BEFORE THE PENNSYLVANIA
HOUSE CONSUMER AFFAIRS COMMITTEE

Testimony of

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Regarding

Extension Of Natural Gas Service

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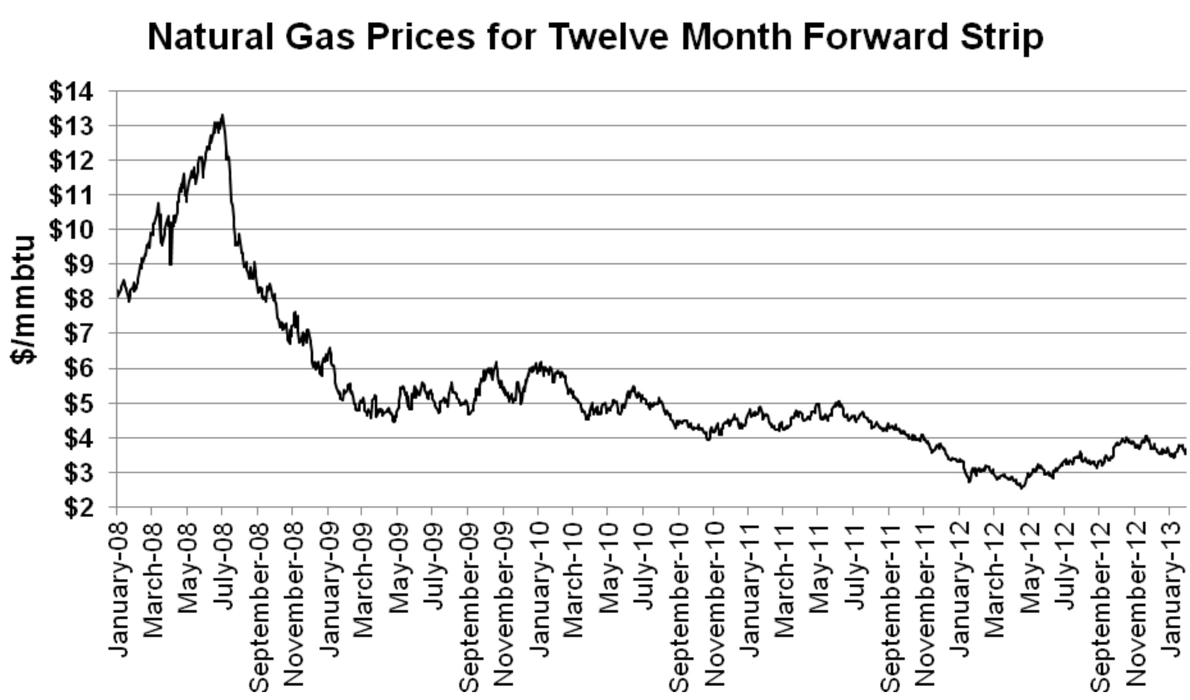
Chairman Godshall, Chairman Daley
And Members of the House Consumer Affairs Committee

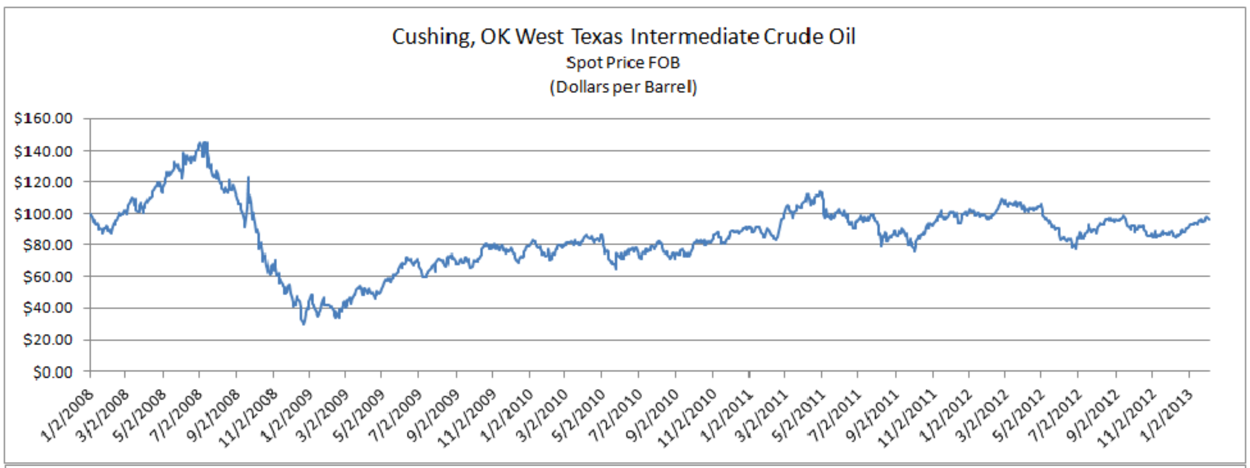
My name is Tanya McCloskey. I have been serving as the Acting Consumer Advocate of Pennsylvania since the retirement of Sonny Popowsky at the end of October of 2012. I have worked at the Office of Consumer Advocate since 1987 with a primary focus on energy issues. Thank you for inviting me to give comments before this Committee regarding the extension of natural gas service.

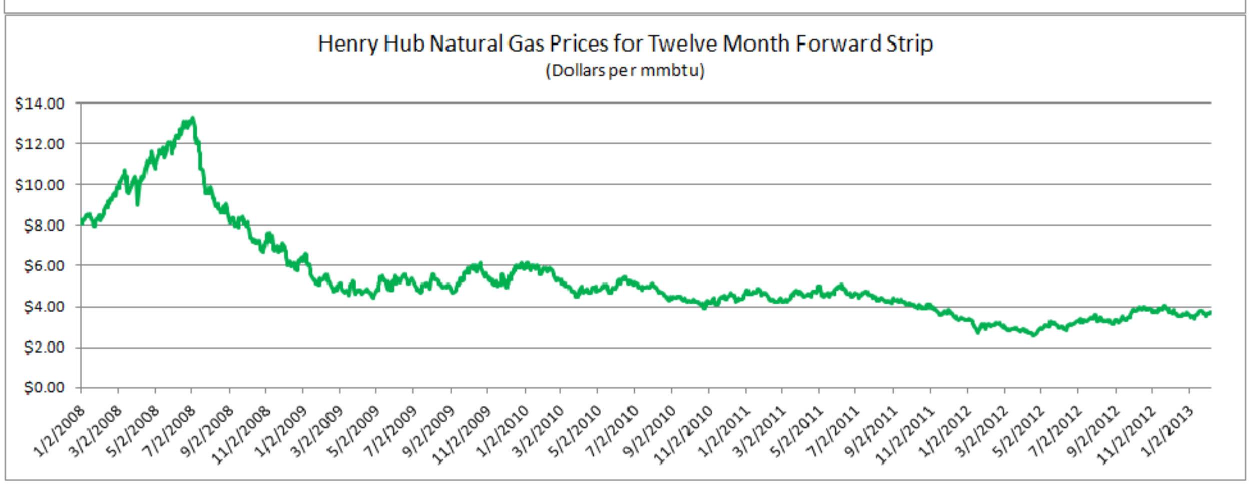
I would like to commend the Committee for convening this hearing to address this vital issue. The extension of natural gas service to unserved and underserved areas is a matter of great importance to Pennsylvania, particularly in light of the dramatic changes in the wholesale natural gas markets through the development of Marcellus Shale and other shale areas of North America. Below is a chart showing the price of 12-month contracts for natural gas purchased at the Henry Hub in Louisiana from January 2008 to the present.



As you can see from this chart, the price of natural gas hit near record highs in the Summer of 2008 when nearly all energy prices spiked in the Nation. Prices plummeted when the recession hit toward the end of 2008 and have remained at these low levels even as the economy has begun to recover.

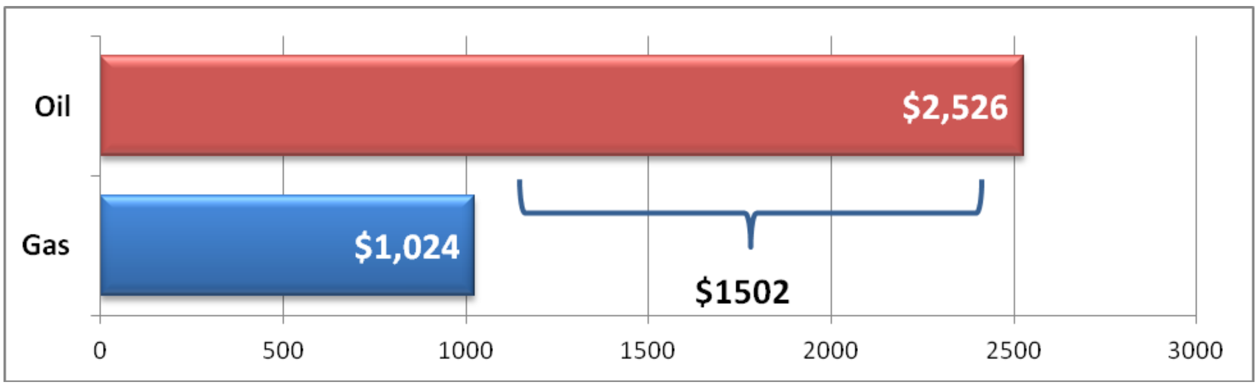
Equally significant is the fact that the changes in the price of natural gas have not corresponded with changes in the price of oil in the world markets. Over the years, the oil and natural gas markets appeared to rise and fall in unison and seemed to be more affected by political turmoil in the Middle East than by economic principles of supply and demand here at home. Below are two charts showing the changes in natural gas prices that I discussed above compared to changes in prices in one of the West Texas oil markets.





As you can see from the above charts, while the prices of both oil and natural gas shot up in 2008 and then fell sharply by 2009, the price of oil has risen again (nearly $100 per barrel, leading to prices at the pump for gasoline near $3.70 per gallon), while the price of natural gas has remained low.

That is not to say that the price of natural gas could not again go up as it did in 2008, but the economic prospects for more stable wholesale natural gas prices are currently positive. The impact of these now lower natural gas prices on a household can be significant. The chart below shows the cost to heat a typical home with oil versus natural gas over the course of a year.



Source: EIA Monthly Energy Review, December 2012.

As can be seen from this chart, under current conditions, customers can save about $1,500 each year by using natural gas to heat their home. This lower heating cost can result in households having more discretionary income that will boost state and local economies. Businesses and industries that can tap in to natural gas service can also realize significant savings. I would add that there are also environmental benefits of utilizing natural gas rather than other fossil fuels in both heating and more significantly, in the generation of electricity.

The primary reason that many rural areas do not have natural gas service is that even though the current price of natural gas is cheap, the cost of building pipelines to sparsely populated areas can be very costly. It is more economical to serve 100 or 1000 customers in a densely populated area than it is to serve 10 or 20 in a more sparsely populated area. Natural gas service presents a particular challenge because unlike other forms of utility service, consumers have alternatives to natural gas for meeting their end use needs. If a utility extends natural gas service to an area, there is no assurance that homes or businesses along the way will sign up for such service if they are already using another form of fuel to meet their needs because the initial cost to convert heating systems and appliances to natural gas can be high.

In representing Pennsylvania's utility consumers, my primary responsibility is to try to ensure that Pennsylvania consumers enjoy safe and reliable utility service at a reasonable price. In this role, my Office has frequently responded to requests from Pennsylvania residents who are seeking to have natural gas utility service extended to their area only to be told by their nearest local gas distribution company that such an extension would be "uneconomic" and that service would be made available to them only if they made a substantial up-front payment toward the construction of the main.

Under current statutes and regulations, regulated public utilities generally have an obligation to extend facilities to serve members of the public who need service, but that obligation is not unlimited. The obligation to extend natural gas mains is generally set forth in the utility's Main Extension Tariff and through this tariff, the utility applies an "economic test" to the request. If as a result of the economic test, the utility finds that it is uneconomical in whole or in part to extend the main, the utility can request that the customer provide a "contribution in aid of construction" to cover the uneconomic portion. The economic portion is included in the utility's rates and ultimately paid for by all customers over time. It is important to note that, as with all utility construction, the economic portion is initially funded by shareholders with a return of and a return on these amounts provided over time through depreciation and rate of return in the ratemaking equation.

While an economic main extension test is an important protection for existing consumers, the outcome often presents a significant barrier to extending mains to unserved areas. Our Office has worked with customers who have been asked to make up-front contributions exceeding $10,000 and $20,000 in order to obtain natural gas service to their homes. It is very difficult, if not impossible, for these homeowners to come up with those sums of money. If it is not a new home or new development, the customer would also have to pay the cost of converting from their current heating source to natural gas, a cost that can run in the $5,000 to $10,000 range. Over the long term, the customer may be better off if natural gas prices remain low as they realize savings in their monthly energy bill, but the up-front capital outlay can be a barrier to obtaining gas service for many households.

These high levels of contributions can sometimes be driven by the assumptions used by the utility in the economic test. By way of example, our Office has worked on cases where the test used by the utility analyzes the revenues received from a main extension over only a five year period to determine if the revenue provided by the customers requesting the main extension will cover all of the costs of the main extension. The main itself, however, has a 30 or 40 year life and certainly the homes of customers who expend significant dollars to utilize natural gas are likely to be served by those mains for far longer than five years. Other assumptions, such as the cost to the utility of financing the main extension can also have an impact on the analysis. I think a critical first step is to revisit the tests being utilized in determining the economics of main extensions and assure that the test and all assumptions are reasonable. Use of an appropriate economic test would be a definitive step in making natural gas service available to more Pennsylvania residents.

Even utilizing assumptions more appropriate to the circumstances we now face, however, will not result in all main extensions being economic, particularly in sparsely populated and rural areas. Several states have started to address this problem through numerous initiatives that share this burden between the customers and communities receiving service, provide for some contribution from other ratepayers, and provide for state funding support. North Carolina, for example, is providing financial support through two initiatives. One initiative allows the issuance of general obligation bonds for natural gas extensions that are not economically feasible. N.C. Gen. Stat. Sec. 62-159. North Carolina has also allowed for the creation of a "Natural Gas Expansion Fund" to facilitate the extension of natural gas service in unserved areas in order to promote the public welfare of the state. Funding sources include FERC-ordered supplier refunds, surcharges on existing customers, and "other sources" approved by the Commission. Maine has also recently enacted legislation authorizing the Finance Authority of Maine to issue bonds for the development of the state's natural gas infrastructure. ME Rev. Stat. Ann. Title 10, §§962(2), 1044 (2012).

Minnesota has taken the approach of authorizing a "New Town Rate" and "New Area Surcharge" where an additional surcharge is applied to the bills of customers in the community where the natural gas main is extended until such time as the uneconomic costs are recovered. Request by Midwest Gas Company for Approval of a New Town Rate Surcharge, Docket No. M-92-785 (Minn. PUC Nov. 1992) and In Re Northern Minnesota Utilities, Docket No. M-92-212 (Minn. PUC 1992). Other states that have utilized some form of surcharge in the new area being served include Florida (Area Expansion Program Surcharge), Georgia (Integrated

Customer Growth Program), Utah (Extension Area Charge) and Virginia (Eligible Infrastructure Development Costs). I would note that many of these states tie the implementation of such a surcharge to a showing that the line extension will contribute to economic development in the newly served areas.

Other forms of surcharges that have been considered are designed to allow the customers receiving the main extension to pay the uneconomic portion through their utility bill over a period of time rather than having to make an up-front contribution in aid of construction. As I mentioned earlier, the contributions in aid of construction can be significant, often over $10,000 or $20,000. Some states allow the utility to include a charge on the individual customer's bill on a monthly basis to collect the contribution amount over time, with interest. The repayment can extend over a significant period of time and stays with the residence so that any new owner moving into the home would have to assume that payment obligation when they sign up for natural gas service.

These forms of surcharges are not without controversy and many policy questions need to be addressed before pursuing this course. This is not intended to be an exhaustive list, but questions arise, for example, as to how to address the situation where there may be a non-payment of the surcharge amount. Other questions arise as to the interest that may be charged by a utility during the repayment period and whether it is greater than what the customer would pay if they simply took out a loan at the bank and made an up-front payment. Clearly, there are many issues that require a careful balancing to produce a result that is just and reasonable for all.

I would like to mention a few other ideas that I believe are worthy of consideration. One approach currently being used in some states is to try to secure a large anchor customer in a region first. By securing this large customer, the economics of the line extension as well as the economic development benefits of the line extension can be secured thus lowering or eliminating up-front costs to other connecting customers along the way. Another approach is to encourage our utilities to partner with financial institutions to offer low interest financing programs for new service areas to help address the up-front costs for many homeowners. And of course, all utilities should be encouraged to coordinate when extending new facilities. If, for example, a water utility will be opening roads to construct mains to new areas, there may be efficiencies to be gained if natural gas service is also needed in that area. These opportunities should not be lost by a failure to coordinate to the greatest extent possible.

I would finally note the recent grant of a certificate of public convenience to a new natural gas utility in Pennsylvania. Leatherstocking Gas Company, an affiliate of New York based Corning Natural Gas Company, is now authorized to serve portions of northern Susquehanna County. This is a promising development. As I understand it, Leatherstocking will "tap in" to nearby pipelines that are gathering and transporting natural gas from the Marcellus Shale and offer service to businesses, public buildings and residences in several townships and boroughs. The development of these types of new utilities is certainly a positive for Pennsylvania.

With the value of our new natural gas service and the web of pipelines now being built in Pennsylvania, I look forward to working with this Committee and the Public Utility Commission in finding ways to assure that an appropriate level of those benefits remain within the Commonwealth and serve Pennsylvania consumers.

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