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January 25, 1997

IN REPLY REFER TO:

Ansley Watson, Jr.
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VIA FEDERAL EXPRESS

Blanca S. Bayo, Director
Division of Records & Reporting
Florida Public Service Commission
Capital Circle Office Center
2540 Shumard Oak Boulevard
Tallahassee, Florida 32399-0850

Re: Docket No. 960725-GU -- Unbundling of Natural Gas Services

Dear Ms. Bayo:

Enclosed for filing in the above docket on behalf of Peoples Gas System, Inc., please find fifteen (15) copies of Peoples Gas System, Inc.'s follow-up comments on issues discussed at the Gas Unbundling Workshop held on December 12 and 13, 1996 in the above docket. A diskette containing the comments is also enclosed.

Finally, I enclose a certificate of service with respect to service of the enclosed comments on parties of record.

Please acknowledge your receipt of the enclosures on the duplicate copy of this letter, and return the same to me in the enclosed preaddressed envelope.

Many thanks for your usual assistance.

Sincerely,

Ansley Watson

ANSLEY WATSON, JR.

AWjr/a
Enclosures

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cc: Mr. Joseph W. McCormick
Parties of Record

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: Unbundling of natural gas services	)))	Docket No. 960725-GU Submitted for Filing: 1-27-97

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the follow-up comments of Peoples Gas System, Inc. on issues discussed at the Gas Unbundling Workshop held December 12 and 13, 1996 in the above docket, has been furnished by regular U.S. Mail to all parties of record in the above docket, this 25th day of January, 1997.

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Peoples Gas System, Inc.
Follow-up Comments on Issues
Gas Unbundling Workshop
October 21-22, 1996
Docket No. 960725-GU

General Comments

Questions and responses in workshops in this docket thus far have examined how unbundling natural gas utilities' services should be accomplished. The docket has provided a forum for free and open discussion of the details involved in unbundling. Peoples believes all parties have gained from the discussion. The focus, however, has been on the details of "how" to unbundle without discussion of the basic question of "whether" unbundling should be pursued.

Two fundamental questions have not been asked or answered:

1) "Should the Commission proceed with further LDC unbundling?" The answer must be based upon the answer to the second question.

2) "Can real net economic benefit be expected to derive to the state and to the body of LDC ratepayers as a whole from further Commission unbundling?"

The questions raised in this docket appear to assume those questions have been asked and the answers to both have been, "Yes!". Peoples has answered the questions as posited. The company is concerned that its silence on the two fundamental questions might be taken to imply agreement.

To be clear on this matter, Peoples firmly believes the answer to both questions is, "No". Obviously, some of Peoples' previous answers to questions in this proceeding do not reflect its position with respect to the advisability of unbundling. For instance Peoples' discussion of the mechanics of aggregation in response to questions 27-32 notwithstanding, the company does not believe that aggregating will provide tangible benefits to the vast majority of its customers. The company's responses to Questions 1-15 notwithstanding, Peoples believes that LDCs should continue to have the public utility obligation to serve. As an important tool for discharging that obligation, Peoples believes the LDC merchant function should be preserved and strengthened. When unwarranted and unfair competitive advantages which marketers currently enjoy, such as the ability to target gas supplies and avoid taxes and fees which LDCs must include in their transaction costs are mitigated, then LDCs can compete effectively and spread the benefits of market based commodity prices to their customers without exacerbating the problem of stranded investment in either pipeline capacity or their own distribution systems.

Questions raised in the December workshop, particularly Question 47, seem to imply that this docket could culminate in a Commission order requiring all natural gas utilities to file revised tariffs further unbundling their service offerings, in short, mandating unbundling. Such an outcome could irreparably damage LDCs and the bulk of the customers they serve. In any event, such a major decision should not be made in the kind of loosely structured procedural vehicle provided by this proceeding.

Peoples believes the potential for economic damage to Florida's economy from further unbundling greatly exceeds the potential for net benefit. There has already been real economic harm to Peoples' customers who are not transporting and to Florida's taxpayers as a result of the limited unbundling permitted thus far. The savings much touted by advocates of further unbundling are not true economic benefits, but merely reflect the transfer of costs or transfer of wealth. Peoples believes that, while unbundling might, at best, result in minimal net benefit to ratepayers, it will almost certainly result in merely shifting costs to non-transporting customers while benefitting only a few large customers and the marketers who come forward to reap the resulting windfall profits. The largest few thousand customers with the most attractive loads may save money; the 205,000 residential and small commercial customers will pay more. Taxpayers will also see increased cost, but no benefit. Absent a clear showing of net benefits to be derived by the entire body of natural gas utility ratepayers, the Commission should not proceed further with unbundling and perhaps should review the steps taken thus far. Peoples' position is not that its large customers should be deprived of the benefits which they might derive from a competitive market. Instead, Peoples encourages the Commission to assist in the creation of fair competition, unweighted by tax disadvantages and operating requirements that all fall on the side of unfairness to the regulated entity.

The following discussion supports Peoples' belief that there is no real economic benefit to be gained.

There is no evidence in this docket or in the marketplace to support the proposition that gas marketers can buy gas cheaper than Peoples. Peoples sells its gas at cost, so marketers cannot accept a lower profit margin. Yet, although marketers cannot buy gas cheaper or make less profit, they can sell gas cheaper to certain customers. How can this be?

There are three reasons unregulated marketers can sell gas cheaper in some market segments: 1) Buying gas through unregulated marketers avoids state and local taxes and fees that must be paid on system sales gas, 2) unregulated marketers can use cheaper, less reliable pipeline capacity, which increases LDCs' customers' costs, and 3) unregulated marketers can purchase gas packages targeted to specific market segments and to specific customers, while LDCs cannot.

Let us examine these three competitive roadblocks:

1) Avoidance of state and local taxes and fees:

> "The State of Florida continues to award a superior marketing position to unregulated marketers by requiring LDCs to pay taxes on gas sold through the utility, but not equally taxing sales by marketers." (Peoples' written comments following the August workshop, Response to Question 9)

A transporting customer avoids Gross Receipts Tax, Sales and Use Tax, Regulatory Assessment Fees, Municipal Utility Tax and Local Franchise Fees on the molecules of gas it buys from a marketer. It must pay those taxes and fees on gas it buys from the LDC. Other taxpayers make up the revenue shortfall to state and local governments. Thus, taxpayers subsidize transporting customers.

Marketers enter into competitive markets with a huge advantage, an advantage that can be as much as almost 26 percent added to the cost of gas, as shown below:

Tax or Fee	**Percentage**
Gross Receipts Tax	2.500%
Sales & Use Tax	7.000%
Regulatory Assessment Fees	0.375%
Municipal Utility Tax[1]	10.000%
Local Franchise Fees[2]	6.000%
Total Tax Advantage:	25.875%

The State of Florida may have lost as much as $18 million in Gross Receipts Tax and nearly $2.8 million in Regulatory Assessment Fees since 1990, on gas transported through Peoples' distribution system alone. Those lost tax revenues have had to be made up by other taxpayers. Many transporting customers are exempt from Sales & Use Taxes, so those losses were not calculated. Expansion of transportation participation, however, will include more non-exempt users and will increase losses from Sales & Use Tax.

Local governments have also lost Municipal Utility Taxes and Franchise Fees, which are

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1 Maximum is 10%, applied against the PGA rate in effect on October 1, 1973 (*cf.* § 166.231(b), Florida Statutes), or $0.05610 per therm.

2 Range is 4-6%, with the majority of localities charging 6%.

calculated as a percent of gross utility receipts. The loss to municipalities is estimated to be approaching $60 million.[3] Again, this is just for Peoples.

Governor Chiles recognized this inequity in his proposed budget submitted January 15, 1997. In it, he proposed a Gross Receipts Use Tax, described as "Impose a 2.5% use tax on natural gas purchased out-of-state and used in-state in order to improve fairness of the tax." (Governor's Budget Recommendations 1997-1998, page XXXVIII) Total revenues were estimated to be $5.7 million in the first year, and $6.2 million recurring. According to an article in the January 16 Florida Times-Union, House Speaker Daniel Webster, R-Orlando, said he would oppose the tax.

This tax bias does not provide any real net benefit to Florida's economy but merely transfers costs from those who benefit to those who do not, which is grossly unfair to taxpayers. The tax artificial price differential favors out of state marketing transactions, thus moving jobs, income and tax revenue out of Florida.

2) Cheaper, less reliable pipeline capacity:

> "Total FGT capacity costs constitute a 'zero sum game'; that is, somebody pays for all of it. Right now, those who benefit also pay." (Preface to Peoples' written comments following the August workshop)

> "The luxury we enjoy today of having excess pipeline capacity into Florida is not a permanent condition. Capacity shortages will return before pipeline expansion brings more capacity into the state." (Peoples' written comments following the October workshop, Response to Question 40)

> "The transporting customer will enjoy lower cost capacity <u>only</u> because someone else is subsidizing its cost. If the Commission requires LDCs to release capacity at discount to third party suppliers, it will be directly responsible for enriching third party suppliers (from the windfall difference between maximum and discounted rates) at the expense of the LDC's system sales customers or the LDC's shareholders. That should be an unacceptable outcome to the Commission." (Peoples' written comments following the October workshop, Response to Question 37)

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[3] Except for Municipal Utility Tax, revenue losses were estimated based on what would have been collected if transported volumes had been sold as system sales gas at Peoples' PGA prices applicable to the various periods. Actual prices of customer-owned transported gas are not available to Peoples. Municipal Utility Tax was calculated by applying the rate to volumes transported at the PGA rate in effect on October 1, 1973 (*cf.* § 166.231(b), Florida Statutes). Also, neither the Municipal Utility Tax nor Franchise Fees are applied outside municipal taxing areas.

A simplified example illustrates the inequity: Peoples had to acquire primary firm capacity to assure service to its customers, thus, for this example, Peoples' capacity acquisitions are assumed to have been prudent. If Peoples paid 40¢ per unit of capacity and Commission mandate results in a need to release half of it to transporters at 20¢ per unit, Peoples' remaining customers, a group including residential and small commercial customers, are burdened with the remaining 20¢ per unit. That increases the transportation component of Peoples' rate for remaining system sales customers from 40¢ to 60¢. A marketer can then remain competitive while providing service at a price that includes a transportation component of up to 60¢, pocketing the 40¢ per unit price differential. Thus, mandatory unbundling, done wrong, has the potential to increase the unit price for both system sales customers and transporting customers from the original 40¢ to 60¢ per unit of transportation capacity. Could this happen? Absolutely. Is this happening now? Yes. Non-transporting customers are picking up the costs transferred from transporting customers, including certain scheduling and balancing costs and even the costs of capacity released at a discount after transporting customers have begun transporting using released capacity or after capacity has been released below max rate following bypass.

Economic harm from shifting capacity costs from transporting to non-transporting customers has not been as large as tax revenue losses, because Peoples has moved cautiously to transportation and, in so doing, has protected the interest of all its ratepayers.

Regarding the use of released capacity, there is no benefit; merely a transfer of wealth from Florida's ratepayers to unregulated marketers. As is the case in tax losses, in many cases, the transfer takes jobs, income and tax revenue out of Florida.

This illustrates the problem with a mandate to release capacity or of the Commission's permitting the use of secondary capacity to provide firm service. Instead, the Commission should support the LDC and the good of its customers in creating tools to maximize utilization of LDC investment in FGT capacity. In order to allow Peoples to compete effectively on behalf of its customers, the Commission should require, to the extent permitted by law, that transporting customers use otherwise unused FGT capacity held by Peoples, rather than capacity purchased in the secondary market. In those instances where discounting of transportation is necessary, the Commission should allow LDCs to pass through to ratepayers the costs of discounting capacity as long as the transaction is demonstrated to yield a net benefit to ratepayers, as a whole.

Aside from economic considerations, the reliability of pipeline capacity must be a central focus for the Commission when considering any expanded access to transportation. Extensive use of secondary capacity would increase the cost to our customers at the same time it decreases the reliability of their service. That brings harm to the general body of ratepayers while pursuing a questionable social goal of providing lower cost to a few customers. Secondary capacity will become increasingly less reliable as temporary excess pipeline capacity into Florida evaporates through growth, so this whole problem will get worse.

3) LDC's must sell all gas at the weighted average cost of gas:

> "...(W)e must be permitted to use the tools to retain customers. Streaming of supplies (targeting the sale of specifically purchased packages of gas to a customer or group of customers at a price different from the WACOG) is one tool that will help us to meet competition. Dedicating supplies to certain customers will benefit other customers by increasing the total volumes Peoples purchases." (Peoples' written comments following the August workshop, Response to Question 9)

Peoples has only a single WACOG (Weighted Average Cost of Gas), which it must charge all customers, regardless of their individual usage, load factor, seasonality of use, interruptibility or other variables. Unregulated suppliers match customer usage characteristics with packages of gas purchased. LDCs cannot now do so. LDCs should be able to offer gas packages meeting the needs of the various market segments and even individual customers at prices that reflect their respective usage patterns. The Commission has sufficient oversight authority to ensure that gas costs are assigned or allocated fairly as long as it benefits the general body of ratepayers. In any competitive market (designated simply by a specified percentage of sales being made by a supplier other than the LDC), Commission price oversight would not be needed. Flexibility in procuring gas packages will permit LDCs to better meet the needs of all their customers, whether analyzed individually or in total.

Again, the price advantage to marketers is not based on real economic benefit, but merely exploits an artifact of outdated regulation.

What should be the next step?

In summary, The Commission should take no further action to unbundle the natural gas industry without first correcting existing inequities that create the opportunity for the few to benefit at the expense of the many.

When those inequities have been resolved, the Commission should then proceed with the following steps: 1) The Commission should permit LDCs to voluntarily modify transportation tariffs to increase or decrease the availability of gas transportation on their systems if LDC management can offer substantial evidence that benefits will accrue to the body of ratepayers. 2) The Commission should approve streaming of gas supplies for LDCs that can offer substantial evidence that to do so would benefit the body of ratepayers. 3) The Commission should permit LDCs to compete with third party suppliers to sell gas to individual customers or groups of customers at competitive prices where LDC management can offer substantial evidence that to do so would benefit the body of its ratepayers. 4) The Commission should permit LDCs to profit on commodity sales in any market that is competitive as defined above, possibly with a sharing mechanism to further benefit the body of ratepayers. 5) The Commission should seek to identify all other means to create a robust natural gas distribution industry that will meet the needs of all ratepayers and all of Florida's citizens.

Throughout this process, the Commission should remain mindful of whether actions benefit the general body of ratepayers. The Commission should proceed so as to protect the viability of the utility to provide a bundled service when to do so is in the best interest of that general body of ratepayers. The Commission should also keep in mind that the LDC benefits only when all of its customers benefit. The marketer benefits most when the interests of only a few customers are served.

Peoples' previous comments and the comments that follow should be considered in view of the above general comments. Peoples may also furnish additional written comments noting changes and trends in the national gas industry since this docket opened. In those additional comments, Peoples reserves the right to modify comments it has previously filed in this docket.

Comments on December Workshop Issues

43. Which dollars would flow to PGA customers, and which services would remain subject to the PGA? (AGDF)

The cost of all services necessary to buy and flow gas to system sales customers should be recovered through the PGA. These include the costs of gas, a proportionate share of pipeline capacity (including a proportionate share of capacity held for future growth) and costs associated with procuring, scheduling, monitoring and balancing both capacity and commodity, including staffing of the utility.

44. Should the LDC's have the discretion to bill the customer in one of two ways? (a) Company bills distribution and commodity components. (b) Company bills distribution component, supplier bills commodity component. (AGDF)

Yes. If an LDC elects to transport, LDCs, customers and alternative suppliers should be free to develop methods of billing. Normally, the LDC will bill customers directly for local distribution charges and perhaps for pipeline transportation. LDCs should also be allowed to offer, at negotiated rates, a billing service for suppliers who prefer to have the LDC handle all billing and collection.

45. Should the PSC adjust rates to parity before requiring further unbundling of LDC's? (AGDF)

No. As a threshold issue, the Commission should not require unbundling of this entire regulated industry for reasons discussed in the general comments.

The Commission must not require LDCs to provide any service compensated at less than cost. To do so would be confiscation of the LDC's investment. If the LDC needs to align its rates among classes, it has the ability to file a rate proceeding before the Commission.

OTHER ISSUES

46. Should the LDC be required to unbundle meter reading, billing, and collections services? (Staff)

No. These are decisions of outsourcing versus in-house and should be made by the utility based upon its needs.

47. Should the LDC be required to file unbundled tariffs within 90 days of the issuance of a Commission order on unbundling? (Staff)

No. This question seems to imply that this docket will culminate in an order requiring unbundling. This has not been a rulemaking proceeding. A Commission order requiring all LDCs to follow some uniform course of action is appropriately a rulemaking proceeding. Such a proceeding must address the threshold question of whether unbundling benefits the general body of ratepayers and must consider the economic impact on all ratepayers. This docket has done neither.

48. Who is responsible for tax collection remittance, who is responsible for bad debts and collection costs, etc.? (AGDF)

The provider of a service is responsible for collection and remittance of taxes and fees on that service.

49. Who is responsible for the costs of educating customers about transportation: LDC's, marketers, state government? (AGDF)

Those providing the services. LDCs must not be held fully responsible for educating customers.

50. Should LDC's be permitted to recover costs of educating customers, if they are required to perform that service? (AGDF)

LDCs should be able to recover costs of their customer education programs, whether required or undertaken voluntarily as a prudent customer service action.

51. Should the FERC Gas Tariff of Florida Gas Transmission (FGT) be used as an unbundled tariff model? (CNB Olympic)

No. FERC and FPSC jurisdiction are quite different, based as they are on the Florida Statutes and the Natural Gas Act, which are quite different. Although there are some similarities, LDC issues are quite different from pipeline issues. LDC tariffs must reflect the needs of their systems.

52. Should the LDC's start-up issues allow for implementation of procedural requirements (such as paperwork, metering, initial eligibility limitations, access fees, and mandatory agreements) if they act as barriers to service? (CNB Olympic)

No.

53. Should supplier/s competitively sensitive information, such as upstream contracts, remain confidential? (CNB Olympic)

Such information should generally remain confidential. It should be subject to disclosure to the LDC, under confidentiality agreement, as needed for the LDC to know whether a supplier has the capacity required to bring gas to the city gate. Pricing information should remain confidential.

54. Should LDC unbundled rates be held confidential to prevent the marketer/broker a competitive advantage? (Staff)

General tariff rates should remain public information in filed tariffs. Rates and other terms for competitive services provided by the utility or its unregulated affiliates should be treated the same as those of any other service provider.

55. What types of alternative regulation of unbundled rates should take place to allow unbundled service to "stand alone" from continued regulation of bundled customer services? (Staff)

This question implies that the decision with respect to whether unbundling should occur has been answered when it has not. The question also mixes the concepts of unbundling with concepts of regulation versus deregulation of certain services.

Unbundled services that become deregulated must be free of any regulation.

Even though, as discussed above, Peoples believes unbundling is an inappropriate course of action at this time, the Commission might well consider, in the context of creating the balanced competitive conditions discussed above, the increased use of revenue caps and incentive regulation. The current system of massive discovery in formal rate proceedings is very expensive. Detailed micromanagement of LDCs must be replaced with more common sense prudence reviews of utility actions. Any changes in future regulation of the gas industry should be further investigated only after experience with any rule changes that may result from Commission decisions in a rulemaking proceeding on unbundling conducted subsequent to the conclusion of this docket.

56. Should the commission mandate intensive technical conferences on each LDC's unbundling proposal: involving all interested parties? (CNB Olympic)

No.

57. Should there be mandatory review of unbundled tariffs: Should there be a plan to come back and fine-tune tariffs implemented? (CNB Olympic)

No. Review of tariffs by the Commission is mandated under current state law. There should be no formalized plan to reopen all tariffs for review.

58. Should the large customers simply be deregulated? (AGDF)

No. The Commission should keep in mind that synergistic benefits of integrated LDC system operations permit economies of scale that yield benefits to all LDC customers, including the 205,000 or more smaller customers that will not benefit from transportation. Destruction of those integrated operating systems by deregulating part of the customer base would deprive LDC customers of those very real benefits.

59. What issues are involved with total deregulation; cost allocation, tax collection and remittance, conflict resolution, etc.? (AGDF)

Breaking apart fully integrated systems, like LDCs, creates many problems. These include stranded costs, cost allocations, allocation of new shared use of future expansions or of increased use of existing systems, accounting and tax implications, among others.

Perhaps the largest issue is the loss of benefits of economies of scale by smaller firm customers. Other issues include the appropriate and ongoing allocation of assets, and the costs associated with operating and maintaining those assets, if the assets supply commingled natural gas supplies to both regulated and unregulated customers. The customer mix on any given main may change continually; thus reallocation would need to be done periodically. Investors would be at risk of recovering costs allocated out from the regulated side which could be expected to raise the cost of capital. The question also arises of whether the Commission has authority to put back into rate base any assets that might be idled by the loss of a customer from unregulated business. This intermingling creates ongoing conflict from trying to run both regulated and unregulated businesses through the same physically integrated system.

60. Should the PSC use a different, lighter-handed regulation for small LDC's as they move to unbundle services and to increase transportation? (AGDF)

Yes. Overall Commission regulation of smaller utilities should be reviewed with an eye toward reducing the cost burden on customers. If Commission decisions on unbundling ultimately result in less LDC revenues remaining subject to Commission jurisdiction, regulatory costs will become a larger fraction of total costs to be recovered through rates. Therefore, there should be less regulation to reduce the burden on customers. Future regulatory costs must be balanced against any perceived benefit to the customers.

61. Should the PSC permit greater discretion to LDC's in setting rates for commercial and industrial customers? (AGDF)

Yes. LDCs should be able to continue to use flexible rates and should be permitted to establish rate ranges. As long as there is a benefit in retaining commercial and industrial customers -- that is, the cost to the remaining body of ratepayers is less with the customer than it would be if the customer were lost -- the LDC should be able to base its rates on market acceptance. The same holds true for streaming of gas supplies and competitive pricing of gas by the LDC in competitive markets.

62. Should the PSC allow LDC's greater flexibility in setting unbundled transportation rates? (AGDF)

Yes. See response to Question 61.

63. Should the Legislature equalize tax levies on all suppliers? (AGDF)

Yes. The Commission should participate fully with the LDCs in assuring that unevenly applied taxation does not continue to impede full, fair and equal competition, thereby allowing LDCs to capture a fair share of market benefits on behalf of their general body of ratepayers.

64. Should municipals with their different state and federal tax treatments, be scrutinized when acting as a marketer outside of their municipal territory and competing with unbundled, FPSC-regulated LDC market affiliates and independent natural gas marketers? (CNB Olympic)

Yes, to the extend permitted by law.

65. Should the Legislature (or perhaps PSC) set requirements for financial capability of suppliers, marketers and brokers? (AGDF)

No.

66. Should the Legislature give the PSC authority to pre-qualify suppliers, marketers and brokers? (AGDF)

No.