

DOCUMENT

Pennsylvania Public Utility Commission  
Docket No. I-00040103

Investigation into the Competitiveness of  
the Natural Gas Supply Market

*En Banc* Hearing Testimony  
Energy Association of Pennsylvania  
Dan Regan  
Vice President & General Counsel  
September 30, 2004



Exh. Energy Association - No. 1

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**Comments to date misstate the mission and scope of the Gas Restructuring Act and this investigation**

- ✓ The Restructuring Act did not endorse competition for its own sake, but only to the extent consistent with safe and reliable service
- ✓ The Restructuring Act is not about service to industrial and large commercial customers



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**For a collaborative to function, all participants must perceive a reasonable expectation of benefit**

- ✓ Comments to date identify no reasonably achievable customer or NGDC gain that would motivate NGDCs to voluntarily enter into collaborative discussions
- ✓ Forced collaboration is a contradiction in terms



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**On three fundamental issues, the General Assembly determined that the potential development of competitive residential and small-volume markets was outweighed by the fundamental need to maintain safe, adequate and reliable natural gas service**

- ✓ Capacity assignment
- ✓ NGDC as Supplier of Last Resort
- ✓ 1307 regulation of SOLR rates



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**Capacity Assignment**

- ✓ The loads at issue in the Restructuring Act demand dedicated, firm interstate transportation and storage services: There is no substitute
- ✓ Suppliers have not used their opportunities under the Act to bring dedicated firm capacity to market
  - ✓ Petitions to prevent assignment: § 2204(d)(5)(ii)
  - ✓ Contract renewal: §2204(e)
  - ✓ Meetings with NGDCs: § 2204(f)(2)



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**NGDC as Supplier of Last Resort**

- ✓ For several legitimate reasons, the NGDCs' supplier of last resort ("SOLR") service remains the service of choice for most of the consumers affected by the Gas Restructuring Act
- ✓ Those who support requiring NGDCs to exit the merchant function would disregard the evident preferences of the citizens served by the Act, and instead impose mandatory customer assignments like those in Georgia
- ✓ Collaboration on SOLR is unnecessary



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**1307 Regulation of SOLR Rates**

- ✓ The General Assembly consciously chose to subject SOLR service to regulation under Sections 1307, 1317 and 1318 because of the consumer benefit embodied in the "least cost procurement" standard
- ✓ With natural gas commodity rates already at extremely high levels, calls for making 1307 rates even higher should be dismissed
- ✓ Allegations that NGDCs manipulate 1307 rates or market them as fixed-price services are unfounded



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**Current policies reflect legitimate differences among NGDCs and should not be disturbed**

- ✓ The purchase of receivables should remain optional
- ✓ Creditworthiness and security standards properly vary from NGDC to NGDC
- ✓ Current penalty provisions properly recognize the role of deterrence: cost-based penalties and "no harm no foul" are improper



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**Final remarks**

- ✓ The Commission-approved marketing affiliate standards of conduct have worked without complaint for years and should be maintained
- ✓ Operational issues that were settled in the various NGDC restructuring proceedings should remain undisturbed, and parties should not be allowed to use this proceeding to retract from positions they agreed to in settlement of NGDC restructuring cases
- ✓ The NGDCs respectfully decline to have their services billed by NGSS



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# Pennsylvania Public Utility Commission

## Investigation into Competition in the Natural Gas Supply Market

Docket No. I-00040103

Adrian Pye

Director

Government & Regulatory Affairs

September 30, 2004

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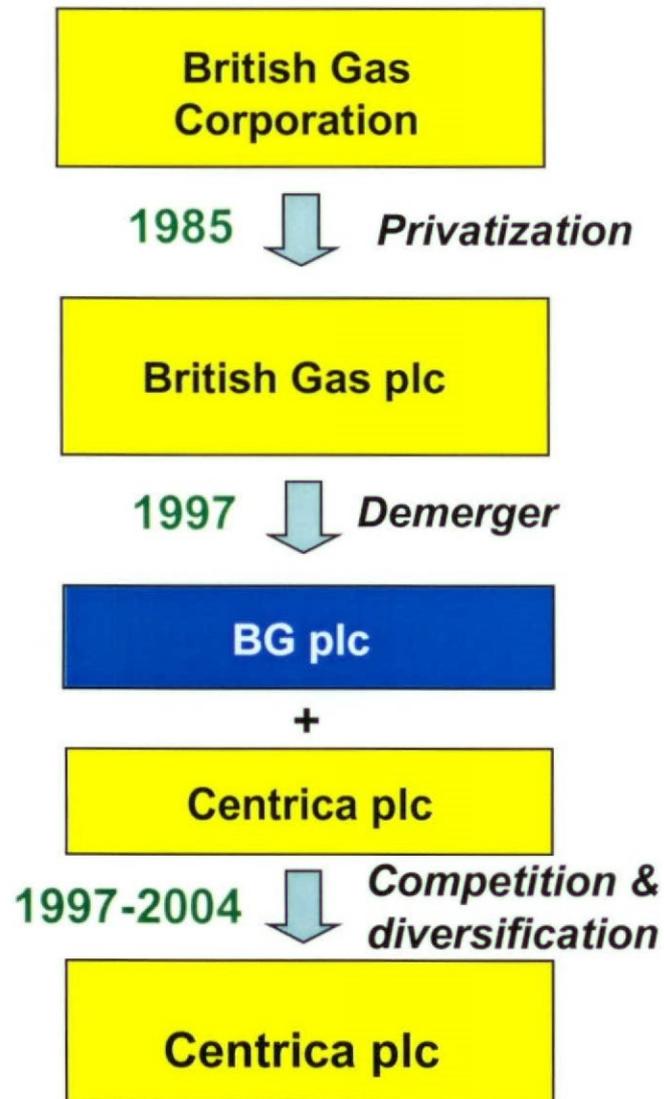
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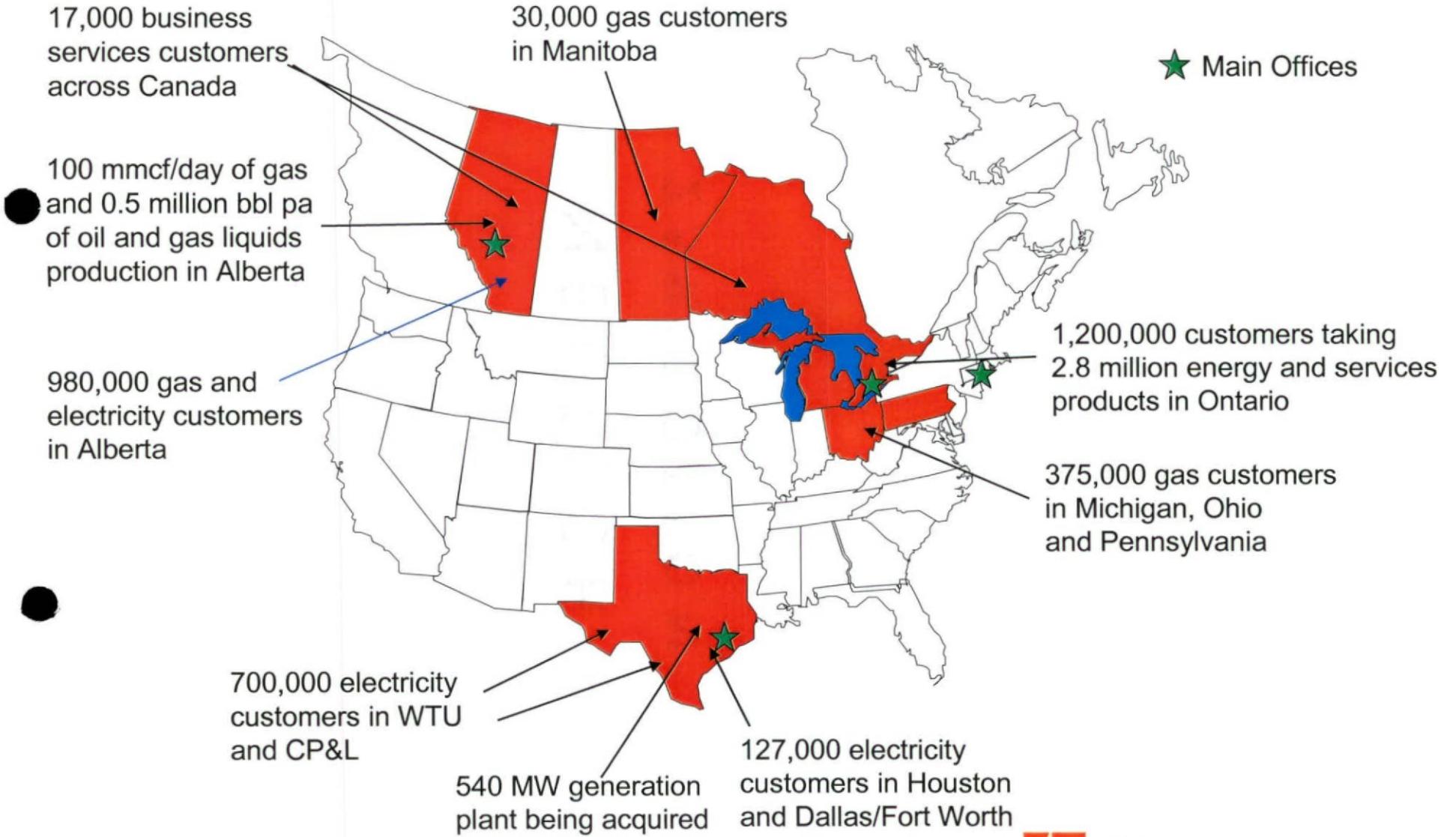
Direct Energy.

## Direct Energy – a Centrica company



- Centrica is a leading provider of energy and other essential services worldwide
  - Serves over 20 million households
  - US\$31bn annual turnover
  - US\$17bn market capitalisation
  - 38,000 employees
  - S&P 'A' credit rating
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## Overall Framework

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- Competition is the law of the land in Pennsylvania
  - it is the right tool to deliver the best service to consumers
  - every decision should be made in favor of more competition, not less
- Supplier Of Last Resort (SOLR) should be:
  - understood as a “last resort” option for consumers
  - designed without anti-competitive or anti-consumer restrictions
  - viewed as a full retail obligation
  - adjusted regularly so the price reflects current market prices
- PUC and local utility rules should:
  - not restrict entry by suppliers
  - not set charges or penalties above utility cost
  - not restrict supplier’s ability to market to or service customers

## Commission's Questions

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- Direct Energy responded to a number of the Commission's questions in its written submission
- By making a number of near term changes the market can be made more competitive
- Direct Energy further examines the issue of the SOLR GCR, the SOLR Provider and competition in this presentation
- On the other issues raised by the Commission, Direct Energy and other suppliers in their submissions, Direct Energy is willing to continue to work with the PUC to create a more competitive natural gas market in Pennsylvania



## Key near term changes to improve the market

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- Gas delivery – have supplier’s deliveries match customer demand with monthly imbalance reconciliations
- Local production – allow suppliers access to this resource
- Customer moves – customers contracts should be able to move with them within their utility area
- Utility Billing fees – these should reflect their cost
- Utility Penalties – these should be market based
- Receivables - utilities should purchase receivables at no discount
- Customer renewals – there should be flexibility in setting the price, terms and conditions of renewal offers and renewal information should be sent between 30 – 90 in advance of the expiration date

## How should the SOLR prices be set?

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- Current SOLR GCR prices do not reflect market prices
- SOLR service must be priced “at market” and adjusted regularly, preferably monthly, to reflect current market prices
- SOLR service must include all costs associated with providing the service, including:
  - All procurement expenses, including cost of carrying storage
  - All Customer Migration expenses
  - All Administrative costs
  - All Operation costs
  - All Customer Care costs
- SOLR pricing should be transparent to allow an understanding of the price and the components that price

## Who should be the SOLR Provider?

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- An alternative supplier can be the SOLR provider per the law (Section 2207 of the Gas Competition Act)
- The Commission should approve alternative suppliers to provide SOLR service to Pennsylvania consumers that have not chosen to receive their gas supply from alternative suppliers
- The PUC should consider a Retail Auction to determine who will act as SOLR provider in each gas utilities territory
  - PUC can define preconditions (e.g., financial security)
  - No reason not to have multiple SOLR providers per territory
  - Direct Energy is the provider of Price to Beat Service to approximately 700,000 electric customers in Texas and is the provider of Default Service to 980,000 gas and electric customers in Alberta, Canada

## When is the Pennsylvania market fully competitive?

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- The Commission should establish a set of objective criteria which, when met, will allow the retail natural gas market to be deemed fully competitive
- In a fully competitive market SOLR prices will be “regulated” by competition
- The criteria could include:
  - High levels of customer awareness
  - The ease with which customers can switch suppliers
  - Levels of customer switching rates



## Conclusion

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- Direct Energy commends the PUC for actively reviewing the gas market
- A few near term changes can significantly improve the market
- Don't assume that the local gas utility must be the SOLR provider
- As can be seen from the level of input and attendance today Direct Energy and other suppliers will work with the PUC and other stakeholders to improve the competitiveness of the market
- Focus on making the most competitive market possible – this will bring the biggest benefits to all consumers

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# Testimony in the Gas Competition Investigation

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On Behalf of the  
Office of Small Business Advocate

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# INTRODUCTION

- Section 2204(g) of 66 Pa. C.S. provides that within five years of the Gas Choice Act's effective date, the Commission "shall initiate an investigation or other appropriate proceeding ... to determine whether effective competition for natural gas supply services exists on the natural gas distribution companies' systems ...."
- If the Commission concludes that "effective competition" does not exist, Section 2204(g) requires the Commission to reconvene "the stakeholders in the natural gas industry in this Commonwealth to explore avenues, including legislative, for encouraging increased competition ...."
- The Act does not define "effective competition" or otherwise specify a procedure for measuring it.

# **“UGLY” SOLR RATES ARE NOT PERMITTED.**

- Nothing in the Gas Choice Act exempts an NGDC from review of its natural gas costs under 66 Pa. C.S. §1307(f), of its least cost procurement policy under 66 Pa. C.S. §1317, and of the justness and reasonableness of its rates under 66 Pa. C.S. §1318.
- If the Commission were to approve an alternative SOLR, 66 Pa. C.S. §2207(f) would require that SOLR to charge “just and reasonable” rates.
- An NGDC has the advantage of being a bulk purchaser when it contracts for natural gas and for the transportation and storage of that gas. If the Commission is adequately enforcing the least cost procurement requirement and is correctly determining the justness and reasonableness of gas cost rates, it would be surprising if NGSs were able to beat an NGDC’s rates for most customers.
- Whether there is “effective competition” can not be determined simply by counting the number of customers who are shopping or by measuring the percentage of gas sold by NGSs. Instead, the determination must rest on whether there are unjustifiable barriers which impede a customer from purchasing from an NGS if that is what the customer chooses to do.

# **PENALTIES FOR NON-DELIVERY SHOULD BE REEXAMINED.**

- As required by 66 Pa. C.S. §2203(12), the Commission has established penalties which an NGS must pay when it fails to deliver the required quantity of natural gas. Those penalties generally include the application of a multiplier to a calculated cost of replacement gas which may far exceed the amount the NGDC actually paid. The penalties vary from NGDC to NGDC.
- It is reasonable to have simple rules for calculating and imposing penalties without having to make evidentiary findings regarding the NGS's motives. Nevertheless, levying the same penalties when there is suspicion of "gaming" as when there is no such suspicion could constitute an unreasonable barrier to entry, in that an NGS must build an excessive premium into its contract price.
- The Commission should consider establishing a two-tier penalty structure for non-delivery, with the higher penalty applicable only in the case of "gaming."
- The Commission should also consider establishing uniform penalties to replace the patchwork of penalties which vary from NGDC to NGDC.

# MANDATORY CAPACITY ASSIGNMENT HAS WORKED WELL.

- Section 2204(d) of 66 Pa. C.S. required that all NGSs serving priority customers take mandatory capacity assignment from the NGDC for a period of three years.
- Section 2204(e) allows NGSs to provide their own capacity as the NGDC's existing capacity contracts expire.
- The end result is that NGSs compete on the commodity – rather than the capacity – portion of the price of natural gas. This approach to capacity has worked very well, allowing NGSs to serve a significant share of the gas market in the Commonwealth, without jeopardizing service reliability or creating stranded costs.
- The Commission should be wary of any proposal which would alter the existing capacity assignment paradigm.

# THE COMMISSION SHOULD MAINTAIN SHOPPING STATISTICS.

- As part of this investigation, the Commission directed the NGDCs and the NGSs to provide shopping statistics for each customer class from 1999 through 2004. This data should not only assist in measuring how much competition there actually is, but could also assist in determining the effect, if any, which specific events and specific changes in regulatory policy have had on competition.
- The Commission should compile and report similar data on a going-forward basis.

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**BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

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

**Testimony of:**

**SONNY POPOWSKY  
CONSUMER ADVOCATE**

DOCUMENT

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OCT 08 2004

**Harrisburg, PA  
September 30, 2004**

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**TO THE MEMBERS OF THE PENNSYLVANIA PUBLIC UTILITY COMMISSION:**

My name is Sonny Popowsky. I am the Consumer Advocate of Pennsylvania. Thank you for permitting me to testify at this *en banc* hearing before the Commission on the subject of natural gas competition in the Commonwealth of Pennsylvania.

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.

This investigation was launched in accordance with Section 2204(g) of the Act, which requires the Commission to initiate an investigation or other appropriate proceeding to determine whether effective competition for natural gas supply services exists in Pennsylvania. The Act requires the Commission to conduct such an investigation five years after the effective date of the Act and to report its findings to the General Assembly.

The OCA has been closely following the development of retail choice for natural gas supply in Pennsylvania by compiling natural gas shopping statistics and preparing shopping

guides to assist customers in making informed choices about their natural gas supply service. In reality, despite some early interest in retail shopping, the vast majority of residential natural gas customers in Pennsylvania continue to purchase their natural gas supply from their incumbent utility providers. The following chart demonstrates the number and percentage of residential natural gas customers who were being served by alternative competitive gas suppliers as of July 1, 2004:

<b>PA Gas Switching Statistics as of 07/01/04</b>			
<b>Company</b>	<b>Total Residential Customers</b>	<b>Residential Customers Served by Alternative Suppliers</b>	<b>Percent of Residential Customers Served by Alternative Suppliers</b>
Columbia Gas	343,706	74,918	21.8
Dominion Peoples	329,091	86,614	26.3
Equitable Gas	240,660	19,902	8.3
National Fuel Gas	199,904	0	0
PECO Gas	418,168	1,732	0.4
PG Energy	140,530	0	0
PGW	481,000	0	0
PPL Gas	65,796	0	0
TW Phillips	55,437	0	0
UGI Gas	268,391	2,995	1.1
Valley Cities	4,655	0	0
<b>Totals</b>	<b>2,547,338</b>	<b>186,161</b>	<b>7.3</b>

As shown in this chart, nearly all the residential customer switching has occurred among the customers of three Western Pennsylvania-based companies – Columbia, Dominion Peoples, and Equitable. The reason for this, I believe, is that those three companies already had substantial retail choice “pilot” programs ongoing well before the 1999 statewide legislation was passed. During those pilot programs, customers who switched from their utility to an alternative gas supplier were exempted from paying the 5% gross receipts tax on their monthly gas bills.

When the Act was passed, however, this advantage was eliminated because the General Assembly eliminated the gross receipts tax on all natural gas service.

For whatever reason, there has been virtually no retail competitive activity for residential customers in most of the remaining natural gas service territories. Even among the three western Pennsylvania gas utilities, the number of customers served by alternative suppliers has decreased by about 20% since the beginning of 2001.

At the outset, I would note that the Commission is undertaking this review during a period of significantly increased wholesale natural gas prices and increased price volatility compared to the 1998-1999 period when retail gas competition was adopted and implemented. Natural gas was trading at the Henry Hub at approximately \$2/MMBtu in 1999, but has fluctuated widely up to \$10/MMBtu in January 2001, down to slightly over \$2/MMBtu again in January 2002 and then a steady increase to over \$5/MMBtu in 2004. Most observers predict that natural gas prices will remain relatively high and that spot market prices will average over \$5/MMBtu for the long term.

I believe that these significant changes in the wholesale natural gas market have likely had an impact on retail natural gas competition for residential customers. Higher natural gas prices and increased price volatility increase the risks, and therefore the costs, that marketers incur when serving retail choice customers. During the course of this investigation, the success or failure of the retail choice market to develop in Pennsylvania must be viewed within the context of these wholesale market conditions and not solely on whether a significant number of retail customers have switched from their incumbent utility to alternative natural gas suppliers.

In general, I believe that residential customers have been and likely will continue to be slow to change to alternative natural gas suppliers for many reasons. There are customers

who are simply unwilling or reluctant to make any change, and others who may believe that the savings on the bill would be too small or too uncertain to undertake the complicated comparisons to make an informed choice. Furthermore, and most importantly in my view, there are relatively few natural gas suppliers actively marketing to residential customers, and even fewer natural gas suppliers who have been able to offer savings to customers. In some NGDC service territories there has been no residential marketing activity at all.

Despite this apparent lack of retail competitive activity, however, I believe that the worst possible result from this investigation would be to take a path that is designed to encourage greater customer switching by either increasing the price or degrading the reliability of the natural gas service that is currently provided to the vast majority of residential customers by their regulated natural gas distribution companies. I am especially concerned with proposals that would take our natural gas distribution companies out of the “merchant” function or would establish pricing mechanisms for our NGDCs that are not based on the least cost gas procurement policies that are currently contained in the Public Utility Code.

When the General Assembly established customer choice principles for residential and small business customers, they 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 the NGDCs’ 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 the NGDCs additional tools with which they could be able to meet those requirements on a cost effective basis.

Pursuant to those statutory provisions, the NGDCs' natural gas purchasing practices continue to be carefully scrutinized by the Commission. Moreover, as the Commission well knows, the NGDCs receive no retail profit on the sale of the gas commodity. They simply pass through the wholesale gas costs to retail customers on a dollar for dollar basis, with no markup. If the NGDCs and the Commission have been doing their job – that is, by following and enforcing a least cost gas policy under which wholesale gas costs are flowed through to customers 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, escalating wholesale natural gas market in which the utilities are buying their gas, thus increasing their costs of serving retail choice customers. In addition, marketers face additional costs in order to acquire customers, serve customers, and earn a profit on the sale of the gas.

I also believe that the relatively low numbers of Pennsylvania residential customers who have opted to take natural gas supply service from an alternative supplier is partly a reflection of how difficult it is for many residential customers to shop for natural gas supply service in a volatile, confusing marketplace. Customers must first make a determination of what they are paying for that portion of their natural gas supply service that is subject to competition, *i.e.*, the “price to compare.” Even though the price to compare is generally available from the NGDC, or from other sources such as the OCA Shopping Guides, it is still no easy task for a typical residential customer to make a comparison of an NGS offer when the NGDC's price to compare changes on a quarterly basis. This is especially true when it can take

up to 45 days or more for a switch to an alternative supplier to take place. In the interim, a quarterly update by the NGDC could turn what looked like a good deal into a bad deal before the term of the new contract with the NGS even commences. Such situations lead to customer confusion and frustration with the retail choice process. Such problems are not as prevalent in the electric choice programs, since the electric generation “price to compare” is set on an annual basis and has generally been determined well in advance. This makes it easier for customers to shop and make meaningful comparisons to offers in the competitive market. In addition, electric distribution company generation rates are not reconcilable for over- and under-recoveries and are not subject to migration riders as is the case for natural gas supply service.

With this background, I would submit that the focus of this investigation should not be solely on efforts to increase the level of retail choice activity in Pennsylvania. While encouraging the benefits of increased retail choice is an important goal in this investigation, it is more important to ensure that consumers are not made worse off by the single-minded pursuit of this goal. The intent of the Act was to provide benefits to consumers by introducing retail choice to Pennsylvania, not to harm them by increasing natural gas cost rates and volatility or diminishing service and reliability. The Act provided small natural gas users with greater direct 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 a retail marketer is able to provide lower prices or other benefits, such as longer term fixed price contracts, customers in at least a few Pennsylvania service territories are free to switch suppliers.

I would strongly urge 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 NGDCs 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 deregulate those prices entirely. That cure, I think, is worse than the disease. 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 are already suffering enough as a result of 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.

There have been various recommendations made by other commenters in this investigation, particularly by members of the marketing community, that I would like to briefly address.

First, I share the concerns of those commenters who pointed out the difficulty that they have in competing with the quarterly adjusted, reconcilable “price to compare”, though I strongly disagree with some of the marketers’ proposals to address this problem. I also agree with those customers who suggested that greater uniformity among NGDCs on a variety of

administrative and substantive areas, including the use of consistent electronic data protocols, would be beneficial. I also have no objection to recommendations calling for the purchase of NGS receivables by NGDCs at an appropriate discount rate, as long as such programs do not impose additional costs on other customers and do not compromise consumer protections for affected customers.

I am adamantly opposed, however, to any suggestions that the goal of this proceeding should be to force or encourage our NGDCs out of the market function or that we should abandon the least cost gas requirements on NGDCs in favor of a monthly “market-based” approach in which NGDC purchased gas rates would be established on the basis of an external market index. I am also opposed to suggestions that the cost to consumers of NGDC gas supplies should be increased through the addition of administrative adders or returns on the sale of gas. There is absolutely no evidence that residential natural gas customers would be better off if they were to lose the option of a regulated, cost-based, no-markup, natural gas service. To the extent that customers can benefit from the additional choices made possible by the Act and by the entrepreneurial skills of unregulated marketers, then that would certainly be a positive development. But the idea that retail customers, particularly residential customers, should be exposed to a highly volatile wholesale natural gas market, in which no entity has the obligation to provide service under a least cost procurement mandate is, in my opinion, totally unacceptable.

I am also opposed to the suggestion that residential customers be “assigned” to marketers, as suggested in some comments, unless there is absolute assurance – as was provided in the Pennsylvania electric restructuring settlements -- that such customers will receive reliable service at rates that are no higher than the default service provided by the regulated utility. Even

then, I would note that the Commission's experience with New Power's "competitive default service" in the PECO Electric service territory would hardly serve as a ringing endorsement of customer assignment as a means of promoting retail competition.

Finally, while I do not oppose the purchase of NGS receivables by NGDCs under the conditions noted above, I would certainly oppose the recommendation that such a program be coupled with the implementation of a "bad debt tracker" for all NGDC uncollectible expense, as suggested in some comments. This type of reconcilable uncollectibles clause is not permitted by the Public Utility Code and should be rejected on a host of legal and policy grounds. This Commission has recently reached the same conclusion in its unanimous decision to reject the PGW Cash Receipts Reconciliation Clause as violative of the Public Utility Code and as bad public policy.

In closing, I would respectfully urge the Commission to report to the General Assembly that while retail shopping has not been prevalent for residential natural gas customers in most parts of Pennsylvania, there should not be any changes in law or Commission policy that would harm the very consumers that the Act was intended to benefit. That is, the Commission should not endorse any proposals that are designed to increase customer switching at the expense of forcing the majority of customers to pay higher rates or receive less reliable service.

Thank you again for permitting me to testify. I would be happy to respond to any questions that you may have at this time.