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NIAGARA MOHAWK

**GENERATION
BUSINESS GROUP**

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May 7, 1998

Mr. Ruben Brown, President
The E Cubed Company
201 West 70th Street
New York, NY 10023

FILES
C97-1-2162

**Re: PSC Case No. 97-F-2162
Bethlehem Energy Center
Your letter of April 23, 1998**

Dear Mr. Brown:

As a preface to a response to your letter of April 23, Niagara Mohawk is obligated, under our "PowerChoice" restructuring agreement with the New York Public Service Commission, to sell all of our non-nuclear generating plants, including the Albany Steam Station, in a competitive auction that will commence shortly. We are prevented under that agreement from having any financial interest, whether directly or through a subsidiary, in any generating plant in New York State, with the exception of Nine Mile Point Units 1 and 2. It is our goal to have successful bidders for our generating plants selected by the end of October 1998, and to financially close on the sales of the plants by the end of June 1999.

While the Bethlehem Energy Center (BEC) is being proposed by Niagara Mohawk, a regulated utility, we have been clear from the outset that we will not be the party to construct the project. We are seeking an Article X certificate so as to create an option for the future owner of Albany Steam Station to be able to build an efficient, combined-cycle, merchant plant. It is consequently anticipated that any certificate granted to Niagara Mohawk will be transferred to the party that purchases Albany Steam Station.

You are correct in stating that Niagara Mohawk's Article X application will be for a 723-MW power plant, an 80% increase from the plant's current 400 MW capacity. However, you are incorrect in stating that there will be a commensurate increase in peak fuel consumption. The current Albany units have an average peak cycle efficiency of 32%. The proposed units would have peak cycle efficiencies of 48%. So, while the plant's capacity would increase by 80%, peak fuel consumption would increase by only 20%.

The concept of interconnecting the project to not only the Tennessee Gas Pipeline but also to the CNG Pipeline was introduced in the BEC Preapplication Report. Given the proximities of both pipelines to the project site, interconnection with both pipelines is a reasonable option for maximizing

flexibility in the supply of natural gas to the plant. While the BEC Preapplication Report indicates that approximately 2.5 miles of offsite pipeline would have to be constructed to interconnect with Tennessee, the report does not indicate the pipeline size or routing, nor does it indicate the party that would construct and own the pipeline. This is because no agreement for interconnection of the proposed project with Tennessee had been reached by the time the report was prepared.

For the past several years Niagara Mohawk has been investigating ways of increasing gas deliverability to its gas-distribution system in the Albany area. As part of these efforts Niagara Mohawk has had ongoing discussions with both CNG Transmission Corporation and Tennessee Gas Pipeline Company. In December of last year, discussions with Tennessee produced a concept under which Tennessee would construct and own a pipeline spur to interconnect its interstate gas pipeline system to Niagara Mohawk's local gas-distribution system. Building upon that concept, in January of this year Niagara Mohawk and Tennessee further discussed sizing the spur for not only the demand of the local gas-distribution system, but also for the peak demand of the proposed Bethlehem Energy Center. The incremental effect of this provision would be to increase the diameter of the pipeline from 12 inches to 16 inches. The history of Niagara Mohawk's discussions with both Tennessee and CNG over the past several years demonstrates that the pipeline spur was not rationalized "as possibly benefitting the local LDC distribution system," but indeed had its genesis as an option for the gas-distribution system.

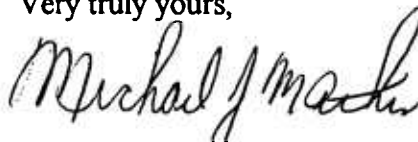
Niagara Mohawk and the Tennessee Gas Pipeline Company are currently in the process of developing an agreement for interconnection of our gas-distribution system with the Tennessee Pipeline. This agreement will not, however, cover the interconnection of the proposed power plant with the Tennessee Pipeline. A separate interconnection agreement between Tennessee and the future owner of the plant would have to be developed should that owner elect to interconnect with the Tennessee Pipeline. The objective of our discussions with Tennessee as they relate to the Bethlehem Energy Center has been to take advantage of present construction opportunities to avoid greater future disruptions and costs associated with interconnecting the Bethlehem Energy Center to the Tennessee Pipeline. Our discussions have not involved any commitments of upstream capacity or supplies of natural gas for the proposed power plant. Decisions on seeking pipeline capacity and natural-gas supplies are appropriately left to the future owner of the plant since Niagara Mohawk's objective is to create options, not binding commitments, for a future owner. Incidentally, we are also discussing service to the proposed project through CNG Transmission Corporation's system.

Your letter refers to Niagara Mohawk's "potential venture partner(s)/supplier(s)." Such characterizations are completely incorrect. In no sense is Tennessee Gas Pipeline Company a venture partner or a supplier for the proposed project. Indeed, in light of the fact that Niagara Mohawk's restructuring agreement calls for the complete divestiture of non-nuclear generation, it is impossible for us to take on a venture partner in this project. Tennessee's contemplated relationship with the proposed project is strictly that of an interstate pipeline company that would have a physical interconnection with the proposed power plant. The relationship involves no capacity commitments to or financial interests in the plant.

Construction of the proposed pipeline spur will be necessary to strengthen the deliverability of gas to Niagara Mohawk's gas-distribution system regardless of whether or not the Bethlehem Energy

Center ultimately receives an Article X certificate. Since Tennessee is the party that will construct and own the spur, it is the party with responsibility and legal standing for procurement of permits. Further, since Tennessee is an interstate pipeline company under the jurisdiction of the Federal Energy Regulatory Commission, the appropriate venue for authorization of the spur is before FERC. Nonetheless, Niagara Mohawk has committed to discussing in our Article X application the incremental impacts associated with the changes to the pipeline plans brought about by requirements for service to the proposed project.

Very truly yours,

A handwritten signature in black ink, appearing to read "Michael J. Mathis". The signature is written in a cursive style with a large initial "M".

Michael J. Mathis
Project Manager

cc: BEC Distribution List
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