

TO THE
INDEPENDENT REGULATORY REVIEW COMMISSION

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

2772

COMMENTS OF THE
OFFICE OF CONSUMER ADVOCATE

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I. INTRODUCTION

At its meeting of August 25, 2011, the Independent Regulatory Review Commission (IRRC or Commission) considered the Revised Final Rulemaking Order of the Pennsylvania Public Utility Commission (PUC) in Natural Gas Distribution Companies and Promotion of Competitive Retail Markets, Docket No. L-2008-2069114 (Final Order) entered on June 23, 2011. In its Disapproval Order, the Commission determined that:

[T]his regulation is not consistent with the statutory authority of the PUC and the intention of the General Assembly. In addition, upon consideration of all of the other criteria of the Regulatory Review Act discussed above, we find promulgation of this regulation is not in the public interest.

Pennsylvania Public Utility Commission Natural Gas Distribution Companies and the Promotion of Competitive Retail Markets, Regulation No. 57-269 (#2772) (August 25, 2011) at 5. Prior to the Commission's Order, the OCA filed Comments with the IRRC on May 11, 2011 and August 19, 2011. In these Comments, the OCA asserted that certain provisions of the PUC's proposed regulations are inconsistent with the Pennsylvania Public Utility Code, 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), and inconsistent with sound ratemaking principles. Therefore, the OCA agrees with IRRC's Disapproval Order and the reasons supporting the disapproval.

On October 13, 2011, the PUC re-submitted its proposed regulations with the Commission without modification. The OCA submits, however, that the regulations require modification in response to the Disapproval Order and to be brought into accordance with the law. Absent such modification, the OCA submits that the PUC's regulations remain inconsistent with the law, inconsistent with the intent of the General Assembly in enacting the Natural Gas Choice and Competition Act, and inconsistent with sound ratemaking principles.

II. COMMENTS

A. INTRODUCTION

In addition to its resubmission of the proposed regulations on October 13, 2011, the PUC also addressed a letter to Commission Chairman Lutkewitte addressing concerns raised in the Commission's Disapproval Order. Specifically, this letter states that the proposed regulations should be approved because they:

- exclude Supplier of Last Resort (SOLR) costs (storage and transportation) which benefit shopping and non-shopping customers from the Price-To-Compare (PTC);
- include within the PTC specific procurement costs (such as acquisition and management costs) which are primarily incurred for the benefit of non-shopping customers; and
- provide that the PUC will consider a natural gas distribution company's claim that significant incremental costs should be recovered in distribution rates, rather than in the PTC due to returning or abandoned shopping customers.

As set forth below, although the PUC's letter seeks to address the concerns raised in this Commission's previous Comments regarding the proposed regulations and in the Disapproval Order, the letter--like the PUC's proposed regulations--fails to adequately address the key point raised regarding the proposed regulations.

The proposed regulations continue to require the establishment of a Gas Procurement Charge (GPC) that includes all Natural Gas Distribution Company (NGDC) procurement-related costs. Customers can avoid payment of the GPC by switching to an alternative Natural Gas Supplier (NGS), but, the NGDC cannot avoid incurring all of these costs when a customer switches. This results in the NGDC incurring costs that it cannot recover, *i.e.*, stranded costs, in contravention of 66 Pa. C.S. § 2203(3). If the NGDC eventually passes these unrecovered costs on to non-shopping customers, then non-shopping customers are forced to subsidize costs incurred for the benefit of shopping customers in contravention of 66 Pa. C.S. § 2203(5).

An NGDC's procurement functions and costs do not all go away when a customer shops for alternative gas supply. The NGDC retains the 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, exists 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.^[1]

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 its customers, while maintaining efficient movement of flowing gas supplies. As such, it

^[1] In its initial comments, IRRRC also expressed its concern that the proposed regulation would result in non-shopping customers supporting the SOLR function that exists to meet the needs of all customers. IRRRC Comments at 6. IRRRC 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." IRRRC Comments at 6. This flaw remains in the PUC's proposed regulations.

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.

As previously set forth, the OCA submits that the proposal to create a Gas Procurement Charge (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 PUC 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. The IRRC raised similar concerns in its Comments filed with the PUC and in its Disapproval Order. While the OCA appreciates the PUC’s explanations in its letter, this key flaw in the regulations has not been corrected by the Commission’s further explanation.

B. THE PUC’S REGULATIONS WOULD RUN AFOUL OF CURRENT LAW.

As previously set forth in Comments of the OCA, Section 2203 of the Natural Gas Competition Act cautions against the creation of stranded costs through unbundling proposals such as the PUC’s proposal. 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 PUC's proposal would run afoul of Section 2203(3) if implemented as proposed because unavoidable costs no longer recovered from shopping customers may become stranded costs if unable to be completely recovered from the remaining non-shopping customers.

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 run afoul of 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 non-shopping 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 undue 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 GPC could be structured as a bypassable surcharge that includes only *avoidable* procurement costs. All costs should be excluded from the GPC unless it can be shown that the NGDC will avoid some or all of these costs when customers shop. 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.

Specifically, the OCA proposed below in the PUC 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) to identify the avoidable natural gas procurement costs included in base rates and shall propose tariff revisions designed to remove those avoidable costs from base rates and to recover, on a revenue neutral basis, those annual costs under 66 Pa. C.S. §1307.

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

Additionally, in order to maintain conformity, for the definition of the GPC under proposed Section 62.223, the OCA proposed the following:

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.

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. As these modifications have not been made, the regulations remain inconsistent with the law.

C. THE EXPLANATIONS CONTAINED IN THE COMMISSION'S LETTER DO NOT CURE THE DEFECTS CONTAINED IN THE PROPOSED REGULATION

1. Exclusion Of Storage And Transportation Costs From The PTC Is Not Sufficient To Ensure That Unavoidable Costs Of The SOLR Function Are Borne By Shopping And Non-Shopping Customers.

In its letter, the PUC seeks to address the concern raised in the Disapproval Order that the regulations do not reflect the fact that the SOLR obligation exists for both shopping and non-shopping customers. The PUC states that the proposed regulations should be approved because they exclude from the bypassable PTC the SOLR costs related to storage and transportation which benefit shopping and non-shopping customers. As the OCA has explained in previous Comments, NGDCs have continuing SOLR obligations which encompass more costs than the storage and transportation costs identified in the PUC's letter, e.g., system management/balancing costs. These costs are incurred for the benefit of all customers—shopping and non-shopping alike. As explained in the OCA's previous comments, such unavoidable costs must not be allowed to be bypassed through shopping as the PUC regulations allow since they benefit non-shopping and shopping customers. The PUC's proposed regulations do not distinguish between costs that can be avoided and those that cannot. Therefore, the PUC's assertion in its letter that exclusion of storage and transportation costs from the PTC cures the defect in the regulation is incomplete as this is only one category of costs

incurred to meet an NGDC's SOLR obligation.

2. The PUC's Arguments For Including All Procurement Costs In The PTC Are Flawed.

In its letter, the PUC states that specific procurement costs (such as acquisition and management costs), which are "primarily" incurred for the benefit of non-shopping customers, will be shifted to the PTC. The PUC argues that this shifting is necessary to ensure that shopping customers can make a valid comparison between rates and also to avoid double-recovery from shopping customers. The OCA, respectfully, submits that the PUC's assertion that including all procurement costs, such as acquisition and management costs, in the PTC for comparison purposes or to avoid double-recovery is incorrect.

The PUC argues that shifting of costs to the PTC will enable customers to be better informed about pricing and to make an informed comparison. The OCA submits, however, that an informed comparison is not dependent upon the specific NGDC procurement cost components of the rate or price. The point of comparison is between the price charged by the NGDC and the price charged by the NGS. The NGS does not set forth its procurement costs in its price and may not even seek to recover certain costs in its commodity price. What the customer sees and compares is the two total price offers—the one the customer will pay if the customer chooses the NGS and the one the customer will pay if he remains with the NGDC.

The PUC makes a similar argument regarding the possibility of double-recovery of procurement costs from shopping customers. The PUC argues that, if customers shop, they have to pay procurement costs of the NGS as well as continuing to support procurement costs of the NGDC.¹

The OCA submits, however, that inclusion of avoidable procurement costs in the

¹As previously stated, these unavoidable costs related to the NGDC's SOLR function—a function that NGSs are not required to perform—should continue to be supported by shopping customers.

PTC would address this concern.² The avoidable costs of procurement when a customer shops best addresses the concern for reflecting the costs an NGS incurs when it procures for a customer. The OCA submits that shopping customers will not be subject to double-recovery if the PUC's regulations only include avoidable costs in the PTC. In this fashion, a shopping customer would pay the NGDC's unavoidable costs, but not its avoidable costs. As such, there would be no double-recovery.

Further, the PUC's argument that these costs "primarily" benefit non-shopping customers does not support including all of these costs in the PTC and seems to now recognize a distinction not reflected in the proposed regulations. The NGDC's procurement personnel and operations also serve SOLR functions and other functions and must continually remain at a ready-to-serve status. While a portion of these costs may be avoided when a customer switches to a natural gas supplier, not all of these costs will be avoided. However, the PUC regulation proposes to shift all of them to the bypassable PTC. 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. Consequently, the PUC's letter of October 13th does not justify the reversal by IRRC of its prior Disapproval Order.

3. The PUC's Offer Of Consideration Of NGDC Claims That Significant, Incremental Costs Should Be Retained In Distribution Rates To Account For Returning Or Abandoned Shopping Customers Is Contrary To The Language Of The Regulations.

² An NGS' price, however, reflects what the market will bear. If the NGS price is lower than the NGDC price, the customer is indifferent to what is (or is not) included in the price, or as to what level of specific procurement costs an NGS may include in its price. Moreover, it is not the purpose of the regulations to decide what components comprise an NGS' price and whether or not they are duplicative of an NGDC's price components.

The PUC's letter states that it will consider an NGDC's claim (in a Section 1308(a) proceeding) that significant, incremental procurement costs incurred due to returning or abandoned shopping customers should be retained in distribution rates. The PUC's proposed regulations, however, fail to make this distinction. Specifically, the relevant portion of the PUC's regulation reads:

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

Whether or not a portion of a procurement cost is incremental is irrelevant in the Section 1308(a) proceedings under the PUC's regulations as written. The Section 1308(a) proceeding does not cure the fundamental problem with the proposed regulations; namely, the failure to acknowledge that only avoidable costs are appropriate to shift to the PTC.

III. CONCLUSION

The OCA respectfully urges the Commission to consider these Comments in its deliberations on this matter. The PUC's letter does not remedy the significant shortcomings of the proposed regulations. As the regulations have not been modified in response to the Commission's Disapproval Order, they should be rejected again.

Respectfully Submitted,

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