

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

CASE 90-G-0379 - Proceeding on Motion of the Commission to
Investigate the Impact of Bypass by Gas
Cogeneration Projects.

CLARIFICATION OF STATEMENT OF POLICY
REGARDING BYPASS OF LOCAL DISTRIBUTION
COMPANIES BY LARGE VOLUME USERS

Issued and Effective: August 12, 1991

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

COMMISSIONERS:

Peter Bradford, Chairman
Gail Garfield Schwartz
James T. McFarland
Henry G. Williams

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CLARIFICATION OF STATEMENT OF POLICY REGARDING
BYPASS OF LOCAL DISTRIBUTION COMPANIES BY LARGE VOLUME USERS

(Issued and Effective August 12, 1991)

BY THE COMMISSION:

On March 6, 1991, we issued a Statement of Policy
Regarding Bypass of Local Distribution Companies by Large Volume
Users (Policy Statement). The Policy Statement expressed our
intent that local distribution companies (LDCs) be free to
negotiate reasonable gas transportation contracts to preclude
uneconomic bypass, provided the contracts benefit the general
body of ratepayers and no undue discrimination results.

By petition dated April 18, 1991, Niagara Mohawk Power
Corporation (Niagara Mohawk) requests several clarifications of
the Policy Statement or, in the alternative, reconsideration.
Before turning to that petition, we consider two general matters
warranting comment.

GENERAL MATTERS

First, there should be no doubt that the pricing flexibility afforded by the Policy Statement is available only where bypass of the LDC is a real possibility. The policy was formulated to permit LDCs to respond to a competitive situation, and does not apply where customers lack alternative opportunities. Therefore, all implementing tariffs should include the potential for bypass as a qualifying criterion.

Second, contracts pursuant to the Policy Statement should be available only to customers using a minimum qualifying volume of gas.¹ Very large volume use is an underlying condition that enhances the likelihood of both bypass and below-average unit costs of service and offers more opportunities for contract trade-offs that could be beneficial to general ratepayers. We will not prescribe specific levels now, but they should be above-average, large-volume consumption levels. Each utility proposing to establish a negotiated contract tariff should include a qualifying transportation volume appropriate to

¹ We said as much in our recent conditional approval of tariff amendments for The Brooklyn Union Gas Company and in National Fuel Gas Distribution Corporation's rate case. The Brooklyn Union Gas Company, S.P.O. 90-G-0658 SP7, (issued May 10, 1991); Case 90-G-0734, Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of National Fuel Gas Distribution Corporation for Gas Service, Opinion No. 91-16 (issued July 19, 1991), mimeo p. 37.

its service territory and present justification for the selected level.

NIAGARA MOHAWK'S PETITION

Niagara Mohawk's requests for clarification fall into four broad areas: undue discrimination and comparability of customers; cost assignment; procedures for evaluating applications; and trade secret status for contracts. They are discussed in order.

Discrimination and Comparability

The Policy Statement requires LDCs to avoid undue discrimination and offer comparable terms to comparable customers. Niagara Mohawk asks for "clear and detailed guidance" with respect to the types of issues to be considered in comparing contracts, a definition of what would be considered "undue" discrimination by LDCs, guidance on how contract terms will be compared, and when differences in contract terms would be held unduly discriminatory.

Emphasizing that Section 65 of the Public Service Law prohibits only "undue" discrimination, Niagara Mohawk asserts that price differentials are not unduly discriminatory as long as they have a rational, if not necessarily cost-related, basis. The company would have us clarify that the Policy Statement grants LDCs the same ability as their competitors to price their service to meet the market and allows contract terms to differ due to such non cost-related factors as value of service, the customer's ability to bypass, and the customer's desired

schedules or perceived benefits of contracting with the LDC. It asks, as well, that existing contracts be allowed to stand without being compared to newer contracts negotiated under changed conditions.

As Niagara Mohawk itself recognizes, we cannot predict the specific terms that might or might not constitute undue discrimination.¹ Accordingly, we will clarify the policy only to make explicit that contract terms may differ to the extent the difference has a rational basis, whether in cost measurement, non-cost considerations, value of service, or other public interest considerations. Adoption now of more specific guidelines would require specifying extensive and inflexible methods for estimating all of the costs and benefits of every contract, when, in fact, comparability of customers and contracts can only be accomplished on a case-by-case review.

As for previously negotiated contracts, we expect them to stand and do not intend to revisit them. Nevertheless, such contracts may be renegotiated where the parties agree that application of current standards can offer mutual benefits to all.

Cost Assignment

The Policy Statement requires contracts to recover incremental costs of the projects, plus some reasonable contribution towards system costs. Niagara Mohawk requests

¹ Petition, p. 7,.

clarification of the level of costs to be attributed to a contracting large-volume customer, the method to be used in reviewing that attribution, and the extent to which the Commission will recognize non-rate benefits to ratepayers and intangible factors entering into contract negotiations. It urges that LDCs be allowed to contract for prices that recover only the cost of facilities constructed at the time service commences, with little or no contribution to system costs.

More specifically, Niagara Mohawk suggests that in some cases, incremental costs would be only those of a spur pipeline to a cogeneration project, and it expresses concern that "incremental" costs might be construed to include as well an allocated share of the LDC's costs all the way back to the city gate. It objects as well to what it sees as our unfair intention to deny rate recovery for the costs of future system expansions needed to serve additional load growth that could otherwise be served by capacity taken up by currently negotiated contract needs.

In addition, the company opposes requiring recovery of a contribution in excess of incremental costs, contending that puts the LDC at a greater competitive disadvantage and promotes bypass. That, in turn, would deny LDCs and ratepayers such benefits as flexibility, economies of scale, and potential peak-shaving. These benefits, it contends, are subtle but substantial and mean that a utility does not merely "break even" by setting prices at incremental cost without contribution. Insofar as the contribution requirement was intended as insurance against the

uncertainty of the actual level of service utilized, it says that insurance is better provided by requiring the contracting customer to commit to pay for minimum volumes and provide a bond or letter of credit as security.

The Policy Statement requires that contracts will recover all costs expected over the term of the contract, plus a reasonable contribution towards system costs. To the extent that service can be provided through the use of available existing system capacity or without utilizing any existing system, the total costs will be only the facility extensions or spur pipeline. But in considering the impact of the contracted service, incremental costs must be measured to include all additions, expansions or upgrades that will be required in order to initiate service, plus any future costs that can be expected because the negotiated service absorbed existing system capacity. If an LDC agrees to a long-term commitment of capacity, we expect it to forecast the full impact of that action over the term of the contract, and take into consideration all future costs that could be reasonably expected to occur as a result of the service being provided. We do not intend to deny rate recovery for future system expansions, but the LDC must be prepared to show that the costs of any such expansions were properly reflected in negotiated contracts to the extent they are attributable to those contracts, or that they could not have been reasonably expected or planned for at the time the contract was negotiated. Failing this criterion, the LDC would be at risk for rate treatment of future plant additions.

As to the required contribution in excess of incremental costs, the premise is that negotiated contracts will apply to very large throughputs of gas for extended periods of time, and it is not unreasonable to expect some contribution towards the system costs. Further, there must be recognition of uncertainty as to forecasts, estimates, and future changes in the industry. While rates and terms for general tariff service can be changed as conditions change, the negotiated contracts generally will not have that latitude, and an allowance must be built in from the beginning.

Niagara Mohawk correctly points out that ratepayers may derive other, less direct benefits from negotiated contracts. But those benefits do not obviate contribution; they merely affect its proper amount and explain, in part, why we have not specified a level of contribution. Some of these benefits will be measurable and factored into pricing terms; others may be more subjective; but all will be considered in evaluating contracts.

Procedures

Niagara Mohawk urges clarification that a hearing will be held in all instances in which the Commission is called upon to evaluate the relative merits of a bypass proposal and a competing proposal by an LDC; it contends that is implied by our

reference in the Policy Statement to "evidence" on the matter.¹ In addition, it cites the statement that an LDC "will be allowed to challenge the evidence only by submitting evidence of its own ability to serve and interest in serving the bypasser's requirements,"² and expresses concern over the implied limitation on the scope of the evidence the LDC may present. It suggests the standard should be one of public interest, as in Public Service Law, Section 68.

While evidentiary hearings may be warranted in some instances to resolve disputed issues of fact, other cases may lend themselves to decision on the basis of written submissions. Hearings will be convened only if and when necessary.

As for the scope of the LDC's evidence, we intended not to limit the evidence that might be presented, but to allow an LDC to challenge a bypass proposal only if it showed a bona fide desire to provide the service itself or demonstrated some other compelling interest. Once that standard is met, it may submit any relevant evidence.

Trade Secret Status

Niagara Mohawk argues that the terms of negotiated contracts should be afforded trade secret treatment. In its view, the filed contracts and the cost information behind the

¹ Policy Statement, p. 17.

² Id.

contracts should be exempt from disclosure pursuant to Public Officers Law, Section 87(2)(d) and 16 NYCRR, Section 6-1.3, in that the information is difficult to develop independently, is not generally known to others, and is worth a great deal in negotiations.

The company's concerns must be balanced against the public interest in avoiding undue discrimination. We will not now grant blanket trade secret treatment of filed contract terms; but parties are free to request confidentiality, on a case-by-case basis, of the cost estimates and operating considerations developed by utilities for use in negotiation.

By the Commission,

JOHN J. KELLIHER
Secretary

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

CASE 90-G-0379 - Proceeding on Motion of the Commission to
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ERRATA NOTICE

(Issued March 11, 1991)

An error appeared in the Commission's March 6, 1991
Statement of Policy in the above-referenced matter. The
title on the cover and inside title page of the Statement
of Policy should read:

STATEMENT OF POLICY REGARDING BYPASS OF LOCAL
DISTRIBUTION COMPANIES BY LARGE VOLUME USERS

A corrected cover and inside title page are attached
hereto.


JOHN J. KELLIHER
Secretary

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

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STATEMENT OF POLICY REGARDING BYPASS OF LOCAL
DISTRIBUTION COMPANIES BY LARGE VOLUME USERS

Issued and Effective: March 6, 1991

TABLE OF CONTENTS

	<u>Page</u>
Introduction.....	1
Threat of Bypass.....	3
Ramifications of Bypass.....	5
Status of LDCs.....	8
Competition.....	8
Flexible Tariffs.....	10
Certification Issues.....	14
Evidence Required.....	14
Conditions in Certificates.....	18
Conclusion.....	19

Appendix

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(ISSUED AND EFFECTIVE March 6, 1991)

INTRODUCTION

On July 3, 1990, we instituted this proceeding and invited comment on the effect of bypass by cogeneration projects on the gas operations of regulated utilities. (As used in this proceeding "bypass" refers to an arrangement under which an end-user receives gas by means other than through the facilities of a local gas distribution company (LDC or utility.)

We posed the following questions:

1. Is there a significant threat that utility transmission facilities will be bypassed by cogenerators owning and operating their own gas transmission pipelines?
2. May revenues be considered lost to the utilities by virtue of cogenerators owning and operating their own gas transmission pipelines?

3. Are there other opportunities that may be lost to the utilities?
4. How should any such losses be considered in certification proceedings involving those transmission facilities?
5. Should any such certificates be specially conditioned?

Comments were received from ten utilities that provide gas service in New York, including gas only and combination companies; eight parties involved with independent power production (IPPs); the New York State Energy Office; and the New York Power Authority. A list of commenting parties and their short designations is attached.

The comments suggest that the significant demand for natural gas by very large users, whether for cogeneration or other purposes, has created a potential for bypass. Its extent will depend in part on our policies and the actions of the LDCs and end-users. A level playing field, where LDCs have the ability to negotiate contracts for transportation service, and where end-users retain the ability to bypass LDC service if the public interest so warrants, will serve to reduce the likelihood of uneconomic bypass.¹ This statement of policy regarding bypass of LDCs by large volume gas users will establish

¹ Uneconomic bypass occurs when the cost of the bypass service is lower than the price that could be charged by the LDC, but higher than the cost to the utility of providing similar service.

guidelines applicable to utilities in dealing with large volume users and to end-users who seek authority to construct transmission facilities which would bypass utility service. We first review the comments responding to the questions we posed and consider their policy implications.

THREAT OF BYPASS

The Independent Power Producers of New York, Inc. estimated that approximately 5,000 MW of gas-fired cogeneration and independent power production are in some stage of development in New York. The State Energy Office agrees, estimating that 77 projects would require a gas supply of about 1200 MMcf/day, or 438 Bcf/year. SEO points out that an overwhelming percentage of this gas would be new usage, and it anticipates that most of the projects will be in operation by the mid-1990s.

NYSEG urges consideration in this proceeding of the effects of all bypass, not only that associated with cogenerators and IPPs. Similarly, Niagara Mohawk provided extensive comments on its perceived risk of bypass by cogeneration projects as well as large industrial customers in its service territory. Other utilities saw no immediate threat of bypass -- though they noted the potential threat -- or could not determine whether potential projects would have sufficient economic incentive to construct their own gas transmission facilities.

The IPPs and IPPNY expressed a willingness to use utility facilities -- existing or new -- to transport their gas. They added, however, that if LDCs cannot or will not provide

service on reasonable terms, end-users must be allowed to construct their own facilities.

The comments in general suggest a significant potential demand for natural gas by very large users. Prospective new customers, as well as existing industrial users, are exploring alternative sources of energy acquisition in order to lower operating costs. The likelihood that an end-user will bypass the LDC depends in part on the user's characteristics; the most likely bypass candidates are customers that consume large volumes of gas, at high load factors, at locations close to a pipeline. But the likelihood depends as well on the LDC's willingness and ability to compete in the transportation market. Indeed, the IPP commenting parties suggest few opportunities for bypass would exist if LDCs offered transportation at prices close to incremental costs, and RG&E sees no good reason why a customer should be able to bypass a utility at a cost less than the utility's actual cost to serve.

Emerging competition in the market for transportation of gas to large users necessarily entails the threat of bypass, which can sometimes make economic sense. On the other hand, uneconomic bypass could result in needless duplication of facilities and otherwise harm gas users. The policy we adopt must promote fair competition, without affording any competitor artificial advantages that skew the outcome.

RAMIFICATIONS OF BYPASS

The commenting parties generally agreed that if a cogenerator or IPP is allowed to construct a pipeline to serve its project, the LDC might lose potential revenue. They agreed as well that the extent of lost revenues cannot be reasonably estimated without examining specific cases. Hadson, accordingly, recommended that the Commission examine this issue on a case-by-case basis rather than in a generic proceeding, for the decision to bypass an LDC will depend on the perceived risks and rewards of the bypasser's energy options in both the short and the long-term.

IPPs and utilities disputed whether LDCs had rights to the lost revenues; SEO agreed with the IPPs that an LDC has no inherent right to serve natural gas customers in its service territory. The parties also disputed whether forgone revenues were properly considered "lost." Brooklyn Union noted that an LDC could put together a contract package that includes the LDC's sale of transportation service at a competitive price and its reservation of an inexpensive "peak shaving" gas supply from the cogenerator. Niagara Mohawk pointed out that bypass would simply encourage competition between LDCs and open access pipelines to serve industrial and cogeneration customers; and SEO commented that utilities are subject to lost revenues from conservation, fuel switching and self-generation in all service classifications and that bypass should be treated no differently than any of these situations. IPPNY and JMC questioned whether

transportation revenues not gained by an LDC as a result of a developer's construction, ownership, and operation of a pipeline to serve its facilities can be considered "lost." IPPNY suggested that an IPP's demand for gas and gas transportation is primarily incremental load that otherwise would not have existed, and these revenues and other opportunities are not lost but are "dispensed with" when LDCs are unwilling or unable to negotiate economic agreements. NFG expressed concern that a cogenerator's steam sales might displace existing gas sales of the LDC.

Other possible consequences of bypass mentioned in the comments include loss of other large volume customers (both existing and potential) and of opportunities to reduce peaking costs.

Concerns involving duplication of facilities, economies of scale, and load diversity were raised in some of the comments. Niagara Mohawk contended that bypass would reduce opportunities for LDCs to use their systems more effectively at peak time and thus promote greater use of existing facilities and reduce unit costs to all customers. LILCO maintained that bypass would deny it the opportunity to develop the least costly, most efficient system to serve its customers consistent with sound environmental and planning concerns. JMC acknowledged that bypass would limit a utility's opportunity to realize synergies or achieve economies that might result from diversity of loads, reliability of supplies, or other characteristics of the utility's and customer's operations.

Service to large customers provides various opportunities for an LDC. These opportunities include: (1) revenue generated by adding incremental load and/or retaining or replacing existing loads; (2) the potential ability to interrupt service to the cogenerator and use the capacity or gas supply to meet peak demands; and (3) use of the large volume load to help support expansion of gas service to new geographic areas that could not otherwise be economically served.

As to the first two items, it is likely that the retained and new loads will be of significant volume, but the comments all imply that the unit rate may have to be much lower than other tariff rates. The addition of a significant load could help an LDC exploit the diversity of demands in using its distribution system most efficiently. Further, if the actual acquisition of a customer's gas is negotiated in conjunction with service interruptions, the cost of meeting requirements of firm customers will be reduced. And the displacement of existing gas sales by cogeneration steam sales (of which NFG warns) would arise irrespective of the bypass issue.

Finally, the expansion of gas service into new service areas is limited by economic realities. Experience has shown that few expansions can be justified solely on the basis of residential and commercial loads. The extension of facilities to serve large cogeneration or industrial loads can mean new opportunities.

On the other side of the coin, bypass of an LDC could result in a potential savings to cogenerators. But while some of the fuel savings may be passed to electric ratepayers through lower buy-back rates, the buy-back contracts are generally negotiated before gas transportation service is arranged; and no connection between gas transportation rates and electric rates may be assumed.

A policy on bypass should give the certificate applicant and the utility the opportunity to enter negotiations on even terms in a competitive market. If they cannot reach agreement, they should be permitted to present fully developed competing proposals for the Commission's evaluation. Finally, the policy should provide for development of an adequate record to consider the public benefit of a certificate in the absence of competition.

STATUS OF LDCs
Competition

The commenting parties generally agreed that current regulatory policies place LDCs at a competitive disadvantage and that recent developments in the energy market warrant a comprehensive review of the regulatory changes necessary to permit LDCs to compete actively and successfully. They are concerned not only about the well-being of the LDCs themselves, but about the beneficial effects of vigorous competition on the market and customers. SEO for example, would encourage competition in the gas transportation market to "...strengthen

the economic viability of current gas-fired electrical generation projects and foster the economic development that can accompany the greater availability of a clean, reasonably priced fuel."¹ It maintains that such competition will favorably affect future rates. IPPNY favors competitive options for gas transportation because they will limit utilities' market power, encourage innovation and result in more efficient gas and gas supply transportation markets.

Open access on pipelines has created a competitive situation and encouraged large volume end users to explore options. Competition arises where end-users contemplate constructing and operating their own transmission facilities to connect directly to pipelines. They then must compare the rates of the LDC and the costs of direct ownership and operations. Regulatory policies should avoid unnecessarily impeding the LDCs' ability to compete in this market, for they may often be able to provide transportation service that will attract cogenerators and large industrial customers while still benefiting the general body of ratepayers. If utilities are afforded reasonable opportunities, the increased competition can yield economic benefits to the end-users, the ratepayers and the economy in general.

¹ SEO's Comments, p. 3.

Flexible Pricing Tariffs

To enable LDCs to respond to competition, many parties favored allowing transportation tariffs to include flexible pricing. LDCs would be permitted to negotiate individual contracts within that flexible rate structure. Niagara Mohawk complains that the Commission appears to have set a minimum contract transportation rate of \$.25/dt and that a uniform application of that minimum precludes successful competition by an LDC for transportation where the bypass would entail less than ten miles of new facilities. Rochester Gas and Electric Corporation, meanwhile, suggests that market-based competitive rates should be allowed, provided that incremental costs are covered. Brooklyn Union recommends that a rate be considered acceptable if it recovers, at a minimum, the carrying charges related to the capital costs and operating expenses incurred to attach and provide service to the customer on an annualized basis over the life of the contract, as well as a contribution to system costs.

The incremental cost of serving individual large loads will differ with circumstances. Service to some loads may involve only limited LDC facilities, while others may be located deep within distribution territories, long distances from supply pipelines. Further, as Brooklyn Union notes, existing transportation rates may not be suitable to address special considerations such as high load factors, higher pressure service

requirements, long-term arrangements, dual-fuel capability, and potential increased utilization of system capacity.

Because the potential size of the gas load and the location and operating characteristics of the customer can require individually tailored service contracts, LDCs will inevitably be disadvantaged in competing if they are unduly required to apply uniform rates and tariffs. To avoid that result, the LDCs should be allowed to negotiate lower rates as needed to participate in competitive markets, as long as those rates not only recover all incremental costs of service¹ but also contribute to overall system costs.² Of course, the statutory prohibition on undue discrimination would continue to apply, and comparable customers would have to be offered comparable terms. Introduction of this approach would serve the public interest by enhancing the LDCs' revenues and service and avoiding bypass that leads to unwarranted duplication of facilities.

¹ A relatively new factor, which utilities should consider, is the impact of new transportation service on take-or-pay costs or the benefit of spreading recovery of these costs over larger volumes.

² If a utility would "break even" in serving a new large volume customer, it could be argued that construction by the utility to serve this customer does not produce an adverse economic situation. However, in such a close call, the ratepayers should not be subjected to the risks associated with long-term commitments based on estimates.

Implementing this policy requires some guidance on how to define "cost" or "incremental cost" -- something none of the commenting parties attempted to do. Actual costs must be determined case-by-case, but certain principles should apply.

The costs should be measured or estimated on a total basis as expected over the life of the contract. While existing available capacity may permit serving some new loads with little initial utility plant investment, service to those loads may necessitate future capacity expansions to meet normal load growth¹ -- expansions that might be avoided if the large loads were not attached. Thus, in justifying negotiated rates, utilities must estimate all current and future incremental operating and capital costs expected over the life of the contract.

Another issue not addressed in the comments is the potential impact on gas supply management, system gas costs, and gas dispatch problems. Cogeneration will require integrating very large volumes of third party gas into the LDC systems. Current transportation tariffs require monthly balancing of deliveries into the system and end-user consumption, with certain carry-over provisions. The scheduling of large gas volumes for a single end-user could impair the LDC's ability to dispatch its

¹ The aggregate projects referenced by SEO and IPPNY would constitute new capacity requirements equal to 50% of current total use in the State.

own system gas. Further, the cost of providing balancing service is proportional to the level of imbalance volumes and the changes in utility gas supply costs during the balancing period. Under current tariffs the costs or benefits of the imbalance are assigned to firm ratepayers through operation of the Gas Adjustment Clause, but the huge potential volumes of IPPs will necessitate tighter control or assignment of associated costs to the responsible contracts. This is another cost consideration that must be recognized and estimated over the life of the contract.

The appropriate level of contribution to system costs will not be established now. Existing interruptible sales or transportation services commonly require floor contributions of \$.10/dt, but the type of contracts expected here may warrant considering other impacts or benefits. However, very small contributions may not be commensurate with the risks associated with long-term contracts and estimates, in which case ratepayers would be better off if service were not provided by the utility and bypass were allowed.

In order to implement the above policy, utilities will be permitted to file tariffs which specify the applicability and common terms and conditions of service, and general guidelines within which detailed terms could be negotiated on a case-by-case basis. Those filings will be subject to normal notice and comment rules. Negotiated contracts should be available to all potential customers that meet qualifying tariff criteria based on

factors such as volumes, load profiles, and interruptibility. Commission approval of the contracts will not be required, but all contracts, along with supporting explanations, estimates of costs, and impacts and justifications of rates and terms, must be filed with the Commission and available for public inspection. The filed material should be in adequate detail to constitute the utility's prima facie case in the event of challenges or prudence reviews.

CERTIFICATION ISSUES

Evidence Required

In franchise approval cases under Section 68 of the Public Service Law, the Commission is required to determine, after a hearing, that the exercise of the franchise is "necessary or convenient for the public service." For transmission lines governed by Article VII of the Public Service Law, the Commission is required to make specific findings before issuing a Certificate of Environmental Compatibility and Public Need to construct a fuel gas transmission line; the scope of the findings depends on various factors. With respect to gas transmission lines less than five miles in length and six inches or less in nominal diameter, the Commission must issue a certificate within 30 days if the filing complies with applicable requirements, unless the Commission finds substantial public interest requiring further review. In that event, it is required to find only that "construction...[of the line] will minimize or avoid adverse

environmental impacts to the maximum extent practicable."¹ For gas transmission lines shorter than ten miles but longer than five miles in length, or transmission lines shorter than five miles in length and greater than six inches in nominal diameter, the Commission is required to find:

- (1) the basis of need for the facility;
- (2) the nature of the probable environmental impact;
- (3) that the location of the proposed line will not impose an undue hazard to persons or property along the area traversed by the line;
- (4) that the location of the line as proposed conforms to applicable state and local laws; and
- (5) that the facility will serve the public interest, convenience and necessity (Public Service Law Sections 121-a(7), 126(1)(a),(b),(c),(f) and (g)).

In all other Article VII proceedings, the Commission is required to find as well that the facility represents the minimum adverse environmental impact.

NFG argues that the public need analysis under Public Service Law Section 121 should include: (1) how the proposed pipeline affects the LDC serving the area and its firm ratepayers; (2) whether the LDC could serve the customer; and (3) the amount of pipeline construction that would be avoided if the

¹ Public Service Law sec. 121-a(7).

LDC served the cogenerator. NYSEG maintains that the "public interest" under Section 126(1)(g) will not be served unless the pipeline seeking to serve an end-user is certificated with conditions that require it to conform to the rates and service obligations currently imposed on LDCs.

The LDCs argue as well that the Commission should consider the effect of a bypassing pipeline on the LDC's revenues. In sharp contrast, the cogenerators vehemently protest consideration in certification proceedings of the revenue impact on LDCs. SEO agrees that review of the revenue implications of bypass is appropriate, but only until the regulatory framework is in place to permit LDCs to successfully compete in the transportation market.

The purpose of any proceeding before the Commission is to determine what actions are in the public interest. Utilities have historically been protected from competing service providers within their service territories, and this protection has generally been accepted as providing the greatest public benefit by reducing costs, avoiding duplication of facilities, and making service widely available. But changes in the industry may sometimes make it more economic or feasible for end-users to bypass utility service, especially where a utility cannot or will not negotiate to provide service. Still, the public interest is best served by the avoidance of uneconomic bypass.

To reconcile the interests of LDCs and potential bypassers, and determine what outcome best serves the public

interest in each instance, we must have before us all evidence of the cost of proposed facilities, the relationship to gas service in the area and the adequacy of service to general service customers in the vicinity of the proposed facilities, and environmental and economic costs associated with any duplication of facilities. Since construction of a pipeline may affect the capacity to introduce gas service into new areas, an applicant must also present a plan for the development of general service in the vicinity of its proposed facility (by itself or in conjunction with a utility) or present evidence why such service should not be considered. A utility will be allowed to challenge the evidence only by submitting evidence of its own ability to serve and interest in serving the bypasser's requirements. A utility's evidence should include all incremental costs of providing service over the term of a potential contract, similar to that which would be required if a contract were agreed to and filed.

The specific issue of "lost revenues" or lost opportunities will not be considered a cost to be assessed on a bypass project, but rather as part of a utility-proposed alternative (capturing otherwise lost opportunities may serve to reduce the transportation rate that the utility could propose).

The evidence outlined above will allow a determination of the best method of meeting specific transportation requirements, taking account of the benefits of improvements or extension of service to the general public.

Conditions in Certificates

We requested comment on whether certificates issued to cogenerators to own and operate their own gas transmission pipelines should be specially conditioned. The parties sharply disagree, LDCs urging us to impose conditions on pipeline owners and cogenerators opposing certificate conditions. JMC questions the right of a utility to serve all new customers that locate within its service territory, and SEO states that certificate conditions should be imposed to prevent unforeseen losses of gas customers.

Oxbow sees no need to restrict pipeline construction by cogenerators. According to Oxbow, the cogenerator's pipeline does not usually duplicate an LDC's facilities, and the utility can compete more effectively for transportation service by offering a rate that is fair to both the cogenerator and utility. JMC and IPPNY would require an LDC contesting a certificate to demonstrate that it has made a bona fide offer to provide comparable service before special conditions are imposed in the certificate.

Con Edison recommends requiring a non-utility certificate holder to relinquish the right to receive service on demand from the bypassed LDC. NYSEG argues that a certificate authorizing construction of a pipeline by a cogenerator should authorize service only to the cogeneration facility.

There is no need for standard or "blanket" conditions applicable to all certificates. The evidence required above from

certificate applicants and utility intervenors will ensure a record to determine whether any special conditions should apply. Finally, Con Edison is correct that a customer who chooses not to use utility service as a primary provider should not have the right to demand service from the bypassed utility. However, utilities may wish to develop and offer standby or backup services at appropriate rates.

CONCLUSION

Our consideration of the comments received in this proceeding and the status of the natural gas market as it relates to large volume customers leads us to adopt a policy on gas bypass embodying the following points:

1. Utilities will be allowed to file large-volume gas transportation tariffs that establish applicability standards and general terms and conditions of service, and contain general guidelines for individually negotiated contracts for all qualifying end-users.
2. Contracts negotiated pursuant to the tariff shall recover all costs expected during the term of the contract (including future capacity expansions required for system growth that would not be necessary but for the contract service), plus a reasonable contribution toward system costs.
3. Negotiated contracts at similar overall terms shall be available to all similarly situated customers.

4. Incremental cost differences, including those occurring because of proximity to transmission facilities of the utility or interstate pipeline, afford a justifiable basis for distinguishing among customers within the classification.

5. Contracts negotiated pursuant to the tariffs shall be filed with the Commission, along with complete cost estimates, assessment of impacts, and justification for the negotiated rates and terms. Supporting material should be in adequate detail to constitute the prima facie case in the event of challenges. All filed material shall be available for public inspection.

6. A negotiated contract shall include recognition of costs associated with daily imbalance of end-user gas supplies. The utility shall submit a plan to integrate the end-user's gas supplies into system gas supply dispatch.

7. Applicants for certificates to construct and operate gas transmission facilities shall submit evidence on the cost of the proposed facilities, the adequacy of gas service to general customers in the vicinity of the proposed facilities, and environmental and economic costs associated with any duplication of existing facilities.

8. Where gas service is not available to the general public in the vicinity of the proposed facilities, a certificate applicant must present a plan for development of such service (by itself or other qualified party) or provide evidence why such service should not be considered.
9. A utility will be allowed to challenge the evidence in a certificate proceeding only on the basis of evidence of its own interest and ability to serve the bypassers' requirements.

By the Commission,

JOHN J. KELLIHER
Secretary

APPENDIX

Parties Submitting Comments

Utilities

The Brooklyn Union Gas Company
Columbia Gas of New York, Inc.
Consolidated Edison Company of New York, Inc.
Corning Natural Gas Corporation
Long Island Lighting Company
National Fuel Gas Distribution Corporation
New York State Electric & Gas Corporation
Niagara Mohawk Power Corporation
Rochester Gas & Electric Corporation
Syracuse Suburban Gas Company, Inc.

Short Designations

Brooklyn Union
Columbia
Con Edison
Corning
LILCO
NFG
NYSEG
Niagara Mohawk
RG&E
SSG

Independent Power Producers/Gas Suppliers

CRSS Capital, Inc.
Falcon Seaboard Power Company/North Country
Gas Pipeline Corporation
Goetz Energy Corporation
Hadson Power Systems, Inc.
Indeck Energy Services, Inc.
Independent Power Producers of New York, Inc.
J. Makowski Company, Inc.
Oxbow Power Corporation

IPPS
CRSS
Falcon Seaboard
Goetz
Hadson
Indeck
IPPNY
JMC
Oxbow

State Agencies

New York State Energy Office
Power Authority of the State of New York¹

SEO
PASNY

¹. Comments late-filed on December 18, 1990.