**BEFORE**

**THE PUBLIC UTILITIES COMMISSION OF OHIO**

**In the Matter of the Joint Motion to Modify the )**

**December 2, 2009 Opinion and Order and the ) Case No. 12-2637-GA-EXM**

**September 7, 2011 Second Opinion and Order in )**

**Case No. 08-1344-GA-EXM )**

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**DIRECT TESTIMONY OF RANDY MAGNANI ON**

**BEHALF OF HESS CORPORATION**

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**November 30, 2012**

**Direct Testimony of Randy Magnani**

**Q. Please state your full name and business address.**

A. My name is Orlando (Randy) Magnani. My business address is One Hess Plaza, Woodbridge, NJ 07095.

**Q. By whom are you employed and in what capacity?**

A. I am employed by Hess Corporation (“Hess”) as Director of Natural Gas Operations.

**Q. On whose behalf are you testifying?**

A. Hess.

**Q. What are Hess’ energy marketing business interests in Ohio?**

A. Hess is a competitive natural gas and electric supplier that operates throughout the East Coast and Midwest. More specifically, Hess is a licensed natural gas supplier that provides supply services to over 9,100 commercial and industrial (“C&I”) customers in 21 states, including in the Columbia Gas of Ohio (“COH”) service territory. In the last few weeks, Hess has closed a deal to acquire the energy marketing business of Delta Energy, LLC (“Delta”). The Delta acquisition includes numerous natural gas supply contracts throughout Ohio, including many behind COH. Additionally, as a result of the Delta acquisition, Hess plans to open a regional office in Dublin, Ohio in mid-December 2012. As you can see, Hess has made significant investment to expand its energy marketing capabilities and to be able to serve customers throughout the Midwest, including Ohio.

**Q. What are Hess Small Business Services, LLC’s energy marketing business interests in Ohio?**

A. Hess Small Business Services, LLC (“HSBS”), a wholly-owned subsidiary of Hess, is a separately licensed competitive retail natural gas supplier (“CRNGS”) in Ohio that specifically focuses on marketing energy supply services to small commercial customers. As part of the Delta acquisition, HSBS acquired numerous Choice contracts throughout the Dominion East Ohio (“DEO”) and COH service territories.

**Q. What are your duties as Hess’ Director of Natural Gas Operations?**

A. As Director of Natural Gas Operations, I oversee all of Hess’ natural gas marketing operations (including forecasting, scheduling, pricing, and regulatory activities) involving the natural gas local distribution companies (“LDCs”) in Hess’ energy marketing footprint. I am responsible for overseeing Hess’ six regional operations offices which have the local day-to-day duties for natural gas operations within their specific geographic regions. Currently, Hess operates behind over 60 LDCs. Additionally, while at Hess, I participated in the DEO and COH stakeholder collaboratives aimed at developing and implementing their standard service offer (“SSO”) and standard choice offer (“SCO”) auction programs.

**Q. What is your educational background?**

A. I obtained a Bachelor of Engineering in Chemical Engineering from Manhattan College in 1970.

**Q. What is your professional background?**

A. Prior to taking on my current role as Director of Natural Gas Operations in 2001, I was a Principal with Navigant Consulting performing various consulting services primarily related to LDC issues from 1998-2001. From 1996 to 1998, I was President and Chief Operating Officer for KeySpan Energy Services, Inc. (“KeySpan”). At KeySpan,[[1]](#footnote-1) I had general supervisory responsibility for its gas marketing business. In the infant stages of retail gas restructuring, KeySpan emerged as one of the first small commercial gas marketers in the country. Among other territories, KeySpan served residential and small commercial customers in COH. From 1971 through 1996, I held several roles at The Brooklyn Union Gas Company (“Brooklyn Union”), the local LDC in Brooklyn, New York. I served as Manager of Gas Operations where I was responsible for the operation and maintenance of the company’s LNG plant and high pressure transmission system, as well as all scheduling activities on interstate gas pipelines. Additionally, I served as Brooklyn Union’s Manager of Rates and Gas Supply where I was responsible for cost allocation and rate design of utility rates, state and federal regulatory affairs, and gas supply planning and contract negotiation and administration.

My resume is attached hereto as Exhibit OM -1.

**Q. Have you previously testified before the Public Utilities Commission of Ohio (“Commission”)?**

A. No, however, I have presented written and oral testimony before multiple public utility commissions (“PUCs”) in my time at Hess and in my previous roles at Navigant, KeySpan and Brooklyn Union, including the New York Public Service Commission, Pennsylvania Public Utility Commission, Maryland Public Service Commission, Missouri Public Service Commission, Massachusetts Department of Public Utilities (formerly, the Department of Telecommunications and Energy), Rhode Island Public Service Commission and the Federal Energy Regulatory Commission. I have testified at PUCs on a variety of competitive natural gas issues, including gas transportation program design and wholesale asset management agreements. As you can see from my previous answers, I have over 42 years of experience working for competitive natural gas suppliers, a natural gas consultant, and an LDC. I am very familiar with traditional LDC default service procurement, SCO auction programs, and Choice programs. I have a detailed knowledge of the various program criteria that are necessary for a natural gas supplier to effectively market natural gas supply services to all classes of retail customers.

**Q. What is the purpose of your testimony?**

A. On October 4, 2012, COH, the Staff of the Commission (“Staff”), the Ohio Gas Marketers Group (“OGMG”), the Retail Energy Supply Association (“RESA”), and Dominion Retail, Inc. submitted a Joint Stipulation and Recommendation (“Original Stipulation”) in this proceeding requesting the Commission’s approval of several modifications to COH’s current SCO auction program design established in the Commission’s December 2, 2009 Opinion and Order and the September 7, 2011 Second Opinion and Order in Case No. 08-1344-GA-EXM (the “Exemption Orders”). On November 27, 2012, The Office of the Ohio Consumers’ Counsel (“OCC”) joined the Original Stipulation and the parties filed an Amended Stipulation and Recommendation (“Amended Stipulation”). My testimony specifically addresses Hess’ position on the following elements of the Stipulation:

1. **Non-Residential Exit Framework**. The Amended Stipulation provides that if non-residential customer participation in the COH Choice program meets or exceeds 70% of Choice-eligible, non-residential customers for three consecutive months, then COH will exit the merchant function with regard to non-residential customers effective the first April 1 that follows.[[2]](#footnote-2)

2. **Residential Exit Framework**. The Amended Stipulation provides that if residential customer participation in the COH Choice program meets or exceeds 70% of Choice-eligible, residential customers for three consecutive months, then COH may file an application with the Commission to exit the merchant function for all Choice-eligible residential customers on the first April that is at least twenty-two (22) months after COH exits the merchant function with regard to non-residential customers. COH and the OGMG will prepare testimony supporting that final exit-the-merchant-function application.[[3]](#footnote-3)

3. **Monthly Variable Rate Allocation**. The Amended Stipulation provides that upon exit from the merchant function for either Choice-eligible, non-residential customers or residential customers, COH will no longer provide default commodity service for that subset of Choice-eligible customers. Instead, those Choice-eligible customers that do not enroll with a supplier will be assigned a supplier, pursuant to COH’s monthly variable rate (“MVR”) program.[[4]](#footnote-4)

4. **SCO Supplier Cash Security Charge**. The Amended Stipulation provides that in addition to the currently-required Letter of Credit, winning SCO suppliers will be required to provide COH with a new $0.06 per Mcf cash “deposit.” This $0.06 per Mcf charge is purportedly to offset COH’s potential default expenses. Should any funds be remaining at the end of the SCO program year, the balance will be credited to the Choice/SCO Reconciliation Rider (“CSRR”) commencing the next year.[[5]](#footnote-5)

**Q. Briefly summarize Hess’ position on these four issues.**

**A.** Hess’ urges the Commission to:

1. approve the Non-Residential Exit Framework;

2. reject the Residential Exit Framework;

3. approve an MVR allocation methodology for non-residential customers that incorporates SCO tranche ownership; and

4. reject the Stipulation’s proposed $0.06 per Mcf SCO security charge.

**Q. How does COH currently procure default commodity service for non-shopping Choice-eligible customers?**

A. Beginning in April 2012, COH has employed an SCO auction model where COH conducts (through a third-party vendor) a descending clock auction whereby CRNGSs can compete to supply one or more shares (up to a maximum of four shares) for COH’s combined SCO customers’ demand. COH’s forecasted demand is divided as equally as possible into 16 tranches with one tranche equal to approximately 5 Bcf per year of gas supply. Bidding suppliers bid a Retail Price Adjustment which will be added to the NYMEX final settlement price each month during the SCO year to determine the monthly SCO price. Winning suppliers are assigned the responsibility to supply individual SCO customers in their assigned tranche(s) for the course of the SCO year (April 1 through March 31). The SCO price each month is the NYMEX final settlement price for the month plus the Retail Price Adjustment determined by the SCO auction as a price per Mcf.

Before the SCO auction program, COH employed an SSO auction program beginning in 2010 that operated much in the same way as the SCO process except that the SCO process (1) allows winning bidders to be assigned individual customers (as opposed to the SSO’s allocated percentage of sales customers’ demand); and (2) SCO customers are subject to sales tax as opposed to gross receipts tax on the gas purchased through the SCO program.

**Q. Has Hess won any tranches in COH’s SCO and SSO auctions?**

A. Yes. Hess won tranches in COH’s 2010-2011 SSO auction and its 2012-2013 SCO auction.

**Q. Are you in favor of the Amended Stipulation’s proposal to end the SCO option for non-residential customers once 70% of Choice-eligible, non-residential customers are shopping?**

A. Yes. The Amended Stipulation calls for the end of the SCO auction for Choice-eligible, non-residential customers once 70% of these customers are taking natural gas supply directly from a retail supplier. I am in favor of this proposal. In my experience, commercial customers have a more sophisticated understanding of their energy consumption needs than residential customers and tend to be more motivated, for business reasons, to achieve price certainty or price stability for their energy costs. Additionally, commercial customers have usage levels that are large enough to take advantage of retail suppliers’ more complex supply-side products that are specifically tailored to a customer’s usage profile and risk tolerance, including, but not limited to, fixed price, index-following, and index with cap offerings. In contrast, the SCO offering is only a monthly variable product. In regards to the non-shopping, non-residential customers that are assigned to MVR suppliers at the time of exit, these customers have a better understanding of the gas market to evaluate multiple supply offerings and to make an informed decision that best fits their budgetary needs, risk tolerance and usage profile. For these reasons, Hess supports the Amended Stipulation’s non-residential exit framework.

**Q. Should the 70% trigger be met, which methodology do you support to assign the remaining pool of non-shopping, non-residential customers?**

A. It is my understanding that (1) the Amended Stipulation calls for an allocation to MVR suppliers, but does not delineate precisely how to assign the remaining pool of non-shopping, non-residential customers once the 70% exit trigger is met; and (2) the Commission plans to resolve the MVR assignment methodology in this proceeding.[[6]](#footnote-6) Hess endorses an MVR assignment methodology that is based on each supplier’s proportional market share at the time of exit, including a supplier’s average historical SSO and SCO tranche ownership.

Hess proposes a proportional allocation ratio that is equal to the number of Choice-eligible customers being served by the supplier, including the average percentage of customers served under the SSO and SCO auctions, divided by the total number of Choice-eligible customers (both shopping and non-shopping).  To determine the number of SSO/SCO tranche customers to be assigned, Hess recommends taking the average number of tranches served by each supplier since the first SSO auction in 2010 through the SCO auction at the time of non-residential exit. I have prepared an illustrative example of how Hess’ proposed SSO/SCO tranche customer assignment methodology would work and attached it hereto as Exhibit OM-2.

Hess’ proposed MVR assignment methodology strikes the appropriate balance between properly recognizing each supplier’s contribution and investment in reaching the 70% exit trigger, while continuing to incent all suppliers (retail and SCO) to offer customers competitive products. Incorporating historical SCO tranche ownership is critical because the SCO auction has been the primary tool in transitioning from LDC-procured default service to providing a market-based benchmark price that Choice customers can use as a means of comparison. Not surprisingly, SCO suppliers, like Hess, have had to make and must continue to make considerable investments in their “back-office” resources (traders, market analysts, customer enrollment personnel and IT systems) to stay competitive in the SCO market. Adopting an MVR assignment methodology that incorporates SCO tranche ownership is necessary to continue to incent investment in the SCO market. Otherwise, if the Commission does not recognize SCO tranche ownership, the Commission will be dissuading SCO suppliers from continuing to make the long-term investments to improve their probability of success in future SCO auctions. Competitive market principles would dictate that this investment disincentive will increase prices to SCO customers.

**Q. Are you in favor of the Amended** **Stipulation’s framework that could end the SCO option for residential customers once 70% of Choice-eligible, residential customers are shopping?**

A. No, I am not. Hess understands that (i) given current shopping statistics, it could take several years to reach the residential exit trigger;[[7]](#footnote-7) and (ii) the Amended Stipulation provides that COH may file an application to exit and is not calling for an automatic exit like the Stipulation does for non-residential customers. However, Hess still recommends that the Commission reject the Amended Stipulation’s residential exit framework because the Commission would be:

(i) Creating regulatory uncertainty in the SCO and retail markets, which will lead to higher prices for residential customers;

(ii) Removing the lowest-cost benchmark price, which provides extremely valuable transparency for residential customers; and

(iii) Subjecting numerous SCO residential customers to higher prices without their consent, which is inconsistent with prevailing Ohio policy and not in the public interest.

**Q. What are the critical differences that warrant different treatment for the residential sector?**

A. First, while price motivates all customers, in my experience, most residential customers are particularly focused on obtaining the lowest price. Unlike commercial customers which have usage profiles and business interests that make fixed price and “index and cap” offerings attractive, residential customers are not as motivated by obtaining price certainty as they are as getting the lowest price. Residential customers traditionally have been on a variable product and are comfortable with any volatility that comes with taking this supply offering. As I will explain in more detail below, competitive market dynamics result in the SCO auction price being the lowest-cost alternative for residential customers.

Second, Hess opposes any framework where COH could exit the merchant function for residential customers once a 70% shopping level has been met. Simply put, the 70% shopping threshold trigger is too low. Using the Choice enrollment data maintained on the Commission’s website (Exhibit OMG – 3), in our estimation, at 70% shopping levels, over 364,000 customers would still be on SCO service. Pursuant to the Amended Stipulation, if an exit was approved, all of these customers would be assigned to retail suppliers at their suppliers’ respective MVR rates, i.e., the customers would have a contractual relationship with the supplier assigned. Competitive market dynamics dictate that these assigned customers will be subject to a higher supply rate (as the SCO price will be lower than any retail supplier’s MVR rate). Moreover, beyond transferring an enormous amount of customers to a higher rate without these customers’ consent, the Commission would no longer have any regulatory oversight of gas supply prices for Choice customers.

**Q. Are there benefits to having the SCO auction continue for residential customers even at shopping levels of 70%?**

A. Yes. The SCO auction is a proven benchmark from which residential customers (and the Commission) can vet suppliers’ offerings. In fact, SCO service has proved to be the lowest-cost option for residential customers. As shown in COH’s response to the Office of Consumers’ Counsel Request for Production of Documents No. 65 (Exhibit OM – 4), since the initiation of the SSO in April 2010, COH’s Shadow Bill data demonstrates that, on a monthly basis, Choice customers (in the aggregate) paid more than $300 million over the SSO/SCO price. During that time period, it is my understanding that there was not one month where Choice customers (in the aggregate) paid less than the SCO price. The SCO’s low price is intuitive given the fact that when COH aggregates the large number of Choice customers that have elected SCO service, the suppliers bid on the fixed basis component at a wholesale level. It is extraordinarily difficult for retail suppliers to compete against the SCO price on a straight cost basis because the SCO program allows suppliers to bid on a huge pool of customers at one time and optimize upstream assets for that large, quantifiable group of customers..

Besides representing the lowest-cost alternative for residential customers, the SCO provides transparency throughout the competitive market place for the residential customers to evaluate various supply offerings. Without the SCO, retail competition can still be robust, but it will be at a higher price than it would with the SCO in place.

Opponents will dispute this fact by arguing that, by eliminating the SCO, the Commission would simply be removing one of over 50 retail suppliers from the market -- hardly a “game changer” for the retail market place. However, the SCO auction is not just one of many similarly-situated suppliers in the market; it is *the* lowest-cost alternative for residential customers who wish to take service under a monthly variable rate (and the supply option with which they are most familiar).

The OGMG and RESA (“Residential Suppliers”) also argue that by taking SCO service and not taking service from a retail supplier, an SCO customer is not engaged in the retail natural gas market. Residential Suppliers’ witness Parisi states in his initial testimony (pages 6-8) that “inactivity” or “passivity” (as the Residential Suppliers put it) is inconsistent with the State’s policy to build a framework where retail customers “can elect the products that meet their respective needs.” I completely disagree with that proposition. The Commission has made significant efforts to develop a framework in COH where customers can elect their natural gas suppliers. COH’s competitive retail market provides a multitude of options for retail customers to consider, including the SCO option, a competitively-derived monthly variable rate product.

One cannot reasonably argue that a customer that has elected to stay on the lowest-cost alternative is not engaged in the market. Rather, those customers are simply taking advantage of the choices that the market has afforded them in selecting their natural gas supplier. In the case of SCO customers, they have made the decision to stay on a monthly variable rate that is uncomplicated and stable, and consistently the lowest-cost alternative. I fail to see how such a common-sense decision demonstrates “disengagement” and “ambivalence,” using the words of Residential Suppliers’ witness Parisi (at page 6). At the end of the day, COH residential customers should not be punished by having the lowest-cost alternative removed from the market simply because certain residential retail suppliers are frustrated that they cannot compete with the SCO price on a cost basis.

**Q. How do you respond to the argument that the SCO program should be eliminated because, while the SCO auction program has resulted in prices significantly lower than retail suppliers’ offerings to date, the SCO price could become much higher at any given moment to the detriment of SCO customers?**

A. Given the nature of the SCO price (fixed basis plus NYMEX price of gas), it is true that the SCO price could swing during the course of the SCO year. Accordingly, if a customer highly values price certainty to hedge against the potential swings in the gas market, then moving off of SCO service to a retail supplier’s fixed-price offering makes sense. However, an argument that that the SCO should be eliminated due to the potential for large intra-year price swings is faulty in two respects. First, the potential for intra-year volatility exists for residential suppliers’ MVR rates just as it does for the SCO price. Second, the argument obviously hinges on the gas commodity market suffering from high volatility. I am very confident that Ohio gas customers will not experience high gas volatility in the near to intermediate future. Given the current unprecedented high levels of domestic natural gas supply in the region, especially in Ohio with increasingly more shale gas coming on-line every day, I cannot envision high volatility in the gas commodity market for several years, possibly several decades to come. Thus, if a customer is primarily motivated by price, common wisdom suggests that the customer should take SCO service.

Of course, if I am wrong and there is severe gas price volatility in the future, SCO customers are always free to leave SCO service and contract directly with a retail supplier. SCO suppliers have always been subject to migration risk and I am, by no means, recommending that retail suppliers be shut off from marketing directly to residential customers. Rather, I am simply noting that there is very little risk that the commodity market will swing severely to the detriment of SCO customers in the near to intermediate future. Any argument for eliminating the SCO program that rests on the potential for high price volatility in the gas commodity market belies market realities and should be disregarded.

**Q. Is assigning COH residential customers to MVR suppliers once the 70% trigger has been satisfied consistent with Ohio policy?**

A. No, I do not believe so. At some point, where there is advanced shopping, it becomes inefficient from a cost perspective for an LDC to continue to operate and SCO suppliers to continue to participate in an SCO auction program. For instance, in DEO, where there is already extensive shopping among Choice-eligible customers, [[8]](#footnote-8) it is likely more cost-effective to assign the remaining non-shopping customers to MVR suppliers. Hess supports the DEO stipulation currently before the Commission where DEO has proposed to exit the merchant function for non-residential customers in April 2013 and to continue to evaluate whether it is efficient to exit the merchant function for residential customers (but not before April 2015). However, there are some key differences in the DEO and COH shopping statistics and exit-the-merchant-function stipulations.

As I pointed out above, DEO is experiencing much higher levels of shopping than COH is currently experiencing. It is my understanding that recent statistics show DEO’s shopping is at over 80% for non-residential customers and 84% for residential customers. In COH, the current shopping statistics are much more modest with 48% for non-residential customers and 37% for residential customers.[[9]](#footnote-9) Unlike DEO, where, at the time of exit, there will be a relatively small amount of customers being assigned to MVR suppliers, if COH exits at the residential 70% shopping trigger, over 364,000 customers will be assigned to MVR suppliers.

Counsel advises that Section 4929.02(A)(7) of the Ohio Revised Code provides that:

It is the policy of this state to, throughout the state:

Promote an expeditious transition to the provision of natural gas services and goods in a manner that *achieves effective competition* and transactions between *willing buyers and willing sellers* to reduce or eliminate the need for regulation of natural gas services and goods under Chapters 4905. and 4909. of the Revised Code. (emphasis added)

Counsel advises that this subsection sets the state policy of transitioning from traditional, LDC-procured default service to a framework that procures gas supply from the competitive market place. In my view, “willing buyers” requires an affirmative decision by customers to select their competitive retail suppliers. If the Commission orders the residential exit at 70% shopping, COH would be assigning over 364,000 customers to MVR suppliers without their consent. Additionally, as explained above, these assigned customers will be subjected to a higher rate than they were receiving under SCO service. An assignment of this magnitude fails to satisfy Ohio’s “willing buyer” policy. Thus, the Amended Stipulation’s proposed residential exit framework contravenes prevailing state policy.

**Q. Do you think the SCO auction promotes a transition to the provision of natural gas services and goods in a manner that achieves effective competition?**

A. Absolutely. LDCs do not have the same incentive to keep their commodity costs and gas procurement costs down as competitive suppliers do since LDCs have established cost recovery mechanisms that are obviously not available to competitive suppliers. The SCO program, in contrast, is set in the competitive market place where SCO suppliers must be extremely efficient and there is downward pressure on margins. As I explained above, COH’s SCO program allows suppliers to compete at the wholesale level and annually produces a reliable, lowest-cost alternative for residential customers that prefer taking a variable rate. With this outcome, the SCO program is a proven, reliable, and cost-effective tool to transition the merchant function responsibilities from COH to the competitive market place. As such, COH’s SCO program clearly fulfills Ohio policy to achieve effective competition for gas supply procurement.

**Q. How do you respond to the argument that the Amended** **Stipulation does not call for an automatic exit and only provides that COH may file an application where the Commission could make a final decision on the residential exit?**

A. I understand the Amended Stipulation’s provision; however, I believe a Commission order approving this framework will severely undermine the SCO and retail markets and unnecessarily increase residential customers’ prices. At first glance, it seems that COH could be several years removed from reaching the 70% trigger for residential customers. However, if one or two large municipal aggregations occur in the COH service territory, the shopping statistics could change dramatically in a very short timeframe. If the Commission approves the Amended Stipulation’s residential exit framework, most participating SCO bidders will infer that the Commission considers 70% a reasonable level at which to terminate SCO service. The Commission will be creating a great deal of regulatory uncertainty in the SCO market. SCO bidders will not be incented to continue to make long-term investments if there is the potential that the SCO program could be discontinued at any moment. As a result, SCO prices will increase without the proper long-term incentives in place.

But, the negative impacts of the proposed framework are not isolated to the SCO market as it will also introduce regulatory uncertainty and open the door for inefficiencies in the retail market. With the potential elimination of the SCO program, retail suppliers will be incented to make investments that they otherwise would not make. For instance, if an MVR assignment methodology is predicated on some form of proportional market share at the time of exit, retail suppliers will be highly motivated to increase their shopping market shares to increase the number of non-shopping customers that they are assigned at exit. This incentive could lead suppliers to invest significantly more resources into marketing efforts. However, if residential shopping reaches 70%, but the Commission postpones COH’s residential exit, those investments by retail suppliers will have been for naught. As a result, retail suppliers will be forced to increase retail prices to offset the financial losses stemming from their uneconomic over-investment in the market.

Given the potential that the Commission’s approval will lead to an increase in residential prices across the board, I do not believe the proposed residential exit framework is in the public interest. The Commission should indicate that 70% is not an acceptable threshold to trigger an exit from the merchant function and the elimination of the SCO program.

**Q. Do the Amended Stipulation’s revisions change your opinion on this issue?**

A. No. I understand that the Amended Stipulation only provides that COH may file a residential exit application once the thresholds are met and increases the time period before which COH may file a residential exit application. However, if the Commission approves the Amended Stipulation’s residential exit framework, it would still be creating regulatory uncertainty in both the SCO and retail markets because the Commission would be sending a signal that 70% shopping is a reasonable level at which to terminate SCO service for residential customers. As I have explained above, such a signal from the Commission will result in an increase in SCO and retail prices.

**Q. Do you oppose retail competitive suppliers continuing to make offers to residential customers?**

A. No, not at all. Hess fully endorses the continuation of the residential retail market. Suppliers should continue to be able to market various fixed- and variable-priced supply offerings to residential customers. However, Hess opposes the proposed residential exit framework because it (i) could lead to the elimination of the lowest-cost alternative for residential customers at too low of shopping levels; (ii) removes a reliable, market-based benchmark that provides transparency for residential customers; (iii) creates regulatory uncertainty in the SCO and retail markets; and (iv) unilaterally assigns hundreds of thousands of non-shopping customers to MVR suppliers without their consent at a higher monthly variable rate.

**Q. Can you please describe the Amended Stipulation’s new $0.06 per Mcf charge to SCO suppliers?**

A. In addition to the current Letter of Credit requirements for a winning SCO supplier to serve SCO tranches, the AmendedStipulation calls for SCO suppliers to provide a cash “deposit” of $0.06 per Mcf as security.[[10]](#footnote-10) The AmendedStipulation explains that the “security will provide a liquid account to meet supply default expenses incurred by Columbia other than compensation to the non-defaulting SCO Suppliers.”[[11]](#footnote-11) The AmendedStipulation goes on to explain that “[a]ny funds remaining at the end of each Program Year will be transferred to the CSRR commencing June 2014, for the 2013 Program Year.”[[12]](#footnote-12) The cash deposit is not charged to Choice suppliers.

**Q. Do you oppose the proposed $0.06 per Mcf charge to SCO suppliers?**

A. Yes. First, COH has provided no evidence that an additional safeguard, beyond the current requirements, is necessary to protect customers in the event of an SCO supplier default. In response to Hess’ discovery requests attached in Exhibit OM - 5, COH confirms that it has never had an SCO or SSO supplier default to date, nor have there been any SCO supplier defaults in any of the other Ohio LDC’s SCO programs. Moreover, according to the Program Outline filed in this proceeding, COH conducts pre-auction credit evaluations of all SCO bidders, and retains the right to make alternative credit arrangements with an SCO supplier should COH deem it necessary (including requiring a guarantee, irrevocable letter of credit or a refundable cash deposit in appropriate circumstances) and to investigate an SCO supplier’s creditworthiness during the SCO year if it believes that it has deteriorated. These stringent requirements are more than adequate to protect COH against default, especially considering there has been no SSO or SCO supplier default in Ohio to date.

Second, the $0.06 per Mcf charge is not a “deposit” as the AmendedStipulation suggests. Simply put, it is a tax on SCO suppliers. The AmendedStipulation provides that remaining funds will be transferred to the CSRR the following year. The CSRR is a rider that is charged to all Choice/SCO customers. Thus, any remaining funds from the SCO security charge will not revert back to the non-defaulting SCO suppliers, but, instead will be credited to all Choice/SCO customers. Assuming there is no SCO default, if SCO suppliers cannot recover the SCO security charge that they submitted to COH, the charge cannot be termed a “deposit.” In actuality, the SCO security charge is a tax on SCO suppliers.

Third, the Residential Suppliers argue that the SCO security charge was included in the Stipulation to offset the alleged cross-subsidization by shopping customers of the costs associated with the provision of SCO service. More specifically, Residential Suppliers witness Parisi (at pages 19-20 of his initial testimony) argues that the new SCO security charge is designed to recover the default customer costs of “education, surveys, and other IT programming needed to ensure continued default service.” Additionally, Residential Suppliers witness Ringenbach (at page 4 of her testimony) argues that the SCO security charge is actually assessed to cover the costs of the SCO auctions.

However, the Residential Suppliers conveniently ignore the subsidies they will receive through COH’s commitment to expend millions of dollars to expand the retail Choice markets to the direct benefit of the Residential Suppliers, including enhanced billing options, expanded rate and bill code capabilities, and rolling enrollment capabilities, as confirmed by the Amended Stipulation.[[13]](#footnote-13)

There is absolutely nothing in the AmendedStipulation or COH’s testimony that even alludes to the notion that the SCO security charge was designed to recover SCO costs incurred by COH. Neither COH nor the Residential Suppliers have provided evidence (i) that a cross-subsidization is occurring; (ii) on the categories of any incremental costs (with supporting backup) associated with the SCO program; and (iii) to demonstrate that the $0.06 per Mcf fee is specifically tailored to recover any incremental costs incurred by COH. Using the current SCO volumes, the $0.06 per Mcf charge would generate $4.8 million annually. Without question, COH’s costs to run the SCO auction pale in comparison to the $4.8 million that would be collected from SCO customers if the SCO security charge was approved. Since there is no credible evidence in the record to substantiate their claims, the Commission should completely disregard the Residential Suppliers’ argument that the SCO security charge should be implemented to offset alleged “subsidies” afforded to SCO customers.

**Q. What impact will the SCO security charge have on the COH market?**

A. The SCO security charge is nothing more than an administrative mechanism designed to artificially bolster the competitive position of retail suppliers compared with the SCO price. If approved, SCO suppliers will have to build this $0.06 per Mcf charge into their SCO bids each year because they will be unable to recover it at the end of the program year. Retail suppliers, on the other hand, will not be assessed this charge and will not need to account for the charge in their offers to Choice customers. Such a construct would make retail suppliers’ offers more competitive to Choice-eligible customers.

Further, since SCO suppliers will be forced to increase their SCO bids by $0.06 per Mcf, the proposed SCO security charge will penalize SCO customers by subjecting them to higher prices. Even though SCO customers will be paying all costs associated with the SCO security charge (via the SCO clearing price), the unused funds will be returned to all customers (*i.e.*, SCO and Choice customers). Thus, only a portion of the unused funds will be returning to SCO customers. As a result, SCO customers will be inappropriately subjected to unequal treatment compared to shopping retail customers.

Even though the Amended Stipulation reduces the SCO security charge by 40% compared to the SCO security charge proposed in the Original Stipulation, the mere existence of the charge violates the most fundamental of competitive market principles by taxing only one subset of competitors and purposefully creating an unleveled playing field in the market. If it approves the SCO security charge, the Commission will be endorsing an unprecedented market interference for no legitimate reason other than to “tip the scales” in the retail suppliers’ favor. Artificially inflating the SCO price just to make retail suppliers’ offerings more competitive on a cost basis is clearly inconsistent with prevailing state policy to “achieve effective competition” in Ohio’s retail natural gas market. For these reasons, the Commission should reject the Amended Stipulation’s proposed SCO security charge as it is not in the public interest.

**Q. Can you please reiterate Hess’ recommendations?**

A. Yes. The Commission should strive for a robust retail competitive market which results in the lowest possible price to customers. In order to obtain this objective, the Commission should not approve a stipulation that will only introduce regulatory uncertainty and inefficiency into the SCO and retail markets. As such, Hess recommends that the Commission order the following:

1. Approve the AmendedStipulation’s framework for COH to exit the merchant function for non-residential customers.
2. Employ an MVR allocation methodology for non-residential customers that incorporates SSO/SCO tranche ownership.
3. Reject the AmendedStipulation’s framework that allows COH to file an application to exit the merchant function for residential customers.
4. Reject the AmendedStipulation’s proposed $0.06 per Mcf SCO security charge.

**Q. Does this conclude your testimony?**

A. Yes, at this time. Hess reserves the right to file Supplemental Testimony.

1. At the time, KeySpan was a wholly-owned subsidiary of The Brooklyn Union Gas Company. [↑](#footnote-ref-1)
2. Amended Stipulation, at 9. [↑](#footnote-ref-2)
3. *Id*. at 10-11. [↑](#footnote-ref-3)
4. *Id*. at 12-14. [↑](#footnote-ref-4)
5. *Id*. at 4. [↑](#footnote-ref-5)
6. Amended Stipulation at 6-10. [↑](#footnote-ref-6)
7. Though with only one or two large municipal aggregations, the residential (along with non-residential) shopping statistics could increase dramatically. [↑](#footnote-ref-7)
8. *See* Exhibit OM – 3. [↑](#footnote-ref-8)
9. *See id*. [↑](#footnote-ref-9)
10. Stipulation at 4. [↑](#footnote-ref-10)
11. *Id*. [↑](#footnote-ref-11)
12. *Id*. [↑](#footnote-ref-12)
13. Amended Stipulation at 16 and Attachment 1. [↑](#footnote-ref-13)