prices. Moreover, while UGI generally requires Choice Suppliers to deliver specific quantities of gas during each gas day, UGI has provided Choice Suppliers with the ability to elect to receive such storage-backed bundled city gate sales throughout the month so that they can take advantage of short-term market opportunities in much the same way as they would if the storage assets and associated inventories were released and sold. This arrangement treats Choice Suppliers fairly, while ensuring the required level of reliability needed to meet UGI's SOLR obligations are maintained.

In this regard, UGI has repeatedly presented testimony in PGC proceedings and elsewhere that there is no known legal mechanism that can ensure, in a way that would be acceptable to Choice Suppliers, that required levels of inventory will be in storage in the event of recall, and in the geographic markets UGI operates it would not enable to find acceptable substitutes on short notice to meet peak core market demands in the event storage capacities were recalled under FERC capacity release rules without required levels of inventory.

In UGI's view, its Commission-approved bundled city gate sales obligations, developed over time in consultation with Choice Suppliers and public parties, constitutes the provision of "virtual access" to its core market gas supply assets that are appropriate for its systems.

UGI believes that the language the ANOPR has proposed to add to the provisions of 52 Pa. Code §62.225(a)(2) is appropriate based on its understanding of "proxy or virtual access" to gas supply assets means as explained above, but believes the existing wording in this subsection should be modified, as shown in red below, to reflect the fact that sometime proxy or virtual access to non-FERC jurisdictional assets such as local production or peaking assets sometimes has to be provided because the supply contracts are not assignable.

§ 62.225. Release, assignment or transfer of capacity.

(a)

* * * * *

> (2) A release**, assignment, transfer or sale** of a**[n]** NGDC's **[pipeline and storage capacity]** **gas supply** assets must follow the customers for which the NGDC has procured the **[capacity]** **assets**, subject only to the NGDC's valid **contractual,** system reliability and Federal Energy Regulatory Commission constraints. **When release must be restricted due to contractual, reliability or other constraints, an NGDC shall develop a mechanism that provides proxy or virtual access to the assets.**

C. *Imbalance Trading*

The ANOPR suggests a new addition to the provisions of 52 Pa. Code §62.225(a) to require NGDCs to provide daily imbalance trading between "market participants" to avoid the potential incurrence of imbalance penalties. In the associated discussion the ANOPR seems to contemplate that this would involve imbalance trading between Transportation Customer and Choice Customer pools, and recognized that investments in technology might be required to permit access to real-time information. In this regard, the ANOPR states:

The current communication mechanisms NGDCs have already established might be sufficient; however, the Commission is interested in parties providing examples or conditions where additional communication could improve the market, particularly, communications practices that facilitate or complicate imbalance trading at the NGDC level. As imbalance trading will need certain real-time information, the NGDC's electronic bulletin board could possibly serve as a general trading hub for each distribution system, with enhancements to fulfill this role.

ANOPR, p. 16.

UGI does not have smart meters that would permit the collection of real time daily imbalance information on its residential customer and small volume commercial and industrial customers for which it has SOLR obligations, and must assure that appropriate deliveries are made to fulfill its SOLR obligations to such customers. Rather, UGI uses modeling to determine the daily deliveries that Choice Suppliers must make to serve their pool of customers, supplies this information to each Choice Supplier in advance of each Gas Day, and Choice Suppliers need only nominate and deliver this UGI-supplied delivery requirement. UGI provides a balancing service to handle any variations between the specified daily delivery amount and actual use. To the extent a Choice Supplier fails to nominate the specified amount, and realizes its mistake, it can make an intraday nomination to try to correct the mistake and make purchases or sales in the wholesale market to make associated revisions.

Some of UGI's Transportation Customers also do not have daily metering installed, and are grouped in separate pools based on meter read dates. Most other Transportation Customers on UGI have daily metering installed and NGSs serving such customers can aggregate such customers into pools and have real time information which would enable the NGS to recognize the possibility of a daily imbalance outside of permissible tolerances and make appropriate intraday adjustments through the additional purchase and delivery or sale of gas in upstream wholesale markets in accordance with FERC posting, bidding and reporting requirements. A NGS wishing to make such intra-day adjustments would not be limited to entering into transactions with other NGSs on UGI's system, but could purchase or sell gas to any wholesale market participant.

On a monthly basis, UGI permits and facilitates trading between NGS pools on its system to avoid monthly imbalance fees, but so far has not developed systems to permit daily trading. In part, UGI has not done so because it is concerned with the moral hazard of NGSs not striving to make nominated deliveries necessary to keep its systems in balance on a daily basis because they might be willing to take the risk that the delivery failure could be made up through a future trade.

UGI believes a further exploration of daily trading opportunities is worth considering based on the circumstances of each NGDC, but does not believe that daily imbalance trading on NGDC systems should be mandated by regulation. UGI would also note that information gathered as part of the RMI Order investigation seems to indicate that penalty assessments have not been significant and cannot be credibly considered a significant barrier to the expansion of Customer Choice.

D. *Penalty Structure During Non-Peak Times*

The ANOPR proposes to add a new section to 52 Pa. Code §62.225(a) that would require penalties during non-peak times to be based on market conditions and not be less than "market price."

UGI and other NGDCs operate "open valve" distribution systems that are shared by various customer groups and which rely on the actions of customers and their NGSs following well-established and clearly communicated rules designed to ensure the reliable operation of the system. The actions of customers sharing NGDC open-valve distribution systems are not under the direct real-time control of NGDCs, and often wholesale markets, or the business conditions of commercial and industrial customers, present profit opportunities that could encourage customers or their NGSs to deviate from the rules. Particularly in eastern NGDC systems that generally do not have significant on-system storage that can absorb sudden unanticipated changes in supply, deviations from system rules can have serious reliability and cost consequences. In western NGDC systems, where differing physical and market conditions prevail, system reliability rules may provide customers and their NGSs with more flexibility, and non-compliance with rules may have fewer reliability and cost consequences. Thus, penalty designs can be influenced by and vary based on NGDC-specific conditions.

In designing penalties, NGDC systems can be thought of as being analogous to the Commonwealth's highway system where many types of vehicles, not directly under the Commonwealth's control, share a transportation system and are encouraged to adhere to a set of rules designed to ensure driver safety through a system of non-cost-based penalties. The Commonwealth would not assess speeding penalties based on whether an actual accident occurred or on the costs of accidents since that would create a moral hazard of encouraging speeding by motorists who might assume they could avoid penalties and thereby take excessive risks. So too NGDC system reliability penalties should also not be based on actual costs alone, but should instead be designed to provide appropriate incentives to customers and their NGSs to adhere to each system's reliability "rules of the road".

Of course, in designing reliability penalties for NGDCs, one significant, but not sole, risk is customers or their NGSs diverting expected sources of system supply to other locations to take advantage of alternative wholesale market opportunities; commonly referred to as "arbitrage risk". This type of behavior not only can threaten system reliability, but can also have significant cost impacts on other customers, including PGC customers, sharing the system. This can occur because non-compliant customers diverting their expected gas supplies can still draw gas delivered for others off of the shared open valve distribution system. This can jeopardize system pressure or require the deployment, if available, of incremental and costlier gas supply substitutes to restore system pressure.

As pages 9-11 of the UGI RMI Presentation, attached in Appendix A hereto, indicate, arbitrage risk can vary significantly across the Commonwealth, can vary over time and can spike significantly during peak demand situations. Since it is important to maintain reliability at all times, including during periods of peak demand when arbitrage opportunities can be extremely high, a fixed penalty would have to be very large to cover infrequent but likely peak demand risks. Thus UGI, in the design of its penalties, has included a component that can vary over time to reflect the fact that arbitrage risks vary over time. Initially this variable component was tied, as the ANOPR's proposed language addition recommends, to UGI's actual cost of gas procured for PGC customers. However, NGSs complained in UGI proceedings that this standard was not sufficiently transparent and instead asked UGI to switch to the use of a publicly available published standard which UGI agreed to do. This variable component to UGI's reliability penalty is not the only component to UGI's reliability penalty because there are other reliability risks beyond arbitrage risk. For example, during the polar vortex years UGI encountered examples of customers ignoring interruptible service restrictions because they did not want to disrupt industrial production schedules. Therefore, UGI's market-based penalty charge applies to unauthorized physical usage overruns in addition to NGS delivery shortfalls (or excessive over-deliveries in off-peak periods where market prices are low). However, UGI still has concerns that publicly available day-ahead pricing publications for the appropriate market area may still be too low (or high during off-peak) to deter arbitrage as often times the intraday market trades at a significant premium (or discount during off-peak) to the day-ahead market for a particular gas day. For this reason, multipliers are needed during periods of peak demand as well as during off-peak periods based on the imbalance percentage.

Finally, UGI would emphasize that if system reliability rules are reasonable and clearly communicated, and penalties are appropriately set to deter risky behaviors, customers and their NGSs should be both able to and actually comply with the reliability rules, thereby avoiding penalties. If penalties are so avoided, UGI does not believe they can be considered a barrier to increased participation in retail markets, and attempting to reduce such penalties should have no impact on retail markets unless the increase in moral hazard attracts new participants not interested in complying with reliability rules. As part of the RMI Order investigation, UGI and other NGDCs submitted information which clearly showed that reliability penalty assessments have not been significant, and thus cannot be credibly considered a significant barrier to the appropriate expansion of retail markets.

Based on the above discussion, UGI would propose the following revisions, should in red, to the ANOPR's proposed addition to 52 Pa. Code §62.225(a):

(6) Penalties during system peak and off-peak periods should be designed to ensure compliance with applicable reliability rules, and should include variable components to reflect the impact changing wholesale [must correspond to market] conditions can have on compliance. Variable penalty components

designed to address wholesale market risks may, to increase transparency, incorporate publicly available index prices reflective of the wholesale market risks presented by alternative markets for gas supplies required to be delivered to the NGDC system.

______[(i) An NGDC shall use the system average cost of gas as the reference point for market based penalties. If an NGDC takes service from a local hub, it may use the local hub as a reference point for market based penalties.

______(ii) The lowest penalty must be set at the market price.]

III. CONCLUSION

UGI believes that after a lengthy period of implementation, frequent structured and informal consultations with Choice Suppliers and NGSs, the examination and resolution of areas of dispute in proceedings before the Commission, multiple Commission retail market investigations and initiatives, the implementation of business system improvements, and after experiencing a steady increase in Choice customer numbers on UGI systems, (a) the Transportation Customer retail market UGI's systems is robust and represents, as indicated in the data UGI submitted in response to the RMI Order, the vast majority of system throughput, and (b) any further barriers to increased Customer Choice counts is not creditably the result of UGI Choice program design flaws or flaws in the Commission's regulations, and is instead the result of individual customer choices not under UGI's control.

As UGI and others have indicated in prior comments to the Commission, the General Assembly, when implementing Customer Choice in the Commonwealth, did not set high Customer Choice counts as a goal, and instead established ground rules for the implementation of Customer Choice as an option to traditional SOLR service, and left it to the wisdom of individual consumers to decide where they wish to obtain their natural gas supply service. In light of the General Assembly's policy choice, and absent statutory changes, UGI does not believe the Commission can or should evaluate the health of the Customer Choice retail market by reference to national surveys comparing the Commonwealth to other states where differing market conditions prevail and differing legislative policy decisions have been made.

Given the inherent complexities associated with comparing NGDCs operating systems with differing characteristics and operating under a system of federal rules that results in very different wholesale market conditions in different geographies, and the desire to ease the regulatory burden on NGSs who might be new to Commission regulation, UGI believes it is understandable the Commission has looked to sometime informal means of communication to gather facts and help develop policy proposals. UGI, to the extent it has been invited, has participated in such informal forums and while they often have merit, they can also present opportunities for individual NGSs to advance proposals focused on their individual business models rather than the public interest or even the interest of all NGSs, and to make allegations about NGDC actions or motives that are unsubstantiated. Thus, UGI appreciates this opportunity and future opportunities the Commission will provide to collect public comment on policy proposals, and believe the Commission should have faith in the existing supplier collaborative process and its own complaint resolution processes, including the formal complaint process and supplier participation in PGC and other proceedings, to identify real problems and resolve them.

The Commission will, of course, after reviewing the comments submitted in response to the ANOPR, decide whether the policy proposals advanced in the ANOPR have merit and are worth the costs of implementation and re-education. To the extent the Commission decides to advance some or all of the ANOPR's proposals to the proposed rulemaking stage, UGI asks the Commission to consider the proposed regulatory language changes UGI has made above.

Respectfully submitted,

Mark C. Morrow

Counsel for the UGI Distribution Companies

Dated: November 1, 2017

APPENDIX A

(UGI RMI Presentation)

UGI UTILITIES, INC.

Gas Retail Market Investigation

Supply Assets and Balancing

Shaun Hart, Manager - Supply

January 29, 2015

Agenda

- Capacity and storage assets
  - Types of customers
  - Capacity, supply portfolio, and pricing
  - Capacity releases
  - Storage allocation
- System balancing
  - Load forecasting / delivery instructions
  - Nominations / scheduling
  - Tolerances
  - Penalties
  - Cash-outs

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Capacity and Storage Assets

Types of Customers

Customer type	Core market	Commodity	Size	Type of service
1. PGC	Yes	Utility	Residential & small commercial	Firm
2. Choice	Yes	Marketer	Residential & small commercial	Firm
3. Firm transportation	No	Marketer	Large commercial & industrial	Firm
4. Interruptible transportation	No	Marketer	Large commercial & industrial	Interruptible

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Capacity - What It Is

- Capacity represents the amount of space available on interstate pipelines to meet natural gas demand
- As demand for natural gas increases, so do pipeline capacity constraints
- A SOLR must meet core market customers' firm peak day demand requirements at least cost. This requires:
  - Interstate pipeline primary firm capacity
  - Alternative primary firm capacity from local production, delivered supply contracts, storage and/or peaking

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Capacity - UGI

- Primary firm capacity is contracted for by UGI to meet firm peak day demand requirement for core market customers (PGC and Choice)
  - Firm transportation (365 days)
  - Local production (365 days)
  - Storage (10-151 days)
  - Peaking (5-15 days)
- Non-Choice firm and interruptible transportation (non-core market) customers are responsible for their own deliveries

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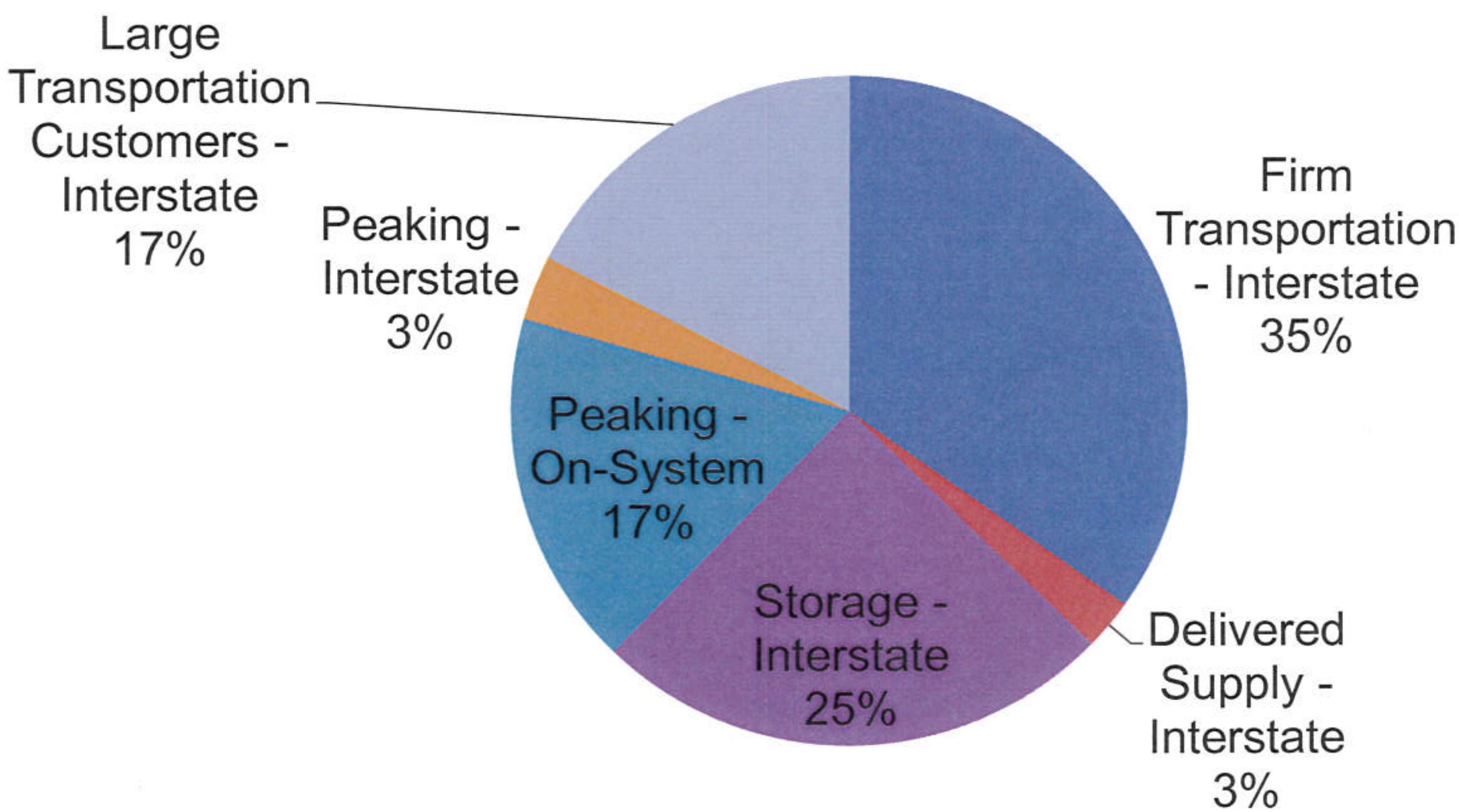
Supply Portfolio - UGI

Firm Design Day Supply Portfolio



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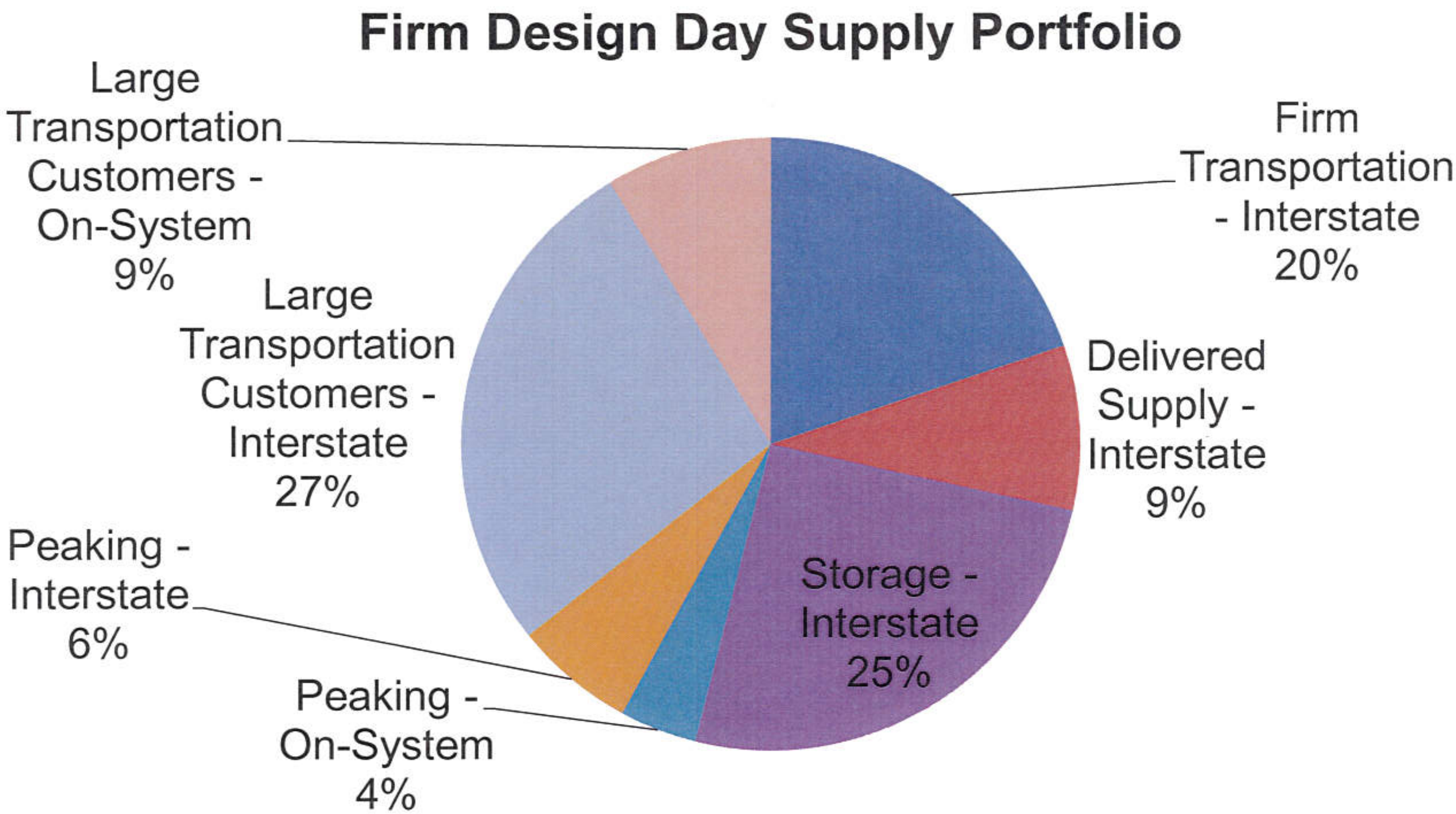
Supply Portfolio - PNG



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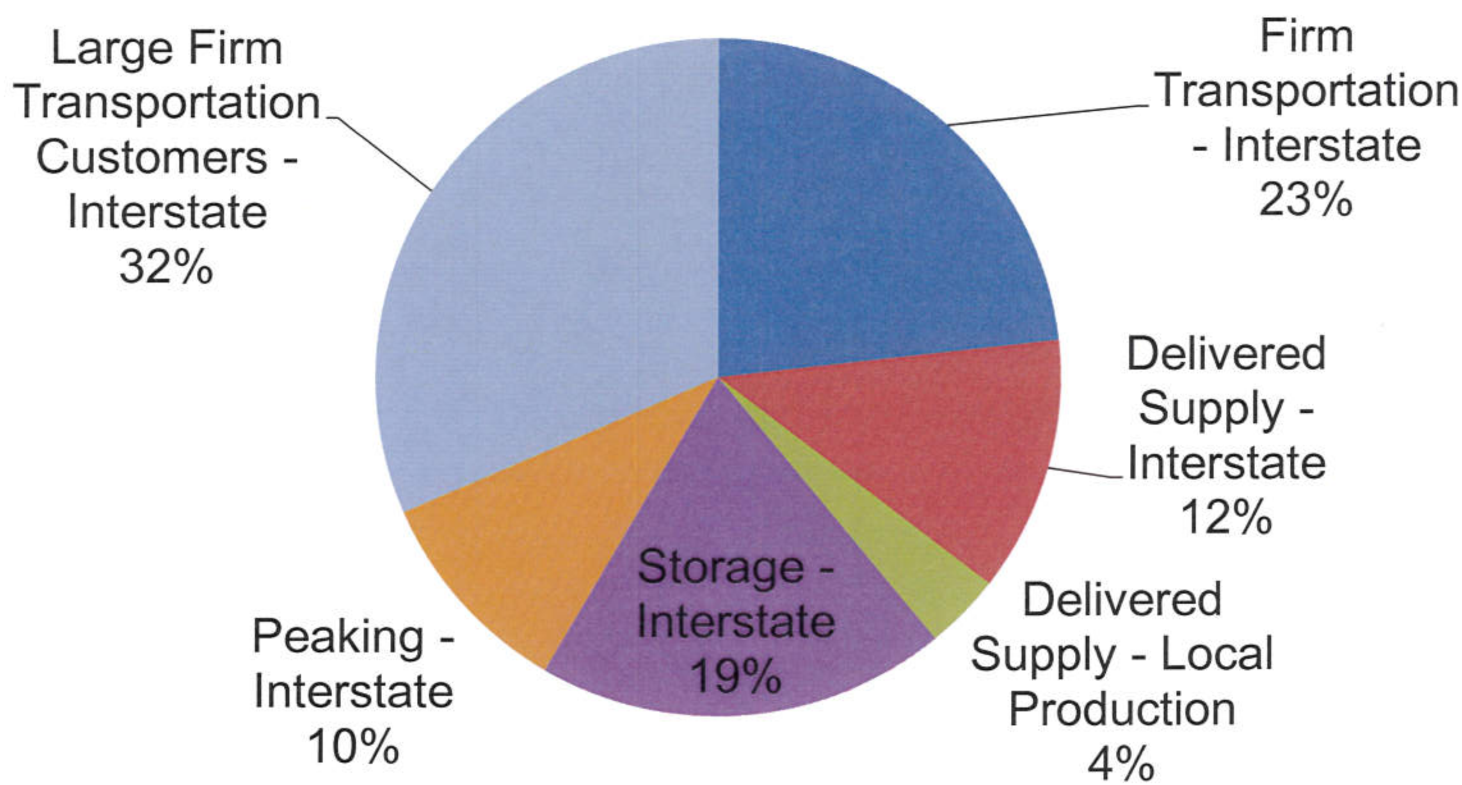
Supply Portfolio - CPG

Firm Design Day Supply Portfolio



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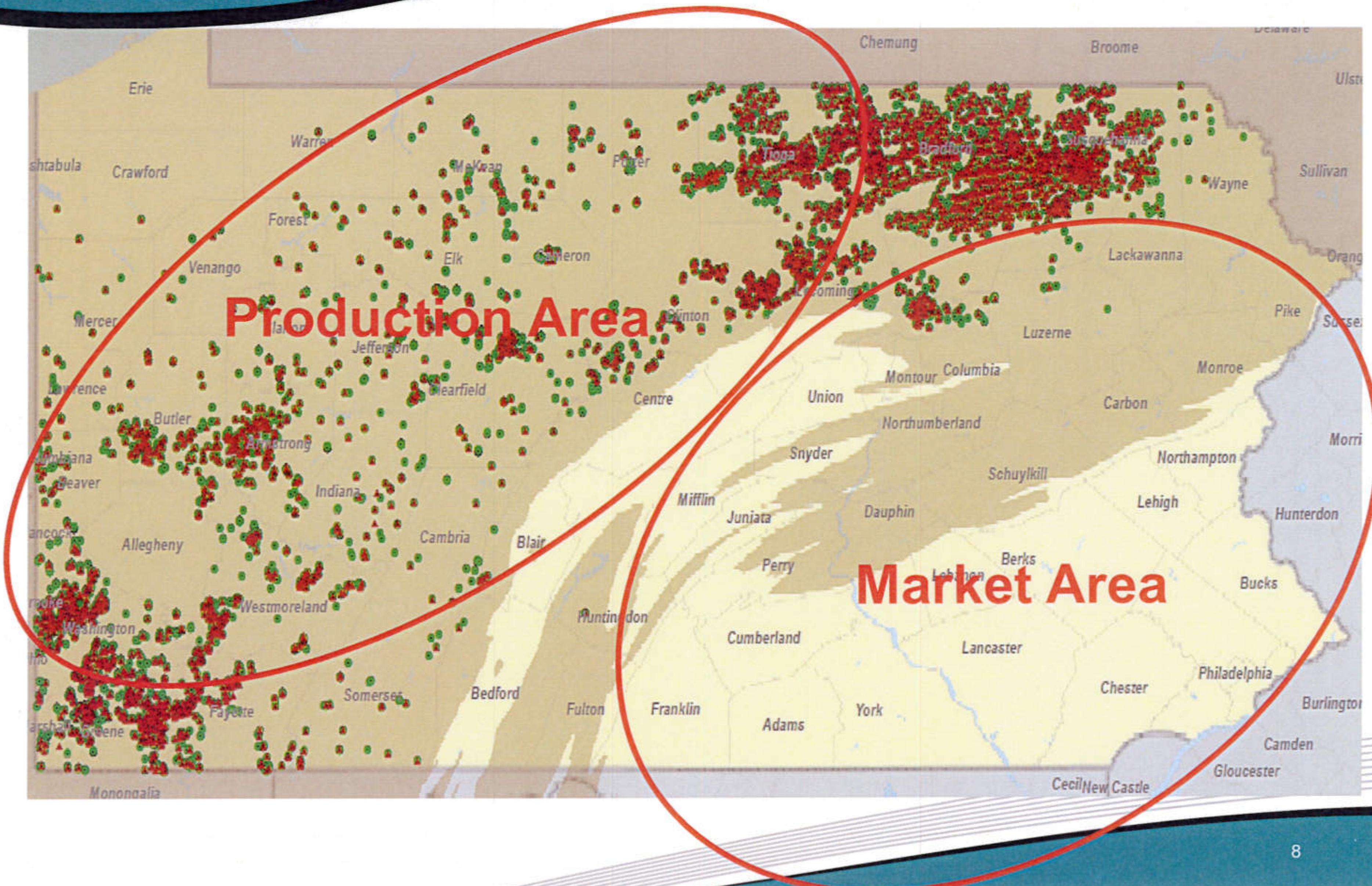
Marcellus Shale Wells



Daily Spot Pricing - Production Areas

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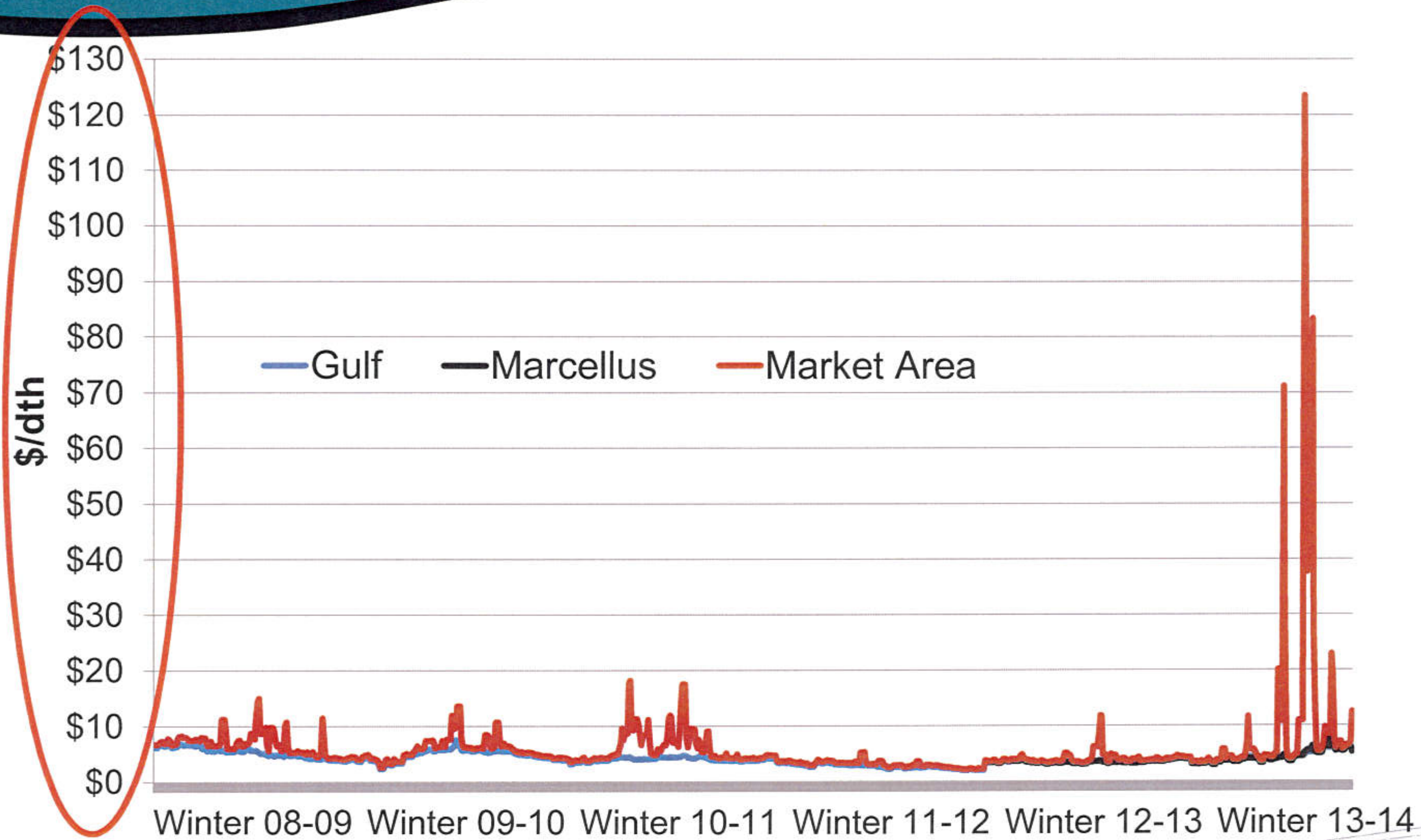
Daily Spot Pricing - Market Area



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Monthly Capacity Releases

- Each month mandatory capacity is released to Choice Suppliers
  - Release quantity is a percentage of Choice Suppliers' peak day demand requirement
  - Release rate is based on UGI's weighted average cost of core market supply portfolio to avoid cost shifting
- Benefits (e.g. flexibility and/or pricing) of local production, delivered supply, storage, and peaking are provided to Choice Suppliers through bundled sales

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Storage Allocation

- Benefits of storage flexibility made available through bundled sales during winter months
  - Must-take monthly bundled sale quantity (MBSQ) is allocated to each Choice supplier along with a maximum daily bundled sale quantity (MDQ)
  - Choice supplier has flexibility to nominate daily up to MDQ while meeting MBSQ for each winter month
  - Commodity price is derived from published summer index pricing

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System Balancing

Load Forecasting / Delivery Instructions

- Choice Suppliers are provided a daily delivery requirement (DDR)
  - DDR equation is a linear equation based on most recent 3 years of historical usage
  - DDR equation is updated daily to reflect current customer enrollments
- Non-Choice transportation customers determine their own delivery needs
- UGI forecasts demand in total for all customers based on temperature forecasts and recent history and procures supply for PGC customers accordingly

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Nominations / Scheduling

- Supplier nominations are due day-ahead
- Corrections and modifications can be made intraday
- UGI reserves firm no-notice capacity to meet potential swings in the supply/demand balance
  - No-notice services allow for firm intraday scheduling
  - No-notice capacity may include firm transportation, local production, storage, and peaking contracts

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Tolerances

- Choice Suppliers must deliver DDR (0 tolerance)
- UGI balances difference between DDR and actual usage
  - Choice Suppliers pay a balancing fee for each dekatherm delivered (approx. $0.02-0.04/dth)
- Non-Choice transportation customers must deliver within tariff-defined tolerances
  - Optional services available for daily and monthly balancing

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Non-Choice Tolerances

Service Type	Period	UGI	PNG	CPG
Basic Balancing	Daily	10%	2.5%	2.5%
No-Notice Service (IT)	Daily	As elected	As elected	As elected
Basic Balancing	Monthly	0%	0%	0%
Monthly Balancing Service	Monthly	10%	10%	10%

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Penalties

- Choice Suppliers can incur penalties for failure to deliver the DDR
- Non-Choice firm and interruptible transportation customers can incur penalties for imbalances outside the tariff-defined tolerance of their balancing service
- Customers with interruptible service can also incur penalties for failure to comply with interruptions
- Penalties are designed to deter non-compliance
    - UGI's cost for incremental supply is at market area prices

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Choice Penalties

Period	UGI	PNG	CPG
Non-Critical Day	$75 / mcf	Transco Zone 6 Non-NY *Gas Daily* high minus Transco Zone 3 *Gas Daily* low, but not lower than $0.25 / mcf	Transco Zone 6 Non-NY *Gas Daily* high minus Transco Zone 3 *Gas Daily* low, but not lower than $0.25 / mcf
Critical Day	$75 / mcf	10 x Transco Zone 6 NY *Gas Daily* high, but not lower than the maximum penalty charge for interstate pipelines in PA	10 x Transco Zone 6 NY *Gas Daily* high, but not lower than the maximum penalty charge for interstate pipelines in PA

* Non-Choice penalties vary by rate schedule

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Cash-outs

- For Choice Suppliers, monthly imbalances are rolled from one month to the next and only cashed out when a Choice Supplier exits the Choice program
- For non-Choice transportation customers, cash-outs occur at the end of the month if monthly imbalance is outside the tariff-defined tolerance (10% or 0% depending on customer's election)

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