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August 22, 2011

Via Electronic Mail

The Honorable Chairman Silvan B. Lutkewitte, III
Independent Regulatory Review Commission
333 Market Street, 14th Floor
Harrisburg, PA 17101

Re: Natural Gas Distribution Companies and the Promotion of Competitive Retail Markets; **PUC Docket No. L-2008-2069114; IRRC No. 2772, Regulation 57-269**

Dear Chairman Lutkewitte:

The Pennsylvania Public Utility Commission (PUC) initiated this rulemaking, *inter alia*, to reformulate the Price to Compare (PTC) so that natural gas consumers could make rational and informed comparison between the cost of natural gas obtained from a Natural Gas Distribution Company (NGSC) and the various offers made by competitive Natural Gas Suppliers (NGSs).[1] One of the key problems in making an informed comparison is that, under present regulations, an NGDC's distribution rates include the cost of procuring natural gas. As explained at page 23 of the PUC's Revised Final Rulemaking Order, unless these procurement costs are removed from distribution rates, "shopping customers are being penalized with a double payment of commodity-related costs." In other words, the shopping customer pays twice for natural gas procurement: once in the NGDC's distribution rates, and again in the NGS' prices (which, of necessity, include both raw commodity costs and commodity procurement costs).

The Gas Procurement Charge in section 62.223(a) of the final-form regulation addresses this problem by removing the procurement costs included in distribution rates and allowing those costs to be recovered, on a revenue-neutral basis, in the Gas Procurement Charge, which is a component of the overall Price to Compare or "PTC". In this fashion, the customer's bill will better reflect and identify the *total cost* of natural gas supply, as a retail commodity, in a form that is directly comparable to the retail prices charged for natural gas supply by NGS firms. If not so included, the NGDC's PTC will understate its true retail commodity costs. In addition, in response to comments from your staff and other parties, we have further narrowed and clarified the elements of the natural gas procurement costs to be removed from distribution rates at proposed section 62.223(b)(1).

[1] The other key purposes of this rulemaking were to establish rules for "purchase of receivables" programs and rules for the release, assignment and transfer of capacity in a non-discriminatory manner. Both are essential to a competitive market for natural gas supply. There are no issues in regard to these aspects of the PUC's regulation.

In the letter filed August 17, 2011, by the Energy Association of Pennsylvania (EAP), it argues that the regulation would create inequity among customer classes because customers would be able to avoid the Gas Procurement Charge by shopping. EAP asserts that an NGDC's procurement activities and costs benefit both shopping and non-shopping customers, and therefore these costs should be paid by all customers.

However, as explained in the PUC's Revised Final Rulemaking Order, this position ignores competitive equity because it fails to account for the fact that NGS firms have procurement costs that, unlike for an NGDC, cannot be socialized. These procurement costs include acquisition and management costs, administrative and legal costs, and working capital; both NGDCs and NGS firms incur these costs. So, to make rational comparisons, the PTC must include these procurement costs; otherwise, there is a competitive subsidy to non-shopping customers because the shopping customer is then required to pay twice for procurement costs.

Second, as to the numerical example offered in the EAP letter, it displays an unlikely "worst case" scenario not presented in the rulemaking below. Moreover, even in the 50% shopping scenario, the assumed costs do not amount to more than $1.80 per year per customer. In fact, given that the current statistics for natural gas shopping indicate that shopping is only about **8%** on a statewide basis as of April 2011, assumptions of 50% shopping or even 100% shopping are not realistic. Even so, the PUC Revised Final Rulemaking Order provided, at page 22, that it would be open to address any significant shortfall if an NGDC's rates are insufficient to cover its residual gas procurement role. Lastly, it should be noted that the NGDC's costs associated with natural gas storage and transportation capacity, which does benefit both shopping and non-shopping customers, remains unbundled within distribution rates.

In similar fashion, comments filed by the Office of Consumer Advocate (OCA) assert that the inclusion of gas procurement costs identified in the regulation at section 62.223(b)(1) would create "stranded costs" and the potential that non-shopping customers will be required to subsidize shopping customers by paying for these stranded costs. OCA Comments at 4. Again, the potential for any substantial degree of stranded costs is unlikely, given the current low level of natural gas shopping in Pennsylvania. Moreover, the PUC notes here that the inclusion of procurement costs in the Price to Compare has been the policy in the electric industry for many years now, with much higher levels of shopping (37.8% in PPL service territory), and with none of the doomsday scenarios suggested by EAP and OCA. *See* 52 Pa. Code § 1808(a)(3) (PTC for electric utilities should include "supply management costs, including supply bidding, contracting, hedging, risk management costs, any scheduling services provided exclusively for default service … and applicable administrative and general expenses related to those activities."). Accordingly, the EAP and OCA concerns regarding stranded cost are overstated and not borne out by experience in the electric industry.

The EAP also takes issues with inclusion of the reconciliation for over and under collections of natural gas costs from the prior period (the "e-factor") in the Price to Compare. Again, inclusion of the e-factor is reasonable and appropriate for the following reasons. First, it reflects the actual out of pocket costs that will be charged to an NGDC's non-shopping customers for the natural gas consumed. As such, including the e-factor in the PTC produces an appropriate and economically rational comparison point to the prices for natural gas offered by competitive suppliers. Second, while the e-factor reflects a reconciliation of costs from a prior period, due to portfolio purchasing strategies, the costs included in the NGDC's natural gas cost rate include various vintages and sources of natural gas purchased at different times and at different prices. As such, the argument that the e-factor costs do not match the current period market price of natural gas is misplaced; where a NGDC has a portfolio of natural gas resources, its weighted average costs *for ratemaking purposes* will not match the current market price of natural gas. However, to exclude e-factor costs from the natural gas costs actually paid by a consumer will, in the PUC's judgment, not yield a valid comparison point and would exclude a cost of gas actually charged and paid by NGDC customers.

For these reasons, the PUC urges the Independent Regulatory Review Commission to approve these regulations that provide NGDC consumers with an improved Price to Compare when comparing the cost of natural gas provide by the incumbent utility and the prices offered by competitive suppliers. Together with the improved Price to Compare, rules for "purchase of receivables" programs, and rules for capacity release and assignment, these regulations will further the development of competitive market for retail natural gas supply in Pennsylvania, consistent with Chapter 22 of the Public Utility Code.

Very truly yours,

David E. Screven
Assistant Counsel