Case 93-G-0932 – Opinion and Order Establishing Regulatory Policies and Guidelines for Natural Gas Distributors, issued December 20, 1994

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

OPINION NO. 94-26

CASE 93-G-0932 - Proceeding on Motion of the Commission to Address Issues Associated with the Restructuring of the Emerging Competitive Natural Gas Market

OPINION AND ORDER ESTABLISHING REGULATORY POLICIES AND GUIDELINES FOR NATURAL GAS DISTRIBUTORS

Issued and Effective December 20, 1994

TABLE OF CONTENTS

TABLE OF CONTENTS

TABLE OF CONTENTS

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BY THE COMMISSION:

PROCEDURAL HISTORY

This proceeding was instituted by an order issued October 28, 1993.[1] The order pointed out that a restructuring of the interstate natural gas industry had been set in motion by the Federal Energy Regulatory Commission (FERC) with the issuance of its Order 636,[2] and it noted that staff had conducted interviews with various stakeholders--pipelines, local distribution companies (LDCs), marketers and customers--to consider and evaluate possible responses to Order 636. Following

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[1] Case 93-G-0932, Proceeding on Motion of the Commission to Address Issues Associated with the Restructuring of the Emerging Competitive Natural Gas Market, Order Instituting Proceeding (issued October 28, 1993).

[2] Docket No. RM91-11-000, Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation Under Part 284 of the Commission's Regulations; and Docket No. RM87-34-065, Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, Order No. 636 (issued April 8, 1992).

those interviews, staff proposed the adoption of the following set of principles to foster consumer protection while maximizing competitive benefits:

1. There will be a commitment to gas service for New York consumers, considering both customer need and economic feasibility.

2. No compromise to the safety of the gas distribution system will be tolerated.

3. Environmental implications and concerns will continue to be carefully considered.

4. An adequate forum for resolving consumer concerns must continue to exist.

5. Rate shock to individual customer classes or groups must be avoided.

6. Deregulation or reduced regulation must not lead to an unregulated monopolistic (or otherwise uncompetitive) market.

7. The ability to reregulate, should any of the above conditions not be met, must be maintained.[1]

In this Opinion and Order, we adopt those principles and are establishing a series of regulatory policies and guidelines consistent with them. Those policies and guidelines, moreover, are also consistent with an eighth principle adopted in this decision, which is as follows:

> "Access to a basic and affordable package of gas services should continue to be provided to core customers."

The instituting order solicited responses from interested parties to 16 questions concerning current and future regulation of LDC services, and requested in addition that the parties discuss whether LDCs' unregulated gas marketing subsidiaries should be permitted to conduct business within the service territories of their parents. After the written comments

[1] Case 93-G-0932, supra, Order Instituting Proceeding, pp. 5-6.

and reply comments were filed, two formal conferences of the parties were held in Albany, on February 8 and March 9, 1994, and an additional informal conference was held on March 10. Staff then prepared a *Report and Recommendations* setting forth proposals for the determination of the various issues. The *Report and Recommendations* was distributed on April 18, 1994, and interested parties were invited to submit comments by May 9. Comments were received from the parties listed in Table 1.[1] A transcribed forum for oral statements by representatives of the parties was held before the Commission on June 9, 1994. Post-forum written comments were received from Con Edison, NFG, the Marketers, Multiple Intervenors, and CPB.

POLICY OVERVIEW

This Opinion and Order sets forth the policy framework to guide the transition of New York's gas distribution industry in the post-Order 636 environment. This framework is designed to assure that (1) incumbent LDCs and new entrants can compete; (2) customers benefit from increased choices and improved performance resulting from a more competitive industry; and (3) core customers continue to receive quality service at affordable rates. As we noted in the May 24, 1994, *Further Notice of On-The-Record Forum* (at p. 4) a key concern "is the extent to which the restructuring of the industry is likely to affect various groups of customers, in particular, residential, small business and low-income customers."

Gas is a major source of heating in New York and is thus an essential service to the residents of this state. It is critically important to assure the continued availability and

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[1] In the first opinion in the competitive opportunities case (Case 93-M-0229), concerning, among other things, the offering of flexible utility rates and the recoupment of "lost" net revenues resulting from discounted rates, the focus of that case was narrowed to issues being faced by the electric industry (Opinion No. 94-15, mimeo pp. 4-5). Comments filed there (by Brooklyn Union, NFG, Niagara Mohawk, St. Lawrence Gas Company, Inc., and Domino Sugar Corporation) addressing only gas issues were referred to this proceeding.

Table 1

Parties Filing Comments on Staff's Report and Recommendations

LDC Interests

New York Gas Group (NYGAS)
The Brooklyn Union Gas Company (Brooklyn Union)
Central Hudson Gas & Electric Corporation (Central Hudson)
Consolidated Edison Company of New York (Con Edison)
Corning Natural Gas Corporation (Corning)
Long Island Lighting Co. (LILCO)
National Fuel Gas Distribution Corp. (NFG)
New York State Electric & Gas Corporation (NYSEG)
Niagara Mohawk Power Corporation (Niagara Mohawk)
Orange and Rockland Utilities (Orange and Rockland)
Rochester Gas and Electric Corporation (RG&E)

Empire State Pipeline

Marketer Interests

New York State Independent Gas Marketers Assoc. (NYSIGMA)
Sunrise Energy Services and Consolidated Fuel (Sunrise)
Enron Gas Services Group (Enron)
"The Marketers":
Appalachian Gas Sales
KCS Energy Marketing
O&R Energy
Tenneco Gas Marketing
Hadson Gas Systems (Hadson)
North Atlantic Utilities (North Atlantic)
O&R Energy

Large Customer Interests

Columbia University
Multiple Intervenors

Small Customer Interests

Consumer Protection Board (CPB)
Public Utility Law Project (PULP)

Other Interests

State Energy Office (SEO)

affordability of this fuel source as the transition to a more competitive environment develops.[1] This will be a formidable challenge. Growth in revenues might not offset the increased transition costs and erosion of subsidies that will inevitably occur in a more competitive market. This could potentially result in severe rate shock for the core customers unless mitigating and transitional measures are put into place. The impacts may vary from company to company, but to move ahead in the transition successfully, we need to establish policies that will protect customers against unreasonable rate impacts. Those policies might include the establishment of firm price caps and lifeline rate approaches for low-income consumers and the adoption of measures to assure that any subsidies implicit in residential rates are assessed fairly to all competitors.

For the most part, the comments of the parties to this proceeding reflected one of two competing views about the role of LDCs in post-Order 636 energy markets. One view holds that Order 636, which requires the elimination of the pipelines' gas sales functions and the unbundling of their transportation functions into discrete service offerings, is a model that should be imposed on LDCs to the maximum feasible extent. The opposing view maintains that end-users of natural gas vary in their willingness and ability to participate in an unbundled natural gas market, and that some end-users would prefer to continue relying on the LDCs that serve them to be responsible for their gas supplies.

Rigid adherence to the "Order 636 model," that is, barring the LDCs from providing merchant services, could have serious consequences for the LDCs' core customers, because that model would not permit LDCs to participate actively in competitive markets by providing bundled services at prices set according to the value of those services to various customers. Once the opportunity to sell services at above-marginal-cost

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[1] *See* the guiding principle set forth at p. 14, <u>infra</u>.

prices was diminished or eliminated, so would the net revenue contributions that help defray the LDCs' joint and common costs of service. As a consequence, a greater share of such costs would have to be recovered from customers who have no effective competitive alternatives to LDC service, especially smaller customers in full-service sales classifications. Thus, the policies and guidelines adopted in this decision consistently reflect the view that LDCs should be strongly encouraged to compete actively, on their own behalf, for sales to customers in competitive energy markets while, at the same time, unbundling services so that marketers and others can compete for market share.

SUMMARY OF POLICIES AND GUIDELINES

The comments of the parties in response to staff's *Report and Recommendations* are discussed in the ensuing sections of this Opinion. Summarized in this section are the regulatory policies and guidelines that follow from our consideration of those comments, in light of the principles we have adopted in this decision.

Definition of Core and Non-Core Markets. *Core market* customers lack alternatives. They take either (a) firm sales service, and lack installed equipment capable of burning fuels other than gas; or (b) firm transportation service. Back-up and standby services provided to firm transportation customers are core market services. *Non-core market* customers have alternatives. They take sales service under flexible rate schedules (including sales services that are labeled as "firm" services in some tariffs, but whose prices are linked to the prices of alternate fuels), have installed dual-fuel equipment, or take interruptible transportation service. Back-up and standby services provided to non-core market customers (if any) are themselves non-core services.

Obligation to Provide Sales Service. So long as a customer's classification as "non-core" is a matter of voluntary self-selection, it is permissible to discontinue bundled sales service to that customer.[1] A utility should not be considered, and should not incur the costs of being, the supplier of last resort to a customer choosing something less than on-demand sales service. The customer must be legally and practically capable of electing to discontinue guaranteed services, and a customer who elects to take non-core services as its primary option should nevertheless have the choice of arranging for utility back-up or standby services if capacity is available. Back-up or standby services to non-core customers are non-core services, and the prices for such services may be market-based. Market-based charges will also be permitted for unauthorized takes of gas by customers who disclaim the need for back-up or standby services.

Rate-Setting: Cost Basis. A subsequent case will be established to examine gas purchasing and affordability issues. In that proceeding, each LDC should address itself to the issue of cross-subsidies among service classifications, taking into account rate impacts, affordability of service, transition cost pass-throughs, and competition.

Rate-Setting: Net Revenue Contribution. Net revenues from LDCs' non-core service classifications should be imputed as a payment for the use of LDC facilities to offset costs otherwise borne by core customers. LDCs may retain net revenues from sales above the imputed levels until a suitable revenue or earnings cap is reached. The details of implementation might vary among LDCs.

Rate-Setting: Market Basis. LDCs should have a great deal of discretion to set the prices of their own services to non-core customers (including any standby and back-up services) so that they are comparable to the prices of the alternatives available to those customers. Nevertheless, a cap on the prices of non-core services will provide a necessary degree of certainty in a rapidly-changing market. The upper limit for the price of a market-priced non-core service will be the lowest firm rate for the service that would otherwise be taken.

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[1] Customers may choose to take firm service regardless of whether they are eligible for non-core services.

Rate-Setting: Incentives. For revenues or credits received from the release of excess capacity and other pipeline services, LDCs will be allowed to retain 15% of the net revenues or credits from such transactions and required to pass along the other 85% to core customers. The 85%/15% recommendation will apply to all LDCs unless or until (1) a different sharing arrangement is justified on a case-by-case basis or (2) a more comprehensive regime of performance-based regulation is adopted. For continuing service to a customer switching from firm sales service to a non-core service (that is, a customer for whom sales and net revenues have been fully forecasted), the incentive would entail leaving in place the previously forecasted margin, with the LDC being allowed to retain any amounts realized above that margin or required to absorb any shortfall below the margin, unless a different incentive is justified in individual rate cases. For streaming transactions, the standard 85%/15% sharing arrangement will apply, but only to off-system transactions. The amount subject to sharing will be the net revenues and the reported cost of the capacity released as part of the transaction.

Rate-Setting: Authorized Return. Establishment of a "band" around each LDC's allowed return on common equity will accompany the adoption of pricing flexibility for non-core services. Earned returns in excess of the upper end of the band would be shared with core customers, and shortfalls--earned returns below the lower end of the band--would be eliminated only prospectively, following the LDC's next general rate case. The range of the band would be determined in each LDC's rate case, taking into account (1) the terms and duration of any rate settlement or order; (2) the amount of non-core market net revenues imputed to the benefit of the core market; (3) the size of the non-core market; and (4) forecasts of future alternate energy prices.

Split Classifications. A non-residential customer may have part of its requirements classified as core and part non-core. The LDCs will be permitted to bill any resulting increased metering and customer costs directly to split-classification customers, if that would be consistent with their treatment of single-classification customers with dual or multiple meters.

Switching Classifications. Restrictions on switching classifications should be linked to gas supply and cost considerations. Such restrictions should be spelled out in the LDCs' tariffs, or the tariffs might provide that individual service agreements will establish the restrictions. Customers requesting to return to core or firm services after taking non-core services, as provided for in the tariff, should be treated no more or less favorably than applicants for new services.

Unbundling. LDCs will be required to offer firm customers access to the upstream facilities, *i.e.*, pipeline capacity, storage facilities and receipt points, that such customers are supporting in their rates. For firm and non-core customers alike, the LDCs will be required to manage the capacity they have reserved so that they minimize their overall revenue requirements in a prudent manner that is consistent with the provision of economical, continuous, and safe service.

Packaged Services. LDCs will be permitted to offer packaged services at prices reflecting their value to those customers, provided that non-participating customers will benefit more from those transactions than without them. The LDCs shall also meet the following conditions: (1) maintain listings of capacity release prices and offerings on electronic bulletin boards; (2) demonstrate in rate cases that they have maximized revenues from the release or packaging of surplus gas supplies and pipeline facilities; and (3) establish strategies for marketing surplus gas and pipeline capacity.

Utility Discretion. LDCs may enter into arrangements where, at certain times within the contract term, the sale price will be less than incremental commodity costs, so long as the average sale price of gas will exceed commodity costs over the course of the sales agreement. LDCs will continue to be required to file tariff addenda that set forth information about their individually-negotiated service agreements. LDCs are permitted to recognize competitive conditions that distinguish otherwise similarly-situated customers, as a basis for charging them different rates. LDCs will be permitted to engage in streaming transactions subject to two guidelines: (1) a streaming transaction itself must not give rise to an opportunity loss to non-participants; and (2) the LDC must demonstrate that non-participants would be worse off *without* the streaming transaction. The same requirements should apply to both the commodity prices and the rates for included services in streaming transactions.

Reporting Requirements. Quarterly reporting of the date, duration, price, cost, and quantity or capacity will be required for each streaming, packaged sales, and capacity release transaction. The reports shall identify customers by their standard industry codes.

Subsidiaries. Marketing by an LDC's subsidiary will not be permitted in that LDC's service territory.

Aggregation. Smaller customers of an LDC will be allowed to combine into groups that would be treated as a single customer for which a pool of gas would be acquired and delivered to the LDC. The LDC would then be expected to deliver the gas to members of the group. The LDCs are encouraged to scale down or eliminate minimum volume requirements, but they will be permitted at the outset to establish minimum aggregation thresholds no greater than the minimum transportation thresholds many currently have, namely, 5,000 Mcf per year. As the LDCs gain experience with aggregation, lower thresholds might be established. Initially, aggregation programs must be submitted as joint proposals of the participating marketers and LDCs, and any waivers of existing rules, requirements, or policies that are necessary to make the programs work should be identified and justified in those proposals. In addition, issues concerning (1) the establishment of metering and procedures to track aggregated accounts; (2) the development of rates for aggregated service; and (3) the development of balancing procedures can be resolved in individual aggregation program proposals filed jointly by the

LDCs and participating marketers. Full-margin rates for aggregation program participants should be charged. The transportation rate established between rate cases for a sales customer who chooses to become an aggregation program participant should be set equal to the average net-revenue margin in the usage block sales rate(s) that would otherwise apply to that customer.

Transition Cost Recovery. Unrecovered pipeline purchased gas costs (FERC Account 191) should be assigned solely to the LDCs' sales customers and recovered through their gas cost adjustments. Pipelines' capital costs and costs of transportation and compression of gas by others will be recovered on the basis of prescribed or generally approved cost allocations. The recovery of stranded investment and gas supply realignment costs will be allocated to both sales and transportation customers. Transportation customers should be assigned a per-unit (therm or ccf) charge that is equal to 50% of the per-unit charge being collected from core customers. The recovery of transition costs should be prospective and levelized taking into account impacts on customers; LDCs should not seek lump sums from customers who have not previously contributed to the recovery of their share of the costs. Transportation customers who pay directly for firm upstream pipeline capacity will be exempted from transition cost recovery. Services subject to flexible or negotiated value-of-service pricing will also be exempted, because market-based prices could not be increased to reflect an allowance for transition cost recovery.

Gas Purchasing. A proceeding to evaluate and adopt standards and procedures for reviewing gas purchasing practices and allowing the recovery of gas costs will be instituted. One purpose of this proceeding will be to find mechanisms more conducive to efficiency than the current 100% flow-through adjustment clauses. No particular endorsement, pro or con, will be given to the use of risk management tools and other financial instruments as part of a gas purchasing program. Utilities are under a duty to minimize costs while assuring reliability, and they should be employing all prudent means to that end in any case. There do not appear to be any efficiencies to be gained by establishing a regional gas procurement entity, but the issue should be left open for further consideration, should subsequent events suggest a need to do so.

Metering. Transportation customers will be required to have installed recording meters for accounts requiring daily or monthly balancing, except for monthly-balancing customers who (1) request in writing that less-expensive meters be used for their accounts, and (2) state, also in writing, that they are willing to accept the accuracy of their LDCs' balancing.

Affordability. The following is adopted as the eighth principle[1] to guide LDCs in the emerging competitive gas market:

> "Access to a basic and affordable package of gas services should continue to be provided to core customers."

This concern was reflected in the emphasis in Staff's *Report and Recommendations* on the customer impacts that could result from lost sales to price-elastic customers (large or small), the offering of new services, and the pass-through of Order 636 transition costs. The LDCs shall submit program proposals for assuring the availability of affordable service to customers in the same proceeding in which gas purchasing practices are to be reviewed.

UTILITY MARKET ISSUES

Core and Non-Core Markets

1. General Definition

a. Proposed Definitions

The instituting order defined the "core" market as "small residential and commercial customers who have no options except to continue receiving bundled sales service from LDCs,"[2]

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[1] The other seven principles are set forth at p. 2, supra.

[2] Case 93-G-0932, supra, Order Instituting Proceeding, p. 5 fn 1.

but invited the parties to offer other criteria to define "core" and "non-core" markets. The order contemplated a distinction between or among customers on the basis of whether LDCs have an obligation to obtain gas supplies for them.

In its *Report and Recommendations*, staff recommended that the distinction between core and non-core markets rest on an assessment of (1) the nature of the services demanded, and (2) the number of suppliers capable of providing them. Staff suggested that in any geographical area where a particular kind or character of gas service that is demanded by customers can be provided only by an LDC (at the time requested), and customers lack the ability and/or discretion to cease taking gas at will without incurring net curtailment costs, that geographical and product market should be considered a core market.

Staff concluded that the following operational definitions describe the distinction between core and non-core product/geographical markets in all regions of the state:

> (1) Core Market: Core market customers take firm sales service and lack installed equipment capable of burning fuels other than gas. A transportation customer who reserves (and pays for) the right to call upon its LDC for gas supplies will be considered a core customer.
>
> (2) Non-Core Market: Non-core market customers take sales service under flexible rate schedules (including sales services that are labeled as "firm" services in some tariffs, but whose prices are linked to the prices of alternate fuels), have installed dual-fuel equipment, or take interruptible or firm transportation service.

b. Comments of the Parties

Several parties proposed alternative definitions. The most sweeping alternative comes from the Marketers, who contend that "the distribution function remains a natural monopoly and all customers behind LDCs' city gates will remain 'core distribution customers.'"[1] Multiple Intervenors and Columbia University contend that, under the foregoing definitions, firm transportation customers should be considered "non-core" only with respect to the LDCs' merchant functions. (Multiple Intervenors and Columbia University also appear to agree with the Marketers' view, when they argue for closely regulated, strictly cost-based pricing of nearly all transportation services.)

Three utilities also offered alternatives to staff's proposed definitions. Central Hudson contends that *customer* definitions do not necessarily delineate *markets*. Niagara Mohawk believes it would be more logical to define the core and non-core segmentation in terms of *services* rather than customers or markets. In Niagara Mohawk's view, core services are those for which there is no competitive alternative to the utility's service offering and non-core services are those for which competitive alternatives exist. And RG&E suggests that core or non-core status should be determined by customer choice.

Two other utilities offered more specific comments about the proposed definitions. Brooklyn Union suggests a more elaborate definition of non-core customers (with all others being considered core customers):

> Customers, other than "human needs" customers (such as schools, hospitals, dwellings where gas is used for heating, cooking, and comparable residential requirements, and facilities providing essential public services), that qualify for service under market-based rate schedules, and have the installed capability to meet their full non-core requirements with alternate fuels; and (2) non-"human needs" customers that voluntarily make legally binding elections to relinquish their rights to obtain sales service (including standby, backup, or emergency service) and qualify for interruptible or firm transportation service.[2]

NYSEG contends that the recommendation that "a transportation customer who reserves (and pays for) the right to call upon its

[1] The Marketers' Comments, Attachment, p. 2.

[2] Brooklyn Union's Comments, p. 3.

LDC for gas supplies will be considered a core customer" is inconsistent with other sections of the *Report and Recommendations* that suggest the pricing of back-up and standby services could be value-based.

c. Conclusion

The distinction between "core" and "non-core" customers initially recommended by staff needs to be refined, as suggested by some commentators, to give greater emphasis to the services customers require. While there is no apparent disagreement that customers requesting bundled, on-demand sales service should be considered core customers and should be accorded the usual protection of rate regulation, the commentators are persuasive in arguing that the reservation of gas supplies should not be the sole basis for the core/non-core distinction. A firm transportation customer might be sufficiently confident of its own ability to obtain secure gas supplies to relieve its LDC of that responsibility, but in all other respects would need the continuous reliable service that only the LDC can provide. Such a customer would commit in advance to pay for reserved capacity, as do bundled sales customers, and would be entitled to a comparable degree of regulatory assurance that it is bearing only its commensurate share of the maintenance and capital costs of the distribution system. Similarly, standby or back-up service that is combined with firm transportation service should be provided at regulated, cost-based rates, because the level of potential demand on utility-provided resources would be reasonably ascertainable, and presumably paid for, in advance.

Accordingly, the operational definitions proposed by staff will be revised to read as follows:

(1) Core Market: Core market customers lack alternatives. They take either (a) firm sales service, and lack installed equipment capable of burning fuels other than gas; or (b) firm transportation service. Back-up and standby services provided to firm transportation customers are core market services.

(2) Non-Core Market: Non-core market customers have alternatives. They take sales service under flexible rate schedules (including sales services that are labeled as "firm" services in some tariffs, but whose prices are linked to the prices of alternate fuels), have installed dual-fuel equipment, or take interruptible transportation service. Back-up and standby services provided to non-core market customers (if any) are themselves non-core services.

2. Obligation to Provide Sales Service

The instituting order asked the parties to comment on whether it is permissible under the Public Service Law, or desirable as a matter of policy, to permit LDCs to discontinue bundled sales service to non-core markets. Staff recommended that so long as a customer's classification as "non-core" is a matter of voluntary self-selection, it is both permissible and desirable to discontinue bundled sales service to that customer. By definition, that customer would have decided that "adequate" service for its own purposes is something less than on-demand sales service, and the utility should not be considered, and should not incur the costs of being, the supplier of last resort. This general recommendation is unopposed, and we agree with it.

Staff's recommendation was subject to two qualifications that drew comments from some of the parties. First, a customer must be legally and practically capable of electing to discontinue guaranteed services in order to be classified as non-core. A "human needs" customer without an alternate fuel source, for example, cannot rely solely on interruptible transportation service if a cut-off of gas service would leave that customer without any heat. Such a customer would not be authorized to assume that risk and could not, therefore, elect to go without any kind of sales service. Second, a customer who elects to take non-core services as its primary option should nevertheless have the choice of arranging for utility back-up or standby services if capacity is available. A utility may not withhold an available service for which a non-core customer is willing to pay a reasonable price (which might be value-based rather than cost-based).

Con Edison argues that there should be a separate proceeding to examine whether there should be an obligation to provide back-up or standby services. Con Edison asserts that value-based pricing would not provide sufficient compensation for such services, because they require reservations of pipeline and storage capacity, and such commitments are made for terms of ten or more years. Con Edison recommends that customers be required to give similarly long-term commitments to take such services.

Apparently in the alternative, Con Edison argues that it should be made clear that customers who choose unbundled transportation and eschew standby or back-up service might be subject to overrun charges "at penalty rates"[1] or to interruption (possibly involving installation of an automatic valve).[2] Central Hudson agrees with that view, contending that "LDCs should not be responsible to determine the extent to which a customer's decision not to take back-up or standby service from the LDC was made 'properly.'" In Central Hudson's view, "[i]t should be dispositive that the customer made the choice," and "[t]he customer's choice should be made meaningful by permitting LDCs to price the back-up or standby services flexibly to maximize margin flow back to firm, core customers."[3]

As already discussed, back-up or standby services to non-core customers would themselves be non-core services, and the prices for such services could reasonably be market-based, that is, based on the prices of alternatives to LDC-provided back-up or standby services if such prices would exceed the LDCs' costs. It would follow that market-based charges should also be permitted for unauthorized takes of gas by customers who

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[1] Con Edison's Comments, p. 17.

[2] RG&E expresses a similar concern about a human needs customer who might take firm utility transportation service but has arranged only interruptible upstream transportation.

[3] Central Hudson's Comments, p. 9.

disclaimed the need for back-up or standby services. Such charges could be based on the customers' own price elasticity of demand, and not simply the prices of substitutes, if the former formulation would yield compensatory prices. Moreover, the posting of some sort of bond by any such customers who cannot be physically interrupted, to pay for emergency back-up or standby service, might be given consideration.

Con Edison argues that it is unclear who will decide whether a customer is legally and practically capable of electing to discontinue guaranteed services in order to be classified as non-core. Con Edison recommends that the term "human needs" be clearly defined, so that different treatment of customers fitting that description would not be held unduly discriminatory under the Public Service Law. Niagara Mohawk defines human needs customers as hospitals and schools, and suggests that simply requiring them to subscribe to appropriate standby or backup services if they take non-core services would be the solution to the problem of having to "rescue" customers whose alternate supply or transportation arrangements fail.

As a practical matter, all of the LDCs have working definitions of human needs customers sufficient to provide guidance about when an attempted election not to take back-up or standby service should be challenged. Such provisions do not result in undue discrimination, because human needs customers by definition would not be comparable to other customers.

SEO asserts that "[a]dequate, verifiable storage capability is necessary to avoid undue, and unnecessary, pressure on the spot oil market in periods of harsh weather."[1] SEO continues:

> The potential for such disruptions should be avoided when planning changes to our existing energy supply picture, as the Commission is doing in this case. Therefore, we recommend that the Commission address the issue of minimum storage and inventory required of dual fuel customers in

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[1] SEO's Comments, p. 11.

this case, or shortly thereafter.[1]

SEO's proposal goes beyond the scope of this proceeding, which is to address the issue of how regulated LDCs should adapt to an emerging competitive natural gas market. The domestic market for oil has been largely free of price regulation since early 1981, and, if SEO is correct, it responds quickly to changes in market forces. There is no apparent need to attempt to influence the demands of customers in an unregulated market.

3. Rate-Setting

a. Introduction

Staff offered two general observations, in its *Report and Recommendations*, about rate-setting in the post-Order 636 industry. Staff noted, first, that a "price cap" ratemaking approach that eliminates all cross-subsidies, while supported in many areas as an ideal regulatory response to competitive pressures, might conflict with the principle set forth in the instituting order that rate shock to individual customer classes or groups must be avoided, and would require a transition period for implementation. However, staff continued, the incorporation of some concepts of price cap ratemaking into traditional cost-of-service regulation would not be inconsistent with that principle.

Staff noted, second, that although a number of parties urged the abandonment of "value-of-service" pricing for non-core markets in favor of a strict cost of service standard, value-of-service pricing has in fact served gas consumers well in the past and should continue to do so even as markets become more competitive. While value-of-service pricing might at times result in gas rates that exceed "cost-of-service" rates (as defined in some parties' studies), that approach has also permitted large consumers to continue using gas at affordable rates when the value of alternate fuels was less than those same

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[1] Id., p. 11.

definitions of "costs of service." Value-of-service pricing, by definition, is responsive to changes in energy prices generally, and LDCs will continue to need additional flexibility in responding to competitive pressures.

On the basis of the foregoing, staff submitted three proposals for the parties' consideration. Those proposals, and the comments on them, are discussed in turn below.

b. Cross-Subsidies/Cost of Service

Staff recognized that there are cross-subsidies among and within classes of customers inherent in most LDCs' sales rates. Because the estimation of costs of service for rate design purposes is not a science, staff recommended against immediate actions to cause all classes or sub-classes of customers to generate the same rates of return in embedded cost-of-service studies. Staff recommended, instead, that the schedules for aligning inter-class and intra-class returns be accelerated, taking into account customer impacts, as performance-based rate regulation (with multi-year rate plans) is implemented.[1]

Three utilities argued that a more concrete plan for eliminating cross-subsidies should be adopted. LILCO urges adoption of a three-year time period for the complete removal of subsidies from LDCs' rate structures. NYGAS recommends that we "*encourage* prompt movement towards equivalent class/sub-class rates of return,"[2] while Central Hudson argues that cross-subsidies should be eliminated promptly. On the other hand, CPB opposes any notion that inter- and intra-class subsidies exist, and PULP argues that existing cost-of-service studies do not accurately depict subsidies. PULP recommends that generic cost of service methodologies be developed to bring consistency across

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[1] Acceleration of the alignment might occur, for example, as the recoveries of take-or-pay and transition costs begin to be completed.

[2] NYGAS's Comments, p. 2.

utilities and, in PULP's view, improve the quality of current studies.

Staff's original recommendation is not inconsistent with any LDC's interest in eliminating cross-subsidies in its rate structures. Moreover, staff's recommendation does not contemplate precluding any party from proposing improvements to cost-of-service methods in those cases, as PULP claims can and should be done. For the present, we shall not require the LDCs to submit new cost of service studies. The LDCs should, instead, address themselves to the issue of cross-subsidies among service classifications in the proceeding to be established to examine gas purchasing and affordability of service issues. Any timetable or plan proposed for the mitigation or elimination of cross-subsidies should take into account the impacts, now being borne by core service classifications, of transition costs and other costs associated with the restructuring of pipeline services.

c. <u>Net Revenue Contribution/Value of Service</u>

(1) <u>Staff's Recommendation</u>

Staff proposed that we adopt, as a "general rule," the imputation of net revenues from LDCs' non-core service classifications, as a payment for the utilization of LDC facilities to offset costs otherwise borne by core customers; and then leave LDCs free to set the prices for their services to non-core markets at competitive (possibly value-based) levels, not prescribed by the Commission, and retain all net revenues from those sales above the imputed levels until a suitable revenue or earnings cap is reached.[1] That proposal would require LDCs to assume the risks associated with changes in competitive markets, and allow them to enjoy the benefits of their successful efforts. Staff argued that the continued transfer of those risks and

[1] Once that cap was reached, additional earnings might be shared or fully flowed through to benefit core service customers, depending upon the arrangements approved in individual LDCs' rate cases.

benefits to core customers would not be proper.

(2) Net Revenue Imputation

Staff's recommended imputation of net revenues was opposed by several parties. According to the Marketers, staff adopted the view of certain LDCs that competition exists in all markets where alternate fuels exist. In so doing, the Marketers allege, staff recommends that we "virtually deregulate these services, which clearly include distribution services over which most LDCs in the State have a monopoly within their service territory." According to the Marketers, "intermingling of regulation and deregulation will undoubtedly cause significant problems for both the Commission and market participants."[1]

The Marketers contend further that staff recommends a "faulty objective" of encouraging each LDC "to manage its affairs so as to maximize the benefits of LDC services they provide to a subset of the LDC's core customers, those that remain core gas customers." The Marketers assert that "[s]uch an objective, if accepted by the Commission, would invite LDCs to engage in anti-competitive and unduly discriminatory behavior."[2]

Imputation of net revenues is opposed by other commentators. SEO argues that "[t]here is no need for this *quid pro quo* for rate design freedom; imputation of revenues is an unnecessary risk with which to confront utilities when the current sharing mechanism can produce similar incentives."[3] SEO contends that imputation will lead to the "gaming" of forecasts, and asserts that, in any event, "fluctuations in revenues recovered from interruptible service are more a product of the price of oil, and the utilities' ability to accurately forecast those prices, than they are reflective of a utility's aggressive

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[1] The Marketers' Comments, p. 3.

[2] The Marketers' Comments, Attachment p. 2.

[3] SEO's Comments, pp. 3-4.

marketing."[1] NYSEG argues that LDCs will have little incentive to aggressively compete with other gas suppliers if they must bear the risks associated with transactions through imputed revenues (and then be subject as well to sharing mechanisms and earnings caps). Columbia University contends that the imputation of revenues from non-core services could encourage an LDC to raise rates when it otherwise would not do so.[2]

The imputation of net revenues is endorsed by PULP, albeit not without qualification. PULP argues that the imputation should include a "cost" component consisting of incremental costs plus some defined level of contribution to common costs, and that an LDC's earnings should not be increased by the recovery of imputed revenues until that cost component is fully recovered. Two other parties are non-committal on the matter: Central Hudson recommends that imputations should be established only pursuant to clearly established rules of general applicability that, for example, provide for some assessment of potential future market sales, while Niagara Mohawk asserts that a clarification is required concerning the order in which imputations, incentives, and return bands would be applied to LDCs.

For many LDCs, adoption of staff's recommended net revenue imputation would result in the continuation of current ratemaking practices. Thus, any suggestion that such an imputation would significantly alter the economics of providing gas distribution service (including incentives) is misplaced. As noted above, staff recommended a "general rule," recognizing both that the details of implementation might reasonably vary among LDCs and that imputation might not be an economically sound approach in all cases. The opponents of staff's recommendations

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[1] Id., p. 4.

[2] Columbia argues further that if small customer aggregation service is permitted, core and non-core customers alike would be using the system for transportation, so one group of customers should not pay for the flow of revenues to another.

have either specified the kinds of details that will need to be addressed in individual LDCs' rate cases, or described the general theoretical conditions under which staff's recommendation would be economically unjustified. We shall, therefore, endorse Staff's proposed general rule and require the opponents of that proposal to make their cases with specific supporting evidence in the LDCs' next rate cases.

(3) Pricing of Non-Core Services

Staff's proposal to leave LDCs free to set the prices for their services to non-core markets at competitive levels, not prescribed by us, is opposed by the Marketers, for the reasons already discussed, and by Multiple Intervenors and Columbia University, who contend that *all* LDC transportation services are monopoly offerings that, in their view, ought to be priced solely on the basis of costs.[1] The three parties assert that the need for closely regulated, cost-based pricing for interruptible transportation service is not lessened merely because most interruptible transportation customers possess dual fuel capability. According to those parties, FERC's restructuring of the gas industry is an effort to foster gas-on-gas competition, and that purpose will be frustrated if LDCs are allowed to price interruptible transportation service based on alternate fuel prices. Moreover, they continue, the ability to burn an alternate fuel might be only an emergency backup (or otherwise limited) capability, and air quality rules can also limit the duration of alternate fuel use.

At the very least, the three parties argue, staff's recommendation should be modified to provide that interruptible transportation rates will be capped at level of the firm transportation rate at a 100% load factor. The parties contend that there would be no justification for charging an

[1] The revised definition of "core" services adopted in this decision includes firm transportation and associated back-up and standby services, and the arguments of the parties in favor of cost-based pricing for such services are not discussed further.

interruptible transportation customer higher rates than those that are applicable to firm service, and capping would assure certainty to interruptible transportation customers, who might view the complete absence of price regulation as disincentive to using gas.

The three parties argue further that balancing and storage services monopoly offerings that should be priced on the basis of cost. In their view, LDCs' balancing and operational requirements should have a direct, rational connection to the balancing and operational constraints imposed by the upstream pipelines on the LDCs, and penalties should recover only the costs actually incurred by LDCs as a direct result of customers' failure to comply with reasonable balancing and operational requirements. Moreover, the parties continue, to the extent customers can assist LDCs in avoiding the imposition of penalties (by a voluntary change in consumption patterns), they should receive rewards or offsets against future penalties or balancing and operational requirements.

PULP also takes the position that the pricing of monopoly "bottleneck" services used for gas-on-gas competition should be cost-based, but PULP suggests that "cost" be defined to mean average incremental cost plus a contribution to fixed costs.

North Atlantic and Columbia University raise somewhat different objections to pricing flexibility for non-core services. North Atlantic argues that LDCs should not have the discretion to adapt their prices and services to compete for sales to non-core customers, because that could lead to predatory pricing, and competition will be reduced and finally eliminated to the detriment of the non-core and core customers alike. Columbia University contends that light-handed regulation violates §66(12-b)(b) of the Public Service Law, which requires the Commission to find that transportation charges "adequately compensate" the LDCs. According to Columbia University, Staff's proposal "would enable LDCs to underprice transportation services relative to the cost of service."[1]

LDCs should have a great deal of discretion to set the prices of their own services to non-core customers (including any standby and back-up services) so that they are comparable to the prices of the alternatives available to those customers. Should non-core customers come to the conclusion that gas will consistently be the economical choice, they will always be free to reserve its future availability (*i.e.*, become firm customers), in which case the rates they pay for gas service will no longer be set with reference to their opportunity costs. If, on the other hand, those customers wish to remain in a more broadly-defined energy market where *consumers* have the option of choosing not to purchase gas (and the freedom to avoid paying for the full fixed costs of the gas delivery system), there is no apparent reason why one segment of *suppliers* to that energy market, the LDCs, should not have suitable pricing flexibility.

Nevertheless, there is considerable merit to the argument that a cap on the prices of non-core services will provide a necessary degree of certainty in a rapidly-changing market. The parties have argued persuasively that the complete elimination of price regulation might prove to be a disincentive to using gas, at least for the near future. We shall, accordingly, leave unchanged the prevalent policy of setting the upper limit for the price of a market-priced non-core service equal to the rate (or net-of-gas margin) for the core service that would otherwise be taken.

d. <u>Incentives</u>

The instituting order requested the parties to comment on whether incentives should be applicable to utility services to non-core markets (along with reduced regulation), and, if so, what safeguards should be adopted to protect core-market customers. The order also asked the parties to discuss the incentive or sharing mechanisms that would be reasonable for LDC

[1] Columbia University's Comments, p. 12.

marketing efforts to individual customers.

1. Capacity release. For revenues or credits received from the release of excess capacity and other pipeline services, staff recommended that LDCs be allowed to retain 15% of the net revenues or credits from such transactions and require them to pass along the other 85% to their customers. Several of the utility parties criticized the retention portion as too low, and some suggested that incentives be fixed for individual LDCs on a case-by-case basis. For example, Niagara Mohawk favors 50%/50% sharing of net revenues over the 85%/15% recommendation and suggests that we be receptive to a variety of plans reflecting individual utilities' circumstances, such as deferring net revenues that would otherwise go to ratepayers to mitigate future rate increases.

The 85%/15% recommendation is a reasonable "placeholder" for all LDCs unless or until (1) a different sharing arrangement is justified on a case-by-case basis or (2) a more comprehensive regime of performance-based regulation is adopted.[1] We shall adopt that arrangement as the general rule.[2]

2. Individual non-core customers. As discussed earlier, staff recommended that net revenues from services to LDCs' non-core service classifications be forecasted and imputed, with the LDCs then being allowed to retain all net revenues from those sales above the imputed levels until a suitable revenue or earnings cap is reached. Staff recommended a similar incentive for an arrangement with a customer switching from firm service to a non-core service (that is, a customer for whom sales and/or net revenues have been fully forecasted). The incentive would entail leaving in place the previously forecasted margin, with the LDC being allowed to retain any amounts realized above that margin or required to absorb any shortfall below the margin.

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[1] Indeed, a comprehensive scheme of performance-based regulation might obviate nearly all discrete incentive mechanisms.

[2] This incentive will apply to all release transactions, not simply those involving the LDCs' own non-core customers.

We shall adopt staff's proposed approach unless a different incentive is justified in individual rate cases. Moreover, the applicability of any such incentive will be extended to the situation where a firm transportation customer switches to a non-core service.

3. Streaming. Staff's *Report and Recommendations* did not specifically address the question of whether a sharing incentive should apply to streaming transactions. We shall apply the standard 85%/15% arrangement only to off-system transactions, in keeping with our policy, discussed later in this Opinion, that on-system streaming transactions will be permitted only when the they are entered into to benefit the general body of customers. The amount subject to sharing will be the net revenues and the reported cost of the capacity released as part of the transaction.

4. Other Matters. Columbia University argues that staff's proposals "would require extensive bookkeeping on the part of the LDC, done on a customer-by-customer basis," and that "[t]here is no way that the Commission or its Staff can realistically monitor the foregoing incentives."[1] Columbia's contention ignores the fact this agency has had extensive experience reviewing a variety of performance incentives, and, in any event, any difficulties encountered in monitoring the incentives at issue here can be taken into account in future rate cases as grounds for modifying them.

e. Authorized Return

Staff proposed that the establishment of a "band" around each LDC's allowed return on common equity should accompany the adoption of pricing flexibility for non-core services. Under staff's proposal, earned returns in excess of the upper end of the band would be shared with core customers, and shortfalls--earned returns below the lower end of the band--

[1] Columbia University's Comments, p. 17. Columbia argues that it would be preferable to require LDCs to conduct marketing to non-core markets through subsidiaries.

would be addressed prospectively, following the LDC's next general rate case. The range of the band would be determined in each LDC's rate case, taking into account (1) the terms and duration of any rate settlement or order; (2) the amount of non-core market net revenues imputed to the benefit of the core market; (3) the size of the non-core market; and (4) forecasts of future alternate energy prices.

Several utilities objected to staff's recommendation. NYSEG, Orange and Rockland, and RG&E argue similarly that non-core markets should be fully deregulated. Brooklyn Union and Central Hudson contend that, in the former's words, "[t]he establishment of bands around authorized returns, sharing and/or rate adjustments for results falling outside of such bands, and comparable rate of return considerations . . . should be left for resolution in the Generic Financing case."[1]

We agree with staff that the range of each LDC's common equity return band should be set in its rate cases.[2] If a particular LDC believes it can reasonably make a case for having an open-ended opportunity to retain earnings, it will have the opportunity to do so. (We would also expect a showing of offsetting benefits to customers under such an arrangement.) The applicability of the generic financing case decision to this issue, if any, will be determined when that case is decided.

Objections have also been raised by the parties representing consumers' interests. Columbia University claims that staff's proposal is discriminatory, because, it contends, overrecoveries would be shared between shareholders and sales customers, while underrecoveries would be recovered from all

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[1] Brooklyn Union's Comments, p. 5.

[2] In a multi-year context, this band would surround an allowed return on common equity that might fluctuate with exogenous changes in capital costs. *See* Case 93-G-0996 et al., Consolidated Edison Company of New York, Inc. - Gas Rates et al., Opinion No. 94-21 (issued October 12, 1994), mimeo p. 16; Case 93-G-0941, The Brooklyn Union Gas Company - Gas Rates, Opinion No. 94-22 (issued October 18, 1994), mimeo p. 7.

customers. Multiple Intervenors argue that an LDC's failure to earn a return within the band might be attributable to imprudent cost overruns, mismanagement, fraud or other causes that should not cause an automatic rate increase. CPB alleges that the proposal provides for a guaranteed rate of return.

Staff's proposal would prohibit a company from seeking a general rate increase for any rate year in which its earned return was projected to remain above the bottom end of the rate of return band.[1] The foregoing comments of the consumer parties miss the point that the rate increase that might be sought, were the company's projected return to fall below the bottom of the band, would have to be obtained in a formal rate case.

f. Applicability

Brooklyn Union argues that all of the foregoing proposals "should be treated by the Commission as general guidelines, subject to adjustment and refinement in individual utility rate proceedings in which the impact, fairness, and feasibility of the proposals can be assessed on a company-specific basis."[2] In the same vein, Corning points out that it has little load growth; 99% of its general service customers are heating customers; half of its throughput goes to three large industrial customers; and 99% of that large industrial throughput is transported gas. Thus, Corning contends, generalized ratemaking theories may not work as anticipated for an LDC of its size, and a flexible, case-by-case approach should be followed regarding incentives, elimination of cross-subsidies, cost- or value-based rates, and return bands. Staff did not disagree with those arguments, and it has in fact proposed general guidelines that permit reasonable variances among LDCs for specific circumstances.

Brooklyn Union proposes in addition that those

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[1] It should be noted again that the authorized return itself might change, if it is established in a multi-year rate plan.

[2] Brooklyn Union's Comments, pp. 4-5.

guidelines "should be applied prospectively only, in general rate proceedings commenced after the effective date of the Commission's order in this proceeding (with the only possible exception being where a particular new service or service option has not been contemplated or addressed in a prior rate settlement or order)."[1] Staff recommends against adoption of Brooklyn Union's proposal, at least as a general or presumptive rule, because there are previously-issued rate decisions and previously-executed rate agreements that contemplate implementation of the decision in this case while those decisions or agreements remain in effect.

4. Split Classifications

Staff suggested that a non-residential customer could have part of its requirements classified as core and part non-core. In such instances, an LDC might meter such services separately. Central Hudson argues that a customer seeking non-core status for a portion of its load should bear any necessary costs of separate metering and other customer costs by direct assignment.

The LDCs will be permitted to bill such metering and customer costs directly to split-classification customers, if that would be consistent with their treatment of single-classification customers with dual or multiple meters.

5. Switching Classifications

In circumstances where a customer would qualify as a non-core customer, but elects to be served under a utility's firm service classification, staff recommended that an LDC should be authorized to require assurances that the customer will not switch to alternate fuel or non-firm service within a reasonable period of time, considering the make-up of the utility's supply portfolio. This would preclude the situation where the LDC would be left with an obligation to pay for gas acquired to meet the

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[1] Id.

needs of customers who are no longer on the system, or who have procured their gas from other sources.

Con Edison argues that the constraint on class-switching should apply to both new customers and customers returning to core services, and should apply to switching from firm sales to firm transportation service. Central Hudson, NYSIGMA, and Multiple Intervenors suggest that clearer guidelines be provided regarding the reasonable period of time within which customers who elect core service may be precluded from switching (without a penalty) to alternate fuel or non-firm service. Multiple Intervenors recommend further that (1) an LDC should not be permitted to impose any entry or departure restrictions, conditions or fees that are not prospectively set forth in its tariffs; (2) such restrictions, conditions or fees should bear a direct and rational relationship to the terms of the customer's contract and the LDC's ability to modify its upstream supply and transportation arrangements; (3) an LDC should be permitted to recover only costs actually (and reasonably) incurred that could not be avoided; and (4) a non-core customer seeking firm service should be treated in the same manner as a new customer entering the service territory.

We expect the LDCs to establish reasonable minimum service terms, with the understanding that what is reasonable might vary among the LDCs, depending upon their own underlying gas purchase commitments. Thus, specific and permanently effective guidelines cannot and will not be specified for all LDCs. The key point is that such restrictions on switching classifications should be linked to gas supply and cost considerations. Such restrictions should be spelled out in the LDCs' tariffs, or the tariffs might provide that individual service agreements will establish the restrictions. As suggested by Multiple Intervenors, customers requesting to return to core or firm services after taking non-core services should be treated no more or less favorably than applicants for new services.

Unbundling

1. Firm Customers

a. Introduction

The instituting order asked the parties to address the issues of (1) whether LDCs should be required to unbundle their systems further[1] by making storage and other services available to their customers; and (2) were further unbundling to occur, how LDCs could assure that the peak day demands of their core customers would continue to be met. Staff recommended that LDCs be required to offer firm customers direct access to the upstream facilities, *i.e.*, pipeline capacity, storage facilities and receipt points, that such customers are supporting in their rates. By doing so, a utility could, at least in theory, re-allocate costs borne jointly by all customers directly to the customers on whose behalf such costs are incurred.

Staff recognized that this requirement might not be easy to implement, because collective individual peak demands might exceed available storage capabilities.[2] Staff observed that the parties interested in having LDCs unbundle pipeline capacity and services used to provide firm utility service would need to address themselves to this issue, as well as the possibility that customers would assign a greater value to access to particular pipelines and receipt points because of, respectively, the availability of lower cost gas supplies or the applicability of lower transportation rates available on those systems. Staff noted further that interested parties would need to work out the details of how assignments can be made to firm customers without affecting the reliability of service to other customer classes or unduly affecting those classes' rates. For

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[1] LDCs are now required to provide transportation service.

[2] Variability of weather conditions and diversity of customer demands might have allowed a merchant pipeline to meet individual demands that, combined, exceeded the maximum amount of gas it could deliver from storage during periods of high demand.

some LDCs, especially those serving the downstate markets, staff suggested that unbundled balancing services might meet the needs of firm customers more economically and efficiently than released upstream pipeline storage capacity.

The comments on staff's recommendation raise several distinct issues, as discussed below.

b. Legal Considerations

NYGAS and Brooklyn Union argue that "the transportation and storage capacity releases permitted under federal capacity release rules are discretionary, federally regulated transactions [that] must be completed in accordance with the terms and conditions of interstate pipeline tariffs,"[1] and that "[t]here is no known legal basis under which this Commission can *require* the release of any particular transportation or storage capacity rights purchased under Federally-regulated transactions."[2] The two parties point out that "FERC does permit LDCs to make pre-arranged releases of pipeline transportation and storage capacity . . . to customers that match all third-party bids for such capacity up to the pipelines' maximum rates,"[3] and that "[u]nder current federal regulation, LDCs cannot assign upstream storage and transportation capacity to their customers nor transfer transportation capacity rights to their customers on a preferential basis."[4] O&R Energy proposes a requirement that all transportation and/or storage capacity under an LDC's control that is in excess of the firm needs of its core customers be posted on an electronic bulletin board maintained by the utility or a group of utilities, with the costs of establishing and maintaining the bulletin board recovered through user fees.

The foregoing comments suggest a reasonable restatement

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[1] NYGAS's Comments, p. 3.

[2] Brooklyn Union's Comments, p. 9.

[3] Id., p. 8 fn 6.

[4] NYGAS's Comments, p. 3.

of staff's recommendation, namely, that the LDCs will be required to manage the capacity they have reserved in a manner that prudently minimizes their overall revenue requirements and which might include "prearranged" releases of capacity to firm customers. Staff's *Report and Recommendations* pointed out that in the post-Order 636 marketplace capacity release transactions might be undertaken to minimize costs of service, but recognized that the unique circumstances of individual LDCs might affect their ability to enter into such transactions. The duty proposed by staff, with which we agree, reinforces the LDCs' obligation to manage their assets and control their costs in a prudent manner that is consistent with the provision of economical, continuous, and safe service.

c. Reliability Concerns

NYGAS, Brooklyn Union, Con Edison, Corning, and NYSEG all have raised concerns about the reliability implications of unbundling. Con Edison argues that an LDC "must be permitted to retain (or be able to recall) sufficient pipeline capacity and storage to serve remaining and prospective core customers,"[1] while NYGAS adds that "[r]eleases by LDCs of particular storage contract rights may not be possible or desirable from a supply adequacy or operational integrity perspective."[2]

Again, nothing in staff's *Report and Recommendations* even remotely suggests that the LDCs should put the reliability of their services at risk. The LDCs' managements are expected to strike a prudent balance between, on the one hand, the risks of system contingencies that would require the recall of capacity, and, on the other hand, the opportunity losses to ratepayers resulting from the reduced prices the LDCs would receive for recallable released capacity.

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[1] Con Edison's Comments, p. 14.

[2] NYGAS's Comments, p. 3.

d. Ratepayer Impact

NYGAS, joined by Brooklyn Union, Corning, and NYSEG, asserts that LDCs, in selecting transportation capacity for release, should make such releases in a manner that maximizes benefits to core customers and does not compromise the cost of service to such customers. NYSEG recommends that customers should be required to take an allocation of the upstream facilities at average embedded cost, thereby protecting remaining sales customers from potential stranded cost or "cherry-picking" of the best upstream facilities.[1] SEO contends as follows:

> [I]f the Commission adopts the Staff recommendation to unbundle transportation services while continuing to charge average rates, it should acknowledge that such an approach will work only so long as the interstate pipelines retain responsibility for upstream pipeline capacity allocation. If the ability to allocate upstream capacity is transferred to the LDCs, these reforms will need to be revisited.[2]

The commenting parties have raised a valid point. The LDCs should select the capacity made available for release with a view toward avoiding (or at least minimizing) increases to the average costs of service borne by their remaining customers,

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[1] Where "best" is defined as "lowest-priced," a "cherry-picking" problem could result from the requirement that notices of capacity allocations be posted on upstream pipelines' electronic bulletin boards. FERC limits the rate that may be charged for a secondary market capacity release to the maximum tariff rate of the pipeline on which it is released. However, the weighted average transportation cost of an LDC served by multiple pipelines might exceed the rate charged by the individual pipeline on which capacity is sought. Were the LDC's average cost greater than the maximum pipeline rate for the released capacity, the remaining customers' rates would be higher unless (1) *all* capacity release revenues were passed through to the LDC's customers, or (2) where applicable, an offsetting *distribution* transportation rate was negotiated to vitiate that imbalance. (On the other hand, were the LDC's average cost lower than the maximum rate of the pipeline on which capacity is released and the lower rate posted on the bulletin board, another party could bid the price up to the maximum tariff rate.)

[2] SEO's Comments, p. 2-3.

especially core customers, while serving the legitimate needs of potential transportation customers. A reasonable balance between these competing interests might be struck by negotiating, along with the capacity release, an "offsetting distribution transportation rate."[1]

e. Additional Proceedings

Con Edison argues that there should be a separate proceeding to explore whether and to what extent an LDC should be required to provide firm customers access to its pipeline capacity, storage, and receipt points.[2] However, the LDCs would be better advised to devote their time and efforts to finding answers that are suitable to their own circumstances, which appear to vary significantly.

2. Non-Core Customers

In order to maximize the use of excess capacity available on LDCs' systems, staff proposed that LDCs be expected to offer non-core customers transportation, storage and load balancing services on a best efforts basis, either for fixed durations or on interruptible terms. Staff advised that individual circumstances should determine whether such services are offered at cost or at market prices.

Con Edison points out that the definition of "non-core" services in staff's *Report and Recommendations* included firm transportation service, although staff also recommended that LDCs be required to offer storage and load balancing to firm transportation customers. Con Edison argues that the "best efforts" obligation should apply only to interruptible transportation customers. "Core" service has now been redefined

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[1] *See* p. 45, fn 1 supra.

[2] Meanwhile, Brooklyn Union has submitted the outline of a program for "appropriate pre-arranged releases of pipeline transportation capacity identified by the Company as freed up by the customers' conversion to transportation service" (Brooklyn Union's Comments, p. 10).

to include firm transportation, so Con Edison's position is effectively adopted.

Con Edison and NFG argue that the "best efforts" standard requires further definition, including the specification of "commercially reasonable guidelines."[1] However, NFG (joined by Niagara Mohawk) contends that the better course would be to eliminate any such obligation. NFG notes that "[a]n LDC's obligation to minimize costs paid by core customers is already governed by the prudenc[e] standard,"[2] and an "LDC should be expected to openly offer unbundled services on a non-discriminatory basis as it sees fit, consistent with prudent management of its overall supply portfolio."[3]

We shall not establish a standard--"best efforts"--with the same meaning as the commercial term of art described by the commentators. In fact, NFG's description of the prudence standard applicable to the management of an LDC's supply portfolio is sufficient. Put simply, an LDC should be expected to take advantage of each apparently reasonable opportunity to release pipeline capacity or be prepared to justify its decision not to do so.

3. Packaged Services

Staff advised that it should be incumbent upon LDCs to take measures to offset increased costs resulting from Order 636, especially those passed along to core-market customers. Accordingly, staff recommended that LDCs be permitted to "package" upstream pipeline services for the purpose of making on-system and off-system sales, provided that an LDC proposing to sell a package of pipeline facilities and gas supply be required to show that such an offering will generate a greater stream of net revenues for the benefit of core customers than would the

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[1] NFG's Comments, p. 5.

[2] Id., p. 4.

[3] Id. p. 4.

tender of the pipeline facilities for release through the pipeline's electronic bulletin board. Staff recommended further that, at a minimum, an LDC should:

1. Maintain a listing of capacity release prices and offerings on electronic bulletin boards.

2. Be required to demonstrate in rate cases that it has maximized revenues from the release or packaging of surplus gas supplies and pipeline facilities. That showing would be in addition to the evidence required by §66(e)-2 of the Public Service Law pertaining to gas purchases.

3. Incorporate strategies for marketing surplus gas and pipeline capacity into its integrated resource plan.

Staff recommended, finally, that if streaming of gas supplies is permitted (as was recommended by staff), the LDCs should also be required to show, when applicable, why the incremental gas supply from existing contracts was not the gas used in streaming transactions.

Central Hudson argues that the "better off with packaging" standard recommended by staff should be eased to a "no worse off with packaging" standard. The Marketers argue from the opposite point of view, asserting that staff should have recommended that the same standard be applied to packaged service proposals as staff would apply to subsidiary operations in LDC-parents' service territories, namely, to "assur[e] that an LDC's unregulated affiliate does not benefit from unfair competitive advantages, especially those that are detrimental to the economic interests of ratepayers."[1]

The Marketers and Multiple Intervenors go further and argue that the packaging of services by LDCs having broad discretion in setting transportation rates for non-core markets might deal a lethal blow to non-LDC gas marketers and essentially permit the LDCs to utilize their monopoly power over distribution

[1] Staff's *Report and Recommendations*, p. 54.

services to gain unfair competitive advantages. Multiple Intervenors argue that prevention of such abuses lies in requiring that LDCs' distribution services be cost-based, unbundled and offered on an equal basis. The Marketers argue that we should "separate an LDC's merchant function in competitive markets from the transportation/distribution function, require the merchant to acquire any upstream capacity or services used to make sales to non-core customers on the open market, and preclude any cross-subsidization between the functions." Sunrise adds that the separation of merchant and transportation functions is essential to foster competition.

The parties' comments, in short, run the gamut from arguing for a looser standard for justifying packaged services to prohibiting packaged sales of gas and distribution service altogether. But staff's recommendation strikes the proper balance. There is certainly no presumption that, in a competitive marketplace, an LDC will have a monopoly on wisdom in procuring gas supplies, and it should be expected to step aside and facilitate the reasonable efforts of customers to seek their own supplies. Nevertheless, it is likely that many customers will prefer not to get into the gas procurement business, and the LDCs will be permitted to offer packaged services at prices reflecting their value to those customers, provided that non-participating customers will benefit more from those transactions than from the release of pipeline facilities. The LDCs shall also meet the other three conditions proposed by staff, set forth above, except that the strategies for marketing surplus gas and pipeline capacity should be established irrespective of whether an integrated resource plan is prepared.

<u>Utility Discretion</u>

1. <u>Below-Incremental-Cost Pricing</u>

In its initial comments, Brooklyn Union described a marketing situation it could face in which its average sale price of gas will exceed commodity costs over the course of a sales agreement, but at certain times within the contract term the price will be less than incremental commodity costs. Brooklyn Union contended that there should be no prohibition of such sales, so long as unrecovered gas costs are not shifted to other customers.[1]

Staff proposed that there be explicit recognition of the distinction between, on the one hand, *not prohibiting* a proposed course of conduct and, on the other hand, *approving* that conduct. So long as (i) any unrecovered gas costs that might result from below-cost sales are not shifted to other customers, (ii) any increased financial risks resulting from such conduct do not threaten to impair service quality, and (iii) none of those costs or risks is reflected in firm service rates, staff found no apparent reason why there should be regulatory intervention to "save an LDC from itself." On the other hand, below-cost sales can be one element of predatory pricing (although that fact alone does not establish predation), so staff recommended that we should not take any action that could be interpreted by a court as an approval of such pricing (with the result that an antitrust action by an injured competitor of the LDC would be defeated by the "state action" exemption from the antitrust laws). Staff proposed that an LDC that wishes to make below-cost sales should absorb *all* risks associated with that course of business, not simply the risk of unrecovered commodity costs.

O&R Energy, North Atlantic, Columbia University, CPB and PULP object to the foregoing recommendation, reciting the fact, already well-acknowledged by Staff, that below-cost prices might be predatory. (O&R Energy candidly acknowledges that it would prefer regulatory intervention in the market under those circumstances to acting on its own behalf in an administrative proceeding or a court case.) Columbia University alleges that "it would take substantial Staff resource[s] to audit LDCs to

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[1] Brooklyn Union's precise proposal was that "LDCs could enforce economic tests to ensure that the present value of future benefits exceed the short term losses under any long term contract and absorb the losses that result from not meeting this test" (Brooklyn Union's Initial Comments, p. 7).

determine that unrecovered gas costs from below cost sales are not being shifted to other customers, and that they are not being reflected in firm service rates."[1]

Staff's recommendation is sound. A fairly narrow set of circumstances would be involved--one where the average sale price of gas will exceed commodity costs *over the course of a sales agreement*, but at certain times within the contract term the sale price will be less than incremental commodity costs. Periodic below-cost pricing (which might also be termed "average-cost" or "rolled-in" pricing) would not appear to be predatory, as that term is commonly understood in contemporary antitrust cases.[2]

2. Filed Rates and Agreements

Empire State Pipeline is required to file "tariff addenda" that set forth information about its individually-negotiated service agreements.[3] Empire wanted the requirement lifted, arguing that it is a new entrant, not an established incumbent, and its potential customer base consists only of a small number of large, sophisticated customers. Right now, Empire's addenda are given trade secret protection, but it contended that there is no guarantee that sensitive commercial information, once filed, would remain confidential and not be publicly disclosed.

Staff noted that §65(5) of the Public Service Law provides that "no . . . classification, schedule, rate or charge shall be lawful unless it shall be filed with and approved by the commission." Staff concluded that there was no apparent reason why the existing protection given to Empire's filings is not

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[1] Columbia University's Comments, p. 16.

[2] *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 113 S.Ct. 2578 (1993).

[3] The filings have been required since the Appellate Division's decision in *MCI Telecommunications Corporation v. Public Service Commission*, 169 A.D.2d 143 (3rd Dept. 1991).

adequate, and that Empire had not shown why it is entitled to a guarantee of any greater protection.

Empire has submitted a second set of comments largely repeating its earlier arguments. Con Edison supports Empire's position, arguing that "[w]hile it may be an appropriate exercise of discretion to continue this requirement for LDC tariffs authorizing individually negotiated rates for local transportation services, requiring tariff addenda for gas sales contracts where the LDC is but one player in a highly competitive market is unwarranted." Con Edison recommends that the requirement be eliminated for "individually negotiated arrangements not involving local transportation."[1]

There is no apparent reason why the existing protection given to Empire's filings should be considered inadequate. Empire has not demonstrated that it needs a guarantee of any greater protection.

3. Elimination of Strict Pricing Uniformity

Public Service Law §§65(2) and 66(12)(d) require that all customers of an LDC who are served, respectively, in "the same or substantially similar circumstances or conditions" or "under like circumstances" shall receive the same rate from that LDC. Some of the utilities contended that the repeal of those provisions is necessary in order for them to have the necessary flexibility to meet marketing opportunities in competitive non-core markets.

Staff concluded that the Public Service Law does not circumscribe our authority to make findings of fact about the kinds of "conditions" and "circumstances" that reasonably distinguish customers. As the markets for natural gas become more competitive, the conditions and circumstances under which an LDC can maximize its sales base and net revenues, to the ultimate benefit of all customers, must necessarily change and might very well vary from one customer to the next even within a service

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[1] Con Edison's Comments, p. 22.

classification or subclassification.

Staff observed further that this Commission, as a state economic regulatory agency with jurisdiction over intrastate sales of utility services, is not bound to observe the price discrimination provisions of the federal Robinson-Patman Act (which pertains to interstate sales of commodities), but in this instance it would do well to seek guidance from the federal agency and court decisions under the Act concerning the recognized justifications for offering different prices to similar customers in unregulated interstate markets, including "meeting competition" and "cost justification." In staff's view, a specially-priced non-core-market transaction that could be defended on the same grounds should pass muster under the Public Service Law.

Central Hudson agrees with staff that the consideration of competitors' claims of improper pricing should be based on recognized judicial rules (such as those interpreting the Robinson-Patman Act). Were different standards to be adopted for this agency, Central Hudson continues, forum-shopping competitors of the utilities might respond by filing complaints concerning commercial disputes that would better be adjudicated elsewhere. Con Edison states that "[i]f the Staff intends, and the Commission agrees, that LDCs have no greater legal obligation in today's marketplace regarding price discrimination than unregulated marketers, then the Company does not take issue with Staff's opinion that no change to this part of the Public Service Law is required at this time."[1] NYSIGMA appears to agree that "the Commission does have the authority to discriminate among ratepayers on reasonable bases for the purpose of maximizing general welfare," but argues that we "should not do so simply to facilitate maximization of revenues [from] noncore customers."[2]

We conclude that no change to the Public Service Law is

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[1] Con Edison's Comments, p. 21.

[2] NYSIGMA's Comments, p. 7.

required before LDCs are permitted to recognize market conditions as factors that might distinguish otherwise similarly-situated customers. The ability of LDCs to establish or maintain such distinctions should be no more constrained than those of unregulated companies, *i.e.*, price differentiation should be permitted if it does not result in injuries to competition in either the primary market (either natural gas alone or all relevant sources energy, depending upon the customers and regions) or secondary markets (the various lines of business in which customers in a given region are engaged).

The only criticism of staff's recommendation, NYSIGMA's, is groundless. A firm that attempts to maximize its output by making its pricing sensitive to the needs of its customers would be behaving in a manner exactly the opposite of what would be expected from an unregulated monopoly. Such behavior should be encouraged, not thwarted, by utility regulators.

4. Streaming

"Streaming" is the arrangement by an LDC for specific gas supplies dedicated to certain customers or markets. The parties were asked to comment about whether LDCs should be authorized to stream gas supplies, and, if so, what protection against undue discrimination would be needed.

Staff recommended that LDCs be permitted to engage in streaming transactions subject to two guidelines: (1) a streaming transaction itself must not give rise to an opportunity loss to non-participants;[1] and (2) the LDC must demonstrate that non-

[1] Some apprehension had been expressed that streaming might involve the procurement of specially-priced gas supplies that *could* be made available to all customers, but which are reserved for especially favored customers. But a "no opportunity loss" guideline would require, as Brooklyn Union had proposed, that (i) the procurement of gas must be on behalf of a customer whose demand profile facilitates the purchase of a specific supply at negotiated rates; and (ii) the streamed supply could not be substituted for any portion of the LDC's existing supply portfolio without abrogating current contracts.

participants would be worse off *without* the streaming transaction. The same requirements should apply to both the commodity prices and the rates for included services in streaming transactions.

Several of the LDCs oppose the foregoing guidelines. NYSEG contends that any implication that core customers need to be protected or compensated for streaming transactions in which the incremental gas supply turns out to be less expensive than gas purchased for core customers is unreasonable. Central Hudson, Niagara Mohawk, and RG&E agree that the "worse off without the streaming" standard should be eased to a "no worse off with the streaming" standard.[1] Con Edison contends (with Niagara Mohawk in agreement) that the recommended standards are "understandable under the current environment," but they would not be warranted after implementation of a performance-based gas cost recovery mechanism, because such a mechanism "would provide an adequate safeguard against core customers subsidizing streaming transactions."[2]

The streaming standard proposed by staff is adopted. That standard supports the kinds of transactions streaming proponents claim would benefit all customers but are not being pursued now, while also requiring that opportunities to provide an even greater quantum of benefits to *all* customers are not missed as customer-specific transactions are being put together. There is more at stake than simply avoiding cross-subsidies running from the general body of ratepayers to specific

[1] NYSEG argues that the requirement that utilities must show that customers would be worse off without the transaction is overly restrictive and burdensome, claiming that it would essentially make streaming transactions available only to potential bypass customers or loss of load customers. That assertion is incorrect: streaming transactions might also lead to improved capacity utilization, so that non-participating customers would be better off with the streaming transactions (and thus worse off without them).

[2] Con Edison's Comments, pp. 20-21.

customers.[1]

NYSIGMA supports the proposed standard, but argues that "independent marketers should have the right to bid to supply these needs to the LDC in order to assure that the competitive market assures the optimal allocation of resources and resulting benefits to the ratepayers."[2] NYSIGMA takes the position that marketers should have comparable access to the customers, and that the authorization of streaming that meets the proposed standard "should not mean that the customer must purchase the tied product, the gas commodity, from the LDC in order to receive the tying product, firm capacity."[3]

Although it is easy to agree in principle with NYSIGMA, there is no apparent need to modify the streaming standard to include an LDC bidding requirement. Presumably, a customer with requirements large enough to attract a streaming proposal would have "shopped around" those requirements and received bids directly from non-LDC suppliers or marketers (or at least would be capable of doing so), so the LDCs should not be required to replicate the process.

Reporting Requirements

Staff proposed to require LDCs to report periodically on their programs or other activities for marketing unbundled upstream pipeline capacity and packaged sales of gas. Staff suggested that this requirement might best be accomplished by amending the format for the LDCs' annual reports to the Commission to include a section for such information.

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[1] North Atlantic and Sunrise argue similarly that, staff's proposed standard notwithstanding, streaming is nothing more than a subsidy from core customers to non-core customers. The two marketers assert that streaming would be employed only to eliminate competition from alternate suppliers of natural gas, and Sunrise contends further that staff's recommendation is "tantamount to allowing LDCs to circumvent FERC Order No. 636" (Sunrise's Comments, p. 7).

[2] NYSIGMA's Comments, p. 6.

[3] Id., p. 6.

Central Hudson (joined by RG&E) argues that "[a]ny reports required by the Commission of LDCs that relate to an LDC's marketing efforts should be specifically protected from disclosure to competitors."[1]

The Marketers argue that, were staff's recommendations regarding packaged transactions adopted, we should establish a reporting requirement that will "define the 'lost opportunity' by which [we] will measure the impact of a particular LDC bundled transaction."[2] The information sought by the Marketers would support the following analysis, which would be applied to *each transaction*:

- What was the current market price of similar interstate capacity on the open market at the time of the transaction? Did the LDC collect more or less than it could have gotten by putting the capacity on the market?
- What was the current market price of gas of similar firmness and load factor on the open market at the time of the transaction? Did the LDC collect more or less than the current market price for such gas?
- If the LDC discounts on-system transportation in a bundled transaction, has it made more revenue by bundling its services with interstate transportation and gas than it would have had all components been separately priced?[3]

Having proposed this requirement, the Marketers then state that they "are concerned that the Commission will not have sufficient resources or information at its disposal to undertake such analyses," and that, because pricing information will be confidential, "only the Commission and the LDC will have access to detailed transaction information, and those with current

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[1] Central Hudson's Comments, p. 10.

[2] The Marketers' Comments, p. 5.

[3] Id.

market knowledge will be unable to participate."[1]

NYSIGMA proposed a reporting requirement regarding streaming transactions. NYSIGMA recommends that, "[i]n order to minimize the cost of monitoring for potential violations [of Robinson-Patman Act standards for permissible price discrimination,] LDCs should be required to report all streaming transactions each month in such a way that primary line competitors can evaluate the potential that they have been discriminated against and secondary line customers can assure that their competitors are not being favored by the LDC in the purchase of an important factor of production to many industries, natural gas."[2] NYSIGMA would have LDCs report the following details:

- The cost and size of the dedicated gas package to the LDC and the price and quantity of the sale to the customer or customers.
- The date each streaming agreement was entered into.
- The duration of each streaming agreement.
- The identity of each customer, or, at least, the customer's SIC.

NYSIGMA concludes as follows:

> By having the LDCs report this information each month it could be the responsibility of the LDCs' competitors and customers to examine and monitor the reports for any potential primary line or secondary line violations which may later be brought up as a complaint or in litigation. This would minimize the extent to which the Staff would have to monitor the transactions. It would also serve as a vehicle for calculating the incentives and revenue flows to the core customers . . . as well as assuring that nonparticipants are better off with rather than without each streaming

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[1] Id., p. 6.

[2] NYSIGMA's Comments, p. 13.

transaction.[1]

The guidelines proposed by NYSIGMA for the reporting streaming transactions are reasonable--although quarterly reporting should be sufficient--and they can be applied as well to the reporting requirements for packaged sales and capacity releases. Accordingly, we shall require quarterly reporting, for each such transaction, of the date, duration, price, cost, and quantity, and to identify the customer by its standard industry code. This information should be publicly available so that, as NYSIGMA recommends, directly interested and affected parties can monitor those transactions to assure that the competition they face is fair. With such interested oversight, a separate analysis of each transaction along the lines suggested by the Marketers would be unnecessary, because actual and potential competitors of the LDCs would have an obvious incentive to search for and report any suspect activities.

Monitoring

Staff recommended against the establishment of a new, formal monitoring system to measure the extent of penetration by LDCs into competitive markets, because, for the most part, existing regulatory processes provide appropriate means for reviewing and evaluating LDC costs, prices, and performance, and for receiving and disposing of complaints about utility conduct from both customers and competitors. No comments disputing staff's position, and we shall adopt staff's recommendation for the present. Should the parties to the proceeding in which gas purchasing and affordability issues are examined see a need for additional requirements, they may address the issue there.

Staff also stated that it believed a properly designed customer survey could provide useful information about non-core customer satisfaction with LDC (and non-LDC) service providers. No party has disagreed with that observation, and we will consider directing that such a survey be conducted for one or

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[1] Id., p. 14.

more LDCs once the policies and guidelines established in this decision have been in effect for at least one year.

Subsidiaries

We sought comments on the question of whether an LDC's own gas marketing subsidiary should be precluded from doing business in that LDC's service territory. After reviewing the parties' comments, staff concluded that there is a "philosophical possibility" that various safeguards or mechanisms could be employed to stem the causes of the concerns previously expressed by us (cross-subsidies, preferential treatment, and perverse incentives), but "they would likely not be foolproof and they would definitely not be cost-free." Staff argued that the pertinent question is whether the social costs of installing those protections would be outweighed by greater social benefits resulting from an LDC's subsidiary engaging in marketing activities in the its parent's service territory.

Staff questioned the validity of the contentions of various parties that the presence of LDC-affiliated marketers in the LDCs' own service areas will result in net benefits to their ratepayers. Staff observed that no party has identified a single relevant product/geographical market in which the elimination of actual or potential competition from *one marketer*--the franchised LDC's affiliate--would measurably diminish competition. On the other hand, the cost of assuring that the LDC's affiliate does not benefit from unfair competitive advantages, especially those that are detrimental to the economic interests of ratepayers, would not be inconsequential. Staff, therefore, recommended that our policies barring LDCs' marketing subsidiaries from operating in their parents' service territories should continue.

NYGAS argues that each of the two subsidiaries whose operations are directly at issue in this case (those of Brooklyn Union and Con Edison) "is operationally staffed with individuals who are not also employees of the utility, geographically separated from the utility's corporate offices, subject to strict cost accounting guidelines on file with the Commission, and required to operate at arm's length from the utility in accordance with Commission orders."[1] NYGAS adds that another controversial planned subsidiary, that of LILCO, "proposes to invest in a national partnership without conducting any business of its own."[2]

More generally, NYGAS continues,[3] "the standard for projecting the effectiveness of such protection should be one of reasonableness, not that such mechanisms must be foolproof."[4] NYGAS asserts that staff "has not explained how or why the imposition of a service territory restriction would resolve its concerns regarding cross-subsidies, etc.," and that the examples cited by staff "could be equally applicable to sales by the subsidiary outside of the LDC's service territory."[5] NYGAS contends that "[w]hile Staff argues that eliminating one competitor (the LDC's subsidiary) from the market will not measurably diminish competition, it has neither supported that argument nor made a case that allowing the subsidiary to compete in its parent's service territory will either harm ratepayers or the LDC's competitors."[6]

NYGAS proposes in the alternative that "[a]t a minimum, such restrictions should be lifted until all disadvantages between LDCs and other marketers are removed, either through regulation or legislation, giving LDCs an equal opportunity to compete for markets."[7] Brooklyn Union adds that given the unequal tax burdens to which LDCs and marketers are subject, there is no current utility advantage that needs to be "leveled"

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[1] NYGAS's Comments, p. 6.

[2] Id.

[3] NYGAS is joined in most of these arguments by SEO.

[4] NYGAS's Comments, p. 7.

[5] Id., p. 8.

[6] Id., p. 9.

[7] Id., p. 10.

by imposing subsidiary restrictions. The other utility commentators (LILCO, Niagara Mohawk, and RG&E) and SEO argue generally that we should allow LDCs and their affiliates to compete as equals against unregulated brokers and marketers. Con Edison adds that implementation of a performance-based gas cost recovery mechanism should eliminate the concerns about cross-subsidies and perverse incentives that led to the restriction.

NYSIGMA supports staff's recommendation, arguing that "the insistence by LDCs to market in their service area to be *prima facie* evidence that they intend to use their natural monopoly to leverage into the unregulated marketplace," because "there is no reason for an LDC to reasonably oppose or to drop the honest concept of establishing an investment in a gas marketing subsidiary if that LDC can only market in 299 service areas in the U.S. rather than all 300."[1] Sunrise and Columbia University, on the other hand, object to the fact that staff did not recommend *requiring* LDCs to compete for sales to non-core customers only through separate subsidiaries that are subject to arms-length dealing restrictions and standards of conduct comparable to those set forth in FERC Order No. 497.

We agree with staff's recommendation that marketing by an LDC's subsidiary should not be permitted in that LDC's service territory. The LDCs miss the point (which the marketers do not) that they will be permitted to compete aggressively for the retention of their current loads. Thus, there is no apparent reason why an LDC's customers would be *better off*, were the same marketing conducted through a separate corporate entity, and the potential for added social costs as a result of such marketing is palpable. This issue may be revisited if the relative costs and benefits appear to change as experience is gained with newly competitive markets.

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[1] NYSIGMA's Comments, pp. 3-4.

Aggregation of Small Customers

1. Introduction

One of the marketers, Enron, proposed that relatively smaller customers of an LDC be allowed to combine themselves into a group that would be treated as a single customer for which a pool of gas would be acquired and delivered to the LDC. The LDC would then be expected to deliver the gas to members of the group.

Staff supports the extension of the benefits of Order 636 to as many end-users as possible, and thus recommended that aggregation programs be permitted. Staff noted, however, that its recommendation contemplated the continuation of full-margin transportation rates where they are currently in effect, and staff recommended that between-cases petitions seeking the redetermination of current rates not be entertained.

Staff's recommendation drew many comments raising a number of issues, discussed in turn below.

2. Usage Thresholds

a. Aggregation Proposals

Some of the parties--all of them LDCs--take the position that aggregation should not supplant minimum usage thresholds for transportation service. Brooklyn Union argues that "[a]ny aggregation proposals must be on a scale that would meet the minimum quantity requirements otherwise applicable to qualification for transportation services."[1] Con Edison argues similarly that the volumetric limit should not be considered eliminated by aggregation, or, if it is, the implications of doing so should be studied in a separate proceeding. Niagara Mohawk simply states that an appropriate level of aggregation should be established.

Although we would encourage the LDCs to scale down or eliminate minimum volume requirements, they will be permitted at

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[1] Brooklyn Union's Comments, p. 6.

the outset to establish minimum aggregation thresholds no greater than the minimum transportation thresholds many currently have, namely, 5,000 Mcf per year. As the LDCs gain experience with aggregation, lower thresholds might be established.

Several parties addressed the issue of "conjunctional billing," that is, the practice, long disfavored by the Commission, of aggregating the usages at several locations into one bill in order to receive higher-volume block rates. Niagara Mohawk appears to be concerned that aggregation might result in a new form of conjunctional billing, while Con Edison and NFG argue that it should not. Sunrise, on the other hand, contends that "it is imperative that third-party suppliers be permitted to aggregate commercial customer loads for purposes of supply, transportation and storage portfolio management (including nominating and balancing), as well as to trade imbalances with industrial customers and other aggregators."[1]

Staff's support for aggregation is not an endorsement of conjunctional billing, and our current policies disfavoring that practice will continue. However, while the LDCs will not be required to combine loads for purposes of determining imbalances --except in unusual circumstances--they will not be precluded from entering into agreements with customers to offset overdeliveries and underdeliveries to minimize imbalance charges.

b. Transportation Generally

Two utilities and two marketers used the aggregation issue as the context for advocating the general elimination of minimum usage thresholds for transportation service. LILCO, with NYSIGMA's support, proposes a deliberate and gradual (phased) elimination of minimum consumption thresholds.[2] While that phase-out is occurring, LILCO continues, customers should not be

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[1] Id., pp. 4-5.

[2] Were the thresholds immediately eliminated, LILCO contends that transitions in the market might occur too quickly to protect core customers from rate impacts resulting from sudden shifts in the core and non-core markets.

permitted to aggregate for the purpose of meeting transitional minimum use thresholds. NFG asserts that "[a] volumetric threshold of zero for transportation eligibility and permission (but not a mandate) to bill full-margin transportation rates presumably would establish a de facto threshold based on cost."[1] Sunrise argues that we should "explicitly grant *all* non-residential customers the option to elect to obtain unbundled firm transportation and related services in lieu of bundled firm sales service" by "requir[ing] LDC tariffs to be revised to remove existing minimum transport volume requirements and other economic barriers . . . that currently prevent many commercial customers from obtaining LDC transportation."[2]

In a recent case, we required NFG to establish a separate "exit threshold" usage level at 75% of that company's 5,000 Mcf minimum (*i.e.*, at 3,750 Mcf) after receiving a petition for relief showing that transportation service would be economical for the customer-petitioner at the lower level.[3] We shall encourage all LDCs to eliminate minimum transportation volume requirements, and we shall require them prospectively to adopt new minimums for individual customers that do not exceed 3,500 Mcf/year.

3. Core/Non-Core Status

Several commentators raised questions about the implications for service reliability resulting from the extension of a transportation service to core sales service customers, through aggregation. Niagara Mohawk contends generally that procedures should be developed for establishing an aggregation

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[1] NFG's Comments, pp. 2-3.

[2] Sunrise's Comments, pp. 3-4.

[3] Case 94-G-0154, Petition of Harbison Brothers, Inc. for a Limited and Temporary Waiver of the Volumetric Requirements of National Fuel Gas Distribution Corporation's Service Class No. 16, Transportation Service, Order Requiring National Fuel Gas Distribution Corporation to File Tariff Revisions (issued June 7, 1994).

marketer's creditworthiness and the quality of its supply portfolio. NFG points out that "Enron proposes that marketers could post bond to assure that LDCs are held harmless in the event of marketers' defaults," and argues that "[t]o the extent Enron envisions aggregation of core customers, its proposal to assume a risk of service fixed by the amount of [a] posted bond is not sufficient to replace the LDC's obligation to serve."[1] Brooklyn Union would require that an aggregation proposal involving core customers (including "human needs" requirements customers) "may not include customers within the non-core category and must incorporate commitments to standby or backup service (including the payment of related pipeline capacity costs, gas storage costs, and fixed gas supply costs appropriate to maintenance of reliable service to the participating customers.)"[2]

It is impossible now to anticipate all the questions that might arise as aggregation programs are attempted, much less answer those questions. As with any relatively novel proposal, there are many questions about customer aggregation. Some of them are largely matters of curiosity and will be answered as proposals are submitted, such as the identity of the marketers offering such services, their experience, the customers to whom such services appeal, and the reasons why those services might appear relatively more attractive than utility services. Others have an important bearing on existing policies, such as the extent to which consumer protection rules (both HEFPA and the non-residential rules) do or should continue to apply to customers participating in aggregation programs. And still others, involving the allocation of rights and responsibilities between and among LDCs, marketers, and customers, might go beyond mere matters of contract and would be subject to our primary jurisdiction.

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[1] NFG's Comments, p. 3.

[2] Brooklyn Union's Comments, pp. 6-7.

The solution is to require, at least initially, that aggregation programs be submitted as joint proposals of the participating marketers and LDCs, and that any waivers of existing rules, requirements, or policies that are necessary to make the programs work should be identified and justified in those proposals. The requested waivers would then be subject to review and approval before the programs could be implemented.

Although Brooklyn Union opposes commingling core and non-core customers in aggregation pools because of reliability considerations, CPB apparently sees "cream-skimming" as a larger concern, and argues that all small consumer aggregation projects should be *required* to include a minimum percentage (20%) of residential customers. We shall encourage broad-based, inclusive aggregation programs; but if a feasible program that is suitable only for relatively less risk-averse non-core customers is the sole proposal submitted at a given time, implementation of the proposal will not be barred simply because there would be no core customer participants. It should be remembered that LDCs' net revenues are earned from the movement of gas through their distribution facilities, not from sales of gas, so core customers would not be adversely affected by the establishment of aggregation programs in which they would not be eligible to participate.

Central Hudson appears more concerned about the costs of providing reliability than reliability *per se*, arguing that a utility should be permitted to demand assurances from core customers eligible for aggregation that they will continue to take sales service for a specified period of time, just as it could require larger customers who choose core services, but who are eligible for non-core services, to remain as core customers for a reasonable period of time. Central Hudson's proposal might have some merit, once aggregation programs are established as on-going alternatives to its on-demand sales services, because then the analogy to customers who can choose between LDCs' core and non-core offerings would be valid. Until that time, however, Central Hudson's concern is speculative, and LDCs will not be permitted to require "assurances" from, potentially, every gas customer.

4. Costs and Benefits

Several commentators have discussed the utilities' administrative costs of implementing aggregation proposals. Brooklyn Union asserts that "[a]ny incremental administrative or other costs attendant to the small customer aggregation proposal must be borne by the customer group purportedly benefitting from such proposal."[1] Niagara Mohawk argues that we must resolve issues concerning (1) the establishment of metering and procedures to track aggregated accounts; (2) the development of rates for aggregated service that include charges to cover costs of managing aggregation program; and (3) the development of balancing procedures that send proper signals to participants so that imbalances can be avoided. Corning contends that facilitating the establishment of an aggregation program will be difficult and relatively costly for smaller utilities, and it requests that it not be required to accommodate such a program until the 1995-1996 heating season.

Niagara Mohawk's argument notwithstanding, these questions can be resolved in individual aggregation program proposals filed jointly by the LDCs and participating marketers. It is possible that no additional costs will be incurred in implementing or maintaining aggregation programs, and we will not, therefore, attempt now to anticipate such costs.

Sunrise argues, without elaboration, that we should "*require* LDCs to allow third-party billing of LDC transportation charges, thereby enabling commercial customers to receive the benefits of deregulation without experiencing deterioration in quality of service."[2] We are willing to consider proposals that include that feature, but we shall not adopt it as a requirement.

Some of the commentators contend that any impacts on

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[1] Brooklyn Union's Comments, pp. 6-7.

[2] Sunrise's Comments, p. 5 (emphasis supplied).

the rates paid by non-participating customers, as a result of aggregation programs, should be taken into account. Orange and Rockland argues for a requirement that non-participants simply be no worse off, while Niagara Mohawk suggests that we should allow the design of new transportation rates that preserve the recovery of net revenues from aggregated customers so that remaining firm sales customers do not incur their own "transition costs." Central Hudson expresses concern that aggregators might solicit customers with the most desirable cost characteristics, and LDCs will respond with a proliferation of rate classifications. In Central Hudson's view, this might cause many disputes over classifications, and it would provide a disincentive for longer stayouts between rate filings.

Two parties go further and suggest that we should, at least in some circumstances, require proof of affirmative benefits before aggregation proposals will be approved. Brooklyn Union proposes that "such proposals should be evaluated against the same standards as streaming activity (*i.e.*, that the core customer class, as a whole, would be worse off without the aggregation transaction)."[1] NYSIGMA argues that, for aggregation proposals submitted between rate cases, "[t]he Commission could . . . require that the customers being aggregated would enjoy some substantial, guaranteed benefit from the program which could be examined in the course of considering a between-case petition."[2]

We shall not adopt either a "no-worse-off" test or a "better-off" requirement for aggregation proposals. Larger individual customers are free to migrate between sales and transportation service classifications without such tests being applied, and there is no apparent reason why a different standard should apply to a group of smaller customers acting in concert.

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[1] Brooklyn Union's Comments, p. 6.

[2] NYSIGMA's Comments, pp. 2-3.

5. Transportation Rates

As discussed earlier, staff's recommendation that aggregation be permitted contemplated the continuation of full-margin transportation rates where they are currently in effect. NYSIGMA appears to support the adoption of that recommendation as a permanent policy, contending that "full margin transportation rates will assure that the beneficiaries of the aggregation program would be the endusers and that the LDCs are whole with regard to the revenues they received in their last rate case."[1] Sunrise asserts, on the other hand, that "Staff's insistence on clinging to full-margin rates will . . . make transportation options unattractive to most end-users."[2]

If all other things are equal, full margin transportation rates will be "unattractive to most end-users" only if the alternative gas supplies accessed by the aggregators were *more expensive* than the LDCs' own sources. The LDCs will not be compelled to provide marketing opportunities for high-priced gas supplies.

Staff recommended in addition that between-cases petitions seeking the redetermination of current rates not be entertained. Con Edison argues that staff's opposition to between-case petitions would be unfair to utilities that do not currently have full-margin transportation rates. Con Edison, however, has misconstrued staff's position. Staff's recommendation, with which we agree, is that the transportation rate established between rate cases for a sales customer who chooses to become an aggregation program participant should be set equal to the average net-revenue margin in the usage block sales rate(s) that would otherwise apply to that customer.

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[1] Id., p. 3.

[2] Sunrise's Comments, p. 4.

6. Further Proceedings

Because small-customer aggregation would be new to this state, some parties contend that further study is required. Con Edison argues for a separate proceeding to "examine company-specific mechanisms for small customer aggregation" and to investigate rate impacts, implementation and administration details and costs, and stranded investment (in "abandoned" gas supply and pipeline capacity).[1] CPB argues that a proceeding should be instituted to examine the promotion of aggregation programs, the need for threshold levels, the reliability requirements of human needs and residential customers, associated back-up services, and billing issues. CPB suggests also that staff develop educational materials on this issue. Niagara Mohawk recommends that LDCs be allowed to phase in aggregation programs with a limited number of participants to identify potential benefits and problems.

Aggregation programs are already underway in other jurisdictions, and at least one experienced aggregator has expressed confidence in its ability to establish programs in New York. The marketplace is a suitable laboratory for new service proposals, and willing providers should not be required to answer every conceivable question before they are permitted to proceed. We shall not institute a further "study" proceeding. However, should aggregation issues requiring a generic determination arise during the pendency of the proceeding examining gas purchasing and affordability issues, the issues may be addressed there.

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[1] Con Edison's Comments, pp. 2-3.

TRANSITION COST RECOVERY

Staff recommended that transition costs resulting from the implementation of FERC Order 636 be recovered in the following manner:

1. Unrecovered Account 191 Costs: All such prudently incurred costs should be assigned solely to the LDCs' sales customers and recovered through their gas cost adjustments.

2. Capital Costs: The recovery of these costs from LDCs' customers should be consistent with the allocations approved for the pipelines by FERC, who will likely follow traditional rate design cost allocation methodologies in assigning responsibility for their recovery.

3. Future Account 858 costs that become "stranded" will be addressed on a case-by-case basis by FERC, and recovery of those costs should be deferred until the FERC Orders allowing their pass-through to LDCs have been analyzed.

4. Stranded Investment: Because it is likely that most "stranded" facilities were installed before the inception of special marketing programs and the issuance of FERC's Order 436, when there was little transportation of customer-owned gas on interstate pipelines, it would be reasonable to allocate the recovery of any such costs that are passed through to the LDCs to both sales and transportation customers. Transportation customers should be assigned a per-unit (therm or ccf) charge that is equal to 50% of the per-unit charge being collected from core customers for stranded investment costs.

5. Gas Supply Realignment Costs: LDCs' transportation customers be assigned a portion of the responsibility for recovering gas supply realignment costs. The transportation customers' per-unit (therm or ccf) charge should be 50% of the per-unit charge being collected from core customers for gas supply realignment costs.

Brooklyn Union proposes that staff's recommendations be treated as guidelines that might be modified from case to case. Brooklyn Union is opposed to the recommendation regarding future Account 858 costs, arguing that they should not have been singled out for deferral and non-current recovery since they "will be billed by the pipelines under FERC-approved rates and allocations, and are not a material part of Order 636 transition costs."[1] Brooklyn Union recommends also that they should apply prospectively only, and "pending or approved rate settlements or existing orders that evidence reasonable consistency with these guidelines [should] not be modified or disturbed."[2] Brooklyn Union argues, finally, that there should be no reversals or rebillings of already-recovered costs.

Hadson supports allocating an equal share of Account 191 costs to both sales and transportation customers, while CPB takes the same position regarding stranded investment and gas supply realignment costs. Both parties contend that disproportionate recovery of those costs could artificially stimulate the demand for transportation, leading to a continuous shrinking of the sales base over which they would be spread. Con Edison agrees insofar as firm transportation customers are concerned, contending that staff's proposal would leave it at a competitive disadvantage vis-a-vis marketers.[3]

NYGAS, joined by Brooklyn Union, Central Hudson, and NFG, argues that any share of transition costs allocated to customers who pay flexible or negotiated value-of-service rates would be unrecoverable, because the market prices could not be increased to reflect an allowance for transition cost recovery. NYGAS argues, therefore, that a requirement that LDCs attempt to

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[1] Brooklyn Union's Comments, p. 18 fn 19.

[2] Id., p. 18.

[3] Con Edison also asked whether a transportation customer who takes back-up or standby service is subject to paying a full-share charge or a half-share charge. The staff proposal distinguishes services, not customers, so sales volumes (back-up and standby services) would be subject to the full charge while transportation volumes would be subject to the lower charge.

recover transition costs from market-priced classifications would violate FERC's requirement that LDCs be permitted to recover such costs in full from their customers. Con Edison contends that the same reasoning would apply to its interruptible transportation customers.

Multiple Intervenors argue (with Columbia University and Niagara Mohawk in general agreement) that transportation customers should not be allocated any portion of transition costs. Multiple Intervenors raise the following contentions:

1. Transition costs are being incurred to benefit firm sales customers. Transportation customers that continue to buy gas on the spot market not only are removed from the origin of gas supply realignment costs, they also are insulated from any benefits that will accrue from the pipelines' reformation. Accordingly, transportation customers should be insulated from the gas supply realignment costs incurred by the LDCs unless they have contracted for standby or back-up sales.

2. There is no causal relationship between transportation customers and the LDCs' incurrence of transition costs. The mere possibility that some transportation customers might be partly responsible for a single LDC's incurrence of gas supply realignment costs does not justify a transition cost surcharge on transportation customers.

3. Transportation customers already incur transition costs as part of the price they pay for upstream transportation. If gas supply realignment costs are recovered from all customers, transportation customers could be subject to a double recovery--once through the FERC-approved rate for firm or interruptible transportation on the upstream pipeline(s) and a second time through and LDC's transition cost surcharge.

Were the recovery of transition costs from transportation customers approved, Multiple Intervenors continue, there should be two additional conditions: (1) such customers should be entitled to a credit for all transition costs paid directly or indirectly to upstream pipelines; and (2) transition costs should be recovered as non-gas costs, in the same manner as any other increase to an LDC's revenue requirement, rather than on a volumetric basis.

With two exceptions, we shall approve the staff recommendations set forth above.[1] Multiple Intervenors argue correctly that transportation customers who pay directly for firm upstream pipeline capacity would be double-charged for transition costs without some revision to those recommendations. Accordingly, the LDCs will be required to exempt such customers from the collection of transition costs.

We agree as well with the various LDC parties who argue that any share of transition costs allocated to customers who pay flexible or negotiated value-of-service rates would be unrecoverable, because the market prices could not be increased to reflect an allowance for transition cost recovery. Such services will be exempted from transition cost recovery.[2]

The parties are reminded that a permanent determination of the allocation of transition costs has been deferred to this proceeding. Accordingly, the amounts to be recovered, pursuant to this decision, from the LDCs' various sales and transportation service classifications should be calculated as of the time each LDC first began recovering transition costs. All recoveries should be prospective and levelized; LDCs should not seek lump sums from customers who have not previously contributed to the

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[1] In particular, we agree with the recommendation that recovery of "stranded" Account 858 costs (for transportation and compression of gas by others) should be deferred until we have analyzed the FERC Orders allowing their pass-through to LDCs. Such pass-throughs will be addressed on a case-by-case basis by FERC.

[2] We disagree with Con Edison that the same reasoning would apply to its interruptible transportation service. The transition cost recovery recommended by staff is similar to take-or-pay cost recovery. Surcharges were imposed on transportation customers, because those customers' gas costs were low enough to allow them to bear take-or-pay costs. But such surcharges were not collected from customers of market-priced services.

recovery of their share of transition costs.

GAS PURCHASING

Standards for Review

The instituting order requested the parties to suggest standards for reviewing LDCs' gas purchasing practices. The parties responded by proposing three different approaches (with variations on each), namely, preapprovals, contemporaneous indexing, and *post hoc* prudence assessments. In its *Report and Recommendations*, staff proposed the institution of a proceeding to investigate the feasibility and desirability of adopting a performance-based gas cost recovery mechanism. The related issue of whether gas cost adjustments should be phased out would also be addressed in that proceeding. In the meantime, staff recommended that gas purchasing practices continue to be subject to prudence reviews, and should be judged on a total portfolio basis.

Central Hudson contends that "[i]t would be more sensible to defer any consideration of 'performance based' regulation for a time while the market forces emerge and are dealt with by all interested parties," because "[a]fter some time all parties will be in a much better position to identify the factors important to any potential 'performance based' mechanism."[1] Orange and Rockland does not oppose institution of the proposed proceeding, but claims the status quo has served customers well and argues that the feasibility and benefits of a performance-based review should be demonstrated before it is adopted. RG&E recommends that pre-approval should not be ruled out as a possible approach and should be examined in any subsequent gas supply proceeding. CPB supports a performance-based recovery mechanism, but appears to insist that it be based on a comparison among New York utilities.

We shall institute a proceeding for the purpose of evaluating and adopting standards and procedures for reviewing

[1] Central Hudson's Comments, p. 12.

gas purchasing practices and allowing the recovery of gas costs.[1] Although the parties will have considerable latitude to develop one or more incentive-oriented gas cost recovery mechanisms, they should understand now that proposals which merely reinforce the incentives served by existing gas-cost pass-through mechanisms (or, worse, prior approval of purchases) will not be entertained, and any LDC relying on their continuation would be imprudent. The parties should direct their efforts to examining proposals that do *not* assume purchased gas costs are uncontrollable and impervious to performance-related rewards and penalties.

Risk Management

The instituting order requested the parties to comment on how gas futures and other financial instruments could be incorporated into LDCs' supply portfolios as risk management tools. After reviewing those comments, staff concluded that there is no need for any special encouragement of the use of financial instruments as risk management tools. Staff advised that the effectiveness of such strategies should not be reviewed on a stand-alone basis, because financial hedging is only one tactic that could be used, in combination with others, to manage a supply portfolio whose total cost and reliability should be examined.

Brooklyn Union argues that, pending action on performance-based gas cost recovery mechanisms, we should permit the costs, benefits, gains and losses resulting from the use of risk management tools to be reflected in the cost of gas recovered through the GAC, subject to "traditional prudence standards measured by overall portfolio costs."[2] Niagara Mohawk requests further clarification about how we would measure the

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[1] Any policies or guidelines adopted in that proceeding will apply to all LDCs, including those that have already entered into multi-year rate plans. *See, e.g.,* Case 93-G-0996, supra, Opinion No. 94-21, mimeo p. 10.

[2] Brooklyn Union's Comments, p. 12.

results of using risk management tools and what penalties may be imposed if use of those tools "failed." SEO contends that "[a]bsent stated criteria for acceptable conduct in this area, it is very likely that utilities will not venture too far from previous approaches to supply portfolios."[1] SEO requests us to "indicate [our] desire to see the use of risk management tools in supply portfolios, and provide the guidance necessary to encourage such approaches."[2]

We agree with staff's recommendation. No particular endorsement, pro or con, will be given to the use of risk management tools and other financial instruments as part of a gas purchasing program, because any statement leaning one way or another will inevitably influence choices that should be based, instead, on reasonable assessments of costs and risks.

Statewide/Regional Procurement Entity

The instituting order requested the parties to comment on whether the establishment of a statewide or regional gas purchasing entity would result in purchasing efficiencies. Nearly all parties agreed that there are no efficiencies to be gained by establishing a regional gas procurement entity, and many agreed further that such an entity might adversely affect the marketplace by limiting the bidding process. Staff agreed with the consensus view, but also advised that emergencies or other special situations could arise in which it would make sense to have in place procedures that would facilitate the cooperative exchange of gas by LDCs and non-utility suppliers and marketers. Staff concluded that no action on this issue is needed now, but recommended that the issue be left open for further consideration, should subsequent events suggest a need to do so.

In its comments on staff's *Report and Recommendations,* SEO noted that the 1994 Draft State Energy Plan recommended that LDCs "should consider joint gas supply planning and joint venture

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[1] SEO's Comments, p. 6.

[2] Id., p. 7.

gas supply and pipeline capacity acquisitions as a means of reducing risk."[1] SEO argued that "*[a]t the very least* they should be explored before they are dismissed out of hand," and recommended that "the Commission require utilities to explore such opportunities and report specifically on the attributes and detriments to such an approach."[2]

Neither staff nor any of the parties has "dismissed out of hand" geographically-based joint purchasing arrangements. There is no need now for such arrangements, nor for the imposition on the LDCs of a study-and-report requirement. The conclusion reached in the *Report and Recommendations* is adopted.

METERING

Staff noted that real time metering is possible using modern standard metering technology that is available at a constantly declining average cost, and that several different types of equipment, produced by different manufacturers, are approved for use in New York for that very purpose. Staff recommended that the LDCs be required to use recording meters to measure gas flows under contracts requiring daily balancing, in order to minimize or completely avoid billing disputes concerning overrun takes of gas. While LDCs relying only on monthly balancing might not see a need to use recording meters, staff continued, they should be required to install them unless they can demonstrate the ability to withstand challenges to the accuracy of their balancing.

Con Edison, NYSEG, Niagara Mohawk, and Brooklyn Union argue similarly that, in Con Edison's words, "[t]ransportation customers should be made directly responsible for any additional metering and telecommunications costs required to provide such service, so that the cost of transportation service is not

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[1] Id., p. 7, citing Draft Plan p. 257.

[2] Id., p. 8.

subsidized by core customers."[1] In addition, Con Edison continues, "responsibility for implementing these programs may appropriately be shared by the marketers."[2] Con Edison also contends that "the need for recording meters is not limited to the implementation of daily or monthly balancing," because "[s]uch devices should be required for all non-core services subject to a daily overrun penalty or service turn-off, whether or not that service is also subject to balancing requirements."[3]

NYSEG contends that its three-year rate settlement agreement is unclear about whether the capital cost of recording meters would be recoverable as an Order 636-related cost under the rate adjustment cap. NYSEG submits that such costs should be considered recoverable under the settlement.

Columbia University argues that "[t]he installation of such meters is useless unless imbalance reports are sent out by the LDC on a timely basis and proper readings are made by the LDC."[4] Columbia University alleges that Con Edison has failed to do so for it.

Sunrise contends that "mandatory electronic metering device requirements . . . discourage customer choice." For example, Sunrise explains, "NYSEG currently requires transportation customers to install electronic metering devices, and by doing so effectively precludes small volume users from obtaining transportation service."[5]

Transportation customers will be required to have installed recording meters for accounts requiring *daily or monthly* balancing, except for monthly-balancing customers who (1) request in writing that less-expensive meters be used for their

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[1] Con Edison's Comments, p. 7 fn 6.

[2] Id., p. 6 fn 5.

[3] Id., p. 6 fn 4.

[4] Columbia University's Comments, p. 23.

[5] Sunrise's Comments, p. 4.

accounts, and (2) state, also in writing, that they are willing to accept the accuracy of their LDCs' balancing. The LDCs shall include proposed metering guidelines and associated charges in their compliance filings in this case.

AFFORDABLE SERVICE

Two parties, CPB and PULP, have discussed the issue of affordable gas rates in their comments on staff's *Report and Recommendations*. Their comments raise a number of issues:

1. How should "affordability" of energy service be defined?

2. What are the public policy arguments in support of setting "affordable" rates?

3. Who should the target population be for such rates? All core customers? Only core residential customers? Only low-income customers?

4. Is there a need for a funding mechanism to be set up to assist the targeted customer group(s)? If so, who should contribute to the fund? What should the criterion or formula be?

5. How does such a program fit in with other assistance programs now available to certain customer groups (*e.g.*, HEAP for low-income customers)?

6. What should be the process for dealing with the issue in *this* case?

The related concept of "universal service" is familiar to the telephone industry. This Commission's commitment to universal service has given rise to the current life-line program, and to a traditional general policy of maintaining low access charges for residential telephone customers.[1]

[1] The maintenance of low access charges reflected a policy of using cross-subsidies from toll services ("settlements") to offset the charges for services for which customer demand is relatively price-inelastic, while preserving cost-based rates for relatively price-elastic services.

"Universal service" is not a commonly used term in energy industries. Nevertheless, past cost allocation and rate design decisions have resulted in monthly "customer" (electric) or "minimum" (gas) charges that are below embedded or incremental costs of service. Moreover, low-income energy efficiency programs were established to help customers manage their own utility bills, as a way of keeping them as connected, and HEFPA provisions assure that customer deposits are not a barrier to taking service.

The order instituting this proceeding set forth seven principles that were "designed to foster consumer protection while maximizing competitive benefits."[1] Included among those principles were the following:

> "There will be a commitment to gas service for New York consumers, considering both customer need and economic feasibility.
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> "Rate shock to individual customer classes or groups must be avoided."[2]

These principles have some pertinence to the issue of "affordable service," but a more direct statement is warranted. Accordingly, we have adopted the following as the eighth principle to guide LDCs in the emerging competitive gas market:

> "Access to a basic and affordable package of gas services should continue to be provided to core customers."

To that end, we expect the LDCs to address the issue of assuring the availability of affordable service to core customers in the same proceeding in which we will review the LDCs' gas purchasing practices. We shall also review the LDCs' affordability-of-service proposals in that proceeding. We recognize that the restructuring of the gas industry resulting

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[1] Case 93-G-0932, supra, Order Instituting Proceeding, p. 5.

[2] Id., pp. 5-6.

from FERC Order 636 and state legislative mandates such as §66-d of the Public Service Law--a restructuring that has resulted in greatly increased reliance on a combination of competitive commodity markets and common carriage to meet customers' service requirements and a move to cost-based rates--presents a challenge for keeping the rates to core customers affordable. But we are strongly committed to this principle as the industry moves into a more competitive arena. Accordingly, we will assign an Administrative Law Judge to convene a prehearing conference in which the parties will establish a framework to have in place an "affordability plan" for our review within six months after the issuance of this Opinion and Order. At a minimum, we would expect the parties to address customer impacts in both the short term and the long term to assure that the transition to a more competitive industry is done in an economic and efficient manner. Issues that should be addressed include, but are not limited to, the establishment of firm price caps; lifeline rate approaches for low-income consumers; and adoption of measures to assure that any subsidies implicit in residential rates are assessed fairly to all competitors, using means such as "access fees." We would anticipate that interested parties come to the prehearing conference with a list of their issues and a plan to expedite this study.

TIMING OF IMPLEMENTATION

The LDCs shall file, within 60 days of the date of issuance of this Opinion, draft tariff leaves (not proposed tariff amendments) setting transportation rates for aggregation customers, establishing minimum transportation volumes, providing for transition cost recovery, and establishing requirements and charges for the use of recording meters, as provided for in this decision. Once those drafts have been reviewed and revisions, if required, have been ordered, the LDCs will then be authorized to submit proposed amended tariff leaves. The remaining policies and guidelines adopted in this decision shall be addressed in the LDCs' next general rate cases or in the proceeding established to examine gas purchasing and affordability issues.

The Commission orders:

1. Each gas utility subject to the jurisdiction of the Commission shall file, within 60 days of the date of issuance of this Opinion and Order, draft tariff leaves setting transportation rates for aggregation customers, establishing minimum transportation volumes, providing for transition cost recovery, and establishing requirements and charges for the use of recording meters, as required by this Opinion and Order. No utility shall submit amended tariff leaves until the draft leaves have been reviewed by staff.

2. Each gas utility subject to the jurisdiction of the Commission shall submit, in its next general rate case filing, proposals to implement the policies and guidelines adopted in this Opinion and Order, other than (i) those policies and guidelines that must be implemented pursuant to Ordering Paragraph 1; (ii) any other policies and guidelines for which implementation was or is proposed before that filing is submitted (*e.g.*, in a currently pending rate case or pursuant to an existing multi-year rate agreement); or (iii) the policies and guidelines pertaining to gas purchasing and affordability of service (and the related issues noted in this Opinion and Order), which shall be addressed in a new proceeding to be established by a separate order.

3. This proceeding is continued.

By the Commission,

(SIGNED) John J. Kelliher
Secretary