STATE OF NEW YORK
DEPARTMENT OF PUBLIC SERVICE

Case 97-G-1380 In the Matter of Issues Associated with the Future of the Natural Gas Industry and the Role of Local Gas Distribution Companies.

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

DISCUSSION OF STRANDABLE COSTS

by

The Department of Public Service Staff

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BACKGROUND

As a part of its restructuring of the gas industry in 1996, the Commission allowed LDCs to assign responsibility for upstream capacity to customers converting to transportation service for a period of three years. In April 1998, the start of the third year, each LDC would have to demonstrate efforts taken to relieve itself of "excess capacity". Stranded costs would be addressed then.[1]

In September 1997, the Commission specified the actions that LDCs are expected to take to mitigate strandable costs and plan for competition, which were to be addressed in their April 1998 filings[2]:

(1) Assess the impact of marketers bringing their own capacity and quantify the resulting strandable costs.

(2) Evaluate and pursue options to address strandable costs. Explore alternative uses and quantify market values for the capacity that could be stranded by converting customers.

(3) Actively encourage competition including collaboration with marketers to expand the number of customers taking transportation service and to provide customer education.

(4) To the extent that LDCs cannot completely shed all the capacity as contracts expire, they should continue to seek lower cost options and more flexibility and shorter contract terms, where cost effective.

LDC April 1998 "EXCESS CAPACITY" FILINGS

Each individual LDC April 1998 Capacity filing is summarized in a separate document, Summary of LDC 1998 "Excess

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1 See "Order Concerning Compliance Filings", issued March 28, 1996, Case 93-G-0932. Strandable costs are measured as the difference between what an LDC must pay for capacity at FERC regulated rates and the lower value that capacity has on the secondary market.

2 See "Order Clarifying April 1998 Excess Capacity Filing Requirement", issued September 4, 1997, Case 93-G-0932.

Capacity" Filings. None of these filings comply with the requirements of the Commission’s September 7, 1997 clarifying order.

In general, the filings consist of descriptions of the LDCs unbundling programs and restatements of their comments on the issues raised in staff’s Position Paper on the Future of the Gas Industry. Instead of focusing on an analysis of how capacity requirements will change with customer migration and estimating the potential impact of such migration on strandable costs, the LDCs focused on issues such as POLR responsibilities, system reliability, load pockets and the need to retain capacity.

In general, LDCs did discuss options to address strandable costs but did not provide any quantitative assessment of the strandable costs associated with customer migration or any detail demonstrating that such options were actually being pursued. Further, they did not quantify market values for capacity that could be stranded.

STAFF’S ANALYSIS

The LDCs have not provided any quantitative assessment of the impact of customer migration if capacity were no longer to be assigned. Given this state of affairs, staff constructed a macro overview of potential strandable cost. This exercise was intended to provide a frame of reference for assessing the parameters of the problem, if indeed there is one, such that methodologies to address it may be formulated. The analysis was for internal use and was not intended to be a definitive statement on the issue.

The assessment concluded that stranded costs do not appear to require special consideration until the 2002-2008 time frame and are concentrated in the greater New York Metropolitan area. Therefore, the parties are provided with a window of opportunity to address innovative financial and other actions to mitigate the impacts. For instance, instead of "real time" recovery of stranded costs, a longer recovery period which would recoup the costs as customers reap the benefit of restructuring may be more acceptable. The possibility of contract restructuring or buyouts may also be an economically efficient solution in some cases.

If upstate LDCs do not renew pipeline contracts upon expiration, stranded costs will not be created. However, for a variety of reasons, including system reliability, providing balancing service and the lack of a mature marketing infrastructure at this time, LDCs will need to formulate a strategy to determine those assets they need to retain in both the short and long term.

The resolution of downstate and upstate capacity issues cannot be developed in a vacuum; all parties need to participate and bring their collective knowledge to bear on the problem. Since each company's situation would vary, a generic format does not seem productive. Instead, individual company negotiations appear to be the most efficient way to proceed.