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TO THE
INDEPENDENT REGULATORY REVIEW COMMISSION

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Natural Gas Distribution Companies :
and the Promotion of Competitive : Reg. No. 57-269
Retail Markets :

COMMENTS OF THE
OFFICE OF CONSUMER ADVOCATE

I. INTRODUCTION

At its meeting of August 25, 2011, the Independent Regulatory Review Commission will be considering the Revised Final Rulemaking Order of the Pennsylvania Public Utility Commission (PUC or Commission) in Natural Gas Distribution Companies and Promotion of Competitive Retail Markets, Docket No. L-2008-2069114 (Final Order) entered on June 23, 2011. The OCA respectfully submits that certain provisions of these regulations are inconsistent with the intent of the General Assembly in enacting the Natural Gas Choice and Competition Act, 66 Pa.C.S. §2201, *et seq.* (1999 Act), inconsistent with the law, and inconsistent with sound ratemaking principles.

The OCA participated extensively in the PUC rulemaking process, as well as in working groups involving competitive retail markets in the Pennsylvania natural gas industry. Further, the OCA filed three sets of comments in the currently pending PUC docket on August 25, 2009, September 9, 2010 and June 9, 2011.

The OCA has stressed that great caution is necessary when attempting to initiate efforts to remove perceived barriers to competition, particularly efforts that will come at the

expense of rate stability for customers; at the expense of appropriate ratemaking principles; and at the expense of necessary consumer protections. Through these comments, the OCA wishes to highlight several key points that it has made throughout this process with respect to the PUC's proposal to reformulate the Price to Compare (PTC) as it applies to Natural Gas Distribution Companies (NGDCs). Toward that end, the OCA will identify areas where it believes that the revised final form regulations are inconsistent with the intent of the Natural Gas Choice and Competition Act. Specifically, the OCA submits that the Commission's proposal to reformulate the Price to Compare to include a Gas Procurement Charge is flawed in several respects.

The OCA submits that for the reasons it has detailed throughout the rulemaking proceedings and as highlighted in these Comments, the revised final form regulations do not carry out the intent of the General Assembly, could result in stranded costs, and could result in improper cost shifting or rate discrimination. The IRRC raised concerns in its initial comments regarding the Commission's proposed reformulation of the PTC and Commissioners Christy and Gardner dissented from this aspect of the Revised Final Rulemaking Order. The concerns identified by IRRC, and in the dissents of Commissioners Christy and Gardner, correctly identify the significant flaws in the Commission's revised final form regulation at Section 62.223.

II. COMMENTS

A. INTRODUCTION

In Section 62.223, the Commission proposes to significantly modify both distribution base rates and purchased gas cost rates to create a Price to Compare (PTC) that customers can use when reviewing competitive offers from natural gas suppliers (NGSs). Rather than having the PTC of a natural gas distribution company (NGDC) reflect the purchased gas cost rate determined in the NGDC's annual Section 1307(f) purchased gas cost proceeding as it does now, the Commission proposes that two other components be included in the PTC: a Gas Procurement Charge (GPC) and a Merchant Function Charge (MFC). The OCA's concern is with the GPC. As proposed by the Commission, the GPC will be "an element of the PTC, expressed on a per Mcf or Dth basis, that reflects the NGDC's total natural gas procurement costs." The natural gas procurement costs to be reflected in the GPC as set forth in the revised final Rulemaking Order include:

- natural gas supply service, acquisition and management costs, including natural gas supply bidding, contracting, hedging, credit, risk management costs, and working capital.
- administrative, legal, regulatory and general expenses related to those natural gas procurement activities, excluding those related to the administration of firm storage and transportation capacity.

Under the Commission's proposal, NGDCs will file tariff revisions under 66 Pa. C.S. § 1308(a) that will identify and remove, from their distribution (delivery) rates, the Company's natural gas procurement costs. The NGDC will then include those same costs in the GPC on a per Mcf or Dth basis pursuant to 66 Pa. C.S. § 1307. The removal of the gas procurement costs is initially to be done on a revenue-neutral basis, meaning that there is to be a concomitant reduction in delivery rates. These Section 1308 tariff filings are to be filed

beginning 90 days after the effective date of these regulations pursuant to a schedule that will be established by the Commission. The natural gas procurement costs are not subject to reconciliation for under-recoveries. Revised Final Rulemaking Order at 25. Further, the NGDC is to file “updated” gas procurement costs in its next base rate case.¹

The OCA respectfully submits that the Commission’s proposal to reformulate the price to compare to include a GPC as proposed by the Commission is flawed in several respects. Most importantly, the inclusion of *all* gas procurement costs, rather than just *avoidable* gas procurement costs in a bypassable surcharge will result in the utility incurring stranded costs and the potential that non-shopping customers will be required to subsidize shopping customers by paying these stranded costs. Both of these outcomes are contrary to the Natural Gas Choice and Competition Act (66 Pa.C.S. §2201, *et seq.*) and sound ratemaking principles.

B. The Commission’s Proposal to Establish a Bypassable GPC That Includes Unavoidable Costs is Improper.

In its Revised Final Rulemaking Order, the Commission retained its proposal that NGDCs file, beginning 90 days after the effective date of the final regulation, tariff revisions that will identify and remove from delivery rates all of the Company’s natural gas procurement costs. These costs will be included in the GPC and will be part of the NGDC’s PTC or commodity rate on a per Mcf or Dth basis. These costs will include natural gas supply service, acquisition and management costs, as well as administrative, legal, regulatory and general expenses. As part of the PTC, these costs will be bypassable, that is, they will be avoided by shopping customers and paid **only** by non-shopping customers. The PTC, however, will include costs that are not

¹ The Commission’s regulation appears to create some confusion by removing base rate costs through a Section 1308(a) proceeding, then including these costs in an automatic adjustment mechanism under Section 1307. The Commission then concludes that these costs should not be reconciled, which seems to run counter to the Section 1307 mechanism used for recovery. The prohibition against reconciliation, however, is consistent with a Section 1308(a) procedure and base rate treatment. The Independent Regulatory Review Commission also highlighted concerns as to the lack of clarity in Section 62.223 on these points. Independent Regulatory Review Commission Comments at 6-7 (September 24, 2009).

bypassable—that is, it will include costs that the NGDC must incur whether a customer shops for natural gas supply or remains with the NGDC.

The OCA submits that the proposal to create a GPC that includes all procurement related costs that are currently included in distribution rates is fundamentally flawed. If the GPC component is to be bypassable as the Commission proposes, then only the *avoidable* costs associated with procurement activity should be included in these costs. It is only avoidable costs of procurement that can be “bypassed” or not incurred when a customer shops.

Of particular importance here, an NGDC’s procurement functions and costs do not all go away when a customer shops for alternative gas supply. The NGDC retains the supplier of last resort (SOLR) obligation for all customers, shopping and non-shopping alike. This obligation is set forth in Section 2207(a) of the Pennsylvania Public Utility Code which reads:

§ 2207. Obligation to serve

(a) SUPPLIER OF LAST RESORT.—

(1) After the effective date of this chapter, the natural gas distribution company shall serve as the supplier of last resort for residential, small commercial, small industrial and essential human needs customers and any other customer classes determined by the commission in the natural gas distribution company's restructuring proceeding until such time as the commission, pursuant to this section, approves an alternative supplier or suppliers to provide such services to any or all of the natural gas distribution company's customers.

(2) For purposes of this section, a supplier of last resort is a natural gas distribution company or natural gas supplier which is designated by the commission to provide natural gas supply service with respect to one or more of the following services:

(i) natural gas supply services to those customers who have not chosen an alternative natural gas supplier or who choose to be served by their supplier of last resort;

(ii) natural gas supply services to those customers who are refused supply service from a natural gas supplier; or

(iii) natural gas supply services to those customers whose natural gas supplier has failed to deliver its requirements.

66. Pa. C.S. § 2207(a). The supplier of last resort obligation, and the procurement functions that accompany it, exist whether there are 50,000 or 500,000 customers on the NGDC's system. Customers shop for alternative supply with the understanding that if their supplier fails to deliver or goes out of business, the NGDC will meet all of their needs as the supplier of last resort. Indeed, as set forth in Section 2207(a) of the Natural Gas Competition Act, NGDCs have an obligation to stand ready to serve all customers located within their service territory irrespective of whether these customers shop for competitive gas supplies. All NGDCs must maintain a state of readiness to meet the supply needs of all customers in their service territory.²

In addition, a NGDC must ensure the safe and reliable operation of its system at all times. 66 Pa. C.S. § 2205(a). Among other things, this entails ensuring that the entire system is "in balance", i.e., managing differences between the deliveries of gas to its system with the usage of it customers, while maintaining efficient movement of flowing gas supplies. As such, it is unreasonable to require that only one segment of customers--those customers that do not shop--bear the costs that a NGDC incurs to meet these obligations. It is critical to again note that when a customer shops, the NGDC does not avoid many of these procurement costs.

The OCA recognizes that the NGDC can avoid some of its procurement costs as customers shop for alternative supply. But, it is only these *avoidable* procurement costs that would be appropriate for inclusion in a bypassable GPC. To include more than these avoidable procurement costs in a bypassable mechanism will result in a NGDC being unable to recover the

² In its initial comments, IRRC also expressed its concern that the proposed regulation would result in non-shopping customers subsidizing shopping customers. IRRC Comments at 6. IRRC stated: "Some procurement costs are related to maintaining the readiness of SOLR. It is not clear in the regulation that all customers will not share in the cost of SOLR, even though SOLR would have to be available to most customers." IRRC Comments at 6. The Commission did not remedy this fundamental flaw in its revised Final Form Regulations.

costs of providing essential procurement functions, i.e., stranded costs will ensue. Vice Chairman Christy raised this point in his June 23, 2011 Statement accompanying the Revised Final Rulemaking Order and explained the impact as follows:

[I]t is only avoidable gas costs which are properly included within the PTC. If unavoidable costs are included in the PTC, shopping customers will be improperly subsidized by those customers that choose to remain under the regulated SOLR service.

Natural Gas Distribution Companies and the Promotion of Competitive Markets, Docket No. L-2008-2069114 (June 23, 2011 Statement of Tyrone J. Christy). Commissioner Christy continued:

[I]f these costs are not avoidable and are included within the PTC, then they may not be recovered by the NGDCs.

Id. at 3. As a result of this concern, Commissioner Christy dissented on the revised Final Rulemaking Order with respect to the PTC and GPC proposed provisions. Likewise, Commissioner Gardner dissented from the revised Final Rulemaking Order, stating that:

Because SOLR service exists for the benefit of every customer, SOLR procurement costs should remain in distribution rates where every customer is required to pay for it. Additionally, because each NGDC is required to provide SOLR service, the associated costs are unavoidable and should be excluded from the PTC. Today the majority votes to remove SOLR costs from distribution rates and put them into the gas procurement charge which will be paid for by non-shopping customers only and will be included in the PTC.

Statement of Commissioner Wayne E. Gardner (June 23, 2011). Commissioner Gardner continued:

The result of this is that customers who choose to stay with the default supplier will subsidize shopping customers who also benefit from the availability of SOLR service. Additionally, the true cost of the NGDCs providing a required service will not be reflected in the PTC. Therefore, I respectfully dissent from the

majority's action and I support the recommendation made by Commission staff in this matter.

Id.

Section 2203 of the Natural Gas Competition Act cautions against the creation of stranded costs through unbundling proposals such as the Commission's proposal here. This provision reads:

§ 2203. Standards for restructuring of natural gas utility industry

(3) The commission shall require natural gas distribution companies to unbundle natural gas supply services such that separate charges for the services can be set forth in tariffs and on retail gas customers' bills. In its restructuring filing, the natural gas distribution company shall establish system reliability standards and capacity contract mitigation parameters and address the unbundling of commodity, capacity, storage, balancing and aggregator services. The commission may address the unbundling of other services only through a rulemaking. *In conducting the rulemaking, the commission shall consider the impact of such unbundling on the labor force, the creation of stranded costs, safety, reliability, consumer protections, universal service and the potential for unbundling to offer savings, new products and additional choices or services to retail gas customers.* The commission's decisions shall assure that standards and procedures for safety and reliability, consumer protections and universal service are maintained at levels consistent with this chapter.

66 Pa. C. S. § 2203(3)(*Emphasis added*). Therefore, the Commission's proposal would run afoul of Section 2203(3) if implemented as proposed.

Further, if these costs are simply shifted to non-shopping customers, i.e., requiring these customers to pay ever higher rates, such a shift would be inconsistent with Section 2203(5) of the Public Utility Code. This provision reads:

§ 2203. Standards for restructuring of natural gas utility industry

The following interdependent standards shall govern the commission's actions in adopting rules, orders or policies and in reviewing, assessing and approving each natural gas distribution

company's restructuring filings and overseeing the transition process and regulation of the restructured natural gas utility industry:

...

(5) The commission shall require that restructuring of the natural gas utility industry be implemented in a manner that does not unreasonably discriminate against one customer class for the benefit of another.

66 Pa. C.S. § 2203(5). Mandating that only non-shopping customers be responsible for the NGDC's essential, unavoidable procurement functions would result in discrimination against these customers in favor of shopping customers. Such an unfair subsidization would be contrary to sound ratemaking principles and also Section 1304 of the Public Utility Code (prohibition against discrimination in rates).

The OCA submits that establishing a rate mechanism in a manner that results in stranded costs to the NGDC and/or higher costs to non-shopping customers to subsidize essential functions for all customers is inconsistent with the law and sound ratemaking principles. Just as non-shopping customers pay for consumer choice education – even if they never shop – so too should shopping customers pay for the unavoidable costs of the supplier of last resort function.

In order to comply with the Natural Gas Competition Act, the OCA submits that the GPC could be structured as a bypassable surcharge that includes only *avoidable* procurement costs. The GPC would not need to be updated or reconciled in any manner between base rate cases. By including only the avoidable cost, the bypassable structure would not create stranded costs or higher charges to non-shopping customers since only bypassable, or avoidable, costs are included in the surcharge. That is, only the share of costs or expenses that are reduced when the customer leaves the system are included in the surcharge.

The OCA submits that the regulation must be modified to reflect that only avoidable procurement costs be recovered through a bypassable, non-reconcilable, GPC

component. The OCA proposed below in the Commission Rulemaking the following modifications to Proposed Section 62.223 to implement this approach. The OCA recommended that the word “avoidable” be inserted throughout Proposed Section 62.223, so that the provision reads as follows:

(B) An NGDC shall file a tariff change under 66 Pa. C.S. § 1308(a)(relating to voluntary changes in rates) to identify the avoidable natural gas procurement costs included in base rates and shall propose tariff revisions designed to remove those avoidable costs from its base rates and to recover those annual costs as part of the PTC (the GPC portion) on a revenue neutral basis.

(1) Avoidable natural gas procurement costs shall include the following elements.

Additionally, in order to maintain conformity, the definition of the GPC under proposed Section 62.222 should be as follows:

GPC—Gas Procurement Charge—An element of the PTC, expressed on a per Mcf basis, that reflects an NGDC’s avoidable natural gas procurement costs and that is removed from the NGDC’s base rate and recovered through a separate charge.

The OCA submits that these modifications are vital to ensure that NGDCs do not incur stranded costs and that non-shopping customers are not harmed.

III. CONCLUSION

The OCA respectfully urges the IRRC to consider these Comments in its deliberations on this matter.

Respectfully Submitted,

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