



September 9, 2010

VIA EXPRESS MAIL

Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street
Harrisburg, PA 17120

**Re: Natural Gas Distribution Companies and the Promotion of
Competitive Retail Markets Docket No. L-2008-2069114**

Dear Secretary Chiavetta:

Enclosed for filing, please find an original and fifteen copies of the written comments of the UGI Distribution Companies in response to the Advance Notice of Final Rulemaking Order entered on August 10, 2010.

Please feel free to contact me with any questions concerning this filing.

Very truly yours,

Mark C. Morrow

Counsel for the UGI Distribution
Companies

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Natural Gas Distribution Companies and :
the Promotion of Competitive Retail :
Markets : Docket No. 1-2008-2069114

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**COMMENTS OF THE UGI
DISTRIBUTION COMPANIES**

The UGI Distribution Companies (“UGI”), comprised of UGI Utilities, Inc. – Gas Division (“UGI-GD”), UGI Penn Natural Gas, Inc. (“PNG”) and UGI Central Penn Gas, Inc. (“CPG”), appreciate this opportunity to submit comments in response to the Commission’s Advance Notice of Final Rulemaking Order (“ANFRO”) entered in the above-captioned docket on August 10, 2010. These comments are intended to supplement those filed by the Energy Association of Pennsylvania at this docket.

I. INTRODUCTION

UGI is the largest provider of natural gas distribution service in Pennsylvania, serving approximately 567,000 customers, and has been an active participant in the Commission’s SEARCH process since its inception. Virtually all of UGI’s larger commercial and industrial customers have been transportation service customers for decades, and almost all receive their natural gas supply service from Commission-licensed natural gas suppliers (“NGS”). UGI NGDCs also have active NGSs (“Choice Suppliers”) serving significant and growing pools of smaller residential, commercial and industrial customers (“Choice Customers”) for which UGI has supplier-of-last-resort (“SOLR”) obligations.

UGI has not waited for the outcome of the SEARCH process to take action to remove potential barriers to retail competition. UGI conducted a “best practices” collaborative with natural gas suppliers (“NGS”) and others to explore ways to reduce barriers to retail competition in both the transportation and Choice Customer markets, and as a result of that process implemented a number of changes supported by NGSs in the PNG and CPG latest base rate proceedings.¹ All of the UGI NGDCs now either have in place or are in the process of implementing Commission-approved Merchant Function Charges (“MFC”)² that either do or will reflect purchased gas cost-related uncollectible expenses in their respective price-to-compare. The Commission has also recently approved a voluntary purchase-of-receivables (“POR”) program for UGI-GD.³

The Commission is to be commended for the many constructive changes it has made to its proposed regulations in response to the comments filed to its Proposed Rulemaking Order entered on March 27, 2009. Many of these changes should reduce the potential for litigation and harm to NGDCs and their customers while pursuing a policy of aggressively promoting retail transportation and Customer Choice.

As discussed in more detail below, however, Section 62.225 of the proposed regulations, addressing the release, assignment or transfer of capacity, plainly conflicts with provisions of the Public Utility Code, would limit flexibility and falsely assumes all NGSs favor and would benefit from mandatory assignment.

¹ UGI filed a summary of the results of its best practices collaborative with the Commission on January 29, 2010 at docket nos. A-2008-2034045, A-2008-2034047, G-2008-2034115 and G-2008-2034132.

² The UGI-GD MFC was authorized as part of a Commission-approved settlement in an Order entered August 23, 2010 at Docket No. P-2009-2145498. The PNGMFC was approved as part of a Commission-approved settlement of PNG’s last base rate proceeding in an Order at Docket No. R-2008-2079660 et al. entered on August 27, 2009. The CPG MFC was approved as part of a Commission-approved settlement in an Order at Docket No. R-2008-2079675 et al. entered on August 27, 2009.

³ Docket No. P-2009-2145498, Order entered August 23, 2010.

In addition, UGI believes the proposed regulations need to further clarify the adjustments to existing quarterly PGC rate adjustment mechanisms the Commission intends to implement and why.

Finally, as the Commission moves forward with its SEARCH-related rulemakings it should be mindful of the important roll the natural gas distribution industry and the broader natural gas industry can play in meeting the Commonwealth's objectives of enhancing energy efficiency, reducing green house gas emissions and promoting economic development. Promoting the direct end use of natural gas for heating purposes is one of the most-effective and powerful ways of promoting energy efficiency in the Commonwealth, and could lead to significant reductions in greenhouse gas emissions as compared to almost all alternative heating energy sources. Pennsylvania has abundant natural gas supplies and has been projected to be a net natural gas exporter by 2013. The responsible development of these resources and their intelligent use in the Commonwealth will provide significant economic development benefits and revenues to the Commonwealth and its citizens, and should be promoted. While the promotion of retail choice may be a top priority for the Commission, it should not pursue that goal in ways that may harm the industry through the promotion of undue price volatility for those that cannot or do not shop, or unintentionally decrease the reliability of gas supplies, thereby making gas less competitive with other less efficient energy sources.

II. COMMENTS

A. §62.225. Release, assignment or transfer of capacity.

1. Applicable statutory provisions.

Section 2204(d)(1) of the Public Utility Code governs the mandatory release, assignment or transfer by NGDCs to NGSs and/or commercial and industrial customers of existing as well as new or renewed NGDC capacity and Pennsylvania production needed to meet the NGDC's "least-cost procurement and other applicable standards pursuant to this title" (hereinafter "Mandatory Assignment").⁴ It unambiguously provides that such Mandatory Assignment is only to be performed at the option of the NGDC providing, in pertinent part:

A natural gas distribution company holding contracts for firm storage or transportation capacity, including gas supply contracts with Pennsylvania producers ...may, at its option, assign or otherwise transfer such capacity or Pennsylvania supply, in whole or in part, associated with those contracts on a nondiscriminatory basis to licensed natural gas suppliers or large commercial or industrial customers on its system. (Emphasis added.)

The discretionary nature of Mandatory Assignment is further reinforced by the provisions of Section 2204(d) (5) which provides, in pertinent part:

On or after July 1, 2002 ... the commission shall have the authority to prevent such assignments, releases or transfers under either of the following circumstances:

(i) the natural gas distribution company, alone or together with one or more natural gas suppliers, voluntarily proposes an alternative to such assignments, releases or transfers, and the commission finds such alternative to be in the public interest. (Emphasis added.)

⁴ Section 2204(d)(1), by its terms, addresses existing capacity and Pennsylvania production, and Section 2204(e)(5) makes the same rules applicable to new and renewed capacity and Pennsylvania production that meet the standards set for in Section 2204(e)(1)-(4).

In addition, Section 2203(5) of the Public Utility Code provides:

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

2. Applicable FERC Rules

The discretion afforded NGDCs under Section 2204(d)(1) and (5) is not provided so that NGDCs can discriminate in their Mandatory Assignments. Such discrimination is prohibited under the statute, and any attempts to improperly discriminate can be addressed in the tariff filings of NGDCs seeking to implement Mandatory Assignment or through the Commission's complaint processes. Instead, the flexibility provided under Section 2204(d)(1) and (5) is needed because NGDCs must comply with FERC rules and must take actions in the context of such rules necessary to enable them to fulfill their SOLR function.

For example, under FERC rules certain capacity and storage contracts, often referred to as Section 7(c) contracts, cannot be released to third parties. UGI has a significant number of such contracts in its supply portfolios, and any state mandate to release such contracts would be in conflict with federal law.

In addition, while FERC rules permit the release of certain other storage capacities, they also require that the holder of such storage capacity own the inventory in the storage. Thus, NGDC releasing such storage capacity must also transfer any associated storage inventories via a purchase or a sale. As a result of FERC's jurisdictional limitations, however, while FERC can make storage contracts recallable by NGDCs in the event the NGDC needs to meet SOLR obligations to customers returning

from a NGS, it cannot guarantee the return of appropriate levels of storage inventories. While NGDCs may seek to impose a contractual obligation on NGSs to return storage inventories, such contractual obligations may not be enforceable, particularly in the event of a NGS bankruptcy. A contractual claim is also no substitute for actual possession of needed storage inventories, particularly for NGDCs located in the eastern part of the Commonwealth where substitute resources may not be available during periods of peak demand. Stated another way, NGDCs, such as UGI, located in geographic areas without significant on-system production, storage or excess pipeline capacity that could be acquired on short notice during periods of peak demand, and who use storage assets in their PGC portfolio, may not be able to fulfill their supplier of last resort obligations in the event of a supplier default or bankruptcy, if they release their storage assets under a Mandatory Assignment program. Therefore, a NGDC would need to hold redundant capacity in order to meet its supplier of last resort obligation or risk curtailing firm customers.

It is also true, of course, that NGDCs holding PGC storage and pipeline assets may release such assets or use them to make off-system sales in secondary markets under FERC rules when they are not needed to meet NGDC SOLR obligations, or use them to take advantage of seasonal variations in gas costs. Some NGSs have viewed NGDC decisions to not include storage assets they view as having value in Mandatory Assignment programs as discriminatory, and the ANFRO apparently accepts this view.⁵ If the Commission wishes to deliver the value of storage capacity to NGSs, however, it need not mandate the release of such assets, since such value can be provided to NGSs in

⁵ *“Additionally, we want to ensure that useable capacity is released to marketers at fair and equitable rates, not the most expensive and least usable capacity.”* ANFRO, p. 32.

ways consistent with Section 2204(d) of the Public Utility Code, FERC rules and NGDC SOLR and least-cost obligations. For example, in UGI PGC settlements pending before the Commission, UGI, public parties and Shipley Energy Company were able to reach agreement on Mandatory Assignment rules which would provide NGSs with the option of combining reduced levels of pipeline contract releases with bundled city gate sales of gas by UGI priced at summer index prices, thereby providing NGSs with the value of UGI storage assets in a fair non-discriminatory manner while enabling UGI to maintain control of its storage inventories so that it has assurance it can meet its statutory SOLR and least-cost obligations. In addition, the bundled sales in UGI's pending PGC settlements, allow UGI to manage changes in demand throughout the day because UGI continues to hold the storage assets.

FERC rules also influence the means by which NGDCs can engage in Mandatory Assignment while not violating the state statutory prohibition against discrimination and cost shifting.

Under FERC regulations FERC-jurisdictional pipeline and storage assets PGC portfolios can and do have differing contract prices. Until recently, these contracts could not be released above their full contract rate under any circumstances, and in many instances could not be released below the contract rate without complying with FERC posting and bidding requirements which might result in the award of the contract to a third party.

Moreover, to the extent a releasable contract is released above the weighted average cost of all PGC assets, its release at the full contract rate to a Choice Supplier reduces PGC rates and could be viewed as unfair to Choice Customers and in violation of

Section 2203(5) of the Public Utility Code. To the extent a releasable contract is released below the weighted average cost of all PGC assets, its release at the full contract rate to a Choice Supplier increases PGC rates and could be viewed as unfair to PGC customers and in violation of Section 2203(5) of the Public Utility Code.

To deal with the conflicting goals of avoiding cost shifts between classes while still complying with FERC maximum rate caps and bidding and posting requirements, most or all NGDC supplier tariffs adopted during the gas restructuring process provided for the pro rata release of all PGC assets. However, the pro rata approach still did not deal with the problem of Section 7(c) contracts or other gas supply assets, such as peaking services, not available for release. Also, as was expressed during the SEARCH process by both NGDCs and NGSs, pro rata Mandatory Assignment programs are administratively complex and burdensome because of the large number of potentially small releases that must be performed and administered. In at least one other state, regulators attempted to address this problem by assessing fees on below average cost releases to avoid cost shifts, but such fees were found to violate FERC maximum rate limitations.

In 2009, however, FERC addressed this problem by issuing FERC Order 717, which removed the price cap on releases of one year or less, and exempted releases performed as part of state Customer Choice programs from FERC tying and bidding restrictions. Thus, NGDCs can now release fewer contracts as prices equal to the weighted average cost of PGC assets to both avoid cost shifts and limit administrative complexity and costs. Section 2204(d)(3) of the Public Utility Code provides that “release, assignment or transfer shall be at the applicable contract rate for such capacity

or Pennsylvania supply and shall be subject to applicable contractual arrangements and tariffs.” (Emphasis added.) Since the FERC Order 717 rules have been incorporated into pipeline and storage tariffs, releases of capacity or storage can now be performed at prices other than contract rates that the Commission finds to be reasonable and which do “not unreasonably discriminate against one customer class for the benefit of another[,]” in violation of Section 2203(5) of the Public Utility Code.

3. Section 62.225(a) of the Proposed Regulations

As originally proposed in the Commission’s Proposed Rulemaking Order entered on March 27, 2009, the Section 62.225(a) accurately recited the Mandatory Assignment provisions of Section 2204(d) on a word-for-word basis. In its comments, the Independent Regulatory Review Commission (“IRRC”) noted that the regulation simply tracked existing legislative language and suggested that the Commission either delete the section or explain the need for it. In its ANFRO, the Commission states that it “declines to revise or delete this proposed section of the regulation” and:

Until the gas market matures, utility operated natural gas capacity release and storage programs in Pennsylvania must be administered in a competitively neutral manner. We determine that the assets of gas pipeline and storage capacity should follow the customers of each utility, regardless of where they purchase their natural gas supply. Additionally, we want to ensure that useable capacity is released to marketers at fair and equitable rates, not the most expensive and least usable capacity. Accordingly we have decided to formalize this regulation in harmony with the existing law in order to give both NGDCs and NGSSs some guidance and to ensure that the requirements that the release, assignment or

transfer of capacity by an NGDC for any new or renewed capacity contract for firm storage or transportation capacity shall be on a nondiscriminatory basis and shall be at the applicable contract rate for such capacity.

ANFRO, pp. 31-32.

Contrary to the stated intention of the Commission, however, the text of the proposed Section 62.225 clearly contains black-lined revisions which were never previously published and which are plainly at odds with the statutory language of Section 2204(d). Moreover, since the ANFRO does not acknowledge that revisions to Section 62.225 (a) have been made, the meaning and intent of the revisions is unclear although the narrative discussion quoted above seems to suggest that the Commission believes that the failure to release storage capacity may be discriminatory, without acknowledging or discussing the reasons why NGDCs may need to retain such assets for the reasons stated above.

Among the changes to Section 62.225(a) is the insertion of the words “NEW AND RENEWED” in the first sentence, and the addition of the words “AS SET FORTH IN 66 PA.C.S. §2204(E){,}” a section of the Public Utility Code addressing new and renewed capacity, at the end of the section.

It is not clear why these revisions have been proposed or how they would relate to the release of storage capacity if that is what the Commission is intending to promote. Section 2204(e) of the Public Utility Code provides for a process under which a NGDC, “[s]ubject to the service obligations imposed by this title, and to the extent such capacity is not needed to meet the natural gas distribution company’s least-cost fuel procurement

and other applicable standards pursuant to this title[.]”before entering into new or renewed contracts for firm storage or transportation capacity must:

offer on a nondiscriminatory basis to each natural gas supplier licensed to do business on its system, and to large volume industrial or commercial customers of the natural gas distribution company being served by such contracts, the opportunity to renew such contracts, pursuant to the rules and regulations of the Federal energy Regulatory Commission, or to enter into other contracts for capacity.

Such offers are not Mandatory Assignment. To UGI’s knowledge, no NGS has ever elected to step into a new or renewed pipeline or storage contract because such contracts often require a long-term commitment while Customer Choice loads are transitory, and because it is not possible under FERC rules for a NGDC to be in a position to fulfill its SOLR obligations unless it obtains gas supply assets in its name and releases such assets when necessary to Choice Suppliers or uses them to make bundled city gate sales to Choice Suppliers.

After the above process is completed for those assets subject to it, the NGDC can then obtain permission from the Commission to enter into the new or renewed contracts and, as explained above, Section 2204(e)(5) makes all new and renewed contracts meeting the standards of Section 2204(e) subject to the same Mandatory Assignment process applicable to pre-existing contracts.

Thus, it is not clear what the black-lined additions to the language of Section 62.225(a) accomplish, even if the Commission had the authority to change the statutory language that comprised the original language of this section on a word-for-word basis.

Section 62.225(a) of the ANFRO also substitutes the word “SHALL” for the word “may” found in Section 2204(d) of the Public Utility Code and the original wording of Section 62.225(a) of the regulations.

The Commission cannot by regulation change the discretionary nature of Mandatory Assignments. However, this does not mean that the Commission is powerless to promote a particular view as to how Mandatory Assignment is to be performed and will be able to reject Mandatory Assignment programs which it believes contain features which unduly discriminatory. It does not need to attempt to make Mandatory Assignment programs mandatory to implement any particular view as to what is unduly discriminatory. Moreover, consistent with the provisions of Section 2204(d)(5)(i) of the Public Utility Code, a NGDC and one or more NGSs may voluntarily propose “an alternative to such assignments, releases or transfers” which the Commission can accept or reject depending on whether it finds them to be in the public interest. The presence of a regulation mandating Mandatory Assignment would create confusion over the viability of this statutory alternative.

4. Conclusion

Thus, for the reasons set forth above, UGI believes the Commission should either remove Section 62.225(a) from its proposed regulations, or retain the original proposed language in this section which tracked the statutory language in Section 2204(d).

Alternatively, to the extent the Commission believes revisions to the originally proposed language of Section 62.225(a) are necessary, it should acknowledge that it is making changes, provide a complete explanation of purpose and intent of the changes, and provide interested parties with the opportunity to comment on the changes.

B. Quarterly Reconciliation Adjustments and PTC

UGI appreciates the Commission's decision to remove those portions of the proposed regulations that would have called for monthly reconciliation adjustments. As the Commission correctly notes, PGC gas supplies are often acquired on a seasonal or other longer-term basis, and monthly PGC adjustments would accordingly not make PGC prices more closely reflect wholesale prices. As currently drafted, the proposed regulations on-their-face would make no changes to current PGC mechanisms.

However, in discussing the removal of mandatory monthly reconciliation from the proposed regulations, the ANFRO states on page 17:

At the same time, to avoid the potential for large positive or negative reconciliation adjustments when a customer switches to an alternate supplier, we shall direct NGDCs to file tariff revisions that provide for quarterly reconciliation adjustments to their gas cost rates as well.

Similarly, on page 18 of the ANFRO, in describing the elements of the Price-to-Compare, the ANFRO includes "the reconciliation for over and under collections[.]"

The Commission should be aware that under the provisions of Sections 1307(f)(3)-(5) and 1318 of the Public Utility Code, PGC reconciliations can only be performed on an annual basis, and only after the Commission makes certain specific findings after a PGC hearing process. Thus, quarterly reconciliations would not be possible absent changes to these sections of the Public Utility Code.

The Commission should also be aware that under Section 1307(f)(1) of the Public Utility Code, NGDCs are authorized to make quarterly adjustments to the gas cost, or C-

factor, component on PGC costs, and do so in accordance with Commission regulations at 52 Pa. Code §53.64(i)(5).

The Commission does have discretion to determine the components of a PTC, which is a concept not found in the Public Utility Code, but in doing so presumably should not attempt to include components that are not authorized in actual PGC rates since doing so would be misleading to consumers. Currently the E-factor is not a component of UGI's PTC, because under the provisions of Section 1307(f)(6) of the Public Utility Code, a customer transferring to transportation service must still pay the E-Factor component of PGC rates for an appropriate period of time.

In any event, to the extent the Commission intends to change current PGC reconciliation regulations or PTC rules, it should only do so after providing notice of the change, an explanation of why the change is required and providing an opportunity for comment.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Mark C. Morrow", with a long horizontal flourish extending to the right.

Mark C. Morrow

Counsel for the UGI Distribution
Companies

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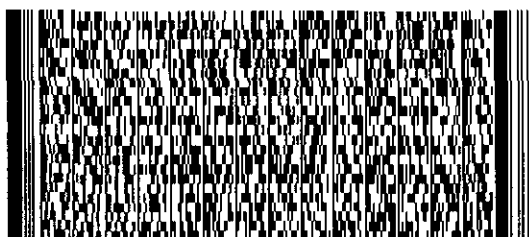
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