BEFORE THE PENNSYLVANIA HOUSE CONSUMER AFFAIRS COMMITTEE

Testimony Of

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Regarding
House Bill 107

Harrisburg, Pennsylvania
April 26, 2017

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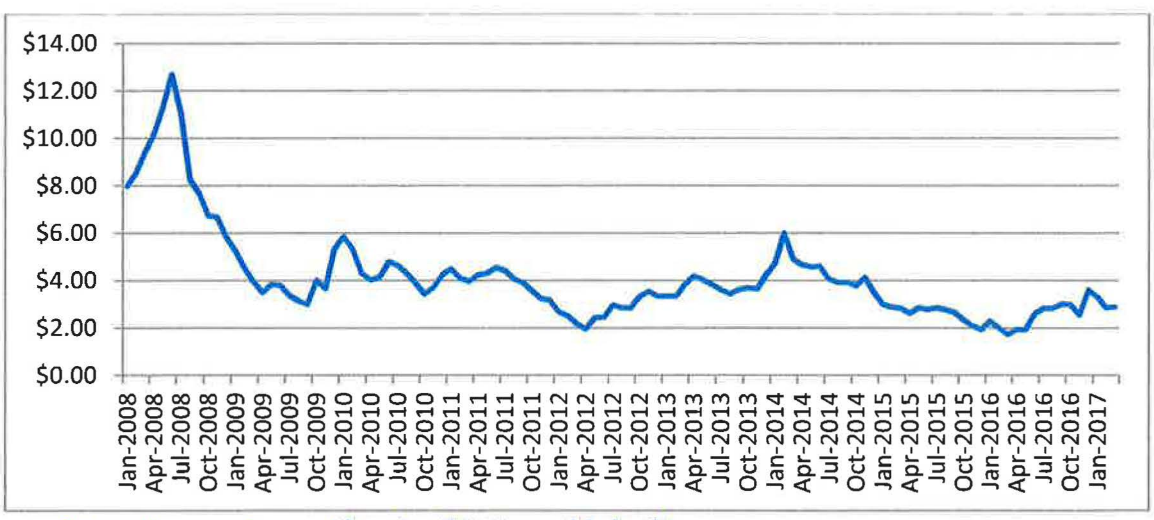
Chairman Godshall, Chairman Caltagirone
And Members of the House Consumer Affairs Committee

My name is Tanya McCloskey. I have been serving as the Acting Consumer Advocate of Pennsylvania since 2012 and 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 House Bill 107 providing for the recovery of natural gas distribution system extension costs.

The extension of natural gas service to unserved and underserved areas of Pennsylvania has been a matter given consideration here at the General Assembly and at the Public Utility Commission over the past few years. 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, wholesale natural gas prices have declined dramatically since the record highs seen in the Summer of 2008 and have remained at these lower levels. The chart below shows the price of 12-month contracts for natural gas purchased at the Henry Hub in Louisiana from January 2008 to present.

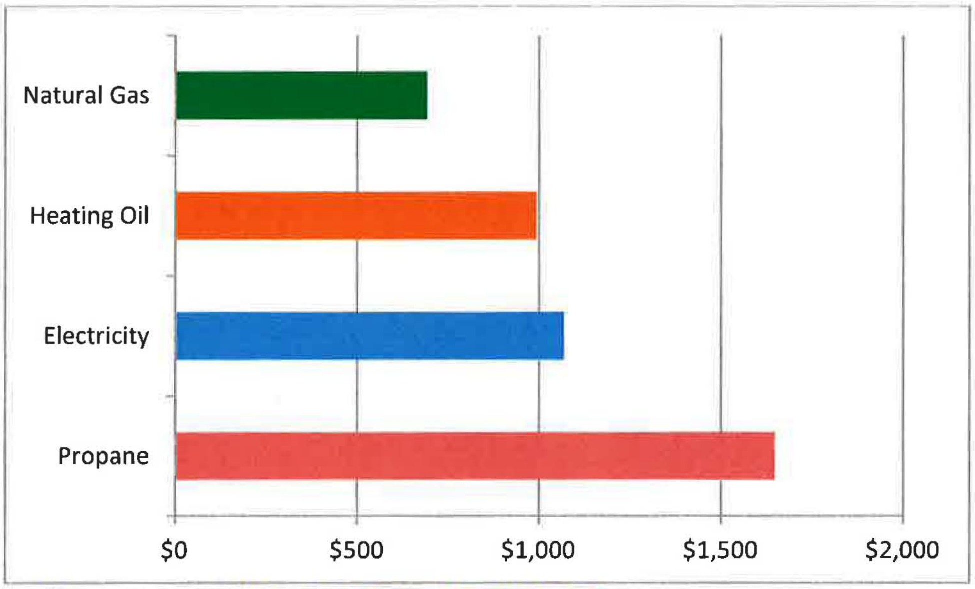
Henry Hub Natural Gas Spot Price (Dollars per Million Btu)



Source: https://www.eia.gov/dnav/ng/hist/rngwhhdm.htm

The impact of these lower natural gas prices on a household heating bill can be significant. The chart below shows the average expenditure for heating a home during the Winter of 2015-2016 with natural gas, oil, electricity and propane.

Average Expenditures for Heating Fuels During the Winter of 2015-16



Source: https://www.eia.gov/outlooks/steo/tables/pdf/wf-table.pdf. Note that the U.S. Energy Information Administration's average consumer winter heating expenditure summary provides information for Electricity, Propane and Natural Gas that reflects average expenditures in the Northeast, while Heating Oil reflects national averages.

As can be seen, during the winter of 2015-2016, households could save between about $300 to $900 a year by using natural gas to heat their homes depending on their current heating fuel source. I would caution, however, that the price of natural gas will not stay at these historically low levels forever and prices of other deliverable fuels will change as well. As to natural gas prices, we have recently seen projected increases in the cost of purchased gas for the winter of 2017-2018 by our natural gas companies in Pennsylvania. I would also note that the price of oil dropped in 2015 and has remained at these lower levels through the winter of 2016-2017.

The primary reason that many rural areas do not have natural gas service is that even though the current price of natural gas is low, the cost of building pipelines to sparsely populated areas can be very costly. It is more economical to serve 100 or 1,000 customers in a densely populated area than it is to serve 10 or 20 in a more sparsely populated area. Natural gas presents a particular challenge because unlike other forms of utility service, customers 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.

It is important to recognize that 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 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 paid for by all customers over time.

While the economic test is an important protection for existing consumers, the outcome often presents a significant barrier to extending mains to unserved and underserved areas. In many cases, the portion deemed to be uneconomic can be significant, resulting in customer contributions in the thousands of dollars for a main extension to move forward. As an initial matter, it is critical to revisit the tests being utilized by the utility in determining the economics of main extensions to assure that the test and all assumptions are reasonable.

The Commission has recently approved a number of pilot programs offered by Pennsylvania's natural gas distribution companies designed to address the impact of these high contribution amounts by allowing the customer to pay this amount as a monthly charge on their bill rather than as an up-front, lump sum payment. My Office has worked with the utilities in designing these pilot programs and we are anxiously awaiting the results. These pilot programs vary in design which may give us a better understanding of how to best meet the needs of customers in unserved and underserved areas.

This brings me to House Bill 107 and the creation of a surcharge mechanism to support natural gas main extensions to unserved and underserved areas of Pennsylvania. House Bill 107 appears to be designed to provide an alternative means to fund natural gas main extensions and overcome some of the barriers associated with the cost of such main extensions. The use of a narrowly tailored, properly designed surcharge mechanism that contains adequate consumer protections could be one tool to provide to the Commission to address natural gas main extensions that will bring benefits to consumers and the Commonwealth. To achieve this purpose, House Bill 107 requires additional discussion, clarification and consumer protections. I will address in this testimony some of my concerns and I look forward to a continuing dialogue to address the issue of natural gas main extensions.

An important point that should be clarified in House Bill 107 is the difference between the economic portion of the main extension and the uneconomic portion of the main extension. The bill should also clarify whether the surcharge is intended to apply to all existing customers or is limited to the customers in the new area being served. Both of these clarifications have important policy implications and consumer protection implications.

In my view, by definition, there is no compelling need for surcharge recovery of the economic portion of a main extension. The economic analysis determines whether the revenues provided by the new customers hooking up to the main are sufficient to pay the main extension cost. If economic, the revenues provided by the customers are sufficient to pay the customers' fair share of the main extension cost and the company begins to receive those revenues with the first bill issued to the customer. It is the uneconomic portion of the main extension that presents a barrier to the new, connecting customer as the customer is often asked to make a large up-front payment or to pay a monthly surcharge for an extended period of time.

If the uneconomic portion of the main extension is being included in a surcharge, issues of fairness to existing customers are raised based on whether the surcharge is applied to all existing customers or only to customers in the new area. Issues of fairness are also presented if the surcharge is used to recover costs that are the responsibility of the homeowner, such as the furnace and appliance conversion costs and the customer-owned service line costs. Conversion costs and customer-owned service line costs can improve the value of the home to the homeowner so asking other ratepayers, whether existing ratepayers or only new area customers, to pay these costs raises issues of fairness and reasonableness.

Several states use a New Area Surcharge approach where the cost of extending the main to the new area (or areas) is reflected in a surcharge to the newly connecting customers over a period of years.[1] This approach treats all customers within the new area similarly and avoids undue burden on existing customers. If the uneconomic portion of the main is to be charged to all existing customers, however, existing customers are being asked to support a utility cost that may not provide benefit to those ratepayers. The recovery, though, will add to

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[1] See, *e.g.*, Minnesota (New Town Rate), Florida (Area Expansion Program Surcharge), Georgia (Integrated Customer Growth Program), Utah (Extension Area Charge).

the overall profit to shareholders if the utility is provided a return (*i.e*, a profit) on this additional plant investment paid for by customers. If this is the path intended by House Bill 107, I would urge that limits be placed on any sharing of the burden as well as the types of costs, and that standards be established that would support such a sharing. For example, in some states, before any surcharge can be imposed, either in the new area or on existing customers, there must be a showing that the main extension will contribute to the economic development of the newly served area. Other public policy goals, particularly those related to providing public utility service to certain areas, such as rural areas, and to benefit customers, could also be standards set forth in the legislation. [2]

I would also recommend that if such surcharge recovery is to be permitted, that natural gas distribution companies wishing to pursue a surcharge should be required to submit a plan for the extension of mains in their service territory, similar to the Long Term Infrastructure Investment Plans that accompany the distribution system improvement charge (DSIC). A coordinated plan to expand the service territory will better ensure that expansion is being done in the most efficient and cost-effective manner. This is particularly important if existing customers are bearing the cost of a portion of this expansion.

Another critical issue is the need to provide adequate consumer protections within House Bill 107. I would suggest consideration of similar consumer protections to those contained in Act 11 of 2012 that implemented the Distribution System Improvement Charge. 66 Pa.C.S. §§1350–1360. Act 11 of 2012 contained several types of consumer protections that

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[2] While as a general matter it is not reasonable to ask one group of ratepayers to subsidize service to another group of customers, when talking about the basic infrastructure used to provide utility service, some accommodation may be needed. At one time or another, virtually every public utility consumer was a "new" customer and received the benefits of a utility system that was previously paid for by existing customers. Even existing customers are not expected to pay the exact costs to service their own location as traditional public utility rates are based on historic embedded costs averaged across all customers in a particular rate class. Clear standards, however, should be established for making these determinations for the extension of natural gas mains.

should be reflected in House Bill 107. First, Act 11 of 2012 contained very specific categories of cost that could be recovered through the DSIC and made clear that recovery of those costs only occurred after the plant was placed in service (*i.e.*, used and useful). 66 Pa.C.S. §§1351, 1357. A similar specification of the costs and the timing of recovery are consumer protections needed for any surcharge regarding main extensions costs. Second, I would additionally commend to you Sections 1353, 1354, 1358 and 1359 of the DSIC mechanism that establish important procedures, notices and consumer protections that should be considered for any surcharge regarding natural gas main extensions.

House Bill 107 does include a critical consumer protection, a cap on the level of the surcharge. If assessed to all customers, however, the cap on the surcharge for natural gas main extensions should be a "hard cap" and should be limited to a percentage of distribution charges only. That is, there should be no waiver associated with this cap. While the General Assembly provided for a potential waiver of the DSIC cap in Section 1358, this waiver is only to be granted if it is necessary to ensure and maintain adequate, efficient, safe, reliable and reasonable service. Main extensions do not raise the same issues of public safety that were presented by the DSIC mechanism. Providing for a waiver at all, and particularly a broad waiver without any meaningful limitations, does not adequately protect consumers.

I also recommend that any cap be set at a much lower level than the 2.5% of the total amounts billed under the applicable rates contained in House Bill 107. The current cap for the distribution system improvement charge contained in Section 1358 is set at 5% of the distribution charges of an NGDC. Given the significant focus on repairing and improving the safety of our existing infrastructure, it may not be possible or reasonable to expect expenditures of an additional 2.5% on main extensions. Under our current main extension Pilot Programs, our

NGDCs are targeting main extensions in the neighborhood of $1 million to $5 million per year. It also does not seem reasonable to require existing customers to support such significant additional expenditures if they are to pay the surcharge when they are also supporting significant expenditures through the DSIC.

I have touched here on some of the larger issues presented by House Bill 107. These forms of surcharges raise many other questions that should be addressed by House Bill 107. While not an exhaustive list, other questions that should be further discussed include how to address the non-payment of the surcharge by customers, what interest rate is included in the surcharge during any repayment period, and whether there should be a standard definition of an underserved area. A careful balancing is needed to produce a result that is just and reasonable for all.

Before closing, I would like to mention initiatives in other states. Several states have addressed this problem through various initiatives. As I mentioned, some states have implemented New Area Surcharges that apply to customers in the new area for a period of time. Some states have sought to share the burden between the customers, communities receiving service and the state. North Carolina, for example, provides for the issuance of general obligation bonds for natural gas extensions that are feasible (N.C. Gen. Stat. Sec. 62-159) and 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 also enacted legislation authorizing the Financing 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). Another approach seen in Maine is to try to secure a large anchor customer in a region first. By securing this large customer, the economics of the main extension as well as the economic development benefits can be secured. Utilities should also be encouraged 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.

I want to thank you again for inviting me to participate in this hearing. I look forward to working with the Committee on House Bill 107.