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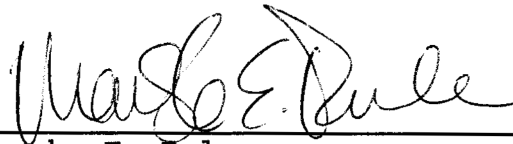
BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Unbundling of Natural Gas Services	)	Docket No. 960725-GU
	)	Filed: 09/25/96

ASSOCIATED GAS DISTRIBUTORS OF FLORIDA'S POST-WORKSHOP COMMENTS

Associated Gas Distributors of Florida hereby files the attached post-workshop comments.

Respectfully submitted this 25th day of September, 1996.



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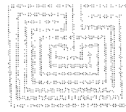

CONSOLIDATED COMMENTS OF ASSOCIATED GAS DISTRIBUTORS OF FLORIDA IN RESPONSE TO FLORIDA PSC STAFF UNBUNDLING WORKSHOP ONE

September 24, 1996

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CONSOLIDATED COMMENTS OF ASSOCIATED GAS DISTRIBUTORS OF FLORIDA IN RESPONSE TO FLORIDA PSC STAFF UNBUNDLING WORKSHOP ONE

PREFACE

Reed Consulting Group (RCG) prepared these comments on behalf of the Associated Gas Distributors of Florida (AGDF) based on both a consolidation of comments from AGDF members and RCG's experience in other jurisdictions. The comments do not necessarily reflect precisely the position of each individual member of the AGDF, however. Such a precise reflection of individual company positions would require a duplication of the individual company comments, which would, of course, be redundant. These comments help to frame the issues and provide additional perspective and information to inform the process, but at the same time reflect an overall position consistent with the tone of the gas distributors' viewpoints.

The AGDF's overall position with regard to unbundling can be divided into five topics: flexibility, individuality, appropriate pace, cost recognition, and retention of control of essential resources. These elements are briefly expanded below and are reflected throughout the comments on the individual issues.

Flexibility: Individual company operating circumstances vary and individual managements have different approaches to providing customers with safe, reliable service. Thus, the distributors take the position that many of the questions that imply additional new "requirements" that may restrict their ability to serve their customers most effectively, as opposed to "allowing" for the adoption of the necessary tools to facilitate unbundling where appropriate, unduly impinge on management prerogatives.

Individuality: Each member of the AGDF is in a different position with regard to important factors such as size, customer mix, and resources. This means that "one size fits all" solutions would not be appropriate and that unbundling programs should be designed with individual company circumstances in mind. In fact, further unbundling may not make sense at all for some of the smaller LDCs.

Appropriate Pace: The appropriate pace of unbundling will vary from company to company depending on size and type of customers, current levels of unbundling, available metering and computer technology, human resources, timing of ratemaking proceedings, etc. It is important to all companies that new and untested concepts not be mandated for implementation on an unreasonable timetable.

Cost Recognition: To the extent that new costs, such as new metering or accounting costs, or different categories of costs, such as stranded cost, or costs that are now embedded in bundled services, such as standby service costs, are identified, these costs must be recognized and included in the prices of regulated services.

Retention of Control of Capacity: The LDCs are unanimous in their concern about ensuring that firm, primary capacity of sufficient magnitude be continuously available to serve the needs of their firm core customers in the future, irrespective of the commodity supplier's identity. Due to a lack of localized peaking resources and their heavy dependence on a single pipeline, if capacity entitlements are transferred off-system, individual LDCs could potentially face serious operational problems during peak requirements periods unless capacity continuity, matched to customer needs, is maintained. (The capacity must follow the customer.)

These comments also describe, in places, an end-state for unbundling in which the LDC "exits the merchant function." This means that the regulated LDC no longer sells gas to the end-user at all. Marketers sell the gas and the LDC provides distribution and ancillary services. This arrangement is the essence of the unbundled model at the federal level. Many of the questions associated with several issues clearly do not contemplate such an end-state and thus are responded to in the implied context. For example, if one asks, "should the LDC be allowed to require a waiting period for transportation customers wanting to return to bundled services?", the clear implication is that there are bundled services to return to. There is no compelling reason for this to be the case, thus individual LDCs should be able to opt to exit the merchant function on a class-by-class basis and to establish a deregulated subsidiary to compete with all other marketers on an equal footing to sell gas to the customers in the unbundled service classes.

The AGDF members have not adopted the "exiting the merchant function approach" at this time; instead, they are studying this model and believe that it should be one option available to them if practical and if reasonable rules can be established for implementing such an approach.

CONSOLIDATED COMMENTS OF ASSOCIATED GAS DISTRIBUTORS OF FLORIDA IN RESPONSE TO FLORIDA PSC STAFF UNBUNDLING WORKSHOP ONE

Obligation to Serve/Service Offerings

1. Should the Local Distribution Company (LDC) be required to be the supplier of last resort?

Before answering, it is necessary to define what is meant by "supplier of last resort." This term has become a central issue as LDCs develop and expand their unbundled service offerings. However, there are distinct differences in the LDC's responsibility to act as supplier of last resort depending on how it is defined. "Supplier of last resort" is often, but perhaps imprecisely, used to describe both of the following:

- the party responsible for delivering gas on demand to end-users; or
- the party responsible for procuring gas for end-users unable or unwilling to procure their own gas or for whom the open market determines to be unacceptably risky.

As suggested below, the second function might better be described as "merchant of last resort." As the party managing the transport of supplies from the city gate to an end-user's burnertip, by default, LDCs will remain the "supplier of last resort," i.e., the party responsible for delivering gas on demand to end-users on its system. This function is accomplished through the use of no-notice service, storage (if available), transportation capacity and supplies retained for balancing and system integrity purposes, and the use of operational flow orders (OFOs). More importantly, as the supplier of last resort, the LDC is entitled to be compensated for the full costs of providing such services. Customers may contract for standby supply service or may pay for such service through imbalance penalties or unauthorized usage charges. Thus, if a transportation customer's (or its marketer's) gas fails to show up at the city gate and the end-user continues to burn gas, the customer (or its marketer) would incur significant imbalance penalties and could be subject to a daily cashout at the upstream pipeline penalty rates.

While it is inevitable that the LDC act as the "supplier of last resort" as defined above, it is less clear that the LDC be required to act in the second role identified in point 2 above. To clarify this distinction, this function should be termed the "merchant of last resort" rather than the supplier of last resort. LDCs currently provide this service and will likely continue this role during any transition period. However, to require an LDC to provide this service in a competitive marketplace would create an artificial restriction on the LDC and the marketplace in general. The LDC as "merchant of last resort" creates an inappropriate sense of security in the marketplace and serves to protect end-users from the full consequences of their purchase decisions. If a customer knows it can always "return to the LDC" if it dislikes its supplier, it is likely to be less careful when making supplier decisions in the first place.

Another important issue in the "merchant of the last resort" role is that of who will serve the high risk customers.

In the final competitive state, the "merchant of last resort" role related to "universal service" for "collection risk" customers could be fulfilled through some type of involuntary market mechanism (see Appendix A). Such mechanisms include a gas fund similar to universal service funds in the telecommunications industry, a state-operated gas merchant, an assigned risk system, or an annual bidding process. In an end-state in which the LDC has exited the merchant function, it should not be required to provide this limited merchant service without adequate compensation. All players in the marketplace should be required to participate in the selected "merchant of the last resort" mechanism.

Related to the supplier of last resort issue is the availability of transportation capacity and the point of sale for competitive purchases. With regard to transportation capacity, upstream firm transportation should be made available to converting LDC customers (or their agents) subject to recall and right of first refusal to ensure capacity is available for remaining LDC sales requirements during any transition period. Capacity should follow the customer if the customer changes suppliers or returns to LDC sales service. The point of sale for all competitive sales should be moved from the burner tip to the city gate. Thus, all transportation customers will be subject to the same transportation terms and conditions regardless of supplier.

2. Should the LDC be required to offer transportation service to all classes of customers?

   LDCs should not be required to offer transportation service to all classes at this time, but rather should be allowed to offer such services as each LDC determines its own capabilities. It is appropriate to phase in the introduction of transportation service to various classes so that adequate time may be spent on customer education and the development of systems and administrative processes to manage the transition to transportation service. Transportation service availability should be made available to large volume customers first and then to progressively smaller volume customers until practical and economic feasibility limits are reached on each individual system.

3. Should the LDC have the obligation to offer back-up or no-notice for firm transportation customers?

   LDCs should not be obligated to offer a specific type of back-up service or no-notice service. Each LDC should determine its own capabilities to offer such services and determine the costs of providing such services for transportation customers. Back-up and no-notice services are competitive supply services. If these services are desired in the marketplace, and to the extent that contestable markets are shown to exist, they should be provided by competitive suppliers. An LDC may want to offer such service on a regulated basis if capable and if customers are willing to pay the full costs of these services.

4. Should the LDC be relieved of its obligation to transport if the customer fails to secure firm supplies or back-up service?

   Yes. To the extent supplies have not been delivered to a city gate, the LDC has no obligation to transport gas to a customer. It may, however, be highly impractical to shut off customers whose supply does not show up. The LDC should have the option to shut the customer off or, to the extent excess supplies are available, the supplies may be provided at the higher of cost or market-based rates on that day. Such costs may be equal to the penalty rate for unauthorized usage on the upstream pipeline.

5. Should the LDC be allowed to use transportation customers' gas in critical need situations?

   Yes. However, the LDC must compensate for the use of these supplies according to provisions set forth in a tariff or contract. Compensation for transporter's gas should compensate for the cost of the fuel taken by paying to the transporter the market price of gas on that day or the transporter's cost, whichever is higher. Utilization of transporter's gas should be allowed only during system constraint conditions and should not be a backup for LDC supply shortfalls or be used by the LDC for economic reasons. If a firm transportation customer does not have alternative fuel capabilities, use of transporter's gas would be functionally equivalent to curtailment under sales tariffs and would fall under LDCs' curtailment provisions and be undertaken in accordance with such provisions.

6. Should LDC's be allowed to curtail gas service to a firm transportation customer who has demonstrated that their gas supply arrived at the city gate?

   Yes. See the previous comment. Existing curtailment provisions should be used as a guide for when curtailment is appropriate and for curtailment priorities.

7. Should the LDC be allowed to require transportation customers using gas for "essential human needs" to contract for standby service?

   If customers have not demonstrated firm supply to the city gate, LDCs should be allowed, but not required, to require standby service for "essential human needs" customers. However, it may be more effective to encourage the development of a competitive market for standby services. LDCs should be allowed to require customers to take assignment of upstream resources, including standby resources in order to minimize stranded cost and to eliminate issues of what resources go with which customers.

8. Should the LDC be required to offer customers the ability to combine unbundled and bundled services?

   LDCs shouldn't be required to offer customers such options; however, if determined by an individual LDC to be beneficial, such combinations should be allowed as a transition measure. If allowed, clarifying the definition of "bundled" and "unbundled" services and policy decisions

regarding the order of deliveries of bundled vs. unbundled services through a customer's meter would be necessary.

Rules would be required regarding interruption, pricing, balancing, etc., particularly if firm and non-firm services are combined. Some LDCs in other regions of the country favor exiting the merchant function -- as a regulated utility -- altogether. The basic regulated utility function would then be to transport the gas from city gate to burner tip. The supplier (or customer) would be responsible for getting the gas to the city gate and the LDC would take custody of the gas on behalf of the customer at the city gate and redeliver it at its location. This notion has been referred to as "moving the point of sale to the city gate."

The corollary is that all players, potentially including affiliates of the LDC, would sell gas to transporting customers behind the LDC's city gate on a competitive (de-regulated) basis. In turn, the LDC would provide open access (regulated) transportation to all marketers (including the LDC affiliate, if any) on the same terms and conditions.

Wisconsin Gas Company (WGC), for one, has supported this approach. The testimony of WGC's Vice President Richard Osborne in this regard is provided as Appendix B.

One of the most attractive aspects of this approach is that it eliminates issues such as what to do when providing sales and transportation to the same customer, how to treat margins when it is appropriate to stream gas, and what the impacts are on the Purchased Gas Adjustment (PGA) Clause. The customer is either in a transportation class or a sales class initially and eventually all customers are transporters. The sales rates and the PGA are eventually eliminated. The concept is clean and many of the issues about being fair to all and how to account for the costs and revenues become moot.

9. Should the LDC's be permitted to stream gas on a competitive basis using a negotiated rate?

If LDCs retain the merchant function, they should be permitted to use such tools as streaming to retain customers. LDCs should be required to demonstrate that streaming of supplies produces a net benefit to remaining customers or at least has no detrimental effect on other sales customers. (See NY regulations.) If streaming is allowed, streamed supplies and related costs should be outside of the PGA and LDCs should be placed at risk for non-recovery of these costs. LDCs should be required to impute credits for the use of core firm capacity to provide streamed sales from the revenues obtained from these sales. These revenues should at least be equal to the average market price for released pipeline capacity in a given month. To ensure fair competition among the LDC and competing suppliers, any negotiated sales must utilize the same LDC transportation service that would be used by third-party marketers.

Competitive sales within the LDC create an oxymoron: regulated competition. Arguably, LDCs could use their monopoly in distribution services to gain a competitive advantage over marketers unless restrictions are placed on these negotiated sales.

These conditions, for the right of the LDC to stream gas, illustrate why transporting gas on the LDC system and de-regulating the sale of the gas (to transporters) makes sense.

10. Should all LDC's be subject to Unbundling?

Before this question is addressed, unbundling must be defined. The traditional regulated merchant service consists of the following elements:

1) procurement of supply in the production area;
2) procurement and use of transportation and storage service to bring gas to an LDC's city gate;
3) distribution of gas through the LDC system to end-users' burner tips;
4) the balancing of deliveries at the city gate with consumption by end-users; and
5) ancillary services relating to the integration and administration of sales service, such as gas control, metering, billing, collections, etc.

Unbundling could simply separate the first element and allow other suppliers to sell to customers at the wellhead. Unbundling, as understood by the AGDF, refers to the separation of the first two elements of service: procurement of supply and procurement and use of transportation and storage services. In other words, unbundling allows customers to simply utilize the LDC's distribution systems and ancillary services. Most Florida distributors offer transportation services to a certain subset of customers. These transportation services generally require the installation of automated metering devices capable of reporting consumption on a daily basis. Consequently, unbundled services are currently available only to larger customers that can realize savings after the capital investment in remote metering. The question should, therefore, perhaps be restated to ask, "To what extent should LDCs be unbundled and how fast?" The response to this question is that for each LDC, the level of unbundling that makes sense will vary, as will the pace.

11. Should LDC services be performed pursuant to filed tariffs and should any desired rate flexibility be effected under a filed rider?

LDC services are monopoly services and, therefore, should be performed pursuant to filed tariffs to establish the terms and conditions of a service. Special contracts to address unique situations should continue to be allowed. Rate flexibility may be offered for services performed for non-core (interruptible) customers within appropriate bounds to the extent beneficial to the system and its core customers. There should be no requirement to make competitive prices public.

12. Should the LDC's have the right to unilaterally terminate transportation agreements without cause?

Termination of LDC (regulated) service should be pursuant to stated provisions in the LDC tariffs or in accordance with contract provisions. LDCs should have the right to terminate

service for specific reasons such as non-payment, supplier defaults, violation of balancing or OFOs, etc. as stated in their tariffs. Termination at the end of contract terms or with agreed notice should, of course, be allowed and be expected. Customers would have normal recourse to file complaints or pursue remedies for breach of contract.

13. Should LDC's be required to "act reasonable" and should "sole discretion" provisions in the tariffs read "reasonable discretion"?

    LDCs are already held to reasonable standards of conduct. No changes in the rules in this regard are warranted or required.

14. Should the LDC be allowed to require a waiting period for transportation customers wanting to return to bundled services?

    LDCs should be allowed, at their discretion, to impose waiting periods for transportation customers desiring to return to bundled sales service. Minimum contract periods for transportation service may be embodied in transportation agreements and/or tariffs. Notifications periods _____ for contract renewal or return to sales service may also be a contract term. These waiting periods are necessary to ensure customers don't swing back and forth from sales to transportation as market conditions change in an attempt to "game the system" to minimize the administrative burden associated with moving customers between services and to ensure that capacity and supply are available (similar to the situation when a new customer comes on line). Of course, this question assumes that bundled sales service would continue to be available for the subject class of customers . The company should have the option to elect to provide no regulated merchant service to a particular class where competitive purchase options are available. LDCs should have the right to waive a waiting period for return to sales at their sole discretion to the extent that there are no negative impacts on other sales customers or to prevent a loss in gas throughput (which could negatively impact remaining customers).

    The length of any waiting period may be dependent on whether or not the customer on transportation is utilizing capacity released by the LDC that can be recalled upon return to sales service. Thus, if the LDC does not have to obtain new capacity, the waiting period is necessary only to serve as a disincentive to game the system. If the LDC does not have capacity to serve the customer, at a minimum, the waiting period should be no longer than any waiting period for a new customer connecting to the LDC's system.

15. Should the price for LDC transportation service be based on cost of service principles?

    Yes. Transportation is a regulated service and prices should remain cost-based in the same sense that current sales rates are cost-based. Any movement toward rate parity should be handled in the context of individual LDC rate proceedings.

LDCs currently have the ability to flex rates as necessary to address competitive circumstances and to recover these discounts from other customers. This flexibility is necessary to improve the competitiveness of gas and to avoid a loss of throughput, which could negatively affect all customers. This flexibility should be continued.

AGGREGATION

27. Should LDC's be required to have aggregation tariffs?

    To the extent LDCs are required to allow customers to aggregate for purposes of nominations and balancing for transportation service, LDCs should be allowed to impose minimum volume requirements for a pool, restrict pooling among customers that may be in different operational areas, and charge additional fees for the administration costs associated with the accounting for pool volumes and balancing. Some LDCs do not currently have the systems and procedures in place to manage aggregation, and, therefore, LDCs should have the ability to phase in aggregation and appropriate tariffs as they develop these capabilities.

28. Should capacity releases to aggregators be subject to recall to correct any mismatch between customer load and assigned capacity outside a determined tolerance?

    Yes. LDCs should have the ability to recall any assigned capacity to correct mismatches or for system integrity purposes as needed. If an LDC has assigned too much capacity to a transportation customer and that capacity is being used in other markets rather than to serve the customer's load requirements, an LDC should have the right to recall that capacity as needed.

29. Should aggregators become the customer of the LDC, rather than the individual customer whose loads are being aggregated?

    Whether or not a formal designation is made of an aggregator by an LDC, these parties will become customers of the LDC as they are made responsible for nominations, balancing, and payment of transportation charges on the LDC system. Aggregators should have contracts with the LDC or be subject to an aggregation tariff regardless of whether they are designated as a "customer."

    However, simply because the aggregator has a relationship with the LDC does not mean that the LDC's relationship with the end-user terminates. LDCs are responsible for the safety and integrity of their distribution systems and are obligated to respond to emergency calls and investigate gas leaks. Thus, traditional customers will continue to be customers as the new category of customers including marketer/aggregators is added.

30. Do LDC's tell suppliers, marketers, and brokers how much gas to deliver into an LDC's system for aggregation customers, or do the suppliers, marketers, and brokers tell the LDC how much

gas they are delivering? (a) How are imbalances handled and (b) who has financial responsibility?

LDCs have proposed (and in some cases implemented) a system in which the LDC estimates the daily load requirements for a pool of aggregated customers that do not have individual remotely readable meters. In these cases, the LDC would tell the transporter/aggregator the amount of gas to deliver and the transporter would be responsible for balancing to the forecasted requirement stated by the LDC.

Based on the current transportation tariffs for large daily metered customers, suppliers and their customers are responsible for estimating daily requirements and nominating daily deliveries into the LDC. Daily deliveries are compared with actual daily consumption on an individual customer or pooled basis. Any difference between daily deliveries and actual consumption may be subject to balancing provisions which may include a balancing tolerance, imbalance penalties, daily and/or monthly cashouts or a banking system.

(a) LDCs should determine their own balancing provisions based on the flexibility they can provide to transportation customers. Balancing provisions could be generally comparable to the balancing provisions the LDC is subject to on its upstream pipelines, although this may not provide useful guidance for individual LDCs.

(b) Financial responsibility for imbalances depends on the established relationships among the LDC, the third-party supplier and the end-user consuming gas. If an aggregation contract or tariff incorporates responsibility for balancing, the supplier or aggregator is responsible for any charges resulting from imbalances. If the end-user is not aggregating and takes responsibility for its own nominations and balancing, the end-user is responsible for any imbalances and resulting charges.

31. Should [aggregators'] customers be able to order transportation service by phone or simply ask their agents to take care of the details of arranging service?

While agency relationship between an end-user and a third-party supplier may simplify the administration of transportation for some customers, LDCs may still require verification of these relationships through phone or written authorization by the end-user. This authorization process is necessary to avoid the "slamming" of customers on to transportation service as experienced in the long-distance telephone industry.

32. Should aggregators be afforded the same load management tools used by the LDC in its capacity as supplier of bundled sales service:

- hold the upstream capacity of their customers, if asked to do so
- receive and pay their customer's transportation bills
- balance all their customers' usage as one pool

- choose to have all LDC penalties and opeational orders direct at their pools, rather than their customers
- aggregate any collection of customers
- aggregate upstream capacity for the purpose of submitting one city gate nomination for their customers

As defined, aggregation is the grouping of customers served by the same third-party supplier. Without the ability to combine end-users for the purposes of nominating and balancing, the role of the aggregator is extremely limited. Thus, aggregation should provide a third-party supplier with the ability to streamline the process of transportation service for its customers.

Any third-party supplier, whether it serves one customer or ten customers, should have the ability hold and manage upstream capacity assigned to a departing sales customer.

Aggregation has limited benefits if customer loads cannot be combined for purposes of submitting a single nomination and balancing the group as a single pool. Pooling affords aggregators the same tools utilized by the LDC to balance its system and reduces the cost of transportation for individual customers. It may be necessary to limit the ability to combine customers if they are located on different areas of the LDC system and cannot operationally be combined for balancing purposes (e.g., non-contiguous service areas, served off different gate stations, etc.). LDCs should designate in their tariffs areas that can be combined for purposes of balancing and allow aggregators to establish a separate pool for each balancing area.

To the extent pooled customers are in an area that is experiencing system distress, LDCs should have the ability to direct OFOs to a pool rather than to an individual customer. For these reasons, it may be necessary to limit pooling to certain operational areas or require pool nominations at the gate station level if required by upstream pipelines. If nominations and balancing occur at the pool level, it would be difficult to separate out an operational order to a customer and determine compliance with this order. Individual OFOs or penalties could be directed at the customer level if the customer was an interruptible customer and subject to curtailment. These problems could be avoided by restricting the ability of aggregators to combine firm and non-firm loads in their pools.

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APPENDIX A

Merchant of Last Resort
Other Industry Approaches

I. Insurance Industry

A. Automobile Insurance Approaches

- Purpose: To guarantee the availability of affordable insurance to all drivers
- Targets high-risk customers as beneficiaries of cross-class subsidies
- Cross-class subsidies flow from low-risk to high-risk, not high-income to low-income.
- Most approaches use a "defined benefits" policy. High-risk customers usually get the minimum coverage required by state law.

1. Assigned Risk Pools
   - Risk-sharing pools under which all insurers in a state share in covering those drivers who cannot obtain insurance through normal market channels
   - Procedure: Companies receive portions of the "undesirable" market in proportion to the amount of voluntary business that the company has. *Operates on the principle of sharing applicants.*
   - Provider of Last Resort: There is no one designated provider of last resort. Each company must provide service for its share of the "undesirable" market.
2. Reinsurance Pools
   - Reinsurance pools establish a reinsurance facility which functions as an unincorporated nonprofit entity to which insurers can transfer a percentage of their losses.
   - Procedure: All auto insurers are required to write insurance for anyone who applies. Insurers then transfer the risk of loss on policies they issued to those in the "undesirable" market to the state reinsurance facility. The reinsurance facility absorbs all the premiums paid and losses incurred by those policies issued to those in the "undesirable" market and annual profits or losses by the facility are shared by all the insurers participating in the pool. ***Operates on the principle of sharing losses.***
   - Provider of Last Resort: There is no single provider of last resort. Instead, each company is required to serve all those who request service
3. Joint Underwriting Associations (JUAs)
   - JUAs are usually made up of the largest insurance companies in the state.
   - Procedure: Each agent or broker has access to a company that has been designated as a servicing company for the "undesirable" market. That company is then designated to cover the applicant. Participating companies are paid a fee to join the organization. ***Operates on the principle of sharing losses.***
   - JUAs generally provide the same coverage as the voluntary market, but at higher rates and with lower policy limits

- A variation on the JUA is the "no profit/no loss" plan in which member companies are not assessed with operating losses. Instead, other sources of income (usually administered by and collected by the state) are used to offset any operating shortfall.
- Provider of Last Resort: Designated servicing companies are deemed the providers of last resort since they are required to cover all applicants.

4. Maryland State Fund:
   - Established a state-funded and operated residual market mechanism that acts as an independent insurance company. The pool centralizes the provision of liability insurance for high-risk customers, while allowing private insurers to cover all others.
   - Procedure: The fund is authorized to charge market-insurers to subsidize all losses from its operations. *Operates on the principle of sharing losses.*
   - Provider of Last Resort: The fund is the provider of last resort.

II. Telecommunications Industry

- Purpose: To ensure a universal provision of telecommunications services in a competitive environment
- The telecommunications universal service programs typically cover "basic service" which includes: basic connection for residential customers to the incumbent LEC network and access to directory assistance and 9-1-1 helplines. Some programs also include local calling within a certain area and touch-tome dialing as a part of basic service.

A. Universal Service Fund (as currently administered by the FCC)

- Provides general subsidies to local phone companies to help cover the cost of serving unprofitable customers.
- Procedure: Fund is administered by the FCC. All LECs pay into the fund, and those LECs with total average cost of service greater than 115% of the national average are eligible to start drawing from the fund. *Cost of the fund is imbedded in the companies rates.*
- Another variation of the USF is using a reverse auction to see if there are any companies willing to serve the "undesirable" market at a lower subsidy level
- Provider of Last Resort: Current local telecommunications company
- Transferability to Gas Industry: FERC could administer the program and all marketers and LDCs providing a merchant function would contribute to the fund. The amount paid into the fund would be based on gross income or profits and the cost of the contributions could be rolled into the marketers' rates.

B. Proposed Wisconsin PSC Universal Service Fund

- A source of subsidy to fund certain basic services to all Wisconsin residents
- Procedure: Eligibility must be determined. Low-income customers who are receive assistance from one of the following programs are deemed eligible: AFDC, Medical assistance under title 19, SSI, food stamps, LIHEAP, or Wisconsin homestead tax credit. Once eligibility has been determined, these customers are eligible for rate subsidies, wavers, and price caps under the fund. All residential customers that have

a local loop charge that is greater than 0.75% of their monthly household income are eligible for high-cost assistance. Provision for the fund are provided by all intrastate telecommunications providers with gross revenues over $500,000 annually who are required to make contributions based on the relative size of the gross revenues and budget set annually by the PSC. *Cost of the fund is imbedded in the companies rates.*

- Provider of Last Resort: The current monopoly provider in areas where local competition has not been authorized. If necessary, PSC will appoint a provider of last resort in competitive areas on a geographically determined basis. Also, PSC will designate the provider of last resort in the intraLATA toll market if it deems it necessary to do so.
- Transferability to Gas Industry: Similar to that of the Universal Service Fund, but would administered at the state level. This program might be most workable during the LDC's transition period when it has not completely shed its merchant function. The fund would then allow the LDC to continue to serve the customers not served by other marketers, without absorbing any of the losses associated with providing these services.

C. NYNEX Proposal of Designated Customer Mix

- Procedure: Those companies who have a similar customer mix as NYNEX will be charged lower line fees. Competing carriers with a differing mix of customers will be charged a higher surcharge on regular line charges depending on how different the mix is. *A specific surcharge on to the regular line charge is used as revenue for fund.*
- Provider of Last Resort: The Local Exchange Carrier
- Transferability to Gas Industry: The LDC's marketing affiliate could act as provider of last resort, and the program could be structured so that those marketers that have a higher proportion of the "profitable" customers than the marketing affiliate would be required to pay higher transportation charges than those serving a larger portion of the "unprofitable" market. The LDC could act as an impartial third-party administrator of the program.

D. Proposed Voucher System with Federal or State Funding

- Customers would be provided with vouchers to help offset the costs of telecommunications services
- Procedure: Eligibility must be determined. Could use system similar to what is used for food stamps. Then, customers could use the vouchers to offset costs of telecommunications service with the carrier of their choice. *Funding for this program could be obtained through some broad-based tax (income tax) or a tax on telephone users (cross-class subsidy).*
- Provider of Last Resort: This option does not require the designation of a provider of last resort.
- Transferability to Gas Industry: Instead of having the state of federal government provide revenue for the fund via taxes, the LDC could administer the program and fund it through a blanket surcharge on transportation rates.

E. Time Warner Proposal of Modified FCC Universal Fund in a Competitive World

- The criteria for paying into and drawing from the existing universal service fund are modified to suit a competitive environment
- Procedure: High cost areas are served through a "reverse auction" procedure. Aid to low-income customers would be made through vouchers or some other "portable" mechanism.
- Provider of Last Resort: The incumbent carrier, until another carrier wins the bid for service
- Transferability to Gas Industry: The reverse auction program might work well in the gas industry to serve high cost areas. The voucher system using the LDC as the fund administrator might also work well in serving the low-income customers.

Goal One: Objective Two - Investigate and Evaluate Other Industry Approaches

ASSIGNED RISK POOLS		
	PROS	CONS
CUSTOMER	Auto liability insurance is available to all	If assigned to a risk pool, customer is randomly assigned to an insurance company. Customer does not have choice in choosing an insurance company. Cross-class subsidies flow from low-risk customers to high-risk customers, not high-income to low-income
MARKETER	Establishes an equitable method for distributing risky customers No one company has to bear an inordinate amount of risk There is a "defined benefits" policy for high-risk customers[1]	Political pressure on regulators to cap assigned risk rates develops when the percentage of insureds increase. Must contribute in covering the costs of serving the high-risk customers. Must take on responsibility of being provider of last resort
LDC	State and regulatory authorities take on the administrative responsibilities of this program Does not need to be the provider of last resort	
STATE/REGULATORY	Insurance for high-risk drivers will be available	Must take administrative responsibility of program No market mechanism[2] in place

[1] "Defined benefits" policy refers to the fact that high-risk customers get only the minimum coverage required by state law.
[2] A market mechanism creates market-based incentives to minimize the cost of providing service.

JOINT UNDERWRITING ASSOCIATIONS		
	PROS	CONS
CUSTOMER	Provides access to insurance for all people	Funds to recoup the losses by the designated servicing companies are provided by higher market rates and lower policy limits Cross-class subsidies flow from low-risk customers to high-risk customers, not high-income to low-income
MARKETER	Losses incurred by the designated companies are recouped through rates Operate on the principle of sharing losses, so that no one company bears the risk There is a "defined benefits" policy for high-risk customers	A designated servicing company would have to take on the responsibility of being the provider of last resort. There will be political pressure to cap JUA premiums when the percentage of uninsured increases
LDC	Would not have to administer program or act as provider of last resort	
STATE/REGULATORY	Would not have to administer program	No market mechanism in place.

REINSURANCE POOLS		
	PROS	CONS
CUSTOMER	Customers get to deal with the company of choice and avoid the stigma of purchasing insurance through an "assigned risk pool"	Cross-class subsidies flow from low-risk customers to high-risk customers, not high-income to low-income
MARKETER	Each company is the recipient of its own surcharges on voluntary premiums Operates on the principle of sharing losses, no one company has to bear an enormous amount of the risk There is a "defined benefits" policy for high-risk customers	In most cases, losses from the reinsurance facilities have been large. There is no single provider of last resort, each company is required to serve any customers that request service. There will be political pressure to cap premiums when the percentage of uninsured increases
LDC	Does not have to take responsibility as the provider of last resort	
STATE/REGULATORY	Regulatory authorities oversee the workings of the facility and have some authority over both market and assigned risk rates.	No market mechanism in place.

MARYLAND STATE FUND		
	PROS	CONS
CUSTOMER	Ensures access to affordable insurance	Cross-class subsidies flow from low-risk customers to high-risk customers, not high-income to low-income
MARKETER	Market insurers are released of any obligation to serve high-risk customers Pool centralizes the provision of liability insurance for high-risk customers, while allowing private insurers to cover all others There is a "defined benefits" policy for high-risk customers	State has the right to assess charges on market-based insurers to recover losses. Would mean state involvement in private market
LDC	Fund is the provider of last resort LDC does not have to take responsibility of administering the fund	
STATE/REGULATORY	Losses are recouped through charges assessed on private market-based insurers The funds the sole recipient of all revenues from high-risk customers	The state must take responsibility of running the fund as an independent insurance company Political pressure to cap premiums when the percentage of uninsured increases Must act as provider of last resort No market mechanism in place.

UNIVERSAL SERVICE FUND		
	PROS	CONS
CUSTOMER	Ensures that all customer classes will be served	
MARKETER	Provides general subsidies to local phone companies to help cover the cost of serving the "undesirable" market Since all LECs must pay into the fund, no one company bears an inordinate amount of the costs	Discourages efficient operations. Local telecommunications company is designated provider of last resort Almost encourages LECs to find the most expensive/inefficient solutions to service problems
LDC	Does not need to take administrative responsibility or act as provider of last resort	
STATE/REGULATORY	Fund is administered by the FCC	Covers too many companies, making it administratively difficult No market mechanism in place.

WISCONSIN PSC UNIVERSAL SERVICE FUND		
	PROS	CONS
CUSTOMER	Provides rate subsidies, price caps and waivers for low-income customers Also provides assistance for those residential customers deemed to be "high-cost"	
MARKETER	Fund reimburses provider for all assistance to low-income and high-cost customers	
LDC		Could be designated as third-party fund administrator
STATE/REGULATORY	Third-party fund administrator audited annually by the PSC is responsible for the fund	Difficult to administer No market mechanism in place

NYNEX PROPOSAL OF DESIGNATED CUSTOMER MIX		
	PROS	CONS
CUSTOMER	Tries to ensure that all LECs will have a good mix of customers	The measure can be seen as distorting price signals, or putting a tax on more profitable customers
MARKETER	Those carriers that take on the responsibility of serving the "undesirable" market will receive the funds generated by the surcharge.	
LDC	Those LECs with customer mix that differs from NYNEX will be charged a higher rate on line use costs depending on how different the mix is. The LEC remains the provider of last resort	Quantifying differences between certain "customer mixes" may be difficult. Would probably have to take responsibility of administering the program.
STATE/REGULATORY	Would not need to administer the program.	No market mechanism in place.

ENERGY VOUCHER SYSTEM WITH FEDERAL OR STATE FUNDING		
	PROS	CONS
CUSTOMER	Customers provided with vouchers to help offset the costs of telecommunications services Customers would have the ability to choose a phone service provider	
MARKETER	No obligation to serve any specific portion of the market	
LDC	No provider of last resort necessary	
STATE/REGULATORY	Market mechanism in place Defines benefits involved	Program would probably need to be funded by state of federal government through taxes. State or federal government must take responsibility of administering this program

TIME WARNER PROPOSAL OF MODIFIED FCC UNIVERSAL SERVICE FUND IN A COMPETITIVE WORLD		
	PROS	CONS
CUSTOMER	Provides a mechanism that addresses both high-cost and low-income customers	There is the chance that there will be some customers that no one bids for, even with subsidy
MARKETER		
LDC	High cost areas would be served through a reverse auction mechanism Aid to low-income customers would be made "portable" and available to whichever carrier actually provides the service.	The provider of last resort is assumed to be the incumbent carrier until another carrier wins the bid to serve a particular market
STATE/REGULATORY	Market mechanism in place	FCC would need to take responsibility of administering the program

Goal One: Objective One - Identify Barriers to Service Provisions in Deregulated Market

BARRIER	DEFINITION	GROUP AFFECTED	AFFECT ON GROUP
Availability	Supply/The ability of sellers to obtain a price that will cover their costs of production	MARKETER/LDC/ CUSTOMER	In low-income/low load factor areas, marketers would not be able to obtain a price that would cover their costs, which would create a lack of availability of gas for this group. This lack of availability would affect LDC's since they would be forced to act as merchants of last resort.
Affordability	Effective Demand/Ability of consumers to pay for the products they require	CUSTOMER	In low-income/low load factor areas, the price demanded by marketers might be much higher than either group can afford.
Inequity	Treating various groups differently	CUSTOMER	Various customer classes treated differently/unfairly by marketers
Insolvency	The inability for a seller to remain financially stable	MARKETERS/LDC	In a deregulated market, intense price wars/scrambles for short-term revenues at the expense of sound financial decisions might force some marketers to become insolvent. This would affect LDC's in that they might have to act as merchants of last resort.
Access	The ability to gain use of infrastructure	MARKETERS/LDC	In high-cost areas, it is not clear who would be responsible for paying for infrastructure and how those costs would be recovered.

BEFORE THE
PUBLIC SERVICE COMMISSION OF WISCONSIN

Investigation on the Commission's Own Motion into the Need for Changes in Natural Gas Regulation for City Gas Company; Florence Municipal Gas Utility; Madison Gas and Electric Company; Midwest Natural Gas, Inc.; Natural Gas, Inc.; Northern States Power Company; St. Croix Valley Natural Gas Company; Superior Water, Light and Power Company; Wisconsin Fuel and Light Company; Wisconsin Gas Company; Wisconsin Natural Gas Company; Wisconsin Power and Light Company; and Wisconsin Public Service Corporation

Docket 05-GI-108
(Phase I)

TESTIMONY OF RICHARD L. OSBORNE

1 Q. Please state your name and address.

2 A. My name is Richard L. Osborne. My business address is 626 East Wisconsin Avenue,
3 Milwaukee, Wisconsin, 53202.

4 Q. What is your position with Wisconsin Gas Company ("the Company")?

5 A. I am Vice President of Energy Services and Gas Supply.

6 Q. Would you please briefly describe your educational background and business experience?

7 A. I earned both my undergraduate degree in Economics and Masters in Business
8 Administration from Indiana University. I have been employed by Wisconsin Gas since
9 1982 in various capacities including Public Affairs, Marketing and Gas Supply.

10 Q. Have you previously testified in proceedings before the Public Service Commission of
11 Wisconsin ("the Commission" or "PSC")?

1 A. Yes.

2 Q. What is the purpose of your testimony?

3 A. I am here to provide testimony on the separate/allocate issue (Issue #1) contained in the

4 Notice for this docket. It is my understanding that the issues in this phase of the docket

5 are to be construed broadly, with implementing details to follow in subsequent phases of

6 the docket. Accordingly, my testimony will cover the policies or general principles that

7 the Commission should adopt on this issue.

8 Q. Please explain the Company's recommendations.

9 A. The competition door for energy markets has been opened. Competition has started in

10 large end-use markets and will progress to the smaller end-use markets. The Company

11 believes that competition should and will ultimately reach down to the core residential

12 market. This is also the Commission's position, as set out in the so-called Model D

13 adopted by the Commission. It is in the long-run best interest of all customers to open

14 markets because this will result in greater choices and correspondingly lower energy

15 prices for all customers.

16 To achieve this end, the Company supports a separation policy, as I will detail more

17 fully. A separation policy commits Wisconsin Gas to pursue open markets for all

18 customers. While there will certainly be a transition period where there are both

19 deregulated and regulated markets, the goal of a separation policy must be to deregulate

20 all markets. Otherwise the regulated markets will ultimately only comprise financially

21 unattractive customers who would be served inefficiently at high costs. This is a result

1 that is not in the public's interest, and further is one which Wisconsin Gas Company
2 cannot accept.

3 In other words, Wisconsin Gas supports Model D with two important qualifications and
4 some caveats associated with overcoming several barriers, which I will discuss later.
5 The two qualifications are: (1) All parties must be committed to seeing Model D through
6 to its logical conclusion, that is, reaching Model A, a state in which all customers have
7 the choice of gas suppliers. Otherwise it is our position that we should not start the
8 process. (2) The move through Model D to Model A must occur in short order. To
9 that end, the Commission must be prepared to approve proposals by utilities to make
10 customer segments competitive and, as appropriate, to abandon the merchant function for
11 these segments.

12 Wisconsin Gas recognizes that there are issues that must be resolved for this transition
13 to occur. Market solutions exist for these problems and Wisconsin Gas is ready to work
14 with all present in this hearing room, and any other interested parties not present, to
15 reach these solutions. However, these answers should be formulated outside the formal
16 hearing process because hearings do not lend themselves to the give and take dialog that
17 will be necessary to achieve workable solutions that assure safe and reliable service.

18 All of my comments that follow in this proceeding are based upon the premises outlined
19 in the previous statements. As stated above, we need to look first to the marketplace,
20 not regulatory agencies, for solution of these challenges. Utilities and market
21 participants must lead the way in developing innovative, yet practical, keys to solve these

1 problems. In other words, they must make the market work. The role of the
2 Commission should be to moderate or facilitate this process, and to ensure that solutions
3 are in the public interest.

4 Q. Why does the Company support the separate option?
5 A. Initially, the separation option may not be the most efficient due to duplication of assets
6 and costs that will be incurred as markets open up. In the longer term, separation
7 appears to be the most efficient, especially when all markets are open and the transition
8 is complete. Separation would provide customers with the maximum number of energy
9 choices, including the option of purchasing most services from a utility, an affiliate or
10 from a third party marketer. At the same time, it would keep the focus of all market
11 players on making the market work rather than fighting over what is a level playing
12 field.

13 Q. What is your definition of separation?
14 A. What I mean by separation involves several concepts. First, separation applies whenever
15 the Commission has determined under Model D that a market segment is sufficiently
16 competitive. The utility would no longer be required to provide merchant service for
17 that market segment, but would have the option of providing merchant service. An
18 affiliate of the utility could sell gas into that market. The affiliate would be a legal entity
19 separate from the utility, although both would be under common ownership. There
20 would be safeguards in place to ensure that the two entities do not share operating
21 employees and do not exchange customer and market information with each other that
22 was not available to other sellers. The affiliate could purchase infrastructure or support

1 services from the utility, and vice versa. Such services could include such things as
2 legal, accounting, tax, payroll, office space and other services. Further, these services
3 would be priced on a negotiated (market) basis between the two entities.

4 Q. Would you envision any regulatory changes being necessary to fully implement
5 separation?
6 A. The Commission's rule that such transactions be priced at cost or market, whichever is
7 lower if the utility is buying, and whichever is higher if the utility is seller, would have
8 to be revised accordingly.

9 Q. Should the allocation methodology and operating rules approved by the Commission be
10 the same for all LDC marketing affiliates regardless of the structure of the utility and
11 affiliate?
12 A. Yes. The allocation and operating rules should be the same for an affiliate in a holding
13 company (WICOR) or non holding company (MG&E/GLENCO), based upon the market
14 price of providing each service. A cost is a cost and a market price is a market price.
15 Transfer pricing rules should be consistent regardless of the corporate structure in place.
16 I have been advised that there is no statutory requirement requiring a different allocation
17 between a holding company and its affiliate and a utility and its nonutility operations.
18 Using a uniform cost allocation method will allow all parties, both independent brokers
19 and utilities, to procure services they desire at the lowest cost from any source,
20 (assuming they choose not to do the work themselves). At the same time utilities would
21 be able to recover additional revenue from selling services to their affiliates and third
22 parties to offset the cost of providing such services for the utility.

1 Q. What barriers to the implementation of separate versus allocation exist?

2 A. Aside from what I have already discussed, most barriers relate to the transition from the
3 highly regulated cost of service industry to a competitively priced industry. Issues that
4 must be resolved include the following, and perhaps others that will come to light as we
5 proceed: stranded investment costs, demand side management, seller of last resort and
6 obligation to serve.

7 Q. Please comment on transition issues, starting with stranded costs.

8 A. As utilities begin to exit the merchant function, they are likely to be left with long-term
9 gas supply and pipeline capacity contracts obligating them to pay fixed costs irrespective
10 of gas purchases or movement of gas using the pipeline contracts. We have to carefully
11 craft the transition to new services in a way that completely avoids the incurrence of
12 transition costs, or at least holds them to an absolute minimum. The key points are:

13 - Potential transition cost exposure is significant.
14 - Those costs were incurred under a state regulatory system that imposed an
15 obligation to serve on utilities with the understanding that prudently incurred costs
16 could be recovered.
17 - Those costs were incurred under a federal regulatory system that among other
18 things, requires straight fixed variable rate design and contract terms of up to 20
19 years for firm pipeline capacity.
20 - There are multiple avenues available to eliminate or minimize these costs.
21 - Costs should be borne by those customers causing the costs (i.e., an exit fee
22 mechanism would be one tool that could be used).
23 - Recovery of legitimate and verifiable stranded costs at this stage in the movement

1 to competition is needed to protect the financial stability of the utility industry
2 (which does impact upon customer costs).

3 The sense of urgency to resolve the stranded cost issue facing utilities is illustrated by
4 the 1997 expiration of Northern Natural Gas Company's contracts. Northern's initial
5 position in its recently filed rate case, FERC Docket RP95-185-000, is that contracts for
6 merchant service should extend from 1997 for ten years under a straight fixed variable
7 rate design. If markets migrate to Model A, Wisconsin Gas or any other LDC, which
8 enters into such contracts, would be stuck with a capacity obligation for a merchant
9 business it may well exit prior to the expiration of the capacity contracts. Wisconsin Gas
10 believes that a LDC cannot accept a ten year term, and therefore, should consider
11 completely exiting the merchant function on Northern's system beginning on October 1,
12 1997.

13 Q. How might this exit occur?
14 A. There are probably many ways. One way would be to allow the utility to subscribe for
15 firm capacity on the terms approved by FERC, but also to require the new third party
16 merchants to use that capacity and any other capacity already under contract to the
17 utility. This would avoid parties having to hold firm pipeline capacity to serve
18 Wisconsin markets and would thereby encourage third party merchants to do business in
19 Wisconsin by allowing them to avoid investing in firm capacity needed to sell gas. It
20 would also ensure that each merchant will have precisely the capacity needed to serve its
21 shifting customer base, thereby achieving efficiency.

1 One might initially think of this model as an assignment of capacity to the merchant, but
2 the concept is really an assignment of capacity to the customer, giving the customer a
3 greater ability to choose a merchant (shipper) and change this choice if the customer
4 wishes. Regardless of whom the customer chooses as its merchant, the capacity would
5 be there in a seamless way. The utility would simply charge this cost on the customer's
6 bill. In reality, no actual assignment of capacity would be necessary. Under this model,
7 it would be very easy to do merchant business in Wisconsin. Another way to view this
8 approach is that reliability and delivery, including pipeline transportation, is assured
9 during the transition period.

10 Q. Are there other potential options available?

11 A. Yes, there are other options. It is not clear today, however, what the ultimate answer
12 on capacity ownership should be. Already we are seeing dramatically different
13 approaches to that question. It appears that California may require utilities to divest all
14 capacity. Capacity would be held by merchants, presumably. That may be a satisfactory
15 answer for California where there is excess pipeline capacity which causes utility long-
16 term capacity contracts to be priced above the current market. That may not be the
17 answer for Wisconsin which enjoys neither excess pipeline capacity in the state nor
18 multiple pipeline suppliers competing against one another on price. In Ontario, Canada,
19 where the third party merchant business has been in place for several years, the decision
20 appears to be that utilities will retain the pipeline capacity for the reasons I mentioned
21 above, namely to eliminate barriers to market entry, to encourage robust competition
22 among numerous sellers, and to make it easy to do business. That may be the better
23 alternative for Wisconsin, but it is too early to say.

1 I would propose that whatever solution is selected be put in effect for at least three years.
2 This would minimize transition costs. Further, the Northern Natural and ANR rate case
3 should be concluded by then. During that transition period, the Commission and
4 interested parties could develop the long-term solution to the capacity issues, and utilities
5 could begin to restructure contracts that expire.

6 Q. What are the issues associated with demand side management (DSM)?
7 A. Again, DSM is a product of a highly regulated environment that must transition to the
8 competitive market place. On the one hand, a utility that is out of the merchant business
9 is not an appropriate entity to be dealing in DSM. On the other hand, the utility is the
10 entity the Commission regulates, so if the PSC is to continue to mandate DSM programs
11 under its current statutory authority, the programs will have to be done by the utility.
12 Wisconsin Gas is currently working towards transforming DSM markets to be market
13 driven. We believe there are market solutions to DSM which will ensure that DSM is
14 practiced, but which will not require either this Commission to dictate or the utilities to
15 deliver DSM services. We believe progress has been made in this effort and we will
16 continue to pursue market solutions for DSM issues which ultimately would put DSM
17 service in the category of market driven.

18 Q. Please discuss your definition of supplier of last resort and the issues related thereto.
19 A. There are two separate aspects of the definition of supplier of last resort. First, there is
20 emergency backup supply for customers who receive supply from a third party, and
21 second, there is supply for a market segment that no one voluntarily chooses to serve.
22 The former involves a small scale supply to ensure integrity of the system when third

1 party supplies don't reach the city gate. This integrity would be needed to cover partial
2 failures of supply merchants to deliver firm supply. The latter involves a much greater
3 commitment on the part of the utility, affiliate or marketer to provide merchant services
4 for an entire special needs market segment.

5 Q. Discuss the first aspect of a supplier of last resort.
6 A. Wisconsin Gas Company, as the operator of the local distribution system, could maintain
7 access to a relatively small supply of gas that would cover the failure of some third party
8 marketers to deliver gas to the gate station. In addition, this supply could cover
9 operational or pressure problems on the system due to emergencies. It is envisioned that
10 this supply would be small. It could not cover large scale failures of third party
11 suppliers.

12 Providing this service will not be without cost to the utility and its customers. The utility
13 providing this emergency service should be compensated appropriately for its cost.

14 Q. Discuss the second aspect of supplier of last resort issue.
15 A. A critical issue to the decision on separate or allocate is supplier of last resort for market
16 segments which no one else wants to serve. Separate implies that the utility will get out
17 of the merchant business, although it will do so over time. The utility should not be the
18 supplier of last resort for such markets if it is not also a merchant of choice that was able
19 to have a full, diverse portfolio of customers. In other words, if there is a critical mass
20 necessary for efficiency in the merchant business, and we believe there is, it would be
21 expensive and inefficient for a utility to maintain gas supply, storage and pipeline

1 capacity to serve only a few, poor load factor, low income customers part of the year.
2 Logically, a merchant should be the supplier of last resort, if any supplier of last resort
3 is really necessary. Whoever takes on this role as supplier of last resort during transition
4 would bear extensive risk of nonpayment and should be fully, fairly, and competitively
5 compensated.

6 Q. Why might a supplier of last resort not be necessary for certain market segments, such
7 as low income customers?
8 A. The supplier of last resort concept is based on the assumption that gas is a necessity and
9 the competitive market might not choose to serve all customers. In fact, that assumption
10 may not be true. For example, fuel oil and food are necessities; yet there appear to be
11 no problems with refusal to serve those markets. Apparently, customers find the money
12 to pay for fuel oil and food and do not freeze or go hungry. In effect, the market makes
13 consumers align their payment priorities with their perceived need or value of the
14 service. That must happen with gas energy, just as it happened with fuel oil energy.
15 There would be no need for a moratorium on disconnection of service for non-payment
16 of gas bills. I hasten to add that there is a serious chronic ability to pay issue which
17 should not be trivialized. However, that issue is unrelated to the issue of whether there
18 needs to be a supplier of last resort and, if so, who that supplier should be.

19 Q. How can the ability to pay problem be resolved?
20 A. We believe that a number of sources could be used to fund low income energy service.
21 Further, we feel that such a fund should be administered under a privatization concept
22 whereby private parties will be encouraged to fill the current need and offer creative and

1 cost effective solutions to providing essential services to this market. We should seek
2 solutions to these problems that are compatible with the market-based approach to
3 regulation.

4 Several approaches to the ability to pay problem are apparent; others will come to mind
5 as we delve deeper into the issues in these dockets. First, an access fee may be a
6 solution. The fee could be volume-weighted. Volume weighting might encourage
7 merchants to sell into the smaller firm markets because there are better margin
8 opportunities, but the access fee would be the same. The fee would be passed on to
9 consumers and would be in the same amount irrespective of the merchant supplier. This
10 fee would be similar to the universal access fee adopted in the recent telecommunications
11 legislation. Second, we could eliminate the sales tax moratorium on energy during the
12 winter months and use the funds for low-income energy assistance. Third, we could
13 establish a state licensing system. Wisconsin licenses all kinds of trades and professions
14 for consumer protection reasons. Licensing would ensure that merchants were financially
15 solvent. Licensing could be the vehicle for establishing standards of conduct, and even
16 standardized contracts. Importantly, licensing fees could be levied, with the proceeds
17 going toward low-income energy assistance and emergency relief, such as where a
18 supplier defaulted on a delivery obligation. If one thinks about the Wisconsin licensing
19 system, a number of analogies in the insurance and other trade regulation schemes, come
20 to mind.

21 Clearly, no one wants to jeopardize the health and safety of Wisconsin citizens.
22 However, we must use this opportunity to question current practices and to try to craft

1 a new solution that fits a future where regulated utilities are basically common carrier
2 transporters for retail energy merchants.

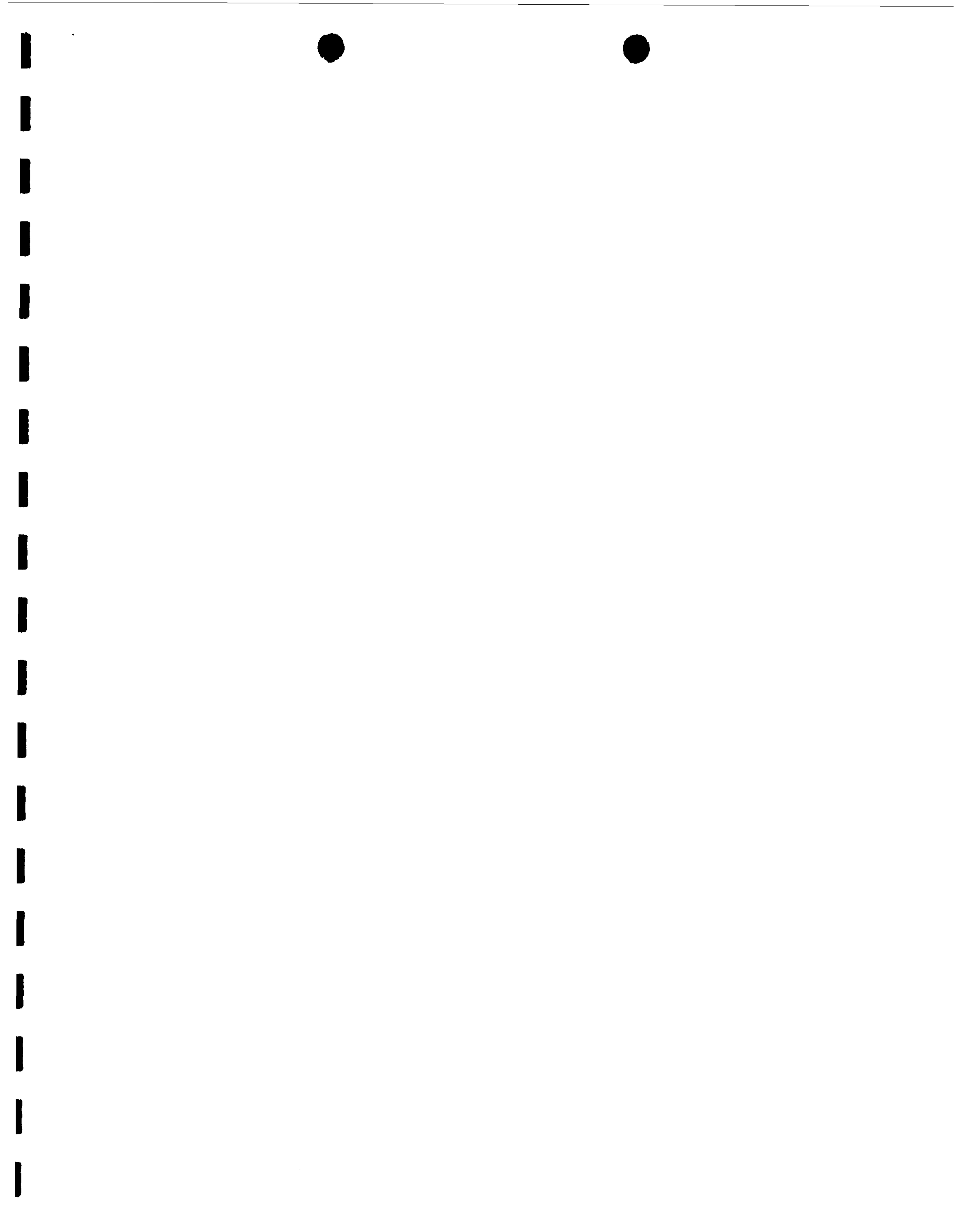
3 Q. What about the obligation to serve?
4 A. This obligation goes hand-in-hand with supplier of last resort. Obligation to serve has
5 been assumed, but not really defined. In the new environment, the utility would have
6 no obligation to serve in the sense of supplying gas, unless of course, the utility were the
7 supplier of last resort. The orders coming out of these proceedings should clarify
8 obligation to serve and provide pre-granted abandonment of that obligation to utilities for
9 market segments as the Commission determines them to be competitive. The utility
10 would, however, have an obligation to provide access to its distribution system. The
11 utility would have some obligation to extend and expand its distribution system so that
12 the customer base could grow and all customers could be ensured of reliable service.
13 A new definition of the utility's remaining obligation to serve will be needed.

14 Another aspect of obligation to serve is the right not to serve. I believe the utility should
15 have the right to exit the merchant business, not the utility business, provided a suitable
16 third party can be a gas supply successor.

17 Q. Please summarize your testimony.
18 A. As I mentioned earlier, the Model D approach envisions a gradual deregulation of the
19 gas supply function as the various customer market segments become competitive. There
20 is a possibility that competition will stop with the larger, higher load factor customers.
21 That may occur because merchants cannot bill thousands of customers, or because they

1 do not want to handle large swings in demand, or for other reasons. Deregulation that
2 ultimately goes only half or part of the way will not be acceptable. I believe it is the role
3 of the utilities to make it attractive for merchants to serve all Wisconsin customer
4 segments, but it is possible that competition will not penetrate certain markets. As I have
5 stated, there may be a critical mass of gas sales that is necessary to make the sale of gas
6 efficient and economical. If Model D leaves utilities with a merchant function obligation
7 for a market that is less than the critical mass, customers will pay too much for their
8 service. We need to pre-think this and other issues so that we have solutions ready for
9 implementation whenever the need arises.

10 Wisconsin Gas supports the separate option because it will keep the focus on the issues
11 I discussed. We strongly support market solutions as opposed to regulatory solutions
12 wherever possible. That is one of the principles underlying the Commission's approach
13 thus far. We must challenge existing practices and rules and tailor solutions for the
14 future. I urge the Commission not to decide the separate-allocate issue prematurely. All
15 the issues I raised and others that the staff has identified in its white paper and is working
16 on are related. It is vital that we achieve an overall integrated solution rather than
17 piecemeal answers that do not come together in a sensible way in the end. We all need
18 to work together to find solutions with the goal of providing competition and its benefits
19 for all customers in the state. finally, we cannot debate, create and refine solutions in
20 a hearing room. We have to move forward in a less formal environment, recognizing
21 that some formal record will have to be created at some point to form the basis for the
22 Commission's ultimate decision.



1 Q. Do you have any recommendations as to how the Commission and the parties should
2 begin to implement deregulation?
3 A. Yes. I would strongly urge this Commission to issue guiding principles that I have
4 outlined in my testimony. They would include:

5 1. Competition in state natural gas markets, and the corresponding benefits, should
6 reach all customers in the state.
7 2. State natural gas utilities should separate their natural gas supply function from
8 other utility operations when serving competitive markets.
9 3. One of the benefits of competition is customer choice. Customers in competitive
10 markets should have the option of procuring their gas supplies from the utility.
11 4. There are significant transition issues to be resolved.
12 • Supplier of last resort
13 • Obligation to serve
14 • Stranded costs
15 • DSM and ability to pay

16 These issues should be resolved with market based solutions in a collaborative
17 effort to assure safe and reliable service to state customers.

18 5. Recovery of prudently incurred verifiable stranded costs by state natural gas
19 utilities is necessary to move competition forward.
20 6. Costs caused, if any, by customers exiting the utilities system should be borne by
21 those customers as competition moves forward.

1 As a final point, I would strongly urge the Commission to assemble a state-wide task
2 force with appropriate representation, under Commission guidance, to begin to craft
3 workable solutions based upon the guiding principles set out above. This work would
4 be completed prior to commencing hearings on Phase II of this docket.

5 Q. Does this conclude your testimony?
6 A. Yes, it does.