

Position: NEUTRAL

Date: 2/20/04

ILLINOIS COMMERCE COMMISSION
93rd GENERAL ASSEMBLY
POSITION PAPER

BILL NUMBER: SB 2525

HOUSE SPONSOR(S):

AMENDMENT:

SENATE SPONSOR(S): Denny Jacobs

Many of the issues implicated in SB 2525, and addressed in this position paper, are currently pending before the Illinois Commerce Commission in Docket 03-0659. Therefore, the Commission takes no position with respect to this bill. The Commission, without expressing either agreement or disagreement with its contents, does not object to circulation by Commission Staff of this position paper in which Staff articulates its concerns with SB 2525.

REVIEW SUMMARY:

What does the bill do?

The proposed bill amends the Public Utility Act ("PUA") by adding Section 7-120. SB2525, in paragraph (b) of the proposed Section 7-120, legalizes unregulated retail sales under existing contracts and does not affect new contracts until after the law takes effect. Paragraph (c) of the proposed Section 7-120 makes three sections of the current PUA apply to unregulated sales of natural gas to end-use customers: Sections 7-102(g) [requires a utility to obtain authorization from the Commission to engage in business not directly related to its role as a utility.], 7-205 [grants the Commission jurisdiction to regulate nonpublic utility business by the utility] and 7-206 [mandates that the Commission may require the public utility to provide separate accounts for its non-public utility business]. Paragraph (d) makes an unregulated retail seller of natural gas to a residential customer or small commercial customer subject to 19-110 (e)(2) [applicant to be an Alternative Retail Gas Supplier ("ARGS") must comply with safety regulations], 19-110 (e)(3)[applicant must comply with Commission established reporting requirements], 19-110 (e)(5) [applicant must comply with all other rules and laws] and 19-115 [the unregulated seller must comply with the obligations of an ARGS]. The proposed Section 7-120 also institutes a series of protections for consumers that might stem from utility sales of gas in competitive markets in paragraphs (e) through (i): (e) utility cannot subsidize unregulated sales through the regulated business, (f) cannot discriminate on the regulated side "based upon the existence of an unregulated sale of natural gas." (g) allows the Illinois Commerce Commission ("ICC") to require a gas utility to file reports of its unregulated sales, which reports are to be kept confidential, (h) grants the ICC access to unregulated sales contracts, (i). Section 7-120 does not apply to unregulated gas sales by a utility affiliate.

How will the bill impact state government?

It permits gas utilities to make unregulated sales of gas anywhere in the state if they comply with the provisions of the law.

How does the bill amend existing law?

SB 2525 allows a gas utility to make unregulated retail sales and adds conditions on unregulated sales by utilities to guard against market abuse.

Which communities are predominately impacted by the bill?

Statewide.

REASONS FOR SUPPORTING THE BILL:

What are the leading reasons people support the bill, and why? Include statistical information, if available.

Under circumstances prescribed within Section 7-120, SB 2525 permits unregulated retail gas sales by a gas utility. One gas utility is currently making unregulated retail sales of natural gas both within and beyond its service territory in Illinois. An Administrative Law Judge has issued a Proposed Order that recommends that the Illinois Commerce Commission find that the utility's activity violates current law and determine that existing contracts are void. It is anticipated that Illinois natural gas utilities might support the bill since it would provide them additional freedom to segment their current tariffed ratepayer community, choosing to serve on an unregulated basis those among their current tariffed customers who might be most likely to choose to obtain their gas supplies by a non-utility gas marketer, and to engage in unregulated natural gas sales beyond their service territories. Passage of SB 2525 would render moot any Commission action against the gas utility currently before the Commission for violation of the law and for additional violations of Commission rules.

REASONS FOR OPPOSING THE BILL:

What are the leading reasons people oppose the bill, and why? Include statistical information, if available.

Alternative Retail Gas Suppliers (ARGS”), and possibly other gas utilities, would oppose SB2525. CUB and other consumer groups could also oppose it. The opposition would likely be based upon the “Agency Position Comments” presented below.

PRIOR LEGISLATIVE HISTORY:

None of which the Commission is aware.

AGENCY RECORD:

Has the agency been on record in support for or opposition to the bill or the issues addressed in the bill?

No.

What is the effect of the bill on agency policies and operations?

The Commission will lose the ability to stop regulated utilities from engaging in unregulated sales. Were the bill to become law, the ICC would only be able to do after-the-fact reviews of this activity.

AGENCY POSITION COMMENTS: Neutral

Why has the agency taken the position indicated above?

- 1) Regulators cannot ensure that ratepayers will not subsidize the utility’s competitive operations;
- 2) Regulators cannot ensure that the utility will not discriminate between regulated and unregulated sales of gas transportation;
- 3) Alternative Retail Gas Suppliers (“ARGS”) and other gas marketers are discouraged from entering a utility’s service territory providing regulated and unregulated gas sales, thus inhibiting competition; and
- 4) SB2525 contains no penalty provisions.

Regulators cannot ensure that captive ratepayers will not subsidize a utility's competitive gas sales through the Purchase Gas Adjustment ("PGA") clause. A utility that buys gas for both regulated and unregulated gas operations will always be required to designate which gas and interstate transportation purchases were made for tariffed gas customers and which were made for competitive gas customers. Commission Staff is concerned that providing a gas utility the opportunity to make that designation will result in the most expensive gas being sold to tariffed customers and the unregulated, competitive customers may be sold the less expensive gas. Were that to occur, the utility would be able to recover the cost of the higher priced gas and interstate transportation from ratepayers through the PGA and sell the cheaper gas and interstate transportation to competitive customers. The unregulated profits from such activity would then flow straight to shareholders and tariffed ratepayers would be paying higher gas prices. From an enforcement perspective, it is very difficult to detect such subtle favoritism, but the economic impact of such favoritism could be quite significant for tariffed ratepayers.

Favoritism in the sales that could occur under SB2525 would be even more difficult to detect than similar unregulated retail sales made by a utility's affiliate. A utility's ability to improperly subsidize unregulated gas sales through regulated businesses far exceeds the regulator's capacity to detect it.

Additionally, other potential subsidies, such as increases to the utility's cost of capital resulting from engaging in more risky unregulated ventures, will be very difficult to measure but could negatively affected tariffed customers.

Regulators also cannot ensure that the utility will not discriminate in transporting gas. A utility with both regulated and unregulated customers must somehow determine which gas to transport, that is, gas for its tariffed customers or gas for its competitive sales customers, when its demand exceeds capacity. Staff's concern is that, in times of constrained pipeline transportation capacity due to very high demand, the utility would be in a position to choose to transport the unregulated gas supply rather than the regulated gas supply.

Within the service territory of each gas utility, there is another important consideration. It is important to ensure that the market for gas in every utility's service territory remains competitive. However, ARGs and other regulated marketers would be discouraged from entering a territory serviced by a gas utility having both regulated and unregulated sales of gas. The gas utility will have extensive knowledge of its tariffed customer gas usage patterns and typical demands. The gas utility will be able, because of that greater knowledge about its customer usage patterns and levels, to choose which customers to attempt to serve on an unregulated basis. This concept is commonly known as "cherry picking." The gas utility would have the ability, as described above, to manipulate the price of competitive gas to the detriment of the captive ratepayers by undercutting the profit margins of potential ARGs for the service territory. Competition is thus inhibited. Without the increased ability to detect market abuse provided by separate affiliates, the market may not be as competitive as it should be.

SB2525 contains no provisions that allow the ICC to penalize or fine a utility for violating the provisions of Section 7-210 other than that which exist in Article IV. Penalties related to the dollar value of subsidies the Commission finds would seem to be appropriate.

Illinois law currently does not permit competitive gas sales by a gas utility, though that activity could legally be conducted through a separate affiliate engaging in the competitive gas sales business. The separation of competitive gas sales from utility business, but permitting that activity by an unregulated affiliate, enables the Commission to exercise its authority to approved operating agreements for the determination of the services to be provided by the utility and the affiliate, the allocation of costs between the utility and its affiliate, and the terms of the transactions to ensure that ratepayers are not harmed.

TESTIMONY AT COMMITTEE:

David Rearden, Energy Division

OGC Representative

REVIEW COMPLETED BY/DATE: