Before the Pennsylvania Public Utility Commission
Harrisburg, Pennsylvania
Friday, April 16, 2010

Marcellus Shale En Banc Hearing on PUC Jurisdictional Issues
Docket No. I-2010-2163461

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Good afternoon Chairman Cawley, Vice Chairman Christy, Commissioner Gardner, and Commissioner Powelson. Thank you for giving me the opportunity to testify on behalf of the Natural Gas Distribution Companies ("NGDCs") that are members of the Energy Association of Pennsylvania[1] on issues concerning the extraction of natural gas from the Marcellus Shale formation.

In my opinion, the development of the ability to economically extract natural gas from the Marcellus Shale, due to advances in drilling technology, is the best economic news Pennsylvania has received in my lifetime. Taking advantage of this opportunity requires the Commonwealth to develop public policies to address some difficult questions. I applaud the Commission for proactively beginning the process of developing policies related to its jurisdiction over Marcellus issues.

The Commission's March 25, 2009 Secretarial Letter posed a number of questions to be addressed by the diverse parties testifying today. I will focus on two questions addressed to NGDCs:

- What effect will the availability of natural gas from Marcellus Shale have on NGDCs' least cost fuel procurement policy?

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[1] Columbia Gas of PA, Equitable Gas Company, National Fuel Gas Distribution Corp., PECO Energy Company, Peoples Natural Gas Company, Philadelphia Gas Works, Pike County Light & Power Co., UGI Central Penn Gas, Inc., UGI Gas Utilities, Inc., UGI Penn Natural Gas and Valley Energy, Inc.

- Should the Commission encourage NGDCs' expansion efforts into the gas fields with the use of long-term contracts to support drilling and processing capital requirements?

My testimony will address these two questions and make a few other points.

1. **The overarching, governing principle for NGDC gas purchasing should continue to be least cost procurement, consistent with maintaining reliable service.**

The Public Utility Code requires NGDCs to follow a least cost procurement approach when purchasing gas for resale to its customers. Specifically, the Code requires the Commission to make a finding that:

> (3) The utility has taken all prudent steps necessary to obtain lower cost gas supplies on both short-term and long-term bases **both within and outside the Commonwealth**, including the use of gas transportation arrangements with pipelines and other distribution companies.[2]

As this language makes clear, NGDCs must protect consumers by looking at both in-state and out-of-state options when purchasing gas. The Commission's gas transportation regulations also state that the "development of Pennsylvania natural gas should be promoted, because it will achieve benefits that accrue to gas utilities and their customers."[3] These two policies – least cost procurement and promoting Pennsylvania natural gas – are not necessarily mutually exclusive where the facts show that developing in-state supplies will advance the interests of consumers in obtaining economical, reliable supplies of natural gas.

The Commission should also recognize that NGDC purchases are not the only competitive option for Marcellus producers. These producers can pursue sales to other market participants and, if necessary, transport the gas through an

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[2] 66 Pa C.S. §1318 (a) (3) (emphasis added).

[3] 52 Pa C.S. §60.1. The Commission's Secretarial Letter in this proceeding stated that this language was in the Public Utility Code, but it is in the Pennsylvania Code. In other words, the language is in the Commission's regulations, not its governing statute.

NGDC's system pursuant to the transportation rates and tariffs on file with the Commission.

2. **Development of Marcellus supplies could have a positive effect on gas prices and on the reliability of supplies.**

The development of gas extraction from the Marcellus Shale is likely to have an impact on future market prices and on the purchasing decisions of NGDCs. All other things being equal, the availability of this new resource should lead to lower prices, more stable prices, and more reliable supplies.

Under the simple laws of supply and demand, the availability of this new resource can be expected to keep prices lower and more stable than they would otherwise be. This is particularly true in Pennsylvania because the Marcellus Shale is an in-state resource. As such, it is in close proximity to the areas served by Pennsylvania's NGDCs and to gas storage facilities located here. In addition, the location of these new supplies in our own "backyard" should improve system reliability by providing a buffer against events such as Hurricanes Katrina and Rita, which battered energy facilities along the Gulf Coast a few years ago, causing gas prices to skyrocket. It should be noted that the availability of Marcellus supplies will benefit customers due to the impact of these supplies on the general marketplace, apart from any particular purchases by NGDCs.

3. **The Commission should consider innovative rate treatment for NGDC capital investments necessary to provide access for Marcellus supplies to the systems of NGDCs.**

The Commission should consider allowing the use of innovative rate mechanisms that would allow for prompt recovery of NGDC capital investments related to the purchase of Marcellus supplies.

Due to the benefits that Marcellus supplies can provide, Pennsylvania NGDCs may, depending on the configuration of their systems, wish to extend transmission or distribution facilities into areas of Marcellus production. However, such an expansion may require significant capital expenditures and NGDCs may be reluctant to make those expenditures due to the regulatory lag they currently face in recovering such costs. By taking steps to reduce that lag and to remove other obstacles to cost recovery, the Commission could encourage NGDCs to make these important infrastructure investments. Innovative rate mechanisms will help ensure that the citizens of Pennsylvania see the most benefit from this local resource.

4. **The Commission should consider NGDC proposals for prospective approval of long-term supply contracts for Marcellus supplies in purchase gas cost proceedings.**

The Commission should consider allowing NGDCs to enter into long-term supply contracts as a means of encouraging Marcellus production. The availability of such contracts may encourage Marcellus producers to develop the formation more quickly and to expend more resources in doing so. From an NGDC perspective, the option of upfront Commission approval of long-term supply contracts will provide piece of mind to the NGDCs who elect to buy such long-term supplies that they will not suffer backlash due to possible future price swings. Without such approval from the Commission, NGDCs may be reluctant to enter into these contracts.

The Commission should not, however, mandate that NGDCs enter into long-term contracts for Marcellus gas. Care must be taken regarding the use of long-term contracts, because these contracts may affect the price of the NGDC's supply service and customers have competitive options in buying supplies. Accordingly, the Commission should keep an open mind to NGDC proposals regarding long-term contracts, but it should not mandate such contracts.

5. **The development of Marcellus supplies does not mean that NGDCs should be expected to surrender rights to interstate pipeline capacity.**

NGDCs should not be expected to surrender their firm upstream capacity on the large interstate pipelines due to development of Marcellus supplies. While each NGDC's system is different, they are all dependent in some way on the major interstate pipelines. These pipelines provide supply and delivery point flexibility to the NGDCs which are critical to controlling prices and maintaining system reliability. Some NGDCs use storage on interstate pipelines as a way to manage demand and supply differences. Demand is cyclical, with the highest in winter, while both supply and the producers' desire to produce that supply are constant. In addition, many NGDCs depend on these pipelines for delivery to captive points on their distribution systems. Further, many NGDCs have existing contracts with these pipelines that contain rights-of-first-refusal that benefit the NGDC and its customers, which may disappear if the contracts are altered. Finally, some NGDCs that are not located in the Marcellus area may need interstate pipeline capacity to transport gas from the Marcellus to their customers.

6. If the Commission exercises jurisdiction over gathering lines, its policies over these lines should discourage bypass of NGDC systems.

One of the Commission's questions addressed to producers in this proceeding is whether the gathering systems that will be built are subject to the Commission's jurisdiction. If the Commission decides that these gathering systems are public utility facilities, it should make clear in certificating them that they may only be used to serve the entities that currently interconnect with these systems. The Commission should not allow these systems to be used to bypass the systems of NGDCs, which could leave the NGDCs with "stranded costs" that will harm both the NGDC and its remaining customers.

8. Gas quality standards must be met regarding Marcellus supplies.

If some gas from the Marcellus Shale does not meet pipeline quality standards, it could have a negative physical or financial impact on down-stream shippers and customers. Two questions that must be resolved are: 1) who will be responsible for treating the gas to bring it up to standard and, 2) who will pay for and install any necessary compressor stations. If an NGDC is expected to bear any of this responsibility, these costs must be factored into the least cost purchasing decision and the Commission may consider innovative rate treatment of these costs.

Thank you again for the opportunity to present this testimony.