Prepared Testimony of

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Introduction

Good morning Chairman Godshall, Chairman Caltagirone, and members of the House Consumer Affairs Committee. I am Gladys Brown, Chairman of the Public Utility Commission (Commission or PUC). I am here today, on behalf of the Commission, to offer testimony concerning House Bill 107 (HB 107), which would authorize a Natural Gas Distribution Company (NGDC), with PUC approval, to implement a 'distribution system extension charge' on customer bills in order to recover the costs of extending service to unserved and underserved areas.

Overview/Commission Priorities

The Commission is committed to addressing our key public safety and regulatory oversight responsibilities – which balance the need for safe and reliable utility service with the importance of maintaining just and reasonable rates – while continuing to encourage innovation and new programs that benefit Pennsylvania consumers.

Presently the PUC regulates 27 NGDCs and oversees 250 natural gas suppliers. When it comes to the energy sector, the Commission endeavors to take a holistic approach:

- Encouraging modernization and improvement of utility infrastructure to help ensure safe and reliable service, as well as to provide greater access to unserved or underserved areas.
- Exploring the future of utility ratemaking, including how to best maintain safe and reliable infrastructure while also encouraging more aggressive energy efficiency and conservation programs.
- And ensuring the reliability and resiliency of utility service in the face of growing physical and cyber threats – often called "Black Sky" events.

Natural Gas Growth

Natural gas plays a prominent role in Pennsylvania's robust energy sector. According to the U.S. Energy Information Association, Pennsylvania is the second largest natural gas production state in the country, following only Texas. A keystone to the Commission's mission is the prudent development of a robust gas distribution grid. In support of this mission, we continue to evaluate and administer policies that will foster prudent infrastructure development. There are approximately three million natural gas customers in the state. This number may seem significant, but the Commission maintains there is room for growth and will strive to see that achieved in an economically responsible manner.

The quantity of natural gas distribution mains in Pennsylvania has increased by about 3.2% over the past decade. This reflects more than 1,500 miles, or 7.9 million feet, of new lines serving business and customers across the state. When analyzed on a company basis this growth varies. The UGI Companies (including UGI Utilities Inc, UGI Central Penn Gas, and UGI Penn Natural Gas) have grown nearly 6% over the past decade. To the contrary, Philadelphia Gas Works (PGW) has seen a *de minimis* growth rate since it already serves the vast majority locations within its dense urban service territory.

The PUC continually challenges NGDCs operating within unserved or underserved territories to creatively propose means that can bring natural gas to more Pennsylvania businesses and homeowners. NGDCs have pro-actively responded to that call-to-action. Under traditional gas extension policy, NGDCs will determine an economic cost of investment based on a net-present value economic analysis. Any cost to extend service above this amount must be paid up-front by prospective customers in order to finance the entire extension. While this traditional method still works, there are often cases where prospective customers must pay up-front costs totaling thousands of dollars. Such capital outlays can be prohibitively expensive for residents and businesses. Newly designed financing programs take this up-front cost and amortize it over a number of years, making the costs more manageable. The programs represent alternative, but not replacements, to traditional NGDC service extension financing. Presently, eight NGDCs offer some form of alternative financing for the extension of gas service.

The UGI Companies Growth Extension Tariff pilot program (GET Gas) allows eligible customers to pay the extension costs over 10 years as an on-bill monthly charge. The most recent reporting from the UGI Companies, submitted in November 2016, indicates that the first two years of their Growth Extension Tariff pilot program (known as GET Gas) resulted in 36 projects, involving the installation of more than 18.7 miles, or 99,000 feet, of gas mains. Another 74 projects are planned through 2018, involving a total investment of over $22 million.

PECO's Neighborhood Gas Pilot Program, approved by the Commission in October 2015, is a three-year, $10 million pilot program that allows new gas customers to pay a fixed, monthly surcharge, rather than a large up-front payment, for the cost of extending natural gas service to their properties. Additionally, the PUC approved changes in PECO's process for calculating any required customer contribution. Here the Commission extended the net-present value from 15 years to 40 years to more accurately reflect the economics of natural gas service from the company prospective. This revision permits the inclusion of 25 years of additional customer revenue in the company's analysis thereby helping to reduce the up-front payments for connection to PECO's gas mains, if they so choose the traditional up-front payment method.

The New Area Service (NAS) pilot program, approved in 2014 for Columbia Gas of Pennsylvania, allows customers to pay the extension costs over 20 years as an on-bill monthly surcharge. The monthly surcharge will remain the same for twenty years or until the customer pays off the remaining balance, whichever comes first. According to the most recent report on the NAS program submitted by Columbia, covering 2015, the effort has resulted in nine projects involving approximately 1.5 miles, or 7,600 feet, of distribution main, at a cost of nearly $600,000 for new mains and service lines.

The Peoples Natural Gas Companies (including Peoples Natural Gas Company LLC, Peoples Natural Gas Company LLC – Equitable Division, and Peoples TWP LLC) are in the midst of a five-year Service Expansion Tariff (SET) pilot program, which allows eligible residential customers to pay the extension costs through a monthly fixed fee of $55 until the outstanding principal balance is zero, for a maximum of 25 years. If necessary, a customer may pay a portion of the extension cost upfront in order to bring the financing period down to 25 years. Residential customers also have an option to pay the costs for the service line through an additional monthly fee of $15, until the outstanding principal balance of the service line cost is zero.

Natural gas development is not only fueling growth of existing companies, but also the creation of new enterprises. Leatherstocking Gas Company (Leatherstocking) was certificated as a new NGDC in 2012 and now serves a growing number of residents and businesses in Susquehanna County. Leatherstocking's formation addressed demands for access to shale gas being produced in that region. Leatherstocking is the first new NGDC to gain PUC certificated authority in more than a half-century.

Pennsylvania is not alone in the quest for new ideas to address access to lower-cost energy – and we are actively working with our colleagues across the country. Just a few days ago, Commissioner John Coleman was named as the co-chair of a new committee created by the National Association of Regulatory Utility Commissioners

(NARUC) to explore natural gas access and expansion. The task force was an initiative led by another of our Commissioners, Robert Powelson, who currently serves as NARUC President. Commissioner Coleman and the NARUC Task Force will be working to help us all better understand the barriers and obstacles to the expansion of natural gas service.

Accelerating Replacement of Aging Infrastructure

While answering the call to extend natural gas service is a priority, the Commission's ultimate responsibility is to foster a safe and reliable natural gas distribution and transmission network. The Commission's Pipeline Safety Division monitors over 47,000 miles of distribution lines and over 1,100 miles of intrastate transmission lines.

Pennsylvania's distribution system still consists of a significant amount of at-risk pipe, predominantly populated by unprotected steel and cast iron lines. Over 10,000 miles of the state's distribution system can be categorized under the federal government's definition of "at risk." This represents approximately 22 percent of total distribution mileage.

In an effort to reduce this figure, the Commission has approved long term infrastructure improvement plans (LTIIPs) for six NGDCs. These plans lay out the timeline for replacement of all at-risk pipes. Most utilities have a range of replacement from 17 years to 28 years, and the Commission continues to take every opportunity to encourage efforts to further reduce those timeframes.

Key components of the statewide effort to accelerate the replacement of aging and at-risk pipes are the Fully-Projected Future Test Years (FPFTY) and the Distribution System Improvement Charge (DSIC). Act 11 of 2012 allowed NGDCs to use FPFTY when setting base rates. The FPFTY permits utilities to set rates based on a projected 12-month period. The projections are then audited by the Commission to make sure projected costs match actual costs. Each NGDC rate case filing made since the passage of Act 11 utilized a FPFTY. Act 11 also permitted NGDCs to establish a DSIC to facilitate infrastructure upgrades. DSIC has become a useful tool in accelerating the replacement of at-risk natural gas infrastructure. Upon the expiration of a FPFTY NGDCs can begin utilization of the DSIC to recover eligible expenses up until reaching the 5% customer protection cap. When used together the FPFTY and the DSIC can significantly reduce the amount of time that elapses from when an NGDC incurs infrastructure improvement costs to when it recovers said costs; otherwise known as regulatory lag. Resulting is a rate-making environment that instills safe service while affording the utility a reasonable opportunity to recover prudent costs; a win-win scenario.

Since the DSIC permits the recovery of additional costs outside of a base rate case its application involves a number of checks and balances. These include:

- Submission of a LTIIP to act as a road map and benchmark for planned infrastructure improvements.
- Filing annual asset optimization plans summarizing progress under the LTIIP.
- Filing of a DSIC tariff, including certification that a base rate case has been filed within the past 5 years.
- Establishing DSIC percentages on a quarterly basis.
- Reconciling DSIC recovery on an annual basis.
- Capping the DSIC at 5%, unless waived by the Commission.
- Resetting the DSIC to zero upon the determination that the NGDC is already earning an adequate return on its investment, as determined by the Commission each quarter.
- Resetting the DSIC to zero as of the effective date of tariff rates based on a FPFTY.
- Auditing the DSIC at intervals determined by the Commission.

FPFTYs and the DSIC have fostered a substantial increase in NGDC infrastructure spending. In 2006, the total amount spent was approximately $100 million. In 2015, that number increased to over $440 million. The Commission believes it is essential to continue this momentum.

House Bill 107

HB 107 provides NGDCs a tariff mechanism, the Distribution System Expansion Charge or more simply the 'expansion charge,' that socializes the costs of service extensions to unserved and underserved areas. This deviates from the existing policy for extension cost recovery, which places such costs directly on new customers. Presently the Commission does not have a position on HB 107. However, I will provide my thoughts on key components of the bill. These thoughts are consistent with the correspondence I sent to you on April 8, 2016 related to House Bill 1946 of the 2015-2016 session.

I believe efforts by NGDCs, the Commission, and the Legislature to provide increased access to natural gas are noble and valuable endeavors. Such efforts, however, must be balanced with the need for replacement of existing at-risk infrastructure. To that end, I'm supportive of making any system expansion charge a separate and distinct charge from that of the DSIC. This will avoid any commingling of replacement costs with expansions costs and facilitate the Commission's continued efforts to have NGDCs target at-risk pipeline replacement.

I'm supportive of establishing customer protections for any system expansion charge, including establishing a cap in a manner analogous to the DSIC cap. A cap percentage lower than the 5% DSIC cap would be most appropriate, again so NGDCs can focus a majority of capital expenditures on existing at-risk replacement projects.

I'm also supportive of placing requirements on NGDCs to assure system expansion charges are designed in a manner which doesn't unreasonably burden existing customers. Consequently, it may be advisable to give the Commission latitude to consider a cost-effectiveness or cost-burden test for NGDCs to use in determining which projects are advanced under any system expansion charge financing mechanism. Absence of such a test may result in existing customers financing extensions with an extremely negative net-present value for the NGDC. Under NGDCs existing LTIIPs the companies are required to make pipeline replacement investments at the areas of highest risk and consequence. In a similar fashion, having NGDCs design an expansion plan detailing planned extensions in the areas justified via economic tests may act as a customer protection.

I do have concerns with permitting cost recovery within the expansion charge of rebates or buy-downs for behind-the-meter equipment, such as in-house piping or furnaces. While such subsidies will indeed make the costs of converting to natural gas more manageable from the new customer prospective, these costs will ultimately be borne by the existing customer base with no discernable benefit to them or any utility owned and operated infrastructure.

As well, consistent with present rate-making principles, it may be beneficial to permit the calculation of separate expansion charges for rate-classes. This can help to avoid cross-subsidization between rate classes and is consistent with the design used for existing NGDC extension pilots. Further, allowing NGDCs to design a cap, by rate class, on the amount of expansion charge financed dollars per account may also serve as a necessary customer protection.

Closing

The landscape of efforts to address our natural gas infrastructure issues, involving both new and old portions of these systems, is as diverse as our Commonwealth.

The construction of distribution networks is expensive and time-consuming, and those projects must be carefully evaluated to ensure that they are economically viable and sustainable. Compelling the state's existing natural gas customers to subsidize the cost of connecting new customers, when those expenses have traditionally been the responsibility of new customers, is a substantial and possibly contentious change – with the potential of pitting existing residents against new arrivals, old neighborhoods against new developments, and aging communities against growing regions.

Typically, this process has been reserved for matters of public safety – such as funding for replacement of at-risk pipelines or programs to assist low-income households – and, even then, there is often opposition. Given the size and scope of ongoing efforts to expand access to natural gas service for Pennsylvania consumers and businesses, including utility initiatives and Commission-approved pilot projects aimed at reducing costs, I urge caution in any approach that would place a new or undue burden on ratepayers. Additionally, it is imperative that we continue to accelerate the replacement of aging infrastructure, which we can all agree must be a top priority.

As always, this Commission is at your service, should you have any questions.