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STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

At a session of the Public Service
Commission held in the City of
Albany on August 22, 2007

COMMISSIONERS PRESENT:

Patricia L. Acampora, Chairwoman
Maureen F. Harris
Robert E. Curry, Jr.
Cheryl A. Buley

CASE 07-G-0299 - In the Matter of Issues Associated with the Future of the Natural Gas Industry and the Role of Local Gas Distribution Companies – Capacity Planning and Reliability

ORDER ON CAPACITY RELEASE PROGRAMS

(Issued and Effective August 30, 2007)

BY THE COMMISSION:

INTRODUCTION

The Department of Public Service Staff prepared a White Paper on Capacity Planning and Reliability (White Paper).¹ The White Paper advocates the mandatory assignment of capacity by local distribution companies (LDCs, utilities) to retail marketers. This requirement is intended to ensure the continued reliability of the natural gas system in New York State, while preventing the inefficiencies that result when duplicative capacity assets are held by the LDCs to backstop marketer supplied capacity. The White Paper also recommends the grandfathering of current levels of marketer-owned capacity.

A notice of proposed rulemaking in this case was published in the State Register on April 11, 2007, in accordance with State Administrative Procedure Act

¹ Case 07-G-0299, supra, Staff White Paper on Capacity Planning and Reliability.

§202(1) (SAPA). The SAPA deadline for filing comments was May 29, 2007. In addition, the Secretary to the Commission issued a notice requesting that parties file initial comments on the White Paper by May 19, 2007 and reply comments by May 29, 2007.

The following parties submitted initial comments: Central Hudson Gas & Electric Corporation (CHGE); Consolidated Edison Company of New York, Inc./Orange & Rockland Utilities, Inc. (CE/ORU); Direct Energy Services, LLC. (DE); Dominion Transmission, Inc. (DTI); Hess Corporation (Hess); Intelligent Energy (IE); KeySpan Energy Delivery New York/KeySpan Energy Delivery Long Island (KeySpan); Multiple Intervenors (MI); National Energy Marketers Association (NEMA); Niagara Mohawk Power Corporation d/b/a National Grid (National Grid); National Fuel Gas Distribution (NFGD); New York State Electric & Gas Corp./Rochester Gas & Electric Corporation (NYSEG/RG&E); New York State Energy Marketers Coalition (NYSEMC); Northeast Gas Association (NGA); Shell Trading and Gas and Power Co. (Shell); Small Customer Marketer Coalition (SCMC); Texas Eastern Transmission, L.P. (TE); and, UGI Energy Services, Inc. (UGI). The following parties submitted reply comments: KeySpan, MI, NYSEG/RG&E, NGA, and UGI.

BACKGROUND

Over the last two decades, the natural gas industry has undergone continuous change. Retail competition began in the mid-1980's when larger customers were given the option to purchase gas directly from suppliers other than their local gas companies. In 1993, we instituted a proceeding that culminated in LDC unbundling and small customer aggregation programs.² The outcome was that the natural gas commodity was unbundled from the distribution service, which allowed marketers to offer commodity service to customers. Aggregation programs combined groups of small customers to achieve the buying power of one large customer.

² Case 93-G-0932, Restructuring of the Emerging Competitive Natural Gas Market, Opinion No. 94-26 (issued December 20, 1994).

In March 1996,³ we allowed LDCs to require that a customer migrating from sales to transportation services take a mandatory assignment of the customer's pro rata share of upstream capacity for up to three years. On September 4, 1997, we released a Staff Position Paper on the Future of the Natural Gas Industry.⁴ After consideration of that Paper and the comments filed by interested parties, we issued a Policy Statement⁵ on the future of the natural gas industry in which we said the following about reliability:

No compromise in system reliability will be permitted....Toward that end, LDCs will continue to be the system operators and will be allowed to maintain access to sufficient assets (e.g., gas supply, pipeline and storage capacities) to assure proper operation of the system. LDCs may impose reasonable requirements on marketers to assure such proper operation.⁶

On March 24, 1999, we issued an Order Concerning Assignment of Capacity,⁷ which permitted marketers to obtain their own capacity. The Order provided that mandatory capacity assignment would only be available to those LDCs where specific operational and reliability requirements warranted. However, we stated that marketers who operate with only secondary delivery point capability may not be able to deliver gas to their customers' city gate on colder days when the gas system may be capacity constrained. Therefore, in order to assure reliability, we required all marketers

³ Case 93-G-0932, supra, Order Concerning the Compliance Filings (issued March 28, 1996).

⁴ Case 97-G-1380, Future of the Natural Gas Industry and the Role of Local Gas Distribution Companies, Notice Inviting Comments on Staff's Report (issued September 4, 1997).

⁵ Cases 93-G-0932 and 97-G-1380, supra, Policy Statement Concerning the Future of the Natural Gas Industry in New York State and Order Terminating Capacity Assignment (issued November 3, 1998) (Policy Statement).

⁶ Policy Statement, p. 6.

⁷ Cases 93-G-0932 and 97-G-1380, supra, Order Concerning Assignment of Capacity (issued March 24, 1999).

serving firm loads to demonstrate that they have firm, non-recallable, primary delivery point capacity to the city gate, but only for the winter season (November through March). We also stated that this issue might be revisited in the then ongoing gas reliability proceedings.

In our Order Concerning Reliability,⁸ we directed that a process be established for examining capacity issues, including capacity requirements that should apply, and the extent to which capacity availability requirements are appropriate in the context of the evolving gas market. To that end, the Natural Gas Reliability Advisory Group (NGRAG) was formed to consider the evolving capacity markets and how they affect reliability, and to inform the Commission about issues that need to be addressed to protect reliability.

In mid-2005, three working groups were formed within the NGRAG to comprise the Capacity Planning Initiative (CPI). The working groups consisted of representatives from LDCs, marketers, pipelines, consumer advocates, and Staff. Given the tight capacity situation currently existing in New York State, the focus of the CPI was to investigate the effects on the reliability of the natural gas supply for all core customers in every franchise area and region of the State resulting from the migration of residential and small commercial sectors to marketers.

The CPI investigation culminated in a Working Group Report (Report) which highlights the reliability concerns of assuring the continued availability of the pipeline capacity provided by gas marketers when needed. Specifically, if marketers exit a utility program, the capacity that they had provided may be needed to continue to serve those customers. This issue is more pressing than ever due to increasing natural gas loads and limited or tightening capacity availability. In order to maintain system reliability, natural gas utilities could hold capacity intended to duplicate that marketer-provided capacity; however, this would be inefficient and could result in cost and environmental

⁸ Case 97-G-1380, supra, Order Concerning Reliability (issued December 21, 1999), p. 10.

impacts associated with obtaining or building duplicative capacity. In the alternative, utilities may possibly decide against renewing their existing capacity contracts, or may renew them at lower volumetric levels, relying instead on the capacity that marketers have contracted. However, if those marketers cease serving customers in New York State and that capacity is no longer available to serve New York consumers, reliability could be adversely impacted.

The Report's findings form the basis of the White Paper. The White Paper recommends that LDCs adopt a mandatory capacity assignment model, along with the grandfathering of existing levels of marketer capacity used to serve core customers. The mandatory assignment of capacity is to address the inefficiencies inherent in duplicative capacity assets held by the LDCs and to help ensure the reliability of the natural gas system in this State.

STAFF PROPOSAL

In the White Paper, the Staff presented a straw proposal, which adopts mandatory capacity release with a modification to accommodate marketers who provide their own capacity. The proposal contains the following elements: (1) all LDCs will have in place mandatory capacity release programs; (2) any marketer currently using its own capacity to meet core customer requirements should be allowed to continue to do so indefinitely at then current volumetric levels (grandfathering); (3) if, at some point in the future, a marketer using its own capacity elects to reduce the amount of that capacity, that reduced level will become the new maximum amount of capacity that a marketer can bring to the LDC's city gates; (4) any marketer using its own capacity to meet some or all of its customer's requirements may pass those grandfathered rights on as a package when it sells its customer book to another marketer; (5) any new or incremental marketer loads would be served using a release of LDC capacity; (6) the Commission should require that firm LDC Primary Delivery Point Capacity that is utilized by a marketer be held by the marketer for 12 months; (7) the LDCs should work with pipelines to encourage implementation of Delivery Point Operator/City Gate Swing Service

(DPO/CSC)⁹ programs where they are currently not offered and, in the meantime, virtual storage programs should continue to be offered.¹⁰

COMMENTS

The parties' comments demonstrate broad, general support for the White Paper recommendations for mandatory assignment of LDC capacity and grandfathering of the current level of marketer-supplied capacity. One party, Shell, does not support mandatory assignment. Several of the parties object to unlimited grandfathering of marketer-supplied capacity. There were also concerns raised involving: capacity released based on total peak day load versus peak day load for firm transportation customers; definition of the types of customers affected; length of time (5 months versus 12 months) that LDC capacity is released to marketers in a given year; and, marketer access to LDC storage assets.¹¹

DISCUSSION

Mandatory Capacity Release

The commenting parties generally support the mandatory capacity release proposal, with the exception of Shell. Shell argues that, with implementation of the recommendation, utilities would enter into long-term capacity contracts and, as a result, would not be able to take advantage of potentially lower cost capacity that would ensue from pipeline and LNG projects on the drawing board and from potential Federal Energy Regulatory Commission (FERC) rule changes. In Shell's opinion, this would be economically disadvantageous to the ultimate customers. Shell urges, instead, that we

⁹ Delivery Point Operator/City Gate Swing Service programs allow marketers access to a virtual, no-notice service of the pipeline's storage assets. Currently, only Dominion Transmission Inc. offers this service.

¹⁰ White Paper, p. 16.

¹¹ Several miscellaneous issues were raised and considered that do not impact our decision. Thus, they are not specifically discussed herein.

adopt either a voluntary or hybrid capacity release program with limits on the variance in the amount of capacity supplied by marketers.

Shell's concern is misplaced. LDCs do take advantage of new capacity as it becomes available. The Millennium project's capacity, which Shell points to, is expected to come on line next year; and, the LDCs have already committed to the capacity.

The recommended capacity assignment gives the appropriate signals to the LDCs that they are responsible for ensuring adequate capacity, but does not absolve them of their obligations to prudently procure the capacity needed to meet their needs. The reasonableness of all capacity costs are subject to our review. We do not expect that LDCs would enter into the 10 or 20-year contracts that Shell is envisioning for all of their capacity needs.

Mandatory release should help in getting new assets built, as the project developers would know that the LDCs would have the obligation to plan for and procure the capacity needs for their systems. A voluntary program, as Shell advocates, adds uncertainty as to who is responsible for procurement. Finally, Shell's argument that FERC might, in the future, issue favorable rules regarding capacity ownership is problematic and can not be counted upon to help ensure reliability in this State. We, therefore, adopt the mandatory capacity release model.

Capacity Released Based on Total Peak Day Load vs. Peak Day Load for Firm Transportation Customers

Some LDCs release capacity to support the peak day load for firm transportation customers, while others release a percentage of the total peak day requirement. Hess requests that we clarify that peak day load for firm transportation customers is covered.

What a utility releases is dependent upon the specific program in effect for that utility. We do not see a change from voluntary to mandatory release as a significant alteration to the existing programs. Some LDCs hold a portion of the peak day requirement as an operational/reliability reserve, and other programs may have the

marketer capacity be the average day of the peak month, with the LDC providing all of the balancing. We do not envision those aspects to necessarily change as a result of this Order.

Grandfathering of Existing Third-Party Capacity Contracts Held by Marketers

The parties are not averse to the grandfathering of existing capacity contracts held by marketers. Some parties (e.g., UGI) argue that the failure to do so could result in economic harm to the marketers and would set a negative precedent in changing the business rules under which the marketers operate. Where the parties diverge, however, is for how long and under what conditions the grandfathering should continue.

The White Paper recommends that any marketer currently using its own capacity to meet core customer requirements should be allowed to do so indefinitely at current volumetric levels. If a marketer elects to reduce that amount of capacity in the future, the reduced level would become the maximum amount of capacity that the marketer can bring to the LDC's city gates. Also, the grandfathered rights may be transferred in whole as a package if the marketer sells its customer book to another marketer. Any new or incremental marketer loads would be served through a release of LDC capacity.

The commenting parties offer a myriad of variations on how the grandfathering should be structured. For example, KeySpan and NYSEG urge that grandfathering not be indefinite;¹² others (e.g., NGA) prefer that grandfathering end when the contracts expire; UGI would allow a marketer to increase its capacity holdings as its load grows; Hess advocates grandfathering at the volumetric level served by the marketer, only reducing the grandfathered level of capacity to the extent customers transfer to another marketer or return to the utility; CHGE, KeySpan, and NFGD would either not allow a marketer that sells its customer book to transfer the capacity (or

¹² NYSEG would have the grandfathering end and the mandatory capacity assignment programs to be in place by November 2011.

transfer only if the entire book is sold) or prohibit a marketer from renewing an expired contract to extend the grandfathered entitlements; and, other parties propose that capacity should follow the customer (e.g., NEMA, DE, and IE).

Grandfathering existing capacity protects marketers from an adverse economic situation resulting from a change in the business ground rules, while minimizing any potential reliability risk by capping the amount of non-utility control of capacity at current levels, which are manageable and relatively small compared to total LDC customer requirements. Not allowing it could potentially have a negative economic impact on marketers, result in sale of stranded marketer capacity out of State, or add administrative complexity to the process. Because, overall, a relatively small percentage, 2.1%, of total system capacity is not LDC-released,¹³ continuing the current level of marketer capacity is reasonable. Also reasonable is the White Paper recommendation that marketer-supplied capacity can be transferred, in whole, to another marketer when a marketer's book of customers is sold.

However, we are concerned about the impact that this decision could have on local gas production. MI notes that, if grandfathering is not provided for, marketers who are contracting with local producers for capacity may no longer do so, thus possibly negatively impacting local production. NFG does not believe that local gas production would be significantly impacted, but recommends that the availability of local gas production be regularly monitored to assure its continued availability to small customer marketers. In conclusion, local gas production connected to the distribution facilities of LDCs should be treated the same as upstream capacity. Firm reliable local gas production, connected directly to the LDC, should continue to be available as a replacement for LDC provided capacity. This will help ensure that existing local gas production and its further development is not negatively effected.

Each LDC with local gas production in its service territory is required to establish a plan for use of local gas production connected directly to their distribution

¹³ The percentage varies by individual LDC from 0% to approximately 10%.

facilities as upstream capacity and its availability as a replacement for capacity provided by local distribution companies. The plan should include required procedures, rules, and practices for an interconnection and any operational balancing requirements needed to ensure the reliability of this gas source as an interstate pipeline capacity replacement. Plans for NFG and Corning are under consideration in the ongoing proceedings reviewing applications for rate increases filed by these Companies.¹⁴ We expect to receive recommendations on the local gas production plans for Corning and NFG in these rate case proceedings. In the event that local gas production is connected directly to the distribution facilities of other LDCs, including NYSEG, RG&E, and National Grid, a LDC with local gas production is directed to include a plan for use of local gas production as a replacement for capacity as part of its next major rate change application; in the event that an involved market participant engaging in local gas production requires a LDC plan prior to the filing of a LDC major rate application, the participant may submit a petition requesting that the Commission direct the LDC to submit a local gas production plan for its consideration.

Definition of Customers Affected

The White Paper defines marketer customers affected by its proposed assignment program to be “those residential and small commercial customers who lack access to alternative fuels and for whom marketers must acquire primary delivery point capacity for the five winter months if they do not accept assignment of LDC capacity.”¹⁵ It also notes that the mandatory assignment program would not apply to large customers such as those that have chosen to take firm transportation service.

In its comments, NYSEG/RG&E asks that the definition of “customer” be extended to all core customers served by marketers. MI requests that we rule that the

¹⁴ Case 07-G-0141, National Fuel Gas Distribution Corporation – Rates for Gas Service; Case 07-G-0772, Corning Natural Gas Corporation – Rates for Gas Service.

¹⁵ White Paper, p. 3, footnote 7.

White Paper's customer definition is not applicable to those large commercial, industrial, and institutional customers that would otherwise qualify as core customers, and that these customers continue to be permitted to choose their level of service on the interstate system. According to MI, a customer characterized as core at the distribution level should continue to be able to choose between secondary firm and primary firm at the upstream pipeline level without having its core status jeopardized.

We find no reason to expand the definition of customers beyond that set forth in the White Paper. The larger customers have chosen their level of service and may employ risk management strategies to cover the possibility of their gas not getting to the LDC's system or may simply be willing to assume the risk of not receiving the gas. These customers constitute the pre-aggregation large volume loads which have been supplying their own capacity for up to 20 years, and the CPI was not intended to include these customers. NYSEG/RG&E and National Grid note in their comments that they no longer hold sufficient capacity to serve these larger customers.

Partial Versus Annual Holding of Capacity

Most LDCs require that marketers taking assignment of capacity do so for all 12 months of the year. Some LDCs allow the taking of released capacity just for the winter season, even though the capacity is contracted for on an annual basis. Currently, marketers who bring their own capacity are only required to have that capacity for the five winter months of November through March.

The White Paper contains a recommendation to require that firm LDC primary delivery point capacity, utilized by a marketer, be held by the marketer for 12 months instead of only the winter months. Under the White Paper's recommendation, month-to-month LDC releases would not be prohibited, and there would be no change to the current primary point capacity requirements for marketer-supplied capacity.

The LDCs generally support the White Paper's 12-month requirement. DTI states that the current five-month holding requirement for marketer-supplied capacity may hinder reliability because contracts less than 12 months are not eligible for Right of First Refusal. UGI's position is that, absent a showing by the LDCs that the

current policy creates operational problems, the five-month requirement should remain. Hess requests clarification that the grandfathered capacity is not subject to the White Paper's recommendation for the annual holding of capacity.

LDC releases should be for the entire year, not just for the winter months. If LDCs held capacity all year, but only required marketers to take wintertime releases, sales customers would be shouldering the difference in cost. This is an equity issue, as the LDC acquires the capacity to meet both sales and transportation load. We note that most LDC release programs already require a 12-month release.

As for grandfathered marketer-supplied capacity, that capacity can be held for the five winter months. Existing rules requiring proof that it is primary point delivery capacity will remain in effect.

Marketer Use of LDC Storage Assets

The White Paper recommends that the LDCs work with the pipelines to encourage implementation of Delivery Point Operator/City Gate Swing Service programs where they are not currently offered. Under a DPO/CSC program, a marketer would be able to balance its deliveries to the city gate throughout the year. If other pipelines serving New York were able to offer a program similar to DTI's DPO/CSC, marketers' access to storage and no-notice services would be enhanced.

A number of parties claim that, under current ratemaking incentives for utilities, it would not be in the LDCs' best interest to release their storage assets to marketers, because the LDCs can, instead, use that storage to make off-system sales and keep a percentage of the resulting profits for shareholders. However, there is no evidence that marketers are denied access to storage for this purpose, and this proceeding is not the appropriate forum for addressing incentives.

All of the LDCs offer marketers access to storage, either as a direct release or through a plan that offers a bundled winter supply that enables marketers to participate in a virtual storage program that mimics the actual release of storage assets. NGA and SCMC want those bundled winter supply offerings to be allowed to continue.

LDCs that utilize multiple storage fields with varied associated costs, storage value, and delivery paths to city gates, may encounter administrative difficulties in instituting a sharing program. Further, delivery capacity from storage to the city gate is not always releasable. Since all LDCs offer some form of access to storage, the White Paper's DPO/CSC recommendation simply adds another option to the marketers for storage accessibility. We will adopt this recommendation and encourage LDCs to work with pipelines to institute DPO/CSC programs where possible; however, we require that current storage offerings continue to be reviewed and enhanced where feasible.

Other items

Hess and the SCMC propose that releases be in proportion to the asset portfolio held by the LDC and that the costs associated with the release also be proportional to that portfolio, so that the resulting cost of capacity to the marketer is comparable to the cost of capacity charged to the LDC's sales customers. Obtaining cost parity is a reasonable goal where LDCs are not able to implement the actual releases in a pro-rata share of its system. In those cases, a customer credit/surcharge mechanism may be used to ensure that the costs to utility and marketer customers are comparable.

National Grid and KeySpan note that mandatory release programs should be tailored to the unique characteristics of each LDC. We agree that each LDC should address its specific operating parameters, such as utilization of local production, in their respective compliance filings. We do not anticipate major changes in existing program structures to result from this transition from voluntary to mandatory capacity release.

NYSEMC urges that LDCs exit the merchant function entirely and that we consider adoption of the East Ohio Gas model for all LDCs in this State. Further, it urges that all of a utility's cost of gas be market-based so that consumers have a basis for comparison. NYSEMC's comments go far beyond the scope of the CPI; and this proceeding is not the proper forum for their examination.

NFGD requests that we acknowledge explicitly that mandatory capacity release, plus grandfathering, satisfies the requirement for safe, reliable, and adequate service. Given the capacity situation as it exists today and as discussed in this Order, we

believe that the capacity release assignment regimen adopted herein will help insure the reliability of the natural gas system in this state. Ultimately, however, it is the LDCs' obligation to provide safe, reliable, and adequate service to all their ratepayers, and we will continue to hold them to that obligation.

CONCLUSION

We find that the White Paper's proposal for mandatory capacity release, along with the grandfathering of the current level of marketer-supplied capacity, is reasonable. The requirement for mandatory capacity release will ensure the continued reliability of the natural gas system in New York State and discourage the maintenance of duplicative capacity assets as a supplement to marketer capacity. In addition, the grandfathering of current levels of marketer-owned capacity will avoid any adverse economic consequences that may result from a change in business rules; and, the requirement is adopted at a time when the level of non-utility controlled capacity is manageable and relatively small compared to total LDC customer requirements. The proposal as stated in the White Paper, consistent with the discussion in this Order, is adopted.

Each LDC is required to file any tariff change necessary to effectuate the requirements in this Order on or before October 1, 2007, to take effect on November 1, 2007 on a temporary basis. National Grid, NYSEG, and RG&E, provided that local gas production is connected directly to their distribution facilities, shall file in its next major rate application a plan for use of this local gas production as upstream capacity and its continuing availability as a replacement for capacity provided by the local distribution company.

The Commission orders:

1. Central Hudson Gas & Electric Corporation, Consolidated Edison Company of New York, Inc., Corning Natural Gas Corporation, KeySpan Energy Delivery New York, KeySpan Energy Delivery Long Island, Niagara Mohawk Power Corporation d/b/a National Grid, National Fuel Gas Distribution, New York State Electric & Gas Corp., Orange & Rockland Utilities, Inc., Rochester Gas & Electric Corp.,

and St. Lawrence Gas are directed to file on or before October 1, 2007 tariff amendments with the Secretary to the Commission as are necessary to implement the requirements in this Order to take effect on a temporary basis on November 1, 2007. The amendments shall not become effective on a permanent basis until approved by the Commission.

2. Niagara Mohawk Power Corporation d/b/a National Grid, New York State Electric & Gas Corp., and/or Rochester Gas & Electric Corporation, if necessary in accordance with the discussion in this Order, shall file in its next major rate application, a plan for use of local gas production connected directly to their distribution facilities as upstream capacity and its continuing availability as a replacement for capacity provided by local distribution companies.

3. This proceeding is continued.

By the Commission,

(SIGNED)

JACLYN A. BRILLING
Secretary