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ALSO ADMITTED IN: DISTRICT OF COLUMBIA

August 27, 2007

Hon. William Bouteiller
Administrative Law Judge
New York State Public Service Commission
Three Empire State Plaza
Albany, NY 12223

Re: Proceeding on the Motion of the Commission as to the Rates, Charges,
Rules and Regulations of National Fuel Gas Distribution Corporation for
Gas Service
Case 07-G-0141

Dear Judge Bouteiller:

Enclosed please find the Reply Brief of Direct Energy Services, LLC.

In accordance with Rule 4.7 (c) of the Commission's Rules of Procedure, twenty-five copies of this brief have been filed with the Commission's Secretary, and a copy of this filing has also been served on all parties on the Commission's Official Service List via first-class mail.

Very truly yours,



George M. Pond
Attorney for Direct Energy Services, LLC

GMP:cam
Enclosure

cc: / Hon. Jaclyn Brillong (25 copies)
All parties in Case 07-G-0141

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STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

) Proceeding on Motion of the Commission
) as to the rates, charges, rules and regulations
) of NATIONAL FUEL GAS DISTRIBUTION
) CORPORATION for gas service.

CASE 07-G-0141

REPLY BRIEF OF DIRECT ENERGY SERVICES, LLC

Seth R. Lamont, Esq.
Direct Energy Services, LLC
197 Lancaster Street
Albany, NY 12210

Dated: August 27, 2007

I. BACKGROUND AND PROCEDURAL HISTORY.

National Fuel Gas Distribution Corporation (“NFG” or “Company”) filed with the Commission, on January 29, 2007, certain amendments to its gas tariff schedule by which it seeks to change its rates, charges, rules and regulations. By NFG’s own estimates, gross revenues would increase by \$52 million or 6.4%, amounting to a proposed delivery rate increase of approximately 19%. On February 20, 2007, the Commission issued an order suspending and setting for hearing NFG’s major rate filing, recognizing that the rights and interest of the public would be affected by the Company’s requested rate increase. Thereafter, Direct Energy Services, LLC (“Direct”) submitted the pre-filed direct testimony of Mr. Chris Kallaher on June 7, 2007 and the pre-filed rebuttal testimony of Mr. Kallaher on June 28, 2007. By motion dated July 12, 2007, NFG sought to exclude from the record certain portions of Direct’s rebuttal testimony. On July 16, 2007, Direct responded in opposition to NFG’s motion. On July 17, 2007, Administrative Law Judge Bouteiller denied NFG’s motion and allowed Mr. Kallaher’s testimony into the record in its entirety. A hearing was held on the record on July 23 and 24, 2007, at which no questions, including from NFG, were asked of Mr. Kallaher.

Initial briefs were filed on August 15, 2007. Both NFG and CPB submitted comments concerning the continuation of competition related programs in NFG’s service territory. Direct now respectfully offers the following reply. As a general matter, competition related programs in NFG’s service territory should be continued. In addition, an ESCO introduction program should be instituted in order to release the grip of the incumbent utility, in this case NFG, on the customer at the point of service

initiation. As developed in more detail, infra, the continuation of the POR program is vital to the development of competitive markets.

II. The Company Should Be Ordered to Continue a Number of Its Competition Related Programs as the Competitive Market is Not Fully Developed with Respect to Mass Market Customers.

The majority of competition-related programs in the NFG service territory should continue uninterrupted. Both the CPB and NFG call for the discontinuance of the majority of competition related programs (see, CPB Initial Brief, at pp. 19-20; NFG Initial Brief, at pp. 173-174). Specifically, NFG takes the position that competition in its service territory is “sufficiently robust” by “any reasonable measure” to warrant such a discontinuance, citing the fact that 100% of its large-volume customers have migrated to competitive supply and 17 % of its “small-volume” customer take their supply from ESCOs (see, NFG Initial Brief, at p. 174). While Direct agrees with NFG that competition is robust with respect to large-volume customers in NFG’s service territory, the market with respect to small-volume customers remains in a nascent state of development.

The market is not sufficiently developed with respect to small-volume, mass market customers to warrant the discontinuation of NFG’s competition related programs. As NFG itself noted , only 17% of these customers have migrated to competitive suppliers to date, which, of course means that NFG has retained 83% of its customers on firm sales service. There is no evidence in the record to support NFG’s contention that 17% migration among small customers indicates the existence of a robust, sustainable market for those customers such that NFG’s competition-related programs should be discontinued. Moreover, because Direct believes that the incremental costs of the

programs it sees as most critical to continued development of the retail market (namely the purchase of ESCO accounts receivable and the implementation of a reasonable ESCO Introduction Program) should be borne by ESCOs, Direct's suggestions represent a "no regrets" approach to these programs. With ESCOs paying the costs of the programs, which even NFG would have to admit increase the commodity choices available to small customers, there is no down-side to the continuation or, in the case of the ESCO Introduction Program, expansion of these programs to ensure the development of a robust, sustainable market for small customers.

III. The Commission Should Order the Parties to Convene a Collaborative in Furtherance of the Implementation of an ESCO Introduction Program, Which Will Be Funded By Participating ESCOs.

In its initial brief, the Consumer Protection Board (CPB) recommended that the Commission order a collaborative concerning the implementation of an ESCO Introduction Program, similar to what was agreed upon in the recent NYSEG Supply Service docket.¹ NFG, on the other hand, contends that the ESCO introduction program is simply a "variant" of the marketer referral program (MRP), and that the cost of any such program should not be borne by the general body of customers (see, NFG Initial Brief, at p. 177). Direct agrees with the CPB that the Commission should order a collaborative in furtherance of the creation of an ESCO introduction program, and that the incremental costs attendant thereto should be borne by participating ESCOs.

Direct agrees wholeheartedly with the CPB's recommendation that an ESCO Introduction Program be pursued as a part of a collaborative process to commence within

¹ Case 07-E-0479, Tariff Filing of New York State Electric & Gas Corporation to Offer Customers a Single Fixed Supply Service. The joint proposal has now been approved by the Commission.

thirty days of an order adopting rates in the instant proceeding, which is the procedure that was adopted in the NYSEG Supply Service case (see, CPB Initial Brief, at p. 21). In addition to the requirement that the collaborative convene within thirty days, Direct recommends that the parties be directed by the Commission to submit a Joint Proposal or otherwise present their findings to the Commission by December 31, 2007. This was the approach set forth in the Joint Proposal in the NYSEG Supply Service Case, which was approved by the Commission at its public session on August 22, 2007, and such an approach would be in the public interest in this case. As the CPB rightly points out, the details of an ESCO introduction program to address the issue of presenting customers with the option of choosing a competitive supplier upon new service initiation is a service territory-by-territory proposition and, therefore, the collaborative process is an appropriate forum in which to develop the terms of the program among the parties (CPB Initial Brief, at p. 21).

B. ESCO Introduction Program Constitutes a New Proposal and Is Not a Mere Variant of NFG's MRP.

The proposed ESCO introduction program will specifically address the barrier to the development of competitive market that is inherent in the process by which customers are placed on firm service at the point of service initiation. NFG contends that the ESCO introduction program is nothing more than a variant of the MRP (see, NFG Brief, at p. 177). There is a critical distinction between the ESCO Introduction Program Direct recommends, and which was the subject of the Joint Proposal in the NYSEG Supply Service Case, and the MRP described by NFG. This distinction is described in the very section of its Gas Transportation Operations Procedures Manual cited by NFG in support

of its contention that there is no difference between the ESCO Introduction Program and the MRP:

New customers (applicants for initiation of distribution and sales service) may join a Supplier's STBA Group by either (1) contacting Distribution, requesting new service and then contacting a STBA Supplier; or (2) consistent with New Delivery Service provisions contained within the UBPs, applying to a STBA Supplier who, as agent on behalf of the applicant, submits the application to Distribution.

NFG Brief, at p. 177, citing Gas Transportation Operating Procedures Manual, v. 1.63 at 23 (December 1, 2006) (emphasis added).

Unlike customers who choose firm sales service from the point of service initiation, customers who might choose to take service from an ESCO from that point cannot accomplish this goal in a single transaction with the distribution company. If they contact the distribution company to initiate service, they must separately contact an ESCO, as NFG's manual states. This places an additional hurdle in the path of customers who would otherwise wish to establish transportation service with the distribution company and take commodity service from an ESCO. Those choosing firm sales service conclude their transaction through one telephone call with the distribution company. The ESCO Introduction Program would provide the missing opportunity for customers to initiate service and sign up for ESCO commodity service in a single transaction with the distribution company

It is the case that customers can accomplish the goal of initiating service and taking ESCO commodity service by applying to an ESCO which would then submit the application for service initiation acting as the customer's agent. This is an important feature that should be retained, and it could be sufficient to level the playing field between ESCOs and the LDC's firm sales service once a more robust and sustainable

level of market development for small customers has been reached. NFG's small customers market is clearly not yet at that level, and the overwhelming majority of customers who wish to initiate service will still contact the distribution company to do so, even where they may also be willing to take commodity service from an ESCO if presented with those options.

C. Participating ESCOs Should Be Called Upon to Pay the Incremental Cost of the ESCO Introduction Program.

Direct is sensitive to the public policy concern that the general body of customers should not necessarily be shouldered with costs that are more appropriately borne by the ESCOs that choose to participate in a retail access program such as the proposed ESCO Introduction Program. For that reason, we do not agree with NFG contention that the implementation of the ESCO Introduction Program “would be yet another utility program designed to shift costs from the ESCO to the utility” (see, NFG Initial Brief, at p. 177). Direct believes strongly that such cost shifting should not occur with respect to the proposed ESCO Introduction Program. Rather, Direct concurs with the CPB's position that “[t]he program should . . . stand on its own” and not be subject to “guarantee or subsidy from ratepayers” (see, CPB, Initial Brief, at p. 21). While Direct would not concede that the costs associated with any retail access program should never be borne by the full body of customers, it nevertheless recognizes that it would be appropriate for ESCOs to bear the cost of the implementation of the ESCO Introduction Program at this time.

Any utility-based program that operates in the furtherance of the creation of competitive markets benefits the full body of ratepayers and thus should not be

characterized as a subsidy *per se*. To the extent that competition related programs serve to bring about a robust competitive market, with a concomitant increase in overall economic efficiency, all customers benefit. In a sufficiently competitive market, ESCO offerings serve as a check on utility rates. In addition, customers benefit from having a choice among energy suppliers, which allows individual customers to find an option that best meets their specific needs. Further, a fully competitive market will yield value added services and innovation that would be impossible to achieve by relying solely on a fully regulated, vertically integrated distribution company

While enhanced competition surely brings net benefits to all customers, large and small alike, Direct nonetheless believes that ESCOs should be required to pay the incremental costs associated with the proposed ESCO Introduction Program. Where incremental costs are incurred by the utility in the implementation and operation of the ESCO Introduction Program, participating ESCOs should pay a share of those costs. This cost structure should be negotiated by the parties a part of the collaborative proceeding recommended by the CPB in its initial brief and now Direct.

D. Implementation of the ESCO Introduction Program is in the Public Interest.

The Commission's nearly decade-long policy of taking steps in furtherance of the development of competitive markets has not, to date, included a focus on the issue of service initiation, which now remains as a barrier to the development of competitive markets. Inasmuch as the ESCO introduction program addresses an issue that has not been hitherto addressed and the Commission has the option of placing the cost of such a

program on participating ESCOs, implementation of the ESCO introduction program is in the public interest.

IV. The Purchase of Receivables Program Should Continue for the Duration of NFG's Rate Plan.

In its initial brief the CPB also expressed support for NFG's testimony concerning its request to gain the right to terminate the purchase of receivables program (POR) at its discretion with one-year's notice to the affected ESCOs. Direct believes that NFG should not be permitted to discontinue the POR program during the upcoming rate year at its discretion, as the POR Program is strongly in the public interest and does not represent a subsidy in favor of ESCO service.

A. NFG Should Not Be Afforded the Discretion to Eliminate the POR Program.

The POR program should be continued throughout the upcoming rate year; NFG should not be permitted to discontinue the POR program at its discretion. While the CPB states that it is generally supportive of the POR program, the CPB also supports NFG's position that it should be permitted, upon one year's notice to the parties, to discontinue the POR program (see, CPB Initial Brief, at p. 20). In the CPB's view, the notice provided by NFG under the proposal "will give all affected parties ample opportunity to bring any concerns they may have before the Commission long before the [NFG]'s decision takes effect" (see, CPB Initial Brief, at p. 20). While the notice period would mitigate to some extent the negative implications of allowing NFG to discontinue the

~~POR program at its discretion, Direct nevertheless takes strong exception to NFG's proposal to be given the sole discretion to put discontinuance of the program into motion.~~

Regardless of the time period that parties will be afforded to contest a decision to discontinue the POR program by NFG, Direct views this proposal by NFG as procedurally defective, as the decision to discontinue the program does not properly rest within the discretion of NFG but, rather, the Commission. In Direct's view, affording NFG the discretion to discontinue programs such as the POR program without specific Commission approval sets a dangerous regulatory precedent. As discussed in Direct's Initial Brief, the program has important benefits for all parties, customers, ESCOs, and the distribution company, and to achieve the full measure of those benefits, market participants require a level of regulatory certainty that would be undermined by NFG's proposal.

B. The POR Program Provides Certainty for Customers.

Continuation of the POR program will provide certainty for energy customers who are currently taking ESCO service or will sign up for ESCO service during the term of the rate plan. In the absence of POR, there is no evidence contained within the record in this case as to how customers taking service from competitive suppliers will be billed for their energy from ESCOs, particularly residential customers. A dramatic change such as the discontinuance of POR would inevitably have an adverse impact on customers who now take supply from ESCOs, or who may sign up for ESCO service during the term of the rate plan. The great majority of mass market customers are billed using utility-consolidated billing with POR, and the discontinuance of POR has the potential to

~~frustrate those customers' existing contracts for competitive supply. Requiring NFG to~~
~~address the issue of the continuation of POR in the course of its next rate filing would~~
allow for the more orderly and thoughtful consideration of the impacts on existing
customers and the competitive market from such an action.

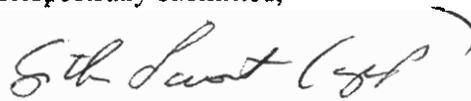
**C. Uncertainty Concerning the Continuation of the POR Program
Serves as a Barrier to the Further Development of the Retail
Market.**

Approval of a rate order in this case by the Commission giving discretion to NFG with respect to the discontinuation of the POR program will create a significant barrier to the development of retail markets for supply service. As described in Direct's Initial Brief, POR brings significant benefits to all market participants, including the distribution company, and uncertainty about the continuation of this foundational program would have a significant negative impact on the overall attractiveness of the NFG service territory to ESCOs, which would, in turn, have a negative impact on the further development of additional supply options for customers, especially mass market customers. A supplier considering entry into NFG's market will certainly take pause upon considering the uncertainty as to whether the POR program will be discontinued in the near term. In addition, POR has long been seen as the lynchpin of the development of competitive markets for supply and, as such, discontinuance of POR at this stage in the development of competitive markets would not be in the public interest.

V. Conclusion.

For the reasons stated above, Direct respectfully request that the Commission order the parties to convene a collaborative in furtherance of the adoption of an ESCO Introduction Program for NFG's service territory that would remain in place at least for the duration of the rate plan that results from this proceeding. Direct also respectfully requests that the Commission order NFG to continue its POR program throughout the upcoming rate year, and deny NFG's request to be given the discretion to unilaterally announce its intention to discontinue the program.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Seth Lamont (y)", is written over a light gray rectangular background.

Seth R. Lamont
Manager, Government and Regulatory Affairs