COMMENTS OF DIRECT ENERGY SERVICES, LLC ON SENATE BILL 504, AN ACT CONCERNING NATURAL GAS CUSTOMER CHOICE

ENERGY AND TECHNOLOGY COMMITTEE

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Direct Energy Services, LLC ("Direct Energy"), a licensed competitive supplier of electricity and natural gas in Connecticut, is pleased to provide these comments in strong support of SB 504, An Act Concerning Natural Gas Customer Choice.

The bill encompasses several key provisions, all of which would constitute significant improvements in Connecticut's natural gas markets.

<u>Residential Gas Choice</u>

First, the bill would provide all natural gas customers in Connecticut with the right to choose their commodity gas supplier. Under the current regulatory framework, residential gas customers are not allowed to choose any supplier other than their local natural gas distribution company ("LDC"). Given the well-developed state of the competitive market for natural gas nationally, there is simply no valid reason to continue to withhold from residential customers the same right to choose a supplier that is enjoyed by commercial and industrial customers. The process of deregulation and restructuring in the gas markets was begun in earnest more than 20 years ago, with the issuance of FERC Orders 436 and 500, which addressed the regulation of natural gas pipelines after partial wellhead deregulation and encouraged pipelines to offer open access, nondiscriminatory transportation services so end users could contract directly with producers for gas supply. Following the passage of the Energy Policy Act of 1992, FERC issued Order 636, which required pipelines to unbundle their sales services from their transportation services and to provide open access transportation service that is equal in quality for all gas supplies whether purchased from the pipeline or some other supplier. The physical nature of the product, which allows for storage, and the availability of effective substitutes (for example, oil, propane, and electricity for home heating) have made natural gas amenable to robust competitive markets with a wide number of options for customers.

Where residential gas choice is available, such options frequently exist in abundance. For example, Direct Energy has several hundred thousand residential gas customers in Ohio, a state in which one of the largest LDCs continues to explore a path toward total exit from the merchant function. In New York, over a million customers are taking service from competitive gas suppliers. In the Atlanta Gas Light service territory, despite significant challenges in the initial move to full competition, nearly all customers are now on competitive supply and have a broad choice of suppliers. With residential customers being presented with a growing range of choices for electricity supply, the time is right to expand their choices to include non-utility natural gas supply as well. The possibility of marketing more than one energy product to a household would increase the overall attractiveness of the Connecticut market to suppliers and would likely bring more suppliers of both gas and electricity into the market.

Full Upstream Capacity Assignment or Release

Second, the bill would also require LDCs to release, assign or otherwise transfer to a customer's competitive gas supplier that customer's pro rata share of the firm storage and transportation capacity held by the LDC in its role as supplier of last resort for gas commodity service. Currently, the LDCs are required to maintain capacity equal to 100 percent of the demand on its distribution system, on the theory that the LDC should stand ready to serve all customers should every competitive gas supplier simultaneously exit the Connecticut market or otherwise be completely unable to serve any of their customers. While Direct Energy disagrees with the policy of requiring the LDC to maintain 100 percent supplier of last resort capacity, the inefficiencies of this system can be greatly mitigated by allowing customers to take their share of that capacity to a non-LDC supplier.

This would be both fair and efficient. It is fair because every customer pays for that capacity; should a customer leave the LDC's firm sales service, he or she should not be required to continue to pay the LDC to hold that capacity while also paying a non-LDC supplier for gas commodity service, which includes a redundant cost of capacity to provide firm service to that customer. It is more efficient because allowing non-LDC suppliers to use the assets their customers have already paid for provides far greater operational flexibility and access to potentially lower cost assets that are being held on the customer's behalf. The result is better pricing for customers. Under the current system, LDCs have little or no incentive to maximize the value of the capacity they hold for customers who have left firm sales service, as they are paid by the departing customer regardless. Moreover, there is no question of the departing customers being subsidized by remaining firm sales customers as suppliers must pay the maximum FERC-approved rates for the capacity assigned or released, ensuring that the LDC is made whole or better.

Fair and Rational Penalty Structures

Finally, the bill would require the DPUC to conduct a proceeding to "establish a procedure for monthly imbalance trading and nonpunitive . . . assessment of market-based penalties in accordance with subsection (a) of this section for balancing and delivery tolerances. The department shall not establish, assess or impose a penalty upon any natural gas seller unless the affected gas company has incurred an actual monetary loss." Under the current system, LDCs are allowed to charge excessive and non-cost-based penalties for imbalances on the theory that those penalties must exceed those of surrounding states in order to create a disincentive for Connecticut sellers to use capacity assigned from Connecticut customers in other states. There is no evidence that this type of behavior occurs in other states that have fairer and more rational penalty structures. These excessive penalties act as the equivalent of a tax on non-LDC suppliers, which bears no relationship to any harm that may have been caused to the LDCs or any threat to the reliability of the natural gas delivery system.

The combination of these excessive penalties and the lack of assignment of a customer's pro rata share of the capacity held by an LDC on that customer's behalf puts Connecticut at a significant competitive disadvantage with respect to all of its neighbors. New York, Massachusetts, and Rhode Island all allow 100 percent capacity assignment to most customers and all have far more rational penalty structures. Rather than causing suppliers to use capacity from those states elsewhere, the regulatory structures in those states have resulted in a robust competitive market that provides customers more value and flexibility than can be found currently in Connecticut.

Thank you for the opportunity to provide these comments.

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