OFFICE OF RETAIL MARKET DEVELOPMENT
ILLINOIS COMMERCE COMMISSION

ANNUAL REPORT ON THE DEVELOPMENT OF NATURAL GAS MARKETS IN ILLINOIS

Submitted Pursuant to Section 19-130 of the Illinois Public Utilities Act

October 2015

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STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

October 1, 2015

The Honorable Bruce Rauner
Governor

The Honorable Members of the Illinois General Assembly

The Honorable Members of the Illinois Commerce Commission

Please find enclosed the ICC's Office of Retail Market Development's annual report on the development of natural gas markets. This report is submitted in compliance with Section 19-130 of the Illinois Public Utilities Act [220 ILCS 5/19-130]. Section 19-130 requires the Director of the Office of Retail Market Development to prepare an analysis of the status and development of the retail natural gas market in the State of Illinois.

Sincerely,

Torsten Clausen

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Annual Report to the General Assembly, the Governor,

and the Illinois Commerce Commission

Submitted pursuant to Section 19-130 of the

Illinois Public Utilities Act

Office of Retail Market Development

Illinois Commerce Commission

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I. Introduction

Traditional gas utility sales service ("sales service") is the sale of natural gas supply to retail customers at rates regulated by the Commission. The rates paid by sales service customers are separated into two parts. The delivery component recovers the cost to distribute gas, including the cost of utility-owned storage facilities, through rates that vary by customer class. The gas commodity component of sales service is regulated by the Commission to ensure that customers pay only for gas that is prudently purchased. Typically, the price for gas commodity fluctuates monthly, but it does not vary by customer class. Gas transportation service ("transportation service") allows alternative gas suppliers ("AGS") to sell competitively priced natural gas commodity to retail customers. It is believed that the wholesale commodity market is competitive, but the delivery function is a natural monopoly. Therefore, by unbundling the commodity from its delivery, retail customers can get direct access to the wholesale market. This has the potential to deliver lower prices, a wider array of services, and customized pricing, terms, and conditions of service to individual customers or groups of customers than is possible with sales service.

The first transportation tariffs simply removed the utility's gas supply charge from the transportation customer's bill, with limited or no access to utility storage assets. More recently, transportation service is more sophisticated. It offers customers a number of alternatives to traditional utility sales service, including allocations of utility storage and flexible delivery and storage withdrawal terms. As will be shown below, most gas transportation volume can be attributed to large volume industrial and commercial customers served by more than 50 retail suppliers.

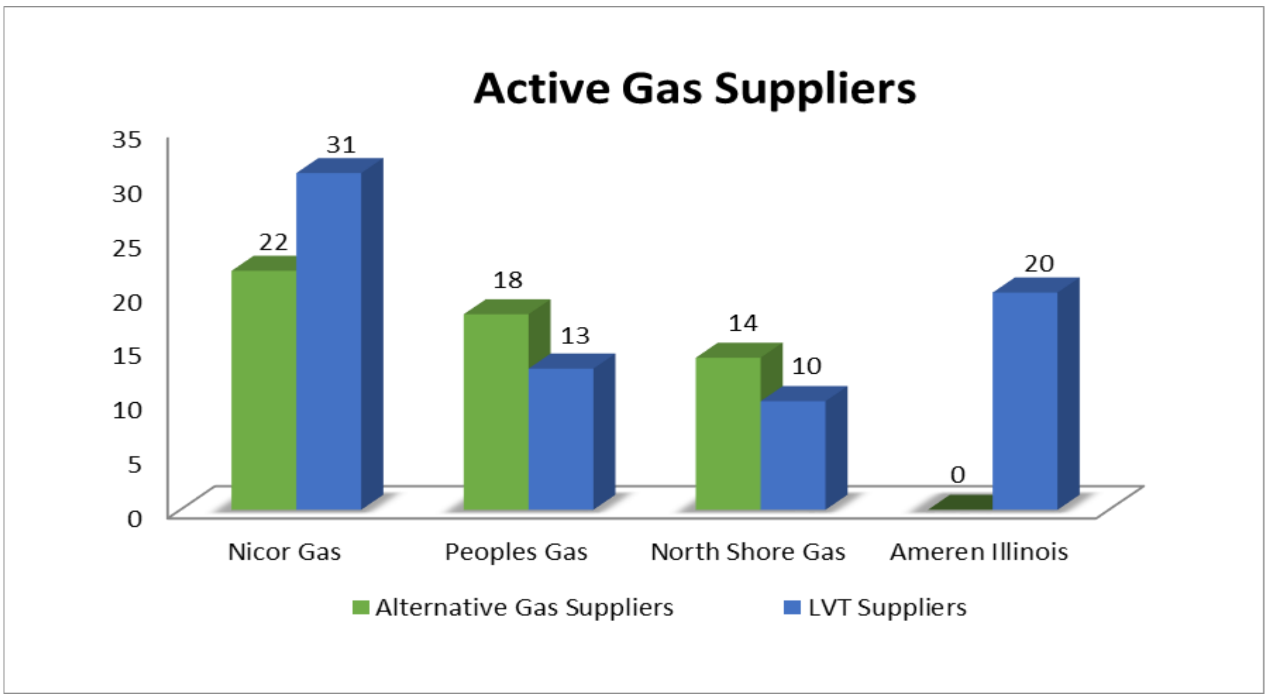
Transportation service for small commercial and residential customers is currently only available in three utility service territories in Northern Illinois (Nicor Gas, People's Gas, and North Shore Gas).

II. Recent competitive activity

A. Number of certified and registered suppliers

Statewide, there are currently 36 alternative gas suppliers that have obtained ICC certification pursuant to Section 19-110. Only alternative gas suppliers that provide services to residential or small commercial customers must obtain a certificate of service authority from the Commission. Small commercial customers are statutorily defined as non-residential customers who consume 5,000 or fewer therms annually.[1] Aside from receiving a certificate from the Commission, suppliers must also register with the gas utility and complete certain technical testing before they can start offering retail natural gas service in Illinois. Twenty-two of those suppliers had residential and/or small commercial customers in Nicor's utility service territory as of December 2014. For the Peoples Gas territory, the number was 18, and for North Shore Gas it was 14. Ameren Illinois currently does not allow residential and small commercial customers a choice of gas suppliers.

The following graph shows the number of active AGS at the end of 2014 by utility service territory. It also shows the number of gas suppliers serving large commercial and industrial customers. Those suppliers are labeled large volume transportation suppliers, or LVT suppliers.



[1] 220 ILCS 5/19-105.

B. Large volume transportation

The Commission has been approving unbundled gas transportation tariffs filed by Illinois LDCs for over four decades. That process continues today. The LDC tariffs, along with interstate FERC-approved pipeline tariffs, create the rules and structure needed to establish competitive retail supply markets for commercial and industrial customers. There are many gas suppliers and marketers that can meet the needs of retail customers that choose to transport their own gas rather than purchasing PGA gas directly from their LDC under bundled tariffs.

Charges for transportation services recoup the cost for providing a firm LDC service level requested by transportation customers. In the early stages of transportation service in Illinois, rate design amounted to deducting the PGA price from transported volumes. When transportation customers consumed LDC-supplied gas, they paid the regular PGA or bundled rate. Transportation tariffs have become more sophisticated, since utilities now supply storage services to transportation customers, while penalizing transporters for deviating from planned deliveries. When customers' gas usage differs from the level contracted for, various penalty charges or above-market rates may apply. The penalty charges try to prevent large-scale imbalances above the level the LDC is prepared to accommodate as specified in the tariff.

1. Switching activity

For purposes of this report, we asked the gas utilities to provide us with switching data that contains the following: (1) annual therms provided by each supplier for calendar years 2013 and 2014, and (2) customer counts for each supplier as of the end of 2013 and 2014. The following table and graph shows how many of the large volume transportation customers had switched away from the gas utility. It also shows how much of the gas usage (therms) was provided by retail suppliers.

The table shows one thing very clearly among all four utility areas: a small percentage of the large customers consume the majority of natural gas for that class of customers. As a result, suppliers only need to contract with a small number of customers to capture a significant portion of the market. Depending on the utility area, gas suppliers provide service to 7-10% of the large volume customers while providing 50-80% of the total therms consumed by all large volume customers.

Second, the table shows that in terms of usage, the Ameren Illinois' territory currently sees the highest percentage of switching in the large volume customer market and Peoples Gas territory sees the lowest percentage. Third, the table reveals that, aside from a decrease in North Shore Gas' territory, the usage provided by gas suppliers did not change significantly from 2013 to 2014.

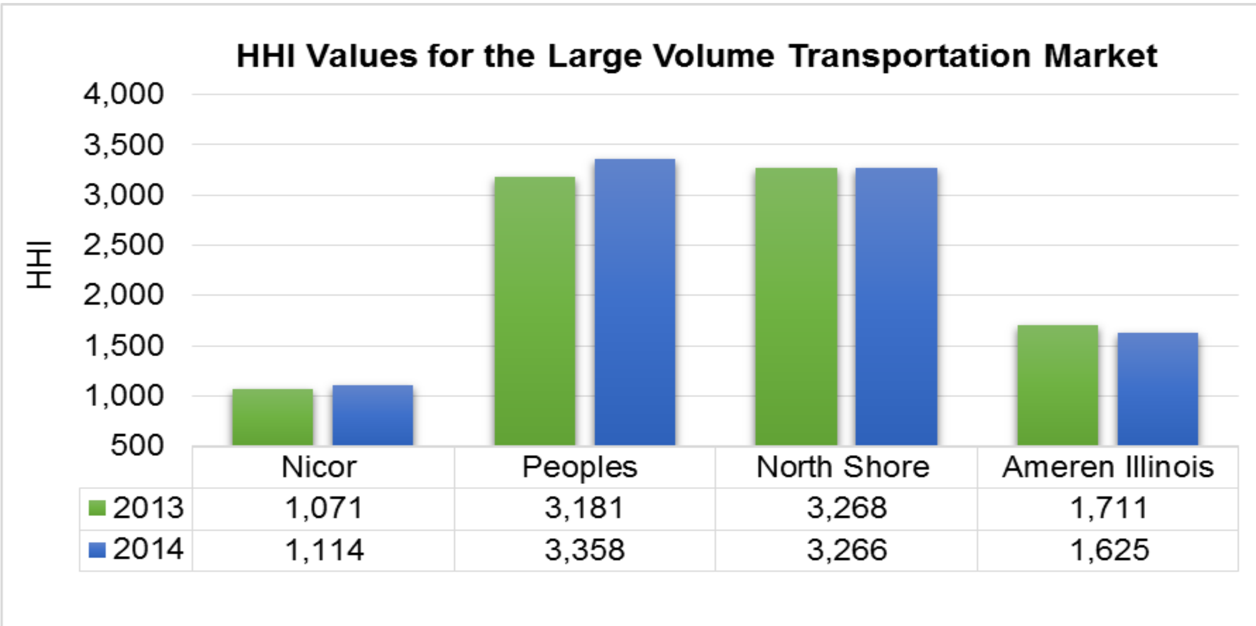
2. Large volume transportation market concentration

Looking solely at the total customers and usage provided by entities other than the utility does not tell us whether a market is dominated by a few large suppliers or more evenly divided among many providers competing in that market. Given the large difference between the percentage of switched customers and the percentage of switched usage shown above, we analyzed the LVT market shares of the individual suppliers by looking at the share of gas usage provided by a supplier instead of the share of customers served by individual suppliers. We assume the amount of therms served might be more closely related to a supplier's financial success than the number of customers it serves.

We are using the Herfindahl-Hirschmann index, or HHI, which is a common indicator to measure competition among firms in a defined market. In order to put the resulting numbers into perspective, we looked at the revised 2010 Horizontal Merger Guidelines by the Department of Justice ("DOJ") and the Federal Trade Commission ("FTC"), which divide the spectrum of market concentration into three regions. Generally speaking, the revised guidelines state that the DOJ and the FTC view a market with an HHI below 1,500 as unconcentrated (meaning many similarly sized firms compete for the same customers), a market with an HHI between 1,500 and 2,500 as moderately concentrated, and a market with an HHI above 2,500 as highly concentrated (very few firms dominating the market).

For this exercise, we tried to exclude entities that provide gas supply only to themselves or their subsidiaries or affiliates since those entities' do not have the goal of competing against other suppliers for customers. Unlike the retail electric market, identifying those entities is not as straightforward and, as a result, we may have included an entity that should not have been included or vice versa. We also need to emphasize that the numbers below reflect only the segment of the large volume transportation market that has already switched to a competitive supplier. In other words, the market concentration analysis shown here does not include the customers on utility sales service.

The graph shows the HHI values for the LVT market among the four utility service areas. While it is unreasonable to assume that all LVT customers are considered to be part of the same market, the overall HHI values shown here (a) allow us to compare the relative market concentration among the utility areas, and (b), display the trend in market concentration from 2013 to 2014.



	Nicor	Peoples	North Shore	Ameren Illinois
2013	1,071	3,181	3,268	1,711
2014	1,114	3,358	3,266	1,625

As the graph shows, the Nicor LVT market is generally less concentrated (meaning more suppliers with customers) than the other three is markets. It also shows that the Peoples Gas and North Shore Gas LVT markets show significantly higher concentration than either Ameren Illinois' or Nicor's markets. Furthermore, according to the DOJ and FTC guidelines, the Nicor market would be considered unconcentrated, the Ameren Illinois market would be good considered moderately concentrated and the Peoples Gas and North Shore Gas markets would be considered highly concentrated.

Lastly, it shows that the concentration levels did not change significantly from 2013 to 2014 for any of the four markets.

C. Small volume transportation

Small volume transportation programs for small commercial and residential customers are an important component of Illinois retail natural gas markets. Like transportation programs for large volume customers, retail choice gives small volume customers the opportunity to purchase competitively priced natural gas commodity from alternative retail gas suppliers rather than traditional bundled utility service. Small volume transportation programs allow suppliers to aggregate customer load and estimate their daily usage for balancing purposes instead of directly measuring daily usage with advanced meters. The Commission has approved three small volume transportation programs. In December 2014, approximately 350,000 residential customers and approximately 56,000 commercial customers were served under small volume transportation programs in Illinois.

In 1997, Peoples Gas filed small volume transportation tariffs that later became known as the "Choices For You" program. In 2000, the Commission approved Peoples' filing to institute a permanent unbundling program for all non-residential customers with an annual consumption of less than 50,000 therms.

In 1997, the Commission approved Nicor's "Customer Select" pilot program and Supplier Aggregation Service. These tariffs allowed Nicor to offer a pilot transportation program to small volume industrial and commercial customers. Residential customers were allowed to choose their own natural gas supplier in Nicor's service territory starting in May 1999. In July 2001, the Commission allowed Nicor to make Customer Select permanent, and on March 1, 2002, Customer Select was available to all of the nearly two million residential, commercial, and industrial customers in Nicor's service territory.

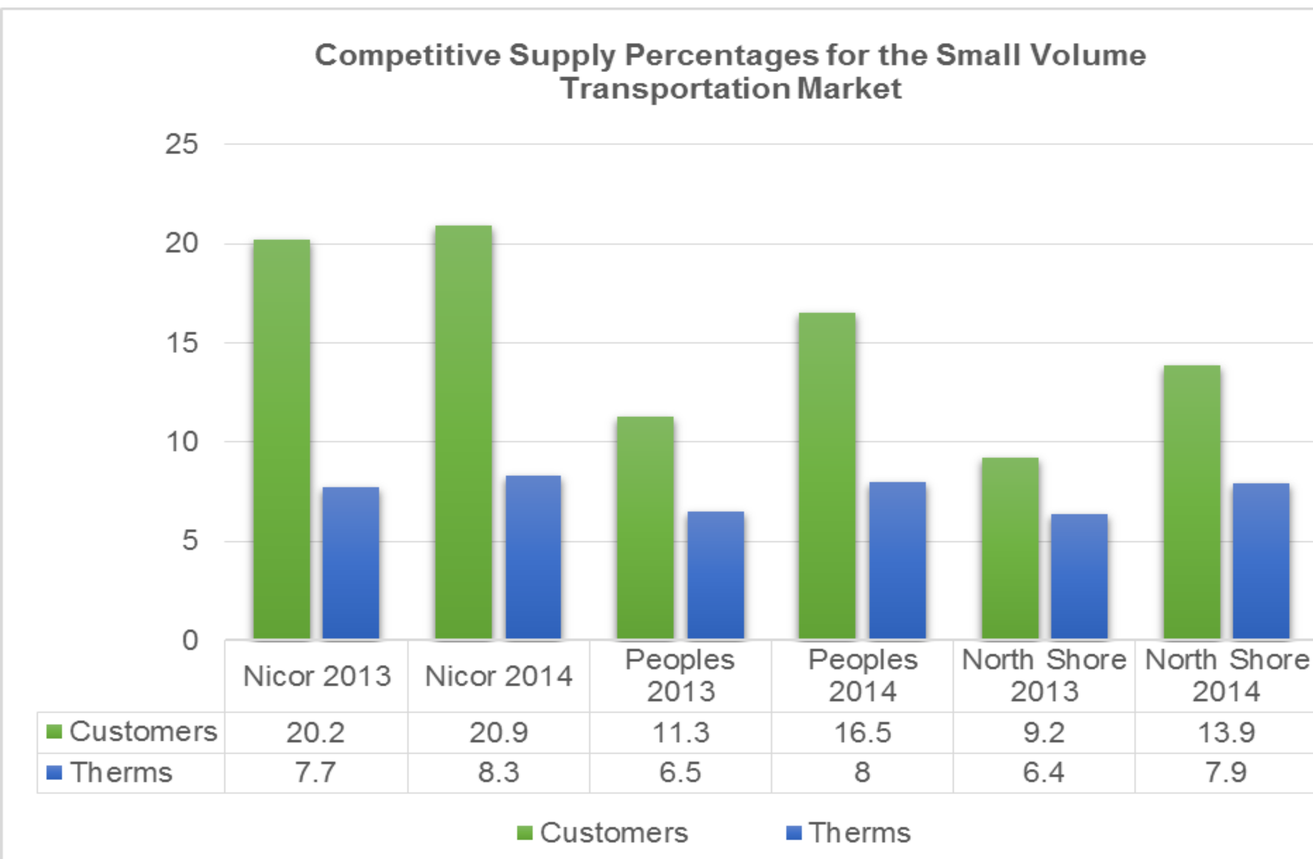
While the Commission does not regulate the price of gas charged by retail suppliers, the Commission does regulate and license alternative gas suppliers in three ways:

1. The Commission approves the utility tariffs that allow for the existence of the programs including delivery requirements for system reliability.
2. The Commission issues licenses and approves qualification for alternative gas suppliers serving small commercial and residential customers.
3. The Commission enforces the provisions of the Public Utilities Act governing consumer protections for gas supply offered by alternative gas suppliers.

In addition, the Commission maintains a website with residential and small commercial offers from suppliers, including a pricing comparison spreadsheet to assist customers when shopping for gas supply service.

1. Customer switching

The following table and graph shows how many of the small volume transportation customers had switched away from the gas utility. It also shows how much of the small volume gas usage (therms) was provided by retail suppliers. As mentioned above, small volume transportation includes residential and small non-residential customers. Also, Ameren Illinois does not have a small volume transportation program at this time.



	Nicor 2013	Nicor 2014	Peoples 2013	Peoples 2014	North Shore 2013	North Shore 2014
Customers	20.2	20.9	11.3	16.5	9.2	13.9
Therms	7.7	8.3	6.5	8	6.4	7.9

Unlike the large volume transportation market, the percentage of switched customers is greater than the percentage of switched usage. This is not surprising, given that virtually all non-residential customers are eligible for both the large volume transportation program as well as the small volume transportation program. In terms of customers, the percentage of small volume transportation customers who have switched is greater than the percentage of switched large volume transportation customers. In terms of usage, the reverse is true. This applies to all three utility areas. In addition, the table shows that Nicor saw the biggest percentage of switched customers among the three utility areas. The table also reveals that Peoples and North Shore saw a significant increase in switched customers from 2013 to 2014 while Nicor's switched customer numbers stayed relatively constant.

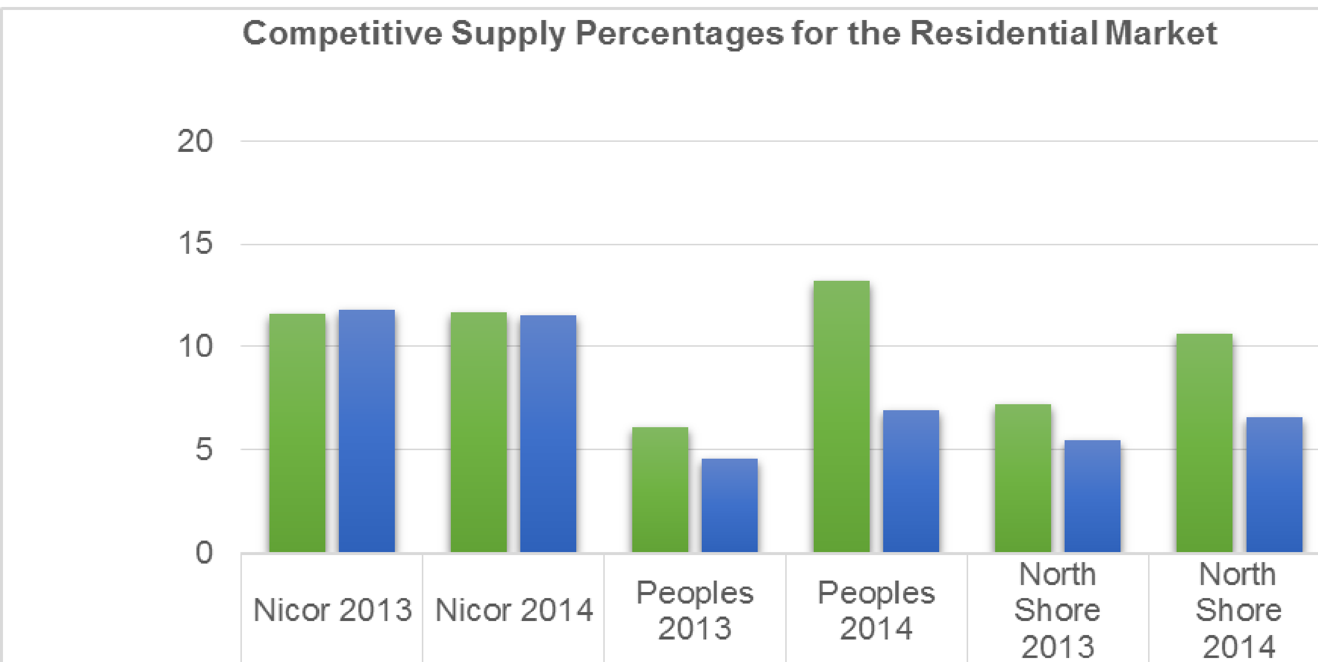
Singling out just the residential customers in the small volume transportation market, the following table shows the total number, as well as the percentage, of residential customers who are receiving supply from a competitive supplier.

Residential Customers on Competitive Supply

	December 2013	December 2014
Nicor:	233,608	235,919
Peoples Gas:	45,571	98,423
North Shore Gas:	10,513	15,327
Total:	289,692	349,669
Nicor:	11.6%	11.7%
Peoples Gas:	6.1%	13.2%
North Shore Gas:	7.2%	10.6%

The table shows that, in terms of actual customer counts, Nicor's territory has the most residential customers on competitive gas service. Also, in terms of percentages, Nicor had the highest share of residential customers receiving AGS service in 2013. However, both Peoples' and North Shore's area saw significant residential switching activity in 2014. As a result, at the end of 2014, the highest percentage of switched residential customers occurred in Peoples' territory.

The next graph shows the percentage of switched residential customers and switched residential usage for 2013 and 2014.



	Nicor 2013	Nicor 2014	Peoples 2013	Peoples 2014	North Shore 2013	North Shore 2014
Customers	11.6	11.7	6.1	13.2	7.2	10.6
Therms	11.8	11.5	4.6	6.9	5.5	6.6

The graph above shows that, compared to the small volume transportation market as a whole, the percentage of switched residential customers and switched residential usage is more aligned. For Nicor's area, it is virtually identical. The table also reveals that, for

Peoples and North Shore, the percentage of residential usage provided by alternative gas suppliers did not increase nearly as much as the increase in switched customers.

Supplier Activity

An additional indicator of switching and supplier activity is the number of residential offers posted by the alternative gas suppliers on the Commission's website. The tables below show the number of suppliers as well as the number of offers posted by the suppliers. Compared to the offers posted by ARES, the numbers of suppliers and offers are relatively small, especially when taking into account that the posting of residential gas offers is mandatory for the ARGS but not for the ARES.

Residential Suppliers Posting on Commission Website

Utility Area	# of Suppliers posting in October 2014	# of Suppliers posting in August 2015	# of Offers posted in October 2014	# of Offers posted in August 2015
Nicor Gas	8	9	25	29
Peoples Gas	7	7	24	24
North Shore Gas	5	6	19	21

The following two tables compare the type of offers posted in the various gas utility areas. Like the table above, we show numbers from October 2014 and August 2015.

Type of Residential Offer	Nicor October 2014	Peoples Gas October 2014	North Shore Gas October 2014
Total	25	24	19
Fixed	17	16	11
Variable	6	4	4
Fixed/Variable	1	3	3
Other	1	1	1
With Early Termination Fee	13	17	15
Without Early Termination Fee	12	7	4
< than 12-month Term	4	3	2
12-month Term	13	11	10
13-23 month Term	1	1	0

24-month Term	2	3	2
> than 24-month Term	3	4	3
> than 36-month Term	2	2	2

Type of Residential Offer	Nicor August 2015	Peoples Gas August 2015	North Shore Gas August 2015
Total	29	24	21
Fixed	20	15	12
Variable	6	4	4
Fixed/Variable	1	3	3
Other	2	2	2
With Early Termination Fee	16	17	17
Without Early Termination Fee	13	7	4

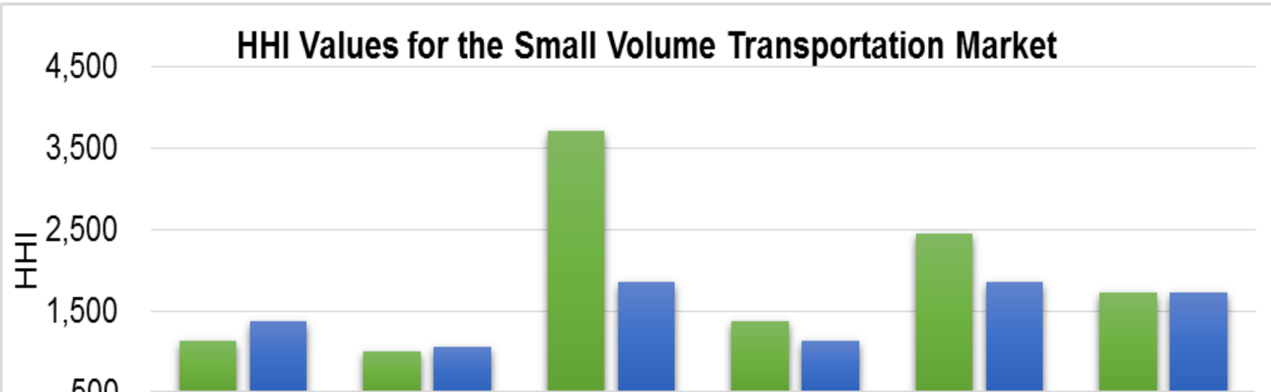
< than 12-month Term	4	3	2
12-month Term	15	12	12
13-23 month Term	2	1	0
24-month Term	4	4	3
> than 24-month Term	2	2	2
> than 36-month Term	2	2	2

The two tables show that the majority of residential offers are fixed price offers with an early termination fee (which is statutorily limited to $50). A few of the offers have both fixed and variable components to them and some offers are "fixed bill" offers where the customer pays the same amount for natural gas supply regardless of the actual monthly usage.

As for term lengths, most offers have a one-year term but, unlike in the residential electric market, a significant portion of the offers has contract lengths of 3 years or more.

2. Small volume transportation market concentration

As we did for the large volume transportation market, we calculated the market concentration for the small volume transportation market. Even though the difference between the percentage of switched customers and the percentage of switched usage is not nearly as marked as it is in the LVT market, we analyzed the SVT market shares of the individual suppliers by looking at the share of gas usage provided by a supplier instead of the share of customers served by individual suppliers. The following table breaks the SVT market into residential and non-residential markets and shows values for 2013 and 2014 by utility area.



	Nicor Residential	Nicor Non-Residential	Peoples Residential	Peoples Non-Residential	North Shore Residential	North Shore Non-Residential
2013	1,136	998	3,708	1,363	2,442	1,728
2014	1,380	1,065	1,857	1,137	1,861	1,722

The graph shows several things. First, except for Peoples' 2013 residential market, all markets show an unconcentrated or moderately concentrated market. Second, Nicor's residential and non-residential markets exhibit the lowest levels of market concentration. Third, the non-residential markets are less concentrated than the residential markets in all utility areas. Fourth, aside from small increases in Nicor's markets, all markets saw a decrease in concentration from 2013 to 2014. The residential markets in Peoples' and North Shore's territories saw the biggest decline in concentration during that period. This is consistent with an increase in suppliers with residential customers as shown below.

Looking at the market share in more detail, the following table shows how the market share of the three largest suppliers has gone down significantly in the Peoples and North Shore area from 2013 to 2014. This time we looked at market shares in terms of residential customers instead of residential usage.

Residential Market Shares by Customers

	Nicor 2013	Nicor 2014	Peoples 2013	Peoples 2014	NS 2013	NS 2014
Share of largest 3 suppliers	56%	55%	80%	63%	80%	68%
# of suppliers with customers	15	15	12	14	9	12
# of suppliers with >15% share	3	2	1	1	3	3
# of suppliers with >5% and <15% share	3	5	4	7	1	3
# of suppliers with <5% share	9	8	7	6	5	6
# of suppliers with < 1% share	3	3	4	4	3	4

It shows that, in Peoples and North Shore territory, the market share of the three suppliers with the highest market share has gone down from 80% at the end of 2013 to 63% and 68%, respectively, at the end of 2014. The table reveals that the Peoples' market saw entry by two additional residential suppliers and North Shore's market saw three additional suppliers entering the market. Also worth noting is that the number of suppliers with a market share between 5% and 15% has increased in all three utility markets. Finally, about half of all suppliers had market shares of less than 5%.

V. Suggested Administrative and Legislative Action

This is the ORMD's first report pursuant to the updated Section 19-130 of the Public Utilities Act. This first report focuses on the status of the retail gas market in Illinois and sets a baseline of data for future annual reports. At this point in time, the ORMD has no recommendations for administrative or legislative action for the Commission or the General Assembly. However, the lack of an option to sell receivables to the gas utility for an AGS' residential and small commercial customers could be a reason why the number of suppliers in this market is substantially smaller than the number of suppliers in the residential and small commercial retail electric market. Furthermore, pursuant to the Order in Docket No. 14-0097, the Commission will soon receive a Staff Report on the currently on-going workshop discussions regarding the creation of a cost-effective small volume transportation program for the three Ameren Illinois rate zones.

For these reasons, the ORMD is not proposing any administrative or legislative action at this time.