REPORT OF THE

NORTH CAROLINA UTILITIES COMMISSION

TO THE

JOINT LEGISLATIVE COMMISSION ON GOVERNMENTAL OPERATIONS

RE:

THE STATUS AND EXPANSION OF NATURAL GAS SERVICE WITHIN THE STATE (PURSUANT TO G.S. 62-36A)

Date Due: May 1, 2014
Date Submitted: April 28, 2014

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Executive Summary

This report includes the Commission's summaries and analyses of the updated expansion plans filed by the local distribution companies (LDCs) and an overview of the status of natural gas service within the State. The Commission concludes that the LDCs' plans for expansion of natural gas service are reasonable; however, this conclusion is made without prejudice to the Commission's consideration of specific future proposals requiring regulatory approval.

Introduction

This report has been prepared and is being submitted pursuant to the provisions of G.S. 62-36A. This statute was promulgated in June 1989 by enactment of Chapter 338 of the 1989 Session Laws, entitled "An Act to Require Natural Gas Local Distribution Companies to Report Plans for Providing Natural Gas Service in Unserved Areas to the Utilities Commission and to Require the Utilities Commission to Report on Expansion of Natural Gas Service to the Joint Legislative Utility Review Committee." In 2011, the statute was amended to require that the report be made to the Joint Legislative Commission on Governmental Operations.

Commission Rule R6-5(11) required each franchised natural gas LDC to file its initial report with the Commission by January 1, 1990. Biennial updates detailing the LDCs' expansion plans have been subsequently filed, including the most recently filed biennial updates which are the subject of this report. The Commission has amended Rule R6-5(11) in order to simplify the biennial reporting requirements for LDCs that no longer have unserved areas within their franchised service territories for which expansion funds could be used pursuant to G.S. 62-158. This amendment significantly limits the reporting requirements for such LDCs.

As required by G.S. 62-36A(c), the Commission's report was prepared independently from the Public Staff. It includes the Commission's summaries and analyses of the updated expansion plans filed by the LDCs and an overview of the status of natural gas service within the State. Overall, the Commission concludes that the LDCs' plans for expansion of natural gas service are reasonable for purposes of G.S. 62-36A; however, this conclusion is made without prejudice to the Commission's consideration of specific future proposals requiring regulatory approval.

There are currently four natural gas local distribution companies operating in North Carolina. They are Piedmont Natural Gas Company, Inc. (Piedmont); Public Service Company of North Carolina, Inc., doing business as PSNC Energy (PSNC); Frontier Natural Gas Company, LLC (Frontier); and Toccoa Natural Gas (Toccoa). Since these reports were begun, Piedmont has acquired NUI North Carolina Gas, North Carolina Natural Gas Corporation (NCNG), and Eastern North Carolina Natural Gas Company (EasternNC). Piedmont now operates as a single regulated entity with a single set of tariffs. On October 1, 2007, Frontier was acquired by Energy West, Incorporated (Energy West). The Commission approved the acquisition in Docket No. G-40, Sub 67.

In the Commission's first report in May 1990, it identified 38 counties that had no natural gas service available or had only minimal service. As of this report, only four counties -- Alleghany, Cherokee, Clay, and Graham -- are unfranchised. There are no current plans for natural gas service in Cherokee, Clay, and Graham. Frontier is "exploring ways to cost effectively expand into Allegheny County to serve the town of Sparta."

Summary and Analysis of Expansion Plans

Frontier Natural Gas Company, LLC

The franchised service territory of Frontier consists of six counties. Five are in northwestern North Carolina (Ashe, Surry, Watauga, Wilkes, and Yadkin), and the other one is Warren County.

Frontier is a relatively new natural gas local distribution company. It first received a certificate of public convenience and necessity from the Commission to serve Surry, Wilkes, Watauga, and Yadkin counties (the Four County Area) in 1996. Piedmont also asked for a certificate to serve those counties. However, Piedmont asserted that it was infeasible to extend service into the Four County Area with investor capital alone and proposed to use a mix of investor capital and expansion funds. On June 19, 1995, the Commission issued an order in Docket Nos. G-38 and G-9, Sub 357, holding the applications of Frontier and Piedmont in abeyance while offering Piedmont a conditional certificate to extend service to the Four County Area without the use of expansion funds. Piedmont declined the conditional certificate, and the Commission issued an order awarding a conditional certificate to Frontier, based on Frontier's assertion that it was economically feasible to extend service into the Four County Area with investor capital. Piedmont appealed the award of Frontier's certificate. Frontier's certificate to serve the Four County Area did not become final until the North Carolina Supreme Court rejected Piedmont's appeal in 1997.

On March 27, 1997, the Commission issued an order in Docket No. G-38, Sub 1, awarding Frontier a certificate to serve Warren County. PSNC had held a certificate to serve Warren County, but had not extended service. Frontier expressed an interest in serving the county, and PSNC agreed to relinquish its certificate to Frontier.

Frontier was assigned a franchise to serve Ashe County and Allegheny County pursuant to the Commission's August 16, 1996 Order in Docket No. G-100, Sub 69, which implemented G.S. 62-36A(b1). However, Frontier forfeited its exclusive franchise rights to Alleghany County in the March 13, 2001, Order in Docket No. G-41, Sub 12 pursuant to G.S. 62-36A(b) because Frontier had neither completed a substantial amount of the design process/service work for Alleghany County, nor acquired rights-of-way for the county, nor renewed its request for bond funds to serve the county.

Frontier was awarded natural gas bond funds in June 2000 to extend service into Ashe County. Frontier completed a transmission line into Ashe County and commenced service there in August 2002.

On October 1, 2007, Frontier was acquired by Energy West. Energy West subsequently changed Frontier's name from Frontier Energy, LLC to Frontier Natural Gas, LLC. The Commission approved the acquisition in Docket No. G-40, Sub 67. In that docket, David Cerotzke, CEO of Energy West, testified, "The expansion of Frontier

Energy's customer base and demand requirements is an important aspect of the company's future financial viability. The Company's expansion will be based on customer demand for Frontier Energy's distribution services, the ability of Frontier Energy to provide cost effective service connections to its system, and the efficient operations of the distribution system."

There are no unserved counties in Frontier's franchised service area. Frontier has completed its approximately 138-mile "backbone" steel transmission system. Frontier is now focused on extending its distribution system, which is currently composed of approximately 324 miles of pipeline.

From September 30, 2011 to September 30, 2013, Frontier has increased its number of customers served from 1,477 to 2,353, a 59% increase, and has added 194,955 feet of distribution pipeline among eight counties (Ashe – 32,985 feet; Davie – 7,040 feet; Iredell – 9,610 feet; Surry – 57,368 feet; Warren – 673 feet; Watauga – 27,373 feet; Wilkes – 32,783 feet; and Yadkin – 27,123 feet). Expansion efforts have focused on extending service strategically to agricultural and commercial corridors and high concentrations of homes.

Frontier states that it is ready, willing, and able to expand its system in all six franchised counties wherever economically feasible, and that distribution pipeline construction and service extensions to new customers are evaluated in response to new customer requests.

In addition, Frontier is exploring ways to cost effectively expand into Allegheny County in order to serve the town of Sparta. Alleghany County is approximately 20 miles from the end of Frontier's current distribution system. The expansion is targeted for 2014/2015 and the expansion depends upon community interest and future capital financing.

It is the overall conclusion of the Commission that Frontier's plans for the expansion of natural gas service within its franchised service territory in North Carolina are reasonable for purposes of G.S. 62-36A.

Piedmont Natural Gas Company, Inc.

Piedmont was incorporated in 1950 and is engaged in transporting, distributing, and selling natural gas in parts of North Carolina, South Carolina, and Tennessee.

In 2003, Piedmont acquired NCNG and a 50% interest in EasternNC. In August 2005, Piedmont acquired the remaining 50% interest in EasternNC. Pursuant to the Commission's November 3, 2005 Order in Docket No. G-9, Sub 499, Piedmont consolidated Piedmont, NCNG, and EasternNC into a single regulated entity. With that consolidation, Piedmont's service territory is now the largest in the State.

Piedmont's service territory includes the following counties: Anson, Avery, Beaufort, Bertie, Bladen, Brunswick, Burke, Caldwell, Camden, Carteret, Catawba, Chowan, Columbus, Craven, Cumberland, Currituck, Dare, Davie, Duplin, Edgecombe, Forsyth, Gates, Greene, Guilford, Halifax, Harnett, Hertford, Hoke, Hyde, Johnston, Jones, Lenoir, Lincoln, Martin, Mitchell, Montgomery, Moore, Nash, New Hanover, Northampton, Onslow, Pamlico, Pasquotank, Pender, Perquimans, Pitt, Randolph, Richmond, Robeson, Rockingham, Sampson, Scotland, Stanley, Stokes, Tyrrell, Union, Washington, Wayne, Wilson, and Yancey Counties; as well as portions of Alamance, Alexander, Davidson, Gaston, Mecklenburg, and Rowan.

Piedmont has transmission facilities and distribution systems in place and is providing some level of service in all of its certificated counties.

In its last biennial expansion report, Piedmont had received 97 inquiries from large commercial and industrial customers about potential gas service. Eleven were successful (new customers were added as a result of those inquiries), 12 were progressing, 32 were unsuccessful or not feasible (did not provide gas to the customer), and 42 were still pending (either waiting for data, being evaluated, or halted progress). Since its last biennial expansion report, Piedmont has received 227 inquiries from large commercial and industrial customers about potential gas service. Of the 227 inquiries, 42 have been successful (new customers were added as a result of those inquiries), 5 are progressing, 84 have been unsuccessful or not feasible (did not provide gas to the customer), and 96 are still pending or on hold (either waiting for data, being evaluated, or halted progress).

The following significant projects have been completed since the last biennial expansion report filing: Monroe Project #1 - Parkwood School Road Project, Monroe Project #2 – Mineral Springs, Taberna – New Bern, and South Whiteville. The Towne Pointe – Jacksonville project has been cancelled.

In 2012, Piedmont completed its agreement with Duke Energy Progress, Inc. (DEP) to provide natural gas delivery service to a power generation facility at DEP's Wayne County site. Piedmont constructed 38 miles of transmission pipeline along with additional compression facilities to provide natural gas delivery service to the plant.

Piedmont completed its agreement with DEP to provide natural gas delivery service to the electric utility's state-of-the-art power generation facility at DEP's existing L.V. Sutton Plant. Piedmont installed approximately 130 miles of transmission pipeline that crosses Richmond, Scotland, Robeson, Bladen, Columbus, and Brunswick Counties.

In New Bern, Piedmont plans to install 25 miles of distribution gas line surrounding the community of Brices Creek including 11 additional existing neighborhoods in Craven County. The Brices Creek project will extend service to approximately 1000 existing homes and will position Piedmont to gain 780 residential cutomers within the first five years of the project completion. In addition in Fayetteville, Piedmont plans to extend service to approximately 300 new residential customers in the Village at Rockfish.

It is the overall conclusion of the Commission that Piedmont's plans for the expansion of natural gas service within its franchised service territory in North Carolina are reasonable for purposes of G.S. 62-36A.

<u>Public Service Company of North Carolina, Inc.</u>

PSNC, a SCANA Company, provides natural gas to more than 500,000 winterpeak customers in 96 cities and communities in central and western North Carolina. PSNC has a franchised service territory that includes all or part of 28 counties in the Piedmont and mountain regions of the State. PSNC's counties are in three clusters, separated by parts of Piedmont's service territory. The eastern cluster includes the Raleigh-Durham-Chapel Hill area and is experiencing significant growth. PSNC serves the Concord-Statesville-Gastonia area, which wraps around Charlotte along I-85. The western cluster of counties includes the Asheville-Hendersonville area, which is attracting retirees and is forecast to continue growing.

With service extended to all previously unserved counties in its franchised service territory, and with no other expansion projects that appeared to qualify for the use of expansion funds, PSNC filed an application to dissolve its expansion fund on February 15, 2007. The Public Staff, the Attorney General, and the Carolina Utility Customers Association, Inc., filed comments supporting the application. The Commission issued an order dissolving PSNC's expansion fund on May 22, 2007.

Natural gas distribution service is being provided in all counties in PSNC's service territory. There are no unserved areas, within the intent of G.S. 62-158 and G.S. 62-2(9), remaining in PSNC's service territory, and PSNC has no projects in progress to serve unserved areas at the time of its last biennial expansion report.

In its last biennial expansion report, PSNC listed 63 service inquiries from potential large commercial and industrial customers received during the two-year period. Fourteen of those resulted in successful projects, 48 were unsuccessful, and 1 is still pending. Since its last biennial expansion report, PSNC has received 60 service inquiries from potential large commercial and industrial customers. Ten of those resulted in successful projects, 22 were unsuccessful, and 28 are still pending.

It is the overall conclusion of the Commission that PSNC's plans for the expansion of natural gas service within its franchised service territory in North Carolina are reasonable for purposes of G.S. 62-36A.

<u>Toccoa Natural Gas</u>

The City of Toccoa, Georgia, operating in North Carolina as Toccoa Natural Gas, received a franchise in December 1998 to provide natural gas service to Macon County. In 1999, construction commenced on an 8-inch transmission line to bring gas service into Macon County, and a distribution system in the town of Franklin. The construction of these lines was completed and Toccoa began service to customers in Macon County in April 2000. As of September 1, 2013, Toccoa has approximately 608 retail customers in North Carolina.

Toccoa does not have any projects in progress at the time of this report. Since its last biennial expansion report, Toccoa has not received any requests or inquiries from potential large commercial and industrial customers considering locations in its service territory that were not economically feasible to serve.

It is the overall conclusion of the Commission that Toccoa's plans for the expansion of natural gas service within its franchised service territory in North Carolina are reasonable for purposes of G.S. 62-36A.

Status of Natural Gas Service within the State

Four natural gas LDCs provide service in 96 of the 100 counties in the State. In addition, eight municipal systems serve communities in North Carolina.

Since the establishment of the biennial expansion reports, a total of approximately $315 million in special funding authorized by statute has been used to supplement investor funding for natural gas expansion projects that would have otherwise been economically infeasible. Special funding includes $200 million of natural gas bond funds, pursuant to G.S. 62-159, and approximately $115 million in expansion funds, pursuant to G.S. 62-158.

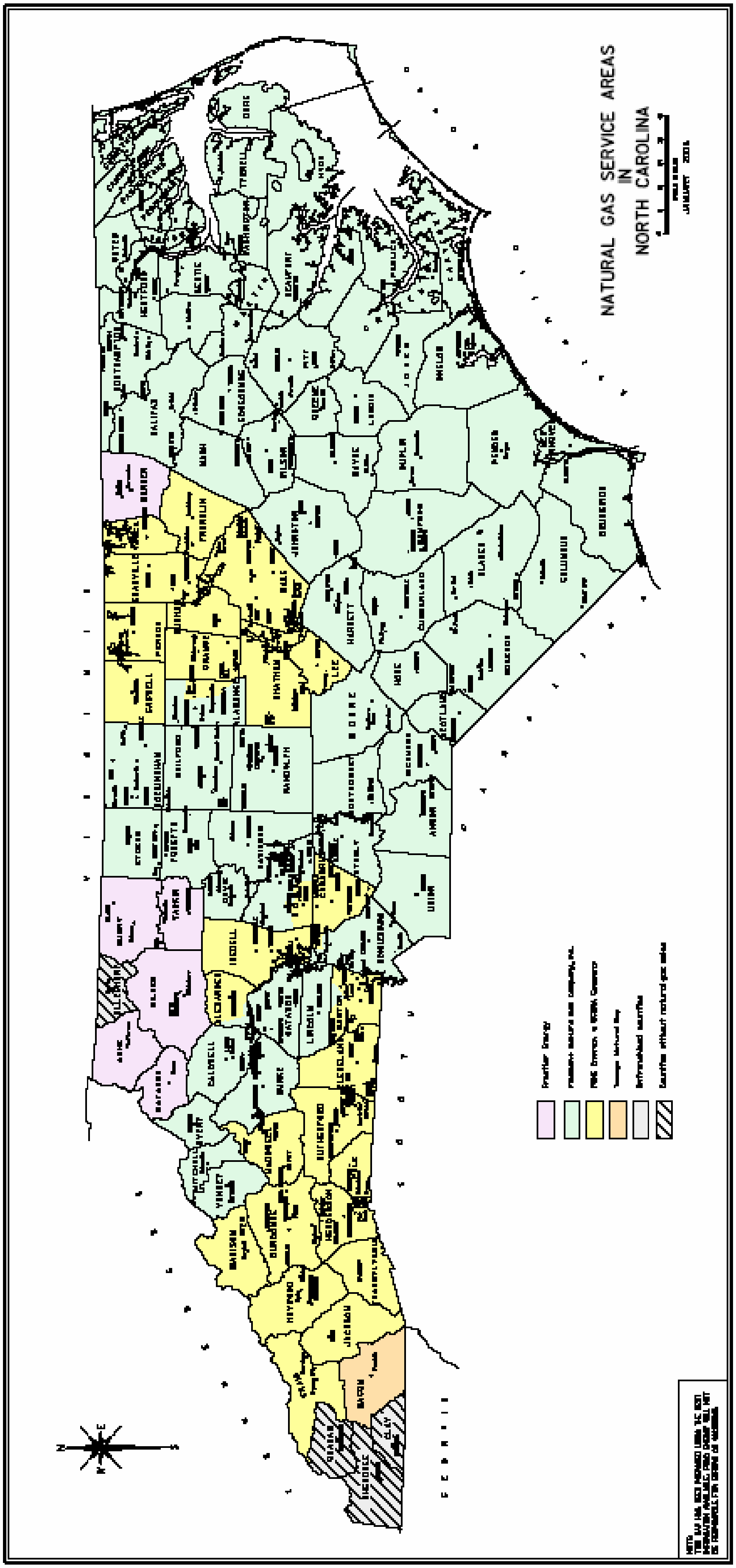
These monies were used to extend service to, or expand service in, 31 counties. Five other previously unserved counties received initial service with investor funding and without the use of special funding. All natural gas bond funds have been expended. The primary source of monies for LDC expansion funds has been refunds from interstate natural gas companies regulated by the Federal Energy Regulatory Commission. Pursuant to G.S. 62-158(b)(1) such refunds could be used to fund each LDC's expansion fund. In the absence of an expansion fund, the bulk of such refunds would be passed back to ratepayers. Interstate supplier refunds are an inherently undependable source of funding. The timing and magnitude of supplier refunds depend on the outcome of proceedings before the Federal Energy Regulatory Commission.

Natural gas prices have increased dramatically since the Commission's first report to the Joint Legislative Utility Review Committee in 1990. That year, the average price of natural gas at the key pricing hub in Henry, Louisiana was $1.70 per dekatherm (dt). Over the next decade, the average annual price of natural gas at the Henry Hub varied from a low of $1.47/dt in 1991 to a high of $2.76/dt in 1996. The average for the decade was $2.01/dt. From 2000 through 2009, the average annual Henry Hub price varied from a low of $3.38/dt in 2002 to a high of $8.86/dt in 2008. The average price for the decade was $5.68/dt, more than two-and-a-half times the average price during the previous decade. Due to the economic downturn and the increase in production of shale gas, the average annual Henry Hub price in 2010 was $4.37/dt, in 2011 it was $4.00/dt, and in 2012 it was $2.75/dt. In 2013, the average annual Henry Hub price rebounded to $3.73/dt.

The U.S. Department of Energy's Energy Information Administration shows industrial natural gas consumption in North Carolina falling from 107 billion cubic feet in 1999 to 82 billion cubic feet in 2009. With lower gas prices, the industrial natural gas consumption in North Carolina increased to 109 billion cubic feet in 2013.

Status of Natural Gas Franchises

The North Carolina map attached to this report shows the status of the natural gas franchised service territories as of this date.


NATURAL GAS SERVICE AREAS
IN
NORTH CAROLINA