

**BEFORE THE PENNSYLVANIA HOUSE
CONSUMER AFFAIRS COMMITTEE**

Representative Joseph Preston, Jr., Chairman

Testimony of

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**Regarding
Natural Gas Utilities**

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Chairman Preston and Members of the House Consumer Affairs Committee

My name is Sonny Popowsky. I have served as the Consumer Advocate of Pennsylvania since 1990, and I have worked at the Office of Consumer Advocate since 1979. Thank you for permitting me to testify today regarding the natural gas industry in Pennsylvania and the impact of changes in that industry on the consumers whom my Office represents.

Pennsylvania natural gas consumers have been on something of a roller coaster ride over the last few years as a result of dramatic shifts in natural gas prices at the national wholesale level. Pennsylvania is far from unique in this respect, as the primary forces that have produced these shifts have arisen in the Gulf Coast of the United States, where much of our natural gas comes from, and as a result of federal policies in Washington, D.C.

Nevertheless, there are policies we can pursue here in Harrisburg that can improve the situation for Pennsylvania natural gas consumers, and there are policies that can make matters worse. It is these state policies that I would like to talk about today.

As many of the members of this Committee recall, the General Assembly acted in 1999 to inject greater competition into the commodity service received by Pennsylvania natural gas consumers. The 1999 Natural Gas Choice and Competition Act (“Act”) came on the heels of, and was in large part based on, the legislation passed by the General Assembly in 1996 to restructure our electric industry. In both cases, a major thrust of these restructuring statutes was to “unbundle” the rates of our electric and natural gas companies so that retail customers would have greater access to competitively priced electric generation and natural gas commodity service. Significantly, in both cases, retail customers retained the option of continuing to purchase unbundled electric generation or natural gas commodity service from their incumbent electric or natural gas distribution company. Alternatively, to the extent that unregulated

suppliers were able to offer electric generation or natural gas commodity service on more attractive terms, the customers were free to select one of those suppliers, and the incumbent utility was required to distribute that unregulated supply service to the customer through its regulated electric distribution lines or natural gas pipes.

Under the 1999 natural gas legislation, all customers have the opportunity to purchase their gas commodity service from retail natural gas suppliers other than their regulated local gas distribution company. Unlike in the case of electricity, however, even prior to our 1999 natural gas legislation, large industrial and commercial natural gas customers already were purchasing their natural gas from entities other than their local distribution companies through “transportation” service. Even residential customers in parts of Western Pennsylvania had been participating in large scale natural gas retail choice “pilot” programs prior to 1999, and indeed all natural gas customers were receiving gas that was purchased by their local utilities through the competitive wholesale markets.

As in the case of electric utilities, the distribution function of the natural gas utilities – that is, the pipes that run down our streets and into our homes – generally remained a monopoly service under the traditional regulated model. And equally important from my perspective, our regulated utilities continued to serve as the “default supplier” or “supplier of last resort” so that all Pennsylvania consumers would continue to have access to these essential energy services even if they could not or chose not to shop in the competitive retail market.

In natural gas, the price of utility default service continued to be regulated by the Public Utility Commission (PUC) just as it had been prior to restructuring. That is, the utility purchases gas in the competitive wholesale market; the PUC reviews the purchases to ensure that they are consistent with a least cost gas procurement strategy; and the wholesale costs are passed

on, with no markup or profit, to retail customers on a reconcilable dollar-for-dollar basis. This is an extremely important point: under our existing law, Pennsylvania local natural gas distribution utilities are required to provide reliable service by purchasing natural gas at the lowest reasonable prices and then passing those purchased gas cost prices along to their customers with no added profit.

I emphasize this point because, as part of its statutorily mandated review of the competitiveness of the Pennsylvania retail natural gas markets, the Public Utility Commission is considering proposals that would force or encourage our natural gas utilities to get out of the gas commodity business and leave the provision of natural gas commodity service solely to competitive retail marketers. The reason for these proposals is to increase “competition” among retail natural gas suppliers. The theory is that if we force our utilities to stop providing least cost gas service to their customers, then more competitors will enter the market.

In my mind, this is a truly unwise suggestion, and one that I hope will not be countenanced by the Commission or by the members of the General Assembly. If removing the local gas distribution company from the gas commodity supply market is the “cure” to a lack of retail competition, then I believe the cure is certainly worse than the disease.

It is true that substantial residential retail gas competition has not developed in response to the natural gas restructuring law that was passed in 1999. Outside of the areas in Western Pennsylvania that had large pilot programs prior to the 1999 Act, there has been little or no residential sales activity, and even in Western Pennsylvania, the number of residential customers served by alternative suppliers has declined, rather than increased. That may be because the 1999 Act actually removed a tax advantage that unregulated marketers had over regulated utility suppliers in that, prior to 1999, customers who bought gas from competitive

suppliers were exempt from the state gross receipts tax while customers who bought gas from their regulated utility had to pay that tax. The 1999 Act eliminated the gross receipts tax for all natural gas customers, thus eliminating the artificial advantage that the competitive marketers had over the utilities.

Some people argue that the lack of retail competition for residential customers means that the 1999 Act was a failure and that drastic steps must be taken to bring about more retail shopping. But from my perspective, if our regulated natural gas distribution companies have been doing their job – that is, by providing gas service pursuant to a least cost gas procurement policy, with no profit or markup – it should come as no surprise that marketers would find it difficult to beat those prices and that customers may have little incentive to switch to an alternative supplier. The unregulated marketers are operating in the same volatile wholesale natural gas market in which the utilities are buying their gas. In addition, marketers face additional costs in order to acquire customers and earn a profit on the sale of the gas. It is not clear whether a competitive marketer can cover wholesale natural gas supply costs, retail acquisition and transaction costs, earn a profit, and still offer enough savings to convince retail residential customers to switch from their local gas distribution utility, who is simply charging retail customers the wholesale gas price with no markup.

The answer to this dilemma, however, is not to force or encourage our utilities to leave the market. Nor is it to artificially increase our utilities' costs of providing natural gas service. The goal of the natural gas restructuring law was to make customers better off, not to make customers worse off by removing their most economical supplier from the market. The goal of the Public Utility Commission and of the General Assembly should not be simply to increase shopping activity among retail natural gas customers. The goal should be to ensure that

all customers continue to receive reliable natural gas service at the lowest reasonable cost. That is the standard under the current provisions of the Public Utility Code, and that standard should not be tampered with as part of a single-minded pursuit of increased retail competition.

When the General Assembly established customer choice for residential customers, it did not eliminate the statutory requirement that Pennsylvania's regulated natural gas utilities must pursue a least cost gas procurement policy. On the contrary, as part of the same legislation that created the customer choice provisions of Chapter 22, the General Assembly amended Section 1307(h) of the Code to make it clear that the cost of natural gas for the purpose of our natural gas distribution companies' annual purchased gas cost proceedings would include costs paid "for employing futures, options and other risk management tools." In other words, the General Assembly not only continued the least cost gas procurement requirements of Chapter 13 of the Code, but gave our regulated utilities additional tools that they could use to meet those requirements on a cost effective basis.

The intent of the Act was to provide benefits to consumers, not to harm them by increasing natural gas cost rates in the name of greater competition. The Act provided small natural gas users with more potential access to the competitive wholesale natural gas market, which was already available to large gas consumers, but at the same time continued the protection of regulation for those customers who wished to stay with their incumbent supplier. Even customers who do not shop, however, still receive the benefit of wholesale natural gas competition as reflected in the least cost gas purchasing practices of their distribution companies. To the extent that retail marketers are able to provide lower prices or other benefits, such as longer term fixed price contracts or a combination of energy products, customers in those service territories where marketers are present are free to switch suppliers.

I have urged the Commission, however, to reject proposals for residential customer choice that would increase costs to the customers as a means of encouraging switching. These models offer little in the way of positive benefits for consumers and treat switching as an end, rather than as a means to lower rates and reliable service. It is essential that the Commission ensure that our regulated natural gas distribution companies continue to provide safe, adequate and reliable natural gas sales service at the lowest reasonable cost. Furthermore, the Commission should continue to require utilities to engage in least cost purchasing practices and to provide natural gas service at reasonable, cost-based rates.

As I noted above, my biggest concern involves those arguments that suggest that the way to get more retail competition in natural gas is to force customers to pay even more for their regulated gas service or to force our utilities out of the provision of that service entirely. I believe it would be disastrous to eliminate the protections that Pennsylvania consumers currently have with respect to the continuation of regulated rates from their natural gas distribution companies. Pennsylvania consumers have already suffered enough as a result of recent price spikes in the wholesale natural gas market; they should not have to face yet more volatility and price increases that might result from allowing unchecked retail gas supply rates.

I am not asking the General Assembly take any action on this matter at this time. On the contrary, I would urge the General Assembly to reject any efforts to modify the current natural gas restructuring model in a way that would reduce the protections now available to Pennsylvania consumers. Our natural gas utilities should continue to provide natural gas service to residential customers by following a least cost gas procurement policy that is subject to review by the Pennsylvania Public Utility Commission. To the extent that unregulated marketers can provide less costly service to customers or offer some other benefits that will encourage

customers to switch suppliers, that is all to the better. But the goal of our legislative and regulatory policy must remain the provision of reliable natural gas service to all customers who desire such service at just and reasonable prices.

I want to thank you again for inviting me to participate in this hearing. I would be happy to answer any questions you may have at this time.

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