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 September 7, 2011 Second Opinion and Order in Case No. 08-1344-GA-EXM	)))))	Case No. 12-2637-GA EXM

DIRECT TESTIMONY OF LAWRENCE FRIEDEMAN

On behalf of Interstate Gas Supply, Inc.

I. INTRODUCTION AND PURPOSE OF TESTIMONY

Q. Please introduce yourself.

A. My name is Lawrence Friedeman. I am employed by Interstate Gas Supply, Inc. ("IGS") as its Vice President of Choice Markets. My business address is 6100 Emerald Parkway, Dublin, Ohio 43016.

Q. What is the nature of IGS' business?

A. IGS is a certified competitive retail natural gas ("CRNG" or "Choice") supplier serving customers in the Duke Energy Ohio, Vectren Energy Delivery of Ohio, Dominion East Ohio and Columbia Gas of Ohio ("Columbia") territories. IGS has over 23 years' experience serving natural gas customers in Ohio. IGS is also currently serving electric customers in the AEP, Duke Energy Ohio and the Dayton Power & Light service territories. Throughout the United States IGS provides natural gas and electric service to over 1 million customers in 11 states and in over 30 utility programs. IGS has approximately 400 employees working at its headquarters in Dublin, Ohio.

Q. Please describe your educational background and work history.

A. I earned a Bachelor of Arts degree from the University of Pittsburgh, a Juris Doctorate from the University of Pittsburgh School of Law, and attended the University of Georgia School of Law as a post-doctoral candidate. As my work experience relates to competitive energy programs, I was the Regulatory Liaison for Columbia Energy Services Inc., the Vice President of Regulatory Affairs for Vectren Retail LLC and am currently Vice President of Choice Markets for Intestate Gas Supply, Inc. I have been involved in the continuing evolution of the competitive natural gas market in Ohio since the inception of the Columbia Gas of Ohio Pilot Choice Program in 1997. Prior to my involvement in the energy industry, I was president of a manufacturing company, an Assistant General Counsel for one of the 10 largest Public Housing Authorities in the nation, and an Assistant District Attorney.

Q. Can you please explain the background of the case in which you are submitting testimony?

A. Yes, in this case Columbia, Commission Staff and a number of other parties filed a joint motion ("Joint Motion") to modify the Public Utility Commission of Ohio's ("Commission") order issued on December 2, 2009 in Case No. 08-1344-GA-EXM ("December 2009 Order"). In conjunction with the Joint Motion the parties filed a Joint Stipulation and Recommendation ("Joint Stipulation") which (among other things) sets forth the framework in which Columbia will transition from the Standard Choice Offer ("SCO") auction mechanism to a Monthly Variable Rate ("MVR") mechanism to provide default natural gas commodity service to customers.

Q. Can you please explain the proposed MVR program filed in the Joint Stipulation?

A. Yes. As set forth in the Joint Stipulation, if Columbia and the competitive market meet certain pre-conditions to exit the merchant function, subject to Commission approval, customers that have not selected a CRNG or Choice supplier will receive natural gas commodity service through Columbia's MVR program. Customers in the MVR program will be assigned to a Choice supplier and will receive a MVR price that will be no greater than that Choice supplier's MVR price listed on the Commission's Apples to Apples chart which must be updated each month. A MVR customer will remain with the assigned Choice supplier at the MVR price until the customer affirmatively choses to receive service from another Choice supplier or chooses another product from the current MVR Choice supplier.

Q. Does the Joint Stipulation address how customers will be allocated to Choice suppliers?

A. No. A mechanism to allocate MVR customers to a Choice supplier was not included in the Joint Stipulation. The parties agreed in the Joint Stipulation that the initial allocation of MVR customers upon Commission approval of Columbia's exit of the merchant function, and the allocation of MVR customers pursuant to that approval, should be addressed in the proceeding in which the Joint Stipulation is filed.

Q. What is the purpose of your testimony?

A. In my testimony I will address the methodology by which MVR program customers are allocated to Choice suppliers. Specifically, I will explain why MVR program customers should be allocated to Choice suppliers based on the proportional market shares of the Choice suppliers. Allocating customers based on market share is the most logical customer allocation methodology and has many advantages for customers, the State of Ohio and the competitive marketplace. Specifically, allocating customers based on market share will:

- incentivize new entrants into the market further vitalizing the competitive marketplace and adding even greater competitive price pressures for the benefit of Consumers in the Columbia service territory;
- incentivize Choice suppliers to offer a more diverse range of products that are tailored to satisfy consumer preference;

- incentivize Choice suppliers to invest in the economies of the State of Ohio and local communities;
- help ensure that Choice suppliers have the necessary technical, financial, and operational acumen to serve customers under the MVR program;
- help ensure that the Choice suppliers serving customers in Ohio demonstrate familiarity with and the capability to satisfy the myriad consumer protection rules and regulations in Ohio;
- reward Choice suppliers who expend the effort and make the investment in Ohio's competitive energy market.

II. <u>ALLOCATION BASED ON MARKET SHARE</u>

Q. Can you explain what it means to allocate customers based on market share?

A. Yes. The Joint Stipulation distinguishes between commercial and residential choice-eligible populations. Insofar as the commercial program eligible population is concerned, when Columbia migration exceeds 70% for three consecutive months, those commercial customers who do not subsequently elect CRNG service will be assigned to certified suppliers for MVR service. Insofar as the residential choice eligible population is concerned, the Stipulation proposes that when Columbia Choice program residential participation exceeds 70% for three consecutive months, Columbia shall file an application to exit the merchant function. If the Commission approves Columbia's application, customers who have not elected competitive retail service will be assigned to a Choice supplier through the MVR program. Thus, if Columbia exits the merchant function the relatively small portion of the consumer population who have not made an election for CRNG service would be assigned to a Choice supplier. If customers are allocated to a Choice supplier based on the Choice supplier's market share, then the Choice supplier will be allocated a percentage of commercial or residential customers to be served in the MVR program equal to the percentage of customers in the relevant customer populations the Choice supplier is serving in the Columbia Choice program. For instance, if a Choice supplier serves 10% of the commercial customers participating in the Columbia Choice program, then one in every ten commercial customer that receives service under the MVR program will be assigned to that Choice supplier. That same allocation methodology would apply to residential customer allocation should the market reach the migration benchmark and should the Commission approve the application that Columbia would subsequently file.

Q. After the initial allocation of customers will there be other times when customers are allocated to a Choice supplier?

A. Yes. After the initial allocation, customers seeking natural gas service will be placed in the MVR program by default; thus, customers will need to be allocated to a Choice supplier even after Columbia exits the merchant function.

Q. Are there other ways MVR customers could be assigned to Choice suppliers?

A. Yes. There are other ways MVR customers *could* be allocated to Choice Suppliers. For instance, Customers could be assigned with numerical randomness to Choice suppliers. Or, all the MVR customers could simply be allocated to the biggest Choice supplier in the market. As another example, customers could be allocated rotationally and equally to every Choice supplier certified in the market, regardless of the amount of customers served or experience in the market. However, as I explain in my testimony, allocating

MVR customers based on market share is, in my opinion, the best methodology to align supplier incentive and customer experience.

III. CUSTOMER BENEFITS

Q. What are the customer benefits associated with allocation based on market share?

A. Simply stated, allocating customers based on market share will encourage new market entrants, will promote even greater competitive price pressure on suppliers, and will motivate the introduction of additional product selections for consumers.

Q. How will allocating customers based on market share incentivize lower priced offers?

A. Pursuant to a proportional allocation methodology, increased "organic" market share (i.e., market share based on customers that affirmatively elect to receive service from a Choice supplier) will result a greater allocation of MVR customers. Thus, Choice suppliers will have even greater incentive to acquire customers directly. One obvious way to increase customer enrollment is to offer lower prices to attract customers. In an effective competitive market, when one supplier lowers its prices, other suppliers also tend to lower their prices in order to compete for customers. Ultimately, the added incentive to enroll customers will result in more competition for customers and lower priced offers.

Q. How will allocating customers based on market share encourage the introduction of innovative products?

A. As I already explained, allocating customers proportionally based on market share will give Choice suppliers added incentive to enroll customers. Inherent in competition is the need to satisfy customer preference through differentiation. Other than reducing price, Choice suppliers can attempt to attract customers through their product offerings. This may include offering products with unique attributes, with customer loyalty programs, or bundling offers with energy savings products. These are just a few examples. Ultimately, diversity of product offerings is limited only by limitation of creativity and imagination. The point being, an added incentive to enroll customers will encourage suppliers to develop even more creative product offerings which will benefit customers.

Q. Will allocating MVR customers equally to all Choice suppliers regardless of market share create the same incentives for Choice suppliers to participate in the market?

A. No. If customers were allocated equally to Choice suppliers regardless of market share there would be comparatively less incentive to participate in Ohio markets. Choice suppliers could acquire customers notwithstanding the expenditure of minimum effort, the attainment of little experiential knowledge, and the absence of significant investment in the Ohio marketplace.

Q. Is it potentially harmful to MVR customers to allocate MVR customers equally to all Choice suppliers regardless of market share?

A. In terms of an initial allocation, yes. An initial rotational allocation does little to motivate a competitive supplier to develop the necessary acumen to properly serve customers. The initial allocation of non-electing consumers could result in the immediate allocation of thousands of customers to new market entrants who do not possess the experience to serve that number of customers.

Q. Does establishing a minimum threshold of customers that must be served before a supplier can be assigned MVR customers create optimal safeguards to protect consumers?

A. No. While establishing a minimum threshold to serve MVR customers is better than no threshold, simply establishing a threshold requirement will not maximally align Choice supplier incentives with customer experience.

Q. Does assigning customers based on market share incentivize Choice suppliers to invest in Ohio?

A. Yes. Generally, in order for a Choice supplier to acquire customers, the Choice supplier must make certain investments to attract customers. For instance, Choice suppliers may choose to use a local sales force for purposes of direct solicitation. Brand awareness is also a key to success. Consequently, competitors may sponsor events and sports teams, or donate to charities and local community organizations in order to be good corporate citizens. All of these investments, either directly or indirectly, are made for the purposes of acquiring customers and increasing market share. If a Choice supplier has diminished incentive to increase market share (as is the case when market share is not the basis of MVR allocation) Choice suppliers will not find it necessary to invest in the means to generate market share. Choice supplier investments to acquire organic customers represent real dollars that go into the local and State economies.

Q. Will the incentive to invest in Ohio markets be enhanced during the transition period before Columbia exits the merchant function?

A. Yes. A condition for Columbia exiting the merchant function is that Choice participation for choice-eligible commercial customers and subsequently choice-eligible residential customers must be at least 70% for three consecutive months. Currently, Choice participation in Columbia is notably less than 70%. This means that in order for Columbia to exit the merchant function, Choice suppliers must move the market significantly. Therefore, during the transition period Choice suppliers will be heavily investing resources in the Ohio market to motivate customer migration to Choice supply service. As already explained, these investments include making more competitive and diverse offers as well as investing in the local and State communities to encourage enrollment.

Q. Will the collective market dynamic of the Columbia market be diminished during the transition period if MVR customers are allocated equally to all Choice suppliers?

A. Yes. By setting a migration benchmark, the Stipulation motivates competitive suppliers to migrate customers to Choice supply service. If a Choice supplier can receive more MVR customers by enrolling customers organically, then a Choice supplier will most certainly enter the market sooner and invest more heavily in the Columbia market while getting to the 70% Choice participation threshold. Conversely, if the amount of MVR customers a Choice supplier receives is not proportional to its efforts to organically enroll customers during the transition period (as is the case when market share is not used as the determinant to assign MVR customers), then a Choice supplier's incentive to enroll customers during the transition period will be dramatically diminished.

IV. ABILITY TO SERVE CUSTOMERS

Q. Is a Choice supplier's market share reflective of that supplier's ability to serve customers?

A. Yes. At its core, competition is about setting customer expectations and then satisfying those expectations. In a vibrant competitive market such as exists in Ohio, if a customer perceives that a supplier has not performed satisfactorily, then that customer will terminate the contractual relationship and seek service through other sources. In order to build market share, a supplier must not just acquire customers, but more importantly, retain customers. Satisfaction and service are key determinants of customer retention. Thus, market share is a reasonable predictor of a supplier's ability to assume service responsibility for allocated MVR customers.

Q. Is there a risk that Choice suppliers may not be able to serve all the customers assigned to them in a scenario when MVR customers are allocated equally to all Choice suppliers?

A. Yes. Although a Choice supplier may be certified to serve customers, that does not mean that the supplier has attained the requisite experience to serve significantly more customers. The infrastructure and human resource requirements are significantly greater. For these reasons I believe that if MVR customers are assigned to all Choice suppliers equally, there is a significant risk that some Choice suppliers will not be able to serve those customers capably and effectively.

Q. Are there currently Choice suppliers in the market serving small numbers of customers?

A. Yes, it is my understanding that there are currently twenty-four Choice suppliers certified in the Columbia territory that serve less than 500 customers. Moreover, it is possible that certain of these suppliers serve only one class of customers, that being only commercial or only residential customers. A sudden allocation of significantly greater customers, many of whom from a different customer class requiring discretely different skill sets to serve, may in my opinion seriously stress the operational capability of suppliers who are ill-equipped to accommodate such an increase in customer base.

Q. Are there other concerns that you have about assigning customers to suppliers that are not active in the marketplace?

A. Yes. First, the retail natural gas business is a highly regulated industry particularly for Choice suppliers serving residential customers. There are a many rules and regulations with which certified natural gas suppliers must comply in order to serve customers. These include the rules for contracting and communicating with customers, enrolling customers, renewing customers and a myriad of other matters regulated by the PUCO. Active Choice suppliers necessarily have to familiarize themselves with these rules and regulations. Also, active Choice suppliers must be engaged with Commission and utility staff because the rules and regulations periodically change. Engagement and responsiveness to regulatory oversight and inquiry are essential to assure that consumers are treated in a manner consistent with the protective nature of the governing rules and regulations. Experience in such matters, particularly in the face of rapid customer base, is an important consumer assurance that should not be overlooked.

Second, in my opinion, the intent of the reasoned progression intrinsic in the Stipulation is to allocate customer to qualified suppliers whose intent is to serve those customers. Rotational allocation of customers to suppliers who do not have significant investment dollars at risk and who have not demonstrated a commitment to the market could lead to a scenario whereby allocated customers are considered nothing more than assets to be sold. This behavior would be counter-productive to the transitional intent of the Stipulation.

V. <u>CONCLUSION AND RECOMMENDATIONS</u>

Q. What are the conclusions of your testimony?

A. Columbia's creation of the MVR program and ultimate exit of the merchant function represent an important opportunity to move Ohio's competitive markets in a manner consistent with legislative directive. It is important that the transition be appropriately structured to promote the long term sustainability of the competitive marketplace. It is my belief that assigning MVR customers proportionally based on mark share will create the appropriate incentives for suppliers enter or to continue to participate in the marketplace; and, thus, ultimately will create a more vibrant and sustainable market.

Q. What are you recommendations with respect to the methodology to allocate MVR customers after Columbia exits the merchant function?

A. I recommend that:

- MVR customers be assigned to Choice suppliers in proportion to the market share a Choice supplier has at the time of assignment;
- assignment be proportional initially for both commercial and residential customers and should continue as the allocation methodology on a continuing basis;

Q. Does that conclude your testimony?

A. Yes it does.

CERTIFICATE OF SERVICE

I hereby certify that a copy the foregoing Direct Testimony of Lawrence Friedeman was served by electronic mail to the following parties on this 13th day of November, 2012:

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