STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

Proceeding on Motion of the Commission to Review the Appropriateness of the Value Added Charge for Natural Gas Utilities of New York State

Case No. 15-G-0469

COMMENTS OF NIAGARA MOHAWK POWER CORPORATION D/B/A NATIONAL GRID, THE BROOKLYN UNION GAS COMPANY D/B/A NATIONAL GRID NY AND KEYSPAN GAS EAST CORPORATION D/B/A NATIONAL GRID

In 2014 and 2015, Niagara Mohawk Power Corporation d/b/a National Grid ("Niagara Mohawk"), The Brooklyn Union Gas Company d/b/a National Grid NY ("KEDNY") and KeySpan Gas East Corporation d/b/a National Grid ("KEDLI") (collectively "National Grid") filed proposed tariff amendments to revise tariff provisions for gas service to electric generators and cogeneration facilities (Case Nos. 14-G-0315, 14-G-0316 and 15-G-0246). The tariff filings included a proposal to allow for the reduction of the Value Added Charge ("VAC") in order to cap non-core electric generators' total delivery rates at the otherwise applicable interruptible delivery rate. In response to comments by a Niagara Mohawk electric generator customer asking the Commission to revise the VAC calculation methodology, particularly as applied to generators operating as peaking facilities, the Commission's order approving National Grid's tariff modifications directed that a formal proceeding be initiated "to review the appropriateness of the value added charge for natural gas utilities of New York State" and invited comments.[1]

National Grid agrees with the Commission that the time has come to reexamine the VAC and its impact on rates for electric generators. National Grid believes the VAC remains necessary in

[1] Case 15-G-0246, *Tariff filing by Niagara Mohawk Power Corporation d/b/a National Grid to establish a new provision to cap the overall transportation rate charged under Service Classification No. 14 – Gas Transportation Service for Dual Fuel Electric Generators contained in P.S.C. No. 219 – Gas*, Order Approving the Tariff Amendments with Modifications, Ordering Paragraph 2 (Issued and Effective July 17, 2015).

order to share with firm customers the benefits electric generators realize from having access to natural gas through the utilities' local distribution systems.[2] National Grid acknowledges, however, that the current VAC calculation methodology results in undesirable price volatility and unintended price differentiation among electric generators. National Grid recommends that the Commission convene a collaborative to consider modifications to the VAC calculation methodology, and submits the following comments:

I. Background

The VAC originated in the Commission's 1999 "Generator Order,"[3] which directed gas utilities to develop standard tariffed rates for gas service to electric generators and which set forth rate components, including a value component that would share with gas ratepayers a small portion of the profit that electric generators realize when wholesale electric prices increase relative to gas prices. The Generator Order directed that the VAC would be triggered by an increase/decrease in the spread between the cost of gas and electricity[4] known as the "spark spread." The Generator Order also required that the VAC be "real time" and be calculated at least daily.[5] In a later order regarding the VAC calculation methodology, the Commission directed that the VAC be set annually at a fixed level based on the spark spread for the prior year, and then, at the end of the year, reconciled against the actual spark spread in order to accomplish the "real time" requirement set forth in the Generator Order.[6]

---

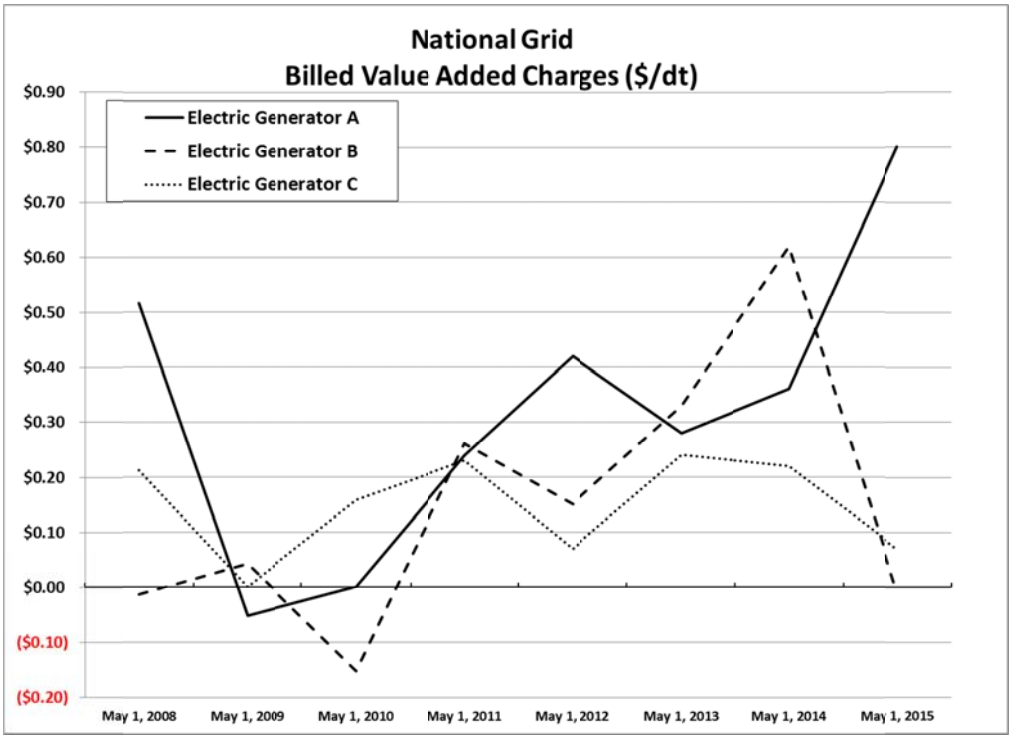
[2] Under National Grid's current rate plans, transportation margins from power generator, including the Value Added Charge and other tariff charges, are generally credited to firm gas customers.
[3] Case 98-G-0122, *Proceeding on Motion of the Commission to Review the Bypass Policy Relating to the Pricing of Gas Transportation for Electric Generation* (Issued and Effective March 17, 1999).
[4] Generator Order at 5.
[5] Generator Order at 4.
[6] Case 03-G-1392, et al., *Ordinary Tariff Filing of the Brooklyn Union Gas Company d/b/a KeySpan Energy Delivery New York to simplify the methodology for calculating the value added charge for Service Class 20 – Transportation Service for electric generation*, Order Approving Staff Proposal at 6-7 (Issued and Effective November 23, 2005).

II. VAC Calculation Methodology and Results

The total VAC rate billed to electric generators consists of three key elements: (1) the VAC calculated from the prior calendar year's spark spread; (2) an annual VAC reconciliation adjustment; and (3) a residual VAC imbalance adjustment. The VAC is determined for each electric generator based on the hourly spark spread in effect each hour the generator burns gas over the year. This hourly spark spread is applied to the electric generator's associated hourly gas usage to determine an average annual VAC. An adjustment is made to account for the estimated heat rate of the electric generator based on a simple proxy that differentiates heat rate by the technology used to generate electricity. This calculated VAC is then used as a proxy for the upcoming 12-month period (May 1st to April 30th) and is billed to the generator regardless of the "actual VAC" in effect during that time, which cannot be known until after the fact. The annual VAC reconciliation adjustment trues-up any difference between the VAC that was billed and the actual VAC during that billing period. Any residual VAC balance resulting from the implementation of the prior period's annual reconciliation adjustment is then rolled into the current VAC rate.

In National Grid's experience, the existing VAC calculation methodology has resulted in an unpredictable range of VACs across customers and volatile price swings from year-to-year for individual electric generators. Since first implemented nearly eight years ago, the VACs billed to electric generators by National Grid's downstate companies have ranged from a low of a $0.15 per dekatherm credit to high of a $0.80 per dekatherm surcharge. It is not uncommon for an electric generator's VAC to vary up and down by more than $0.25 per dekatherm each year.

Table 1: Sample VAC Billing for Generation Customers



A key driver of this volatility is the annual reconciliation adjustment, which is often very large and can swing either way (*i.e.*, a charge or credit). Despite the rigor and precision employed to compute the VAC from actual hourly spark spread and hourly gas usage data, the VAC rate charged to electric generators is often influenced more by the annual reconciliation adjustment than by any other factor in the calculation, including the spark spread. Using the prior year's VAC as a proxy results in large price discrepancies because the underlying drivers of the VAC, including gas and electricity prices, weather, electricity demand and gas fuel use, are not predicated on the past and may change significantly from year to year. This variability causes the actual VAC to differ from the prior year's proxy that is invoiced to the electric generators, which may result in a large annual reconciliation adjustment. Furthermore, it is not

uncommon for the annual reconciliation adjustment to result in a credit that completely offsets the calculated spark spread and results in a net VAC credit that can be substantial.

The Company finds that additional volatility may also result from the collection of the annual VAC reconciliation adjustment and the residual VAC imbalance that results from an over or under collection of this adjustment in prior periods. Because of the year-to-year variability in the electric generator's gas use, it is not uncommon for National Grid to significantly over collect an annual VAC reconciliation adjustment factor and to end up with a residual VAC imbalance that far exceeds the amount it sought to eliminate in the first place.

The VAC calculation methodology also seems to disadvantage peaking generators, which generally operate only when electric demand is high and the price of electricity is at a premium to the cost of gas (*i.e.*, higher spark spread). These generators are more likely to pay a higher VAC, which can negatively impact their economics as compared to a base load facility.

III. The Commission Should Retain the VAC But Modify the Calculation Methodology

The Commission should retain the VAC because electric generators benefit from access to gas distribution systems that are predominantly paid for by utilities' firm gas customers but pay delivery rates that are discounted compared to those of the firm gas customers. The economic benefits of gas for generators can increase significantly when the price of electricity is much higher than the price of gas. Accordingly, the Commission should revise and simplify the VAC calculation so that the VAC continues to compensate firm customers for generators' access to gas but at a level that is more uniform and stable to provide greater price certainty to electric generators, and to strike the balance that the Commission originally contemplated in establishing tariffed rates for electric generators.

The Company offers the following suggested framework for purposes of modifying the VAC:

- Reduce year-to-year volatility.
    - Consider using an average VAC developed from three to five years' experience.
- Eliminate the price differentiation between the base load and peaking units.
- Increase the number of proxy heat rate tiers and/or introduce flexibility in application of the existing tiers to differentiate by generation technology.
- Eliminate the annual reconciliation.
- Simplify the VAC calculation so that it is easier to audit and validate.
- Consider calculating the VAC using forecast rather than historical spark spreads.
    - Rely on publicly-available commodity forecasts of natural gas price forward curves to determine forecasted gas inputs and/or use locational-based marginal pricing for the electric price inputs.

The Commission should consider whether abandoning the "real time" requirement might be helpful to achieve the above-listed goals. National Grid recommends that the Commission convene a collaborative in order to develop a revised VAC calculation methodology.

Respectfully Submitted,

/s/ *Katherine E. Smith*

Katherine E. Smith
Senior Counsel
National Grid USA
1 MetroTech Center
Brooklyn, NY 11201
Katherine.Smith@nationalgrid.com
(t) 929-324-4502

Dated: November 16, 2015