BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Investigation into Competition in the Natural Gas Supply Market	**)** **)**	**Docket No. I-00040103**

TESTIMONY OF
THE NATIONAL ENERGY MARKETERS ASSOCIATION

The National Energy Marketers Association (NEM)[1] hereby submits the testimony of Craig G. Goodman, President of NEM, pursuant to the Commission's Order of May 27, 2004. The Commission initiated this proceeding pursuant to Section 2204(g) of the Natural Gas Choice and Competition Act that provides that,

> Five years after the effective date of this Chapter, the Commission shall initiate an investigation or other appropriate proceeding, in which all interested parties are invited to participate, to determine whether effective competition for natural gas supply services exists on the natural gas distribution companies' systems in this Commonwealth. The Commission shall report its findings to the General Assembly. Should the Commission conclude that effective competition does not exist, the Commission shall reconvene the stakeholders in the natural gas industry in this Commonwealth to explore avenues, including legislative, for encouraging increased competition in the Commonwealth.

The Commission asked the parties to respond to the following topics in their testimony as well as other relevant issues: 1) assessment of the level of competition in Pennsylvania's natural gas supply service market; 2) effect of the price of natural gas on competition; 3) effect of consumer education on competition; 4) effect of customer information/service on competition; 5) effect of supplier financial security requirements on competition; 6) effect of natural gas distribution company penalties and other costs on competition; and

[1] NEM is a national, non-profit trade association representing wholesale and retail marketers of natural gas, electricity, as well as energy and financial related products, services, information and advanced technologies throughout the United States, Canada and the European Union. NEM's membership includes independent power producers, suppliers of distributed generation, energy brokers, power traders, electronic trading exchanges and price reporting services, advanced metering, demand side management and load management firms, billing, back office, customer service and related information technology providers. NEM members are global leaders in the development of enterprise solution software for energy, advanced metering, telecom, information services, finance, risk management and the trading of commodities and financial instruments. NEM members also include Multiple Service Organizations (MSOs), inventors, patent holders, systems integrators, and developers of advanced Broadband over Power Line (BPL), Power Line Communications (PLC) technologies, and Hybrid-PLC as well. NEM and its members are committed to helping federal and state lawmakers and regulators to implement a consumer-focused, value-driven transition to a reliable, price and technology competitive retail marketplace for energy, telecom and financial related products, services, information and technologies.

7) any avenues, including legislative, for encouraging increased competition in Pennsylvania. NEM appreciates this opportunity to offer its observations and recommendations on these issues.

NEM submits that, ultimately, it hopes the Commission will encourage utilities to exit the merchant function by a date certain. In the interim, there are a number of measures the Commission can implement to improve the competitive environment in the Commonwealth including use of monthly market-based utility pricing, competitively neutral consumer education programs, facilitation of easy, cost-effective data flows, establishment of reasonable creditworthiness requirements, elimination of unreasonable supplier fees and penalties, and requiring reasonable discount rates for utilities that purchase marketer receivables.

1. Level of Competition in Pennsylvania's Natural Gas Supply Service Market

There are a number of indicia that can be referred to in determining the level of competition in the Commonwealth's natural gas supply service market. These statistics can provide a valuable reference point for the Commission to consider. For instance, from October 2001 to July 2004, the overall percent of residential customers served by alternative suppliers has declined from 12.57 percent to 7.3 percent.[2] Migration in the Columbia Gas, Dominion Peoples and Equitable Gas programs has been somewhat more robust than in the other service territories.[3]

Relatedly, the amount of natural gas delivered for the account of others has not increased for residential, commercial and industrial consumers from 1999 through 2002. The amount of natural gas delivered for the account of residential customers was 27,254 in 1999 and 26,521 in 2002.[4] The amount of natural gas delivered for the account of commercial customers was 61,752 million cubic feet in 1999 and was 53,048 million

[2] Pennsylvania Office of Consumer Advocate, Pennsylvania Gas Shopping Statistics, July 1, 2004, July 1, 2003, July 1, 2002, and October 1, 2001.
[3] Id. Residential migration in the Columbia Gas program was at 31.88 percent in October 2001 and declined to 21.8 percent by July 2004. Residential migration in the Dominion Peoples program was at 35.36 percent in October 2001 and declined to 26.3 percent by July 2004. Residential migration in the Equitable Gas program was at 11.4 percent in October 2001 and declined to 8.3 percent by July 2004. Migration was at zero to 1.5 percent for other utilities during this time period.
[4] Energy Information Administration, Natural Gas Annual 2002, issued January 2004, at page 129.

cubic feet in 2002.[5] The amount of natural gas delivered for the account of industrial customers was 204,506 million cubic feet in 1999 and 190,139 million cubic feet in 2002.[6]

Another indicator of the level of competition in the Commonwealth's natural gas supply service market is the number of market participants. As of January 2004, there were four suppliers serving residential consumers in the Commonwealth.[7]

These statistics, while not giving a comprehensive view, do provide a basis for comparison about customer and marketer participation in choice programs. While additional information about regulatory environment and utility tariffs and operational procedures are necessary to form a full assessment, these statistics do indicate that it is appropriate for the Commission to consider additional measures to encourage competition in the natural gas supply market.

2. Effect of the Price of Natural Gas on Competition

The Commission has asked about the effect of the price of natural gas on competition. NEM submits that the relevant inquiry should be restated as the effect of utility pricing of natural gas on competition. In order to encourage competition in the Commonwealth, it is imperative that consumers be permitted to see and respond to proper price signals. Toward that end, utility pricing must be permitted to fluctuate with current market conditions and do so on a timely basis. NEM recommends that the Commission require utilities to implement a monthly-adjusted Purchased Gas Cost (PGC) rate. This will permit utility pricing to be more reflective of market conditions and send better price signals to consumers as is necessary to support a competitive market that efficiently matches demand with supply, prevents shortages and price spikes, and encourages conservation.

The Commission is permitted by Pennsylvania statute to require monthly adjustments. 66 Pa. C.S. § 1307(f)(II) provides that,

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[5] Id.
[6] Id.
[7] Energy Information Administration, Retail Unbundling – Pennsylvania available at: http://www.eia.doe.gov/oil_gas/natural_gas_restructure/state/pa.html.

> A natural gas distribution company may also file a tariff to establish a mechanism by which such natural gas distribution company may further adjust its rates for natural gas sales on a regular, but no more frequently than monthly, basis to reflect actual or projected changes in natural gas costs reflected in rates established pursuant to paragraph (2), subject to annual reconciliation under paragraph (5). In the event that the natural gas distribution company adjusts rates more frequently than quarterly, it shall also offer retail gas customers a fixed rate option which recovers natural gas costs over a 12-month period, subject to annual reconciliation under paragraph (5). The Commission shall within 60 days of the effective date of this subparagraph, promulgate rules or regulations governing such adjustments and fixed rate option, but the Commission shall not prohibit such adjustments or fixed rate option. (emphasis added).

However, the Commission's regulations on the matter anticipate quarterly adjustments. 52 Pa. Code § 53.64(i)(5) provides that,

> A Section 1307(f) utility which files tariffs reflecting increases and decreases in gas costs in accordance with 66 Pa. C.S. § 1307(f) shall make quarterly filings in accordance with the following provisions:
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> (i) Quarterly filings shall be made 3 months, 6 months, 9 months and 12 months after the effective date of the Section 1307(f) tariff. Each filing shall be based upon a recalculation and reconciliation of gas costs for a quarterly period commencing 4 months prior to the filing date.

NEM urges the Commission to amend its regulations to require monthly adjustments to the PGC rate. NEM notes that the statute contemplates that if monthly pricing adjustments are used that a utility fixed price option would also be offered. NEM would caution that the addition of a fixed price option could create a confusing shopping environment for consumers and a potentially harmful competitive environment as it would create two utility "prices to beat." Therefore, NEM recommends that a monthly utility pricing adjustment requirement be instituted without a utility fixed price option. Consumers that desire the pricing stability of a fixed price option can purchase such a product from a competitive supplier.

NEM supports a monthly-adjusted PGC rate based on a market-based formula that is tied to a published and credible index such as the NYMEX that closes at least one month in advance of the current month. This will permit marketers to market against a formula that is known sufficiently in advance, and give transactional certainty to both the utilities and the marketplace so that adjustments to a migrating customer's bill can be avoided

after the migration date. The PGC mechanism should only provide over- or under-collections or other supply-related costs that were attributable to the period prior to migration to avoid any potential double charging or recovery of such charges.

The use of this approach would permit utilities to update their PGC filings to ensure that rates are more reflective of current market conditions yet the "price to beat" against which marketers must price commodity and related services would be more transparent, give the marketplace enough time to compete against it, plus give consumers better pricing information and discovery. Moreover, NEM submits that using a formula that is published one month in advance of the delivery month would reflect accurate market signals and not unduly restrict the flexibility of utilities to recover costs.

NEM notes that the Public Utilities Commission of Ohio examined this issue and found that the utilities, "GCR [Gas Cost Recovery] rate [may] be revised more frequently than on a quarterly basis."[8] The Commission decided to permit this, "flexibility to accommodate company contract arrangements, supply portfolios, demand shifts, billing/accounting systems' changes, further evolution of the choice programs and changing natural gas market conditions."[9] The Ohio Commission previously approved the individual requests of Vectren Energy Delivery and Cincinnati Gas and Electric to make monthly GCR rate adjustments.[10] NEM urges this Commission to examine Ohio's approach.

3. Effect of Consumer Education on Competition

Consumer education is critical to support competitive energy markets. It is also critical that consumers receive a unified, coordinated and easily understandable message from all market participants to avoid customer confusion about their potential options. Toward that end, NEM submits that competitive suppliers should be permitted to be involved in the development of Commission and utility consumer education messages about choice

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[8] PUCO Case No. 03-1384-GA-ORD, In the Matter of the Commission's Review of its Rules Regarding the Uniform Purchased Gas Adjustment at Chapter 4901:1-14, Ohio Administrative Code, Finding and Order, issued March 11, 2004, at page3.

[9] Id at page 5.

[10] PUCO Case 03-939-GA-UNC, In the Matter of the Application of Vectren Energy Delivery of Ohio, Inc. for Authority to Make Monthly Adjustments to the Expected Gas Cost Component of the Gas Cost Recovery Rate; PUCO Case 03-1584-GA-UNC, In the Matter of the Application of Cincinnati Gas and

in order to ensure the competitively neutrality of the information presented. NEM suggests that consumer outreach and education should include collaboration with competitive suppliers regarding the message and method of communication. Even though choice has been available for some time to Pennsylvania gas consumers, subsequent to the Commission's decision in this proceeding, it may be advisable to reinitiate a campaign that educates consumers about the general benefits of choice programs as well as any specific market changes the Commission decides are appropriate.

4. Effect of Customer Information/Service on Competition

In order to avoid duplication of the response to Item 3 above, NEM construes this issue to refer to ease of data flow between utilities and competitive suppliers concerning customer information. Seamless, low-cost, efficient data and information exchange is the key to lowering the cost of energy and related services as well as enhancing reliability. Critical to the long-run success of a competitive energy industry is the ease of entry into the marketplace of competitive suppliers of all sizes. The greater the number of competitive suppliers, the more price competition and variety of value-added services will be offered to consumers. In order facilitate competitive entry, standardized business practices and a consistent set of information standards should be utilized. In particular, NEM recommends that the utilities provide historical load profile information in a web-based application and that utilities provide customer lists to competitive suppliers.

In the absence of standardized business practices, market participants are forced to divert scarce resources to customize billing, back office, and customer care facilities, and to develop and maintain non-standardized information protocols or develop specialized knowledge of different rules in each jurisdiction, driving energy prices higher nationwide. Consistent and uniform implementation of business rules will allow marketers to compete in different jurisdictions in a more cost-effective manner.

5. Effect of Supplier Financial Security Requirements on Competition

Supplier financial security requirements have a direct impact on competitive market entry. Financial security requirements should not be unduly burdensome and onerous. Security requirements should be designed to provide the utilities with reasonable compensation in the event of a supplier default. However, requirements should reflect reasonable costs of procuring alternate supplies during reasonable weather conditions, not severe, atypical weather conditions that are seldom seen.

Companies with certain S&P or Moody ratings should already meet reasonable standards. Others should be able to meet the financial standard with, for example, cash, letters of credit, parental guarantees, or a reasonable bonding requirement. Excessive financial security requirements increase the costs associated with energy commodity and limit competition.

6. Effect of Natural Gas Distribution Company Penalties and Other Costs on Competition

Gas utility penalties and unreasonable fees have the effect of limiting competition. Fees for balancing and related services should be cost-based. NEM submits that delivery tolerances should be instituted within which reasonable fees or penalties will not be assessed. A true-up procedure should be performed every thirty, sixty, or ninety days to account for supply imbalances, and marketers should be allowed to engage in imbalance trading to minimize fees incurred. Similarly, unreasonable administrative charges, access fees or pooling charges are artificial barriers to competition and should be prohibited.

NEM also urges that utility settlement and balancing processes must be established on a more definitive and less discretionary basis in order to provide competitive suppliers with greater certainty of their costs of participating in the market. For instance, in the Columbia Gas program the utility has the sole discretion to require suppliers to either flow gas or provide cash to cash out imbalances. It is difficult for suppliers to prepare for and respond to this contingency.

7. Avenues for Encouraging Increased Competition in Pennsylvania

In its responses to Issues raised by the Commission in Items 1 through 6 above and Issue 8 below NEM offers suggestions about how to improve the competitiveness of the Pennsylvania gas market during a transitional period while the utilities remain in the merchant function. NEM also recommends that the Commission adopt an end-state vision for this market, setting forth a date certain by which utilities will exit the merchant function.

NEM asserts that in the long term, all consumers in restructured energy markets should be served by energy service providers at competitive prices, and it is desirable to get to that end state as quickly as possible. Furthermore, it is imperative to set a date certain by which to complete the transition to a competitive market. The longer it takes to implement competitively restructured energy markets, the higher energy costs will be. Investment capital must have both political and financial certainty in order to be competitively deployed for the benefit of Pennsylvania consumers.

NEM also recommends that the SOLR function can and should be a competitively bid function and should reflect all of the political, social and reliability concerns of providing Last Resort service.

8. Purchase of Accounts Receivable

NEM recommends that the consolidated billing party should purchase the receivables of the non-billing party until the utility billing function is competitively outsourced or unbundled from utility rates based on the utility's fully allocated embedded costs of providing billing and collection services. NEM also supports the application of a reasonable discount rate for the purchase of receivables to permit the utilities to collect what should be a minor incremental cost of collecting 100% of the utility-generated bill rather than a portion of the same bill. Given the utilities' already low uncollectible rate coupled with their on-going obligation to collect delivery charges for migrating customers as well as both energy and delivery charges for full service customers, the incremental costs of collecting all outstanding charges should be de minimus.

It is NEM's understanding that the discount rate for purchase of receivables in the Columbia Gas choice program is 5%. NEM submits that this rate is excessive. For instance, Detroit Edison and Consumers Energy in Michigan purchase receivables without assessing any discount rate. In Ohio, Vectren Energy Delivery, Dominion East Ohio and Columbia Gas of Ohio purchase receivables at 2%, 1% and no discount rate, respectively. Additionally, the discount rate for purchasing receivables proposed by two New York utilities is also well below the amount charged by Columbia Gas. A recently filed Consolidated Edison settlement proposed a discount rate of between 1 1/4% and 2% for its gas choice program,[11] and a recently filed Central Hudson settlement proposed a discount rate of .9% for purchase of receivables in its gas and electric choice programs.[12] New York Public Service Commission decisions in these proceedings are expected soon. NEM submits that these discount rates are far more reasonable and urges the Commission to reexamine the Columbia Gas discount rate accordingly.

9. Conclusion

NEM appreciates this opportunity to offer its observations on whether effective competition for natural gas supply services exists in Pennsylvania and urges the Commission to adopts its recommendations to improve the climate for competition in the Commonwealth.

Sincerely,

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[11] NYPSC Case 03-G-1671, Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Consolidated Edison Company of New York, Inc. for Gas Service.

[12] NYPSC Cases 00-E-1273 and 00-G-1274, Proceeding on Motion of the Commission as to Rates, Charges, Rules and Regulations of Central Hudson Gas & Electric Corporation for Gas and Electric Service.