STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

OPINION NO. 99-1

CASE 97-G-0388 - Complaint of New York City Energy Group Against The Brooklyn Union Gas Company Concerning Gas Service to New York City Energy Group's Proposed Cogeneration Facility.

OPINION AND ORDER PRESCRIBING TERMS FOR GAS TRANSPORTATION SERVICE

Issued and Effective: February 3, 1999

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APPEARANCES

FOR DEPARTMENT OF PUBLIC SERVICE STAFF:

Saul A. Rigberg, Staff Counsel,
Three Empire State Plaza, Albany, New York 12223-1350.

FOR NEW YORK CITY ENERGY GROUP, LP:

Cohen, Dax & Koenig, P.C. (by John W. Dax, Esq. and
Richard B. Miller, Esq.), 90 State Street,
Albany, New York 12207.

FOR THE BROOKLYN UNION GAS COMPANY:

Cullen & Dykman (by Jospeh P. Stevens, Esq.),
177 Montague Street, Brooklyn, New York 11201.

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COMMISSIONERS:

Maureen O. Helmer, Chairman
Thomas J. Dunleavy
James D. Bennett

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BY THE COMMISSION:

INTRODUCTION

This order addresses a dispute between The Brooklyn Union Gas Company (Brooklyn Union or the utility) and New York City Energy Group (NYCEG). Pursuant to Public Service Law (PSL) §66-d, the Commission has the authority to establish the terms and conditions relating, among other things, to the transportation by a utility of gas owned by a consumer.

In March 1995, NYCEG began negotiating with Brooklyn Union to arrange for gas to be transported to a planned electric cogeneration facility at the Brooklyn Navy Yard.[1] After negotiations proved fruitless, a complaint was filed by NYCEG. As a consequence, hearings were held in January 1998 before Administrative Law Judge Robert Garlin. By order issued April 14, 1998[2] (the April Order), we established rates for gas

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[1] Thereafter NYCEG abandoned its plans to construct a cogeneration facility and instead plans to construct a "merchant" power plant.

[2] Case 97-G-0388, Order Concerning Ratemaking Issues (issued April 14, 1998).

transportation service to be provided NYCEG by Brooklyn Union. We also indicated our expectation that the parties would undertake to execute a precedent agreement for such gas transportation within 60 days of the order or risk having contract terms prescribed. The parties, despite our preference that these contractual terms be resolved via negotiation, and despite the efforts of Judge Garlin, have been unable to conclude such an agreement and have referred a number of contract terms to us for resolution.

The position of NYCEG is summarized in a brief dated September 1, 1998. Brooklyn Union responded in a reply brief dated September 14, 1998. Subsequently on September 21, 1998, the parties entered into an agreement resolving certain of these issues. The remainder are addressed below.

In reaching our determinations, we have adopted several decisional guidelines. These are as follows:

1. The integrity of Brooklyn Union's system is considered inviolate in all circumstances;

2. Competition should be fostered wherever practical or whenever ratepayers are better served by competition;

3. Brooklyn Union and its ratepayers should be at risk for some expense in connection with the conclusion and execution of a contract since both will benefit if a gas transportation contract is consummated and a facility is constructed; and

4. An existing gas transportation contract for service to the adjacent Brooklyn Navy Yard Cogeneration Partners project is not dispositive with respect to all of the issues herein.

The unresolved issues between NYCEG and Brooklyn Union pertain to three agreements[1] that would be required to establish gas transportation service. Some issues pertain to two or all three of the agreements. Such issues are discussed the first time they arise, and there is a notation that their resolution affects one or both of the other agreements.

Finally, a number of issues, some of which are uncontested, are set forth in an Attachment. The remaining issues in the Attachment are relatively minor ones where one party has taken a further position and the other party has not responded. In those instances, silence is treated as acquiescence.

PRECEDENT AGREEMENT

Effective Date

In the April Order, we stated that "NYCEG's eligibility to receive transportation service at rates meeting the guidelines established in this order will be subject to the condition that NYCEG's planned facility must begin commercial operation within 30 months following the date of execution of a service agreement."[2] While the order directed the parties to execute a precedent agreement (PA) within 60 days (subject to extensions), that requirement was not intended to fix an effective date for the PA.

The draft PA given NYCEG--a mark-up of Brooklyn Union's agreement with the Brooklyn Navy Yard Cogeneration Project (BNYCP)--sets forth an effective date of July 1, 1998.[3] The draft delivery agreement (DA) sets forth a commencement date of January 1, 2001.

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[1] A Precedent Agreement, a Delivery Agreement and a Facilities Construction and Reimbursement Agreement.

[2] April Order, p. 25.

[3] PA, p. 1.

NYCEG's position is that the effective date of the PA should be the date it is executed by the parties. NYCEG argues that "Brooklyn Union's proposal to employ July 1 appears to have been chosen merely to place pressure on NYCEG to agree to Brooklyn Union's proposal."[1] NYCEG argues similarly that the commencement date of the DA should be changed to the date 30 months following the date on which the PA is executed.

Brooklyn Union argues in response that "NYCEG would have the Commission reward it for its unwillingness to accept terms comparable to the BNYCP transaction . . . by extending the 30 month option period until some unspecified date NYCEG may choose to execute the contract document envisioned by the Order."[2] Brooklyn Union adds that it has proposed "to relax the requirement for commercial operation so long as NYCEG executes a Delivery Agreement and assumes responsibility for minimum billing obligations at any time prior to the end of the 30-month period."[3]

The establishment of a date certain for commercial operation would effectively eliminate NYCEG's ability to negotiate with Brooklyn Union on an equal footing. The utility offers no reason why its, or the public's, interest would be disadvantaged if NYCEG's position were adopted. Moreover, Brooklyn Union's position is at odds with the April Order which provides only that "NYCEG's planned facility must begin commercial operation within 30 months following the date of execution of a service agreement."[4] Accordingly, the effective date of the PA should be its date of execution. But, because it would not be in the public interest to allow compliance with this

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[1] NYCEG's Brief, p. 1.

[2] Brooklyn Union's Reply Brief Concerning PA Issues, p. 2.

[3] Id.

[4] April Order, p. 25.

order to be prolonged, the 30-month period should begin to run not later than 45 days from its effective date.[1]

Milestones

1. General

The PA introduces a series of interim deadlines ("milestones") within the 30-month period between execution of the PA and commercial operation. Those deadlines are described as "conditions precedent" that must be fully satisfied or waived for the execution of the facilities construction and reimbursement agreement (FCRA) and the DA.

NYCEG points out that we previously refused to adopt milestones, but nevertheless accepts as reasonable a milestone of eight months before the end of the 30-month period,[2] for the finalization of plans and the commitment of funds for Brooklyn Union construction.[3]

Brooklyn Union argues that additional milestones need to be specified in the PA, and it contends that the performance required from NYCEG to meet those milestones would consist of "minimal evidence of progress in 'development' within the first 17 months" of the 30-month period. If such evidence cannot be provided, Brooklyn Union continues, it "ought to have the option to remove the encumbrance on the capacity that would otherwise have to be reserved for the NYCEG proposal . . . ."[4]

In the April Order we considered and rejected the concept of project milestones "because their attainment could be

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[1] If we find that Brooklyn Union is hamstringing compliance, we shall waive this requirement and we may consider a revenue imputation in Brooklyn Union's next rate case.

[2] Elsewhere in its comments, NYCEG describes this milestone as falling within six to ten months from the end of the 30-month period.

[3] NYCEG's Proposed Amendment to PA, p. 4, paragraph (d).

[4] Brooklyn Union's Reply Brief Concerning PA Issues, p. 4.

frustrated due to nobody's fault."[1] The justification offered by Brooklyn Union is insufficient to reverse that determination, especially since NYCEG is agreeable to a significant milestone, eight months before the end of the 30-month construction period.

2. Commission Action

The PA anticipates that 60 days after its filing with us one of the following actions will ensue:

a. Authorization of the PA, FCRA, and DA in accordance with their respective terms and without the need for further waivers or approvals.

b. A decision not to disapprove the PA, FCRA, and DA.

c. A determination that there is no need for waivers, approvals, or authorizations, accompanied by no action to disapprove or reject any of the agreements or their provisions.[2]

NYCEG argues that "[b]ecause the contracts executed by Brooklyn Union and NYCEG will be the product of a Commission Order, there is no reason to make subsequent Commission approval a condition precedent . . . ."[3]

Brooklyn Union responds that its tariff does not authorize service to a NYCEG facility at the unique rates and terms set out in the contract documents. Brooklyn Union contends that "[a]uthority to effectuate and perform the unique construction arrangements and transportation service contemplated in this proceeding . . . must be expressly granted by the

[1] April Order, p. 25.

[2] PA, p. 3.

[3] NYCEG's Brief, p. 1.

Commission, and may or will require waivers of the Commission's regulations."[1]

In this case, we will exercise our authority to review, and, if necessary, condition the contract to be executed by Brooklyn Union and NYCEG. Because our responsibilities under the Public Service Law include protection of the public interest, the possibility of subsequent Commission action must be acknowledged by the parties.

3. Upstream Transportation Contracts

The PA would require Brooklyn Union to give NYCEG at least 45 days' prior notice of the date the interconnection between Brooklyn Union and NYCEG is ready for service. NYCEG, in turn, would have until 30 days before the "ready" date to provide "binding contractual arrangements acceptable to the company by which [NYCEG] has entered into upstream pipeline transportation agreements."

NYCEG argues that Brooklyn Union should not have the prerogative to approve NYCEG's transportation agreements, or otherwise condition its performance on the provision of "acceptable" contracts. NYCEG contends that Brooklyn Union is adequately protected by the DA's provisions for security deposits, minimum bills, demand charges, and imbalance penalties.

Brooklyn Union responds that it needs to retain a milestone related to NYCEG's upstream transportation arrangements, because NYCEG "would be a relatively large load on Brooklyn Union's system, characterized by a firm service obligation much of the year."[2] Brooklyn Union states that it would be willing to revise the milestone so that commercially sensitive provisions are redacted for the copies of the upstream transportation contracts. Brooklyn Union states further that it would agree that NYCEG need provide only a copy of each binding

[1] Brooklyn Union's Reply Brief Concerning PA Issues, p. 5.

[2] Ibid., p. 6.

upstream agreement under which NYCEG will tender gas at the DA's receipt points in a manner adequate to perform NYCEG's obligations under the DA.

The modifications offered by Brooklyn Union seem adequate to address NYCEG's concerns. In particular, there is no longer a requirement that binding contractual arrangements be acceptable to the company. Accordingly, NYCEG should provide such contracts, with their commercially sensitive provisions redacted, 30 days before implementation thereof.

4. Extensions of Deadlines

The PA provides that if a condition whose deadline is not met pertains to NYCEG's gas supply or transportation arrangements, conveyance of land rights, or commencement of facilities construction, NYCEG must pay Brooklyn Union $30,000 for each month's extension to one or more of the deadlines.[1] NYCEG argues that the special provision's applicability "should be limited to extensions requested in either the milestone for the commencement of Brooklyn Union's construction activities or the in-service deadline."[2] (However, NYCEG proposes to modify the PA so that the special provision would apply only to the deadline for NYCEG's conveyance of land rights to Brooklyn Union.)

Brooklyn Union responds that "the maintenance of an economic incentive for timely performance is just as valuable here as it was in the BNYCP contract." Brooklyn Union characterizes the special provision as an incentive "for NYCEG to make basic development decisions in time to allow Brooklyn Union

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[1] The same $30,000 amount would be owed regardless of whether one, two, or all three of the deadlines were extended through a given month. The payments for deadline extensions would either be credited against NYCEG's payment obligations under the DA, once NYCEG's facility was constructed and put into service, or retained by Brooklyn Union, were NYCEG's project to be cancelled.

[2] NYCEG's Brief, p. 3.

to (i) plan and construct its service facilities in the normal course of business and (ii) review NYCEG's upstream contracts in time to prepare to initiate service."[1]

To the extent NYCEG's actions are untimely and preclude Brooklyn Union from being able to fulfill its obligations reasonably, it will be NYCEG that suffers, except where the commencement of Brooklyn Union's construction activities are concerned. Accordingly, this provision should be retained only insofar as it pertains to the commencement of construction.

Termination Payment

The PA and DA would require NYCEG to pay Brooklyn Union $608,898 if NYCEG or an affiliate "enters into a buyout or similar agreement, or otherwise takes any action which results in the [power plant] no longer being developed, constructed or operated."

NYCEG disputes Brooklyn Union's calculation of the termination payment, which is based on the ratio of its proposed cogeneration plant's maximum daily quantity (MDQ) to BNYCP's MDQ, arguing that the correct amount is $558,423. Brooklyn Union disagrees, arguing that the correct MDQ was used in the calculation.

Beyond that dispute, NYCEG asserts there should be no provisions for a termination payment. NYCEG calls imposition of the payment "an abuse of the utility's monopoly position," and argues that it "sends the wrong signals to would-be entrants into the new competitive wholesale electricity market and drives up the capital costs of building new generating sources." Because NYCEG would pay all incremental capital costs and operation and maintenance expenses directly, and would incur demand charges and a minimum bill, NYCEG contends that Brooklyn Union "cannot claim that it has undertaken any risk associated with a termination by

[1] Brooklyn Union's Reply Brief concerning PA issues, p. 9.

NYCEG of its facility plans."[1] NYCEG argues further that BNYCP's willingness to accept a termination payment should not create an obligation for NYCEG, because BNYCP's plant was developed as a "PURPA QF"[2] with an obligatory customer (Consolidated Edison) while the NYCEG plant would be a merchant plant.

Brooklyn Union responds that the termination payment is an important part of the BNYCP agreement, and must therefore be included in the NYCEG agreement "to meet any rational application of the comparability standard employed in the Order." Brooklyn Union argues that the termination payment in the BNYCP contract is "a stipulated amount to compensate for costs, and loss of economic expectations and opportunity under [the delivery agreement] arising from a voluntary buyout or cancellation of the BNYCP contract." Furthermore, the utility contends that NYCEG's proposed project "has higher initial and ongoing risk of project abandonment since there is substantial concern whether a project sponsor will be found, financing attracted and generating facilities constructed within the [30-month] period, and thereafter whether the project will be viable over the contract term."[3]

Brooklyn Union and its customers are not at risk for NYCEG's failure to construct or operate the facility. And, Brooklyn Union cannot reasonably expect to be compensated for the loss of economic expectation and opportunity because it does not have capacity constraints and could contract with other parties, as well as NYCEG. Moreover, since Brooklyn Union will realize a profit as a result of construction and operation by NYCEG, it

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[1] NYCEG's Brief, p. 2.

[2] Public Utility Regulatory Policies Act--Qualifying Facility.

[3] Brooklyn Union's Reply Brief Concerning PA Issues, p. 7.

should be prepared to absorb some increased risk.[1] However, Brooklyn Union to date has expended a significant sum in an effort to negotiate a contract (largely for counsel fees). For that reason, a limited termination fee of $300,000 is warranted.

Another provision of the PA at issue states that Brooklyn Union's recourse for claims under the PA is limited to NYCEG itself, except in the case of a termination payment. Should "buyout or other funds" be "paid directly to an affiliate of a partner in" NYCEG, Brooklyn Union would be entitled to seek recovery of a termination payment from that affiliate. (Different language to the same effect is written into the DA.) NYCEG has proposed, without elaboration, that the termination payment exception be eliminated from the PA and DA. Brooklyn Union opposes deletion of the exception, arguing that affiliates of NYCEG receiving buyout payments should be subject, as well, to the termination payment obligation.

As discussed above, Brooklyn Union is not at risk for incremental capital costs or direct operation and maintenance expense. Consequently, there is no reason to attach a termination payment to a NYCEG affiliate.

Commission Modification

The PA provides that NYCEG may either (1) terminate the PA on 30 days' notice, or (2) initiate negotiations with Brooklyn Union to amend the PA (or the related agreements) on 10 days' notice, should we "disapprove or condition, in whole or in part, or identify any deficiencies in this [PA], or the attached [FCRA or DA] and/or any related agreement required to be filed with or approved by the PSC." If negotiations are initiated, the PA gives each party the right to terminate the PA, on 30 days'

[1] During the term of the company's existing six-year rate plan adopted by the Commission, all of the revenues will flow directly to the company unless the company's return on equity exceeds the equity sharing trigger that has been established, in which case there will be a sharing of excess earnings. The equity sharing trigger is 14.0% in 1999; 13.75% in 2000; 13.50% in 2001; and 13.25% in 2002.

notice, if an agreement to amend the PA cannot be reached after 60 days of "ongoing and continuing . . . good faith negotiations." (Such termination can be superseded by an agreement to amend the PA reached during the 30-day notice period.)

NYCEG argues that this provision can be deleted, because the agreements that will result from this proceeding will be established by us, and "there is no need to anticipate subsequent PSC modifications."[1]

Brooklyn Union responds that the provision "calls for good faith negotiations in an effort to avoid termination due to Commission rejection, disapproval, or refusal to sanction the unique terms of the transaction."[2]

The provision that gives each party the right to terminate the PA on 30 days' notice offers Brooklyn Union the opportunity to cancel the PA for reasons that may be less than compelling. Accordingly, this provision will be deleted.

Assignment of PA

The PA states that NYCEG or Brooklyn Union "may, without the approval of the other and without relieving itself of its obligations hereunder, assign pledge or mortgage this [PA] as security for the obligations or indebtedness of the assignor."

NYCEG proposes to add language to this provision allowing either party to assign the PA "to any affiliate, successor-in-interest, or affiliate thereof." NYCEG states that its obligations under the PA would continue following such an assignment, so a requirement for Brooklyn Union's consent is unnecessary.

Brooklyn Union opposes NYCEG's proposal, arguing that "NYCEG has obtained service rights based on the comparability of its merchant plant proposal at [sic] the Brooklyn Navy Yard."

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[1] NYCEG's Brief, p. 3.

[2] Brooklyn Union's Reply Brief Concerning PA Issues, p. 8.

Brooklyn Union adds that the "legal structure of NYCEG [a limited partnership] is sufficiently flexible to accommodate the inclusion of appropriate parties needed to actually construct a project."[1]

Had we demanded that the PA be a recitation of the BNYCP's PA, there would have been no necessity to adjudicate the dispute. However, that is not the case. In this instance, since NYCEG's obligations remain unaltered whatever the nature of an assignment of the PA, since such assignment may enhance NYCEG's competitive position, and since Brooklyn Union's risks are minimal, because NYCEG is absorbing incremental capital costs and direct operation and maintenance expense, the utility's position is rejected.

Deposits and Reimbursements

The PA provides that NYCEG shall pay Brooklyn Union, at or before delivery to the utility of a fully executed original of the PA, a $20,000 security deposit that would either (i) be applied toward NYCEG's payment obligation under the DA after service commenced or (ii) be refunded if service never commenced, after deducting costs (up to $20,000) incurred by Brooklyn Union to "process" the PA, FCRA, and DA. The PA provides further that NYCEG shall pay Brooklyn Union a non-refundable "deposit" of $40,000 "to reimburse [Brooklyn Union] for a portion of the costs incurred to negotiate and develop agreements with [NYCEG] and costs to be incurred to process regulatory submissions associated with such agreements." A footnote states that NYCEG and Brooklyn Union have not agreed about the reimbursement of the utility's additional costs. (The preamble to the FCRA includes a cross-reference to this provision of the PA, and the FCRA itself sets forth a reimbursement obligation.)

NYCEG opposes this provision of the PA. NYCEG objects to reimbursing Brooklyn Union for any costs other than reasonable engineering costs in connection with interconnection studies and

[1] Ibid., p. 11.

construction, actual interconnection construction costs, and reasonable legal fees incurred by Brooklyn Union at NYCEG's request for easement review and project financing. NYCEG objects to paying for Brooklyn Union's costs of processing and negotiating contracts, especially costs that might have been incurred with a view toward "avoid[ing] providing the service or [doing] so only on onerous terms and conditions."[1]

Brooklyn Union argues that it should not be "required to subsidize the transaction costs for work that is performed for the benefit of third parties and obviously is outside the normal course of [Brooklyn Union's] business." The utility asserts that "[s]uch reimbursement and deposits were material commercial provisions of the BNYCP contracts," and an "audit process" is provided for in the PA. Brooklyn Union contends further that "all deposits other than the initial non-refundable deposit will be treated as credits to NYCEG's first service bill."[2]

It is unreasonable for Brooklyn Union to require NYCEG to provide these "security" deposits and they will not be required. As indicated above, it is not unreasonable for Brooklyn Union to assume a small risk in the expectation of economic gain for itself and its ratepayers. The costs that Brooklyn Union would avoid through the deposit process are properly absorbed by Brooklyn Union since they differ from those that otherwise would be incurred by the utility if a contract is executed.[3]

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[1] NYCEG's Brief, p. 4.

[2] Brooklyn Union's Reply Brief Concerning PA Issues, p. 10.

[3] Those latter costs would be consequential, would likely arise in the event of NYCEG's default, and would preclude any economic gain. Thus, greater justification exists for assuring that NYCEG absorbs such costs. These include, among others, filing and approval fees, various design, engineering and inspection costs, overtime or additional charges necessitated by project changes, etc.

Confidentiality

The PA and DA recite that "commercially sensitive" or "confidential trade secret" information might be shared between the parties and might be set forth in the PA, FCRA, and/or DA. (The FCRA's confidentiality provision is more briefly worded, with a general cross-reference to the PA's provision.) The agreements provide that NYCEG and Brooklyn Union agree, individually, to "maintain such material . . . in strict confidence and not cause or permit disclosure to any third party . . . without the express written consent of the other party." There are several exceptions to this general provision (the quoted language which follows is from the PA; similar passages are included in the DA):

1. Brooklyn Union may disclose such information to the Commission and Staff "pursuant to the provisions of the PSC regulations on trade secrets or under a confidentiality agreement or protective order to the extent required by law or regulation."

2. NYCEG may disclose such information "to the extent required to obtain long-term financing" under "a confidentiality agreement of comparable effect."

3. Either party may disclose such information "to the extent required in a proceeding conducted by a court or agency exercising jurisdiction over [the PA] or over either party if the party aware of such proceeding notifies the other party of such disclosure requirement promptly and seeks from such court or agency an order protecting the confidentiality of any confidential material disclosed to such court or agency."

4. If NYCEG seeks financing through a public securities offering (or in a "public-style offering"), the PA provides that representatives of Brooklyn Union shall meet with NYCEG and its underwriters "to negotiate in good faith the scope of disclosure, if any," of confidential information. The PA states further that "to the extent disclosure is required, it shall be effectuated in such manner as to avoid compromising the interests

> of the parties in maintaining the confidentiality of such material to the fullest extent reasonably possible."

NYCEG has proposed deletion of the entire sections of the PA, DA, and FCRA setting forth the foregoing protocols. NYCEG offered no comment specifically pertaining to the PA; but it argues that no provision of the DA should require confidential treatment, and that Brooklyn Union has not listed the provisions of the FCRA requiring such treatment.

In its responses pertaining to the PA and DA, Brooklyn Union notes that (quoting the PA response) "[t]he BNYCP [agreement] terms have been modified to require the specific identification of materials a party seeks to have treated as confidential." Brooklyn Union argues that "[t]his section benefits both parties, is an industry norm for complex commercial transactions, and is in no way in conflict with Commission practice or policy." Brooklyn Union contends further that NYCEG "is in no way prejudiced here by an inability to broadcast to the public commercially sensitive information or provisions of which it has full knowledge."[1] In its response pertaining to the FCRA, Brooklyn Union contends, in addition, that it "is exposed to vigorous third-party competition regarding construction of this nature (and was in connection with the BNYCP project)."[2]

The reason for this disagreement is obscure since NYCEG, pursuant to the PA, may disclose information to secure financing (paragraphs 2 and 4 above). As for paragraphs 1 and 3, they appear to impose little, if any, burden on NYCEG. In view of our obligation to protect information properly deemed confidential, and in view of the fact that the instant terms are not onerous to NYCEG, they will not be deleted.

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[1] Brooklyn Union's Reply Brief Concerning PA Issues, p. 12 (emphasis in original).

[2] Brooklyn Union's Reply Brief Concerning FCRA Issues, p. 7.

FACILITIES CONSTRUCTION
AND REIMBURSEMENT AGREEMENT

Liability for Failure to
Complete Construction on Schedule

The FCRA includes a disclaimer stating that "it is understood and agreed that Brooklyn Union does not and cannot guarantee or insure that the Subject Facilities will be operational by [the due date, not yet specified], and that Brooklyn Union will not be liable to NYCEG or otherwise in the event that the Subject Facilities are not completed by such date."

NYCEG argues that "[u]nless excused by force majeure, Brooklyn Union's delay in completing construction should expose it to potential liability for damages (as with other construction contracts) in order to assure NYCEG that Brooklyn Union will perform. NYCEG adds that "[i]f Brooklyn Union wants to propose a defined penalty amount, NYCEG would entertain it."[1]

Notwithstanding NYCEG's recognition of a force majeure excuse, Brooklyn Union responds that it "will not guarantee (or assume exposure to damages or penalties [for]) a completion date in a situation such as this where virtually all of the construction will take place in city streets and involves conditions and potential interference over which Brooklyn Union has little or no control (as was the case with BNYCP)." Brooklyn Union contends that the disclaimer was a material term of the agreement entered into with BNYCP, on which the FCRA is based. Brooklyn Union notes that it will earn no profit from construction of the facilities, under the FCRA as written, and argues that "NYCEG remains free to include delay penalties in the prime installation contract (assuming it wishes to pay the increased costs of same)."[2] Brooklyn Union has, however, accepted NYCEG's proposed modifications to the FCRA, page 4,

[1] NYCEG's Brief, p. 4.

[2] Brooklyn Union's Reply Brief Concerning FCRA Issues, p. 3.

committing the parties to cooperate with each other and "expeditiously complete" the interconnection.

While construction contracts typically provide for penalties in the event milestones go unmet, this situation is complicated by the fact that construction will take place in New York City streets and may involve conditions which preclude timely completion of construction by Brooklyn Union and which conditions are outside of Brooklyn Union's control. In these circumstances, the public interest precludes a guarantee that the facilities will be operational by a date certain.

Cost Reimbursement

As discussed earlier, NYCEG objects to any provision requiring it to reimburse Brooklyn Union for the cost of negotiating with NYCEG. NYCEG has proposed edits to §2 of the FCRA, pp. 4-5, that appear to be intended to address this position. In response, Brooklyn Union argues that deletions by NYCEG of references to third-party services go too far, because a substantial part of the expected construction cost would be for third-party services. (Brooklyn Union also cautions that "[t]he cost of furnishing pipe, fittings, valves, metering and appurtenant equipment will not be borne by Brooklyn Union without reimbursement from NYCEG"[1]; but, it does not appear that the modifications proposed by NYCEG would require Brooklyn Union to do so.)

Costs that are incurred by Brooklyn Union which relate to third parties, such as fees payable to governmental authorities, should be paid by NYCEG since these, by definition, are incremental to Brooklyn Union and are little different from material and construction costs.

Payment Schedule

NYCEG, because it would be required to pay 85% of the construction costs by the time the work is only 50% complete,

[1] Id.

objects to the payment schedule set forth in the FCRA. NYCEG has proposed to modify the FCRA so that NYCEG's payment schedule would coincide with the payment schedule in the agreement between Brooklyn Union and its construction contractor. NYCEG adds that it has offered to use a letter of credit "funded in the full amount of the contractor's price that authorizes BU to draw on it as required to meet the payment schedule."[1]

Brooklyn Union responds that the payment schedule proposed in the FCRA comes from its agreement with BNYCP and was a "material element" of that agreement. Brooklyn Union claims that the schedule specified in the FCRA takes into account the advance payments Brooklyn Union would make for design, engineering, and purchases of pipe and materials.

This disagreement between NYCEG and Brooklyn Union carries over to another provision of the FCRA requiring NYCEG to post a letter of credit (or deposit funds in an escrow account) equal to 45% of estimated construction costs within seven days after Brooklyn Union's award of the initial construction contract. In response to NYCEG's comments on that provision, Brooklyn Union retorts, somewhat peevishly, that increasing the face amount of the letter of credit from 45% to 100% of estimated construction costs "would be fully justified given the lack of any information that demonstrates that NYCEG is or ever will be creditworthy."[2]

Brooklyn Union has explained why NYCEG should pay 85% of construction costs, at a time when construction may only be 50% complete; i.e., Brooklyn Union will make payments in advance of the immediate construction costs. That explanation is unchallenged and the provision appears reasonable given the parties' agreement essentially to hold the utility harmless from such costs.

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[1] NYCEG's Brief, p. 5.

[2] Brooklyn Union's Reply Brief Concerning FCRA Issues, p. 6.

Final Invoices

The FCRA provides that final invoices will be issued to NYCEG not later than one year after the completion of construction. NYCEG argues that the deadline should be reduced to 60 days, because the longer period would hamper NYCEG's efforts to convert construction financing to permanent financing. Brooklyn Union responds that a one-year deadline is supported by its experience; assertedly the final costs of post-construction activity, especially activity to accommodate the requirements of third parties (including New York City), cannot be determined within 60 days after construction is completed. Brooklyn Union contends that a one-year deadline should not interfere with NYCEG's financing efforts, because material items are likely to be known and reported early in the post-construction reconciliation period.

This issue involves conflicting priorities--namely, NYCEG's need to secure permanent financing and Brooklyn Union's likely inability to determine final costs precisely within 60 days after construction is complete. The clearly greater priority is NYCEG's. To the extent final costs are unavailable 60 days after completion of construction, Brooklyn Union, based on its considerable experience, is directed to advance reasonable estimates at that time. Final invoices should be submitted as they become available.

Prompt Payment

The FCRA provides for a lag of 10 days between invoice date and payment date. Without explanation, NYCEG proposes to increase the lag to 20 days. Brooklyn Union opposes that change, stating that it did not agree to such a lag for BNYCP and would not do so for NYCEG.

The FCRA provides further that if a payment is not received by 20 days after its due date (that is, 30 days after the invoice date), Brooklyn Union may suspend construction activity, accelerate the due date for remaining payments, or do both. NYCEG opposes the acceleration-of-payments remedy, arguing

that cessation of construction work should provide a sufficient incentive for prompt payments. NYCEG adds that this entire provision would be unnecessary, were Brooklyn Union to accept a fully-funded letter of credit with a drawdown schedule.

Brooklyn Union responds that it "is unwilling to be 'left holding the bag' in the event of a payment default by NYCEG in the midst of construction under an 'at cost' contract, and was not willing to place itself in that position with BNYCP . . . ."[1] Brooklyn Union calls acceleration of payments a "material term" that should not be altered even if a letter of credit is provided.

NYCEG's proposal to increase the lag is not justified. Equally unjustified is Brooklyn Union's proposal to accelerate the due date for remaining payments if a payment is not received within 20 days of its due date, provided that NYCEG supplies a letter of credit.

Selection of Contractors

Although the FCRA provides that Brooklyn Union will decide, in its sole discretion, which contractor(s) will be hired for facilities construction, it also provides that Brooklyn Union will confer with NYCEG about the contracting process, provide NYCEG with a list with no fewer than three eligible contractors, and add performance-related terms to the construction contract at NYCEG's request (provided that NYCEG reimburses Brooklyn Union for the additional costs of including those terms). Brooklyn Union has agreed with NYCEG's suggestion that price caps be included in the list of possible terms.

NYCEG argues that "there should be no objection to NYCEG[']s] having approval authority over the contract and contractor."[2] Brooklyn Union responds that, to the contrary, NYCEG has no known experience in constructing or operating gas

[1] Brooklyn Union's Reply Brief Concerning FCRA Issues, p. 5.

[2] NYCEG's Brief, p. 5.

facilities, and the facilities in question "will be a part of Brooklyn Union's system, the integrity of which is Brooklyn Union's responsibility."[1] Brooklyn Union argues further that the conditions under which bids will be awarded are not known at this time, and it is therefore unwilling to delegate in advance the discretion to select contractors.

Brooklyn Union's position is sound. The selection of contractors goes to the integrity of Brooklyn Union's distribution system and should not be shared with NYCEG, even if NYCEG had experience constructing and/or operating gas distribution facilities.

Assignment of FCRA

The FCRA states as follows:

> Except for assignments solely for the purpose of creating a security interest for financing, each of the parties hereby agrees not to assign or otherwise transfer its rights and interests under this FCRA without the prior written consent of the other party.

NYCEG would add, at the end of the foregoing passage, the following phrase: "which shall not be unreasonably withheld or delayed." Brooklyn Union responds that the proposed change is "not acceptable," because its obligations under the FCRA "are unique to NYCEG and the circumstances of this case." Brooklyn Union states that, as with the BNYCP agreement, Brooklyn Union "has no intention of generally extending such unique commitments to unknown third parties, unless the Company concludes that such action is beneficial to its ratepayers and shareholders."[2]

There seems little point either to NYCEG's suggestion or Brooklyn Union's refusal to implement it since the term "unreasonably withheld or delayed" is open to varying

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[1] Id.

[2] Ibid., p. 8.

interpretations. Thus, to append it to the contract would be superfluous, at best.

DELIVERY AGREEMENT

Definitions

NYCEG proposes to modify the definitions in the DA of "Customer's Beginning of the Day Nomination," "Daily Imbalance Tolerance," and "MDQ" so that the respective quantities are "exclusive of loss factor." Brooklyn Union contends in response that the modifications are not necessary, because the definition of "Net Receipt Quantity" includes a specified allowance for "system use and losses."

Brooklyn Union's response would be convincing if the definitions of the first three terms included the term "Net Receipt Quantity," but they do not. Accordingly, the proposed modification is approved.

Upstream Transportation Agreements

As discussed earlier, NYCEG has objected to various provisions of the DA stating or implying that NYCEG's upstream transportation agreements are subject to Brooklyn Union's approval. The utility has proposed modifications to respond to NYCEG's objection.

NYCEG has included in its list of objectionable provisions the second sentence of §3.1(a) of the DA, which provides as follows:

> Customer shall maintain Upstream Transportation Agreements in effect during the term of this Agreement that are compatible with the provisions of this Agreement and permit the performance of Customer's obligations under this Agreement.

Brooklyn Union argues that the foregoing provision is distinguishable from the other provisions and should be retained, because it merely requires NYCEG to meet its operational obligations.

The clause at issue seems somewhat redundant. Absent suitable upstream transportation agreements, NYCEG will be unable to operate. If it is unable to operate it likely would have to default on its payments to Brooklyn Union thus enabling the utility to take whatever legal action would be appropriate. Accordingly, this provision should be deleted.

Interruptibility

The April Order directed Brooklyn Union to prepare a "preliminary offer" that included "19 days of winter period interruptibility" (page 26), which the April Order stated is the "limited . . . interruptible service NYCEG is seeking" (page 24).

The DA prepared by Brooklyn Union would permit interruption[1] of a gas volume equal to 19 days times the maximum daily quantity. However, that interruption could be allocated over as many as 30 days; in other words, the character of the interruptible service would be 19 days full/30 days partial.

NYCEG opposes this provision, pointing out that the April Order did not specify such service, and that Brooklyn Union has offered no consideration for the greater flexibility it proposes.[2] NYCEG's position is that interruption of its generation facility should be "all or nothing"--if Brooklyn Union wants to interrupt service, it must interrupt the entire daily nomination. NYCEG has proposed new language to reflect its position (DA, pp. 17-18).

In Brooklyn Union's view, the April Order merely sets forth a "short-hand reference to '19 days of winter period interruptibility,'" and Brooklyn Union claims it was intended that NYCEG receive the same 19 days full/30 days partial interruptible service as provided for in the BNYCP contract.

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[1] The parties agree that passages allowing Brooklyn Union to "interrupt" or "curtail" service to NYCEG should be modified to provide only for interruption.

[2] However, the April Order (p. 14) states that NYCEG sought service comparable to BNYCP.

According to Brooklyn Union, "NYCEG's elimination of the 30 part day interruptible option . . . would impose unique operational limitations and is a fundamentally different character of service from that provided BNYCP."[1]

NYCEG's contention that interruption should be on an "all or nothing" basis is somewhat extreme and contradicts the testimony of its witness Montrose that it sought an interruptible provision comparable to BNYCP (30 partial days, 19 full days).[2] Accordingly, there should be no amendment of this feature.

O&M Reimbursement

The DA provides that NYCEG will reimburse Brooklyn Union for "actual reasonable operating [sic] and maintenance ("O&M") expense associated with providing service to the Customer . . . ." A non-exclusive list of such expenses accompanies this provision.

NYCEG proposes that the phrase "providing service to the Customer" be replaced with the phrase "operating and maintaining the Transmission Facilities and Metering Equipment, as defined in §1.14 hereof." NYCEG also proposes that its obligation be limited to incremental "actual reasonable" O&M expense and "capped at a reasonable amount" that is not specified.[3]

Brooklyn Union responds that the DA's provision parallels "material terms of the BNYCP agreement" and provides for reimbursement of Brooklyn Union's "actual, reasonable costs of maintaining and operating delivery facilities, including meters and associated filters, that are directly associated with the NYCEG service without regard to who holds legal title to the facilities." Brooklyn Union asserts further that (i) "NYCEG has now requested the right to own certain facilities upstream of the

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[1] Brooklyn Union's Reply Brief Concerning DA Issues, p. 2.

[2] Tr. 1,791.

[3] NYCEG's Brief, markup of DA, pp. 28-29.

meter and the meter station itself"; (ii) "[t]here is and was no provision in the . . . base rates [in] this and the BNYCP contracts for [associated] O&M costs"; and (iii) such costs "cannot be predicted over the term of the contract and hence are billed separately." Brooklyn Union concludes that, "[t]he suggestion of a cap is inconsistent with this understanding and should be rejected."[1]

There is no obvious reason why O&M expense should be capped or limited to the "incremental actual reasonable" (however that term may be defined) expense. Presumably, the developer will be recovering such costs in its sales to the purchaser of its energy. If the developer, in turn, does not reimburse Brooklyn Union for those costs then the company's bare bones per unit profit margin will be lessened. Since the delivery rate did not apparently account for Brooklyn Union's assumption of such costs, it would appear indefensible to assign them in the fashion proposed by NYCEG. If, upon being billed, NYCEG believes that the costs in question are unreasonable, it may seek relief from us.

Steam Sales

The April Order determined that transportation service rates under a Brooklyn Union/NYCEG contract should generate average revenue of 22.9¢/dt at NYCEG's maximum annual quantity, in order to be comparable to BNYCP's contract rates. That determination "assumes that NYCEG will not provide steam service that displaces company gas loads, because NYCEG's currently-planned facility would not be a cogeneration plant," and that "[t]he average unit revenue figure for the BNYCP contract, 22.9¢/dt, is net of lost margins from gas sales displaced by steam sales."[2]

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[1] Brooklyn Union's Reply Brief Concerning DA Issues, p. 3 (emphasis in original).

[2] April Order, p. 21

The BNYCP agreement provides, in pertinent part, that "[f]or each . . . existing firm or temperature controlled service customer of the Company as of the date of this Agreement . . . that is provided steam service by Customer," monthly gas transportation rates and charges will be adjusted as follows:

1. The average annual volume of sales to the customer over the two-year period ended in the month before steam service begins will be multiplied by the average margin ($/dt) earned by Brooklyn Union from the customer's service classification during the same two-year period.

2. The resulting product will be divided by 12 to yield the average monthly lost margin.

3. The monthly lost margin will be "allocated equally to . . . demand and commodity charges."

4. The total annual dollar value of the adjustments to demand and commodity charges shall not exceed $400,000.

Brooklyn Union proposed to offer a similar provision to NYCEG, with two significant exceptions: (i) the provision would be triggered if NYCEG sold steam to <u>any</u> "existing" firm or temperature controlled service customers, not just customers of Brooklyn Union as of the date of the DA; and (ii) there would be no annual cap on the amount of the lost-steam-sales adjustments to transportation rates and charges. NYCEG argues that the limitation to existing customers as of the contract date should be retained, and that a proportional annual cap of $170,000, based on the relative gas volumes of the BNYCP plant and planned NYCEG plant, should be established.

Brooklyn Union responds that NYCEG proposes "to edit this section to defeat the clear intent of the Order which was to set rates assuming no steam sales," pointing out that no cap was contemplated by the April Order. Brooklyn Union argues, in addition, that the cap proposed by NYCEG is "intentionally misleading and conceptually erroneous," because "the $400,000

figure in the BNYCP text was only a portion of the estimated margin loss."[1] The utility also claims that the transportation rates established in the April Order would reduce the NYCEG facility's operating costs (below the costs it would incur paying tariffed transportation rates) to such an extent that Brooklyn Union would lose gas-fueled thermal loads generating $1.5 million of net revenues to NYCEG's steam service.

Of the two issues to be resolved one is relatively straightforward, namely, whether the provision would be triggered if there were sales to any existing customers of Brooklyn Union. The April Order specifically recognized that "NYCEG will not provide steam service that displaces company gas loads, because NYCEG's currently planned facility would not be a cogneration plant."[2] Thus the rates established therein were not designed to account for lost margin in the event of steam sales. In these circumstances, Brooklyn Union's proposal is adopted.

While there is no reason to preclude NYCEG from making steam sales to potential customers of Brooklyn Union after a contract has been executed, no cap on the lost steam sales is warranted. The comparable term in the BNYCP contract took account of the fact that BNYCP would serve an existing Brooklyn Union customer, thereby reducing its annual revenues by $400,000. Such a circumstance is precluded here.

System Improvements and Reinforcements

As discussed in the April Order,[3] a study of Brooklyn Union's recent estimate of its marginal distribution cost of serving firm customers, predicated on a load increment of 2,464,000 dt, identified relevant investment (to a customer in NYCEG's situation) of $985,000 (including capitalized interest and allocations); with a carrying charge of 18%, the annual

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[1] Brooklyn Union's Reply Brief Concerning DA Issues, p. 4.

[2] April Order, p. 21.

[3] Ibid., pp. 19-21.

revenue requirement would be $177,300, and the unit cost would be 7.2¢/dt.

Because NYCEG's minimum bill determinant is an annual volume of 3,462,390 dt, Brooklyn Union sees NYCEG's contract as generating revenues sufficient to meet a marginal-cost-based revenue requirement of about $292,300 (minimum volume times 7.2¢/dt). With a carrying charge of 18%, the underlying incremental investment that would be supported, in Brooklyn Union's view, would be $1,385,000.

The draft DA prepared by Brooklyn Union provides that "[i]n the event changes in firm load or other comparable circumstances (excepting a drop of pressure to the Company's LNG facility) necessitate construction of additional facilities or improvements or reinforcements to existing facilities of the Company during the term of this Agreement in order to continue service to Customer as provided in this Agreement, the Company shall so notify Customer in writing." Upon such notice, the DA offers NYCEG a choice: (i) accept changes in Brooklyn Union's service obligation to NYCEG that would allow Brooklyn Union to avoid the construction; or (ii) reimburse Brooklyn Union "for the documented actual costs in excess of $1,385,000 incurred by the Company for such construction over the life of this Agreement, together with any liability associated with such reimbursements."

The April Order compared the relevant marginal cost of 7.2¢/dt with the average revenue target of 22.9¢/dt and concluded that "the resulting average rate of contribution would be 15.7¢/dt." The April Order then stated that "it is not our expectation that NYCEG's transportation rate will be set as a fixed monetary amount for the duration of its transportation service agreement." Instead, it was concluded that "NYCEG's contract should provide for a reasonable rate of escalation."[1]

NYCEG argues that when we established a rate subject to escalation, two-thirds of which is "pure" contribution and one-third of which is a conservative (i.e., high-end) estimate of

[1] April Order, p. 21.

marginal cost, it provided Brooklyn Union with plenty of money to pay for future system improvements, the need for which is driven in part by NYCEG's demands.[1] NYCEG argues for deletion of the provision for additional, non-rate recovery of Brooklyn Union's system costs.

Brooklyn Union responds by accusing NYCEG of presenting a "tortured analysis" of the April Order. In Brooklyn Union's view, the provision is proper because "the Commission did not cap NYCEG's responsibility to pay life-of-contract costs to maintain facilities adequate to render the character of service required by the Order." Instead, Brooklyn Union maintains, we "reminded Brooklyn Union of its responsibility to provide for recovery of such costs from customers granted discounted rates, or be at risk should the utility attempt to include future system capital costs associated with such discounted service in overall rates."[2]

Brooklyn Union's position is inconsistent with BNYCP. The 7.2¢/dt component of the rate is intended to recognize the average per unit marginal cost of system growth.

Pressure Drop on LNG Inlet Line

The April Order includes the following footnote:

> Brooklyn Union has taken the position that NYCEG should assume the full cost of upgrading the inlet line to the company's liquified (sic) natural gas (LNG) plant to correct a 3 psig pressure drop that will occur, according to a company computer model, shortly after NYCEG's load is attached. The company's position assumes that NYCEG would be taking its expected maximum daily quantity on certain days in the heating season when the company can inject gas at the LNG plant but inlet pressure might fall below the required minimum level. Because

[1] NYCEG also contends that the 18% factor used in Brooklyn Union's calculations is improperly overstated. This rate can vary depending upon many factors and is appropriate at this time.

[2] Brooklyn Union's Reply Brief Concerning DA Issues, p. 7.

> NYCEG is requesting limited interruptible service, however, we are not prepared to reach a conclusion at this time about how the costs of any required upgrade to the inlet line should be apportioned. This matter remains subject to negotiation. At the very least, the apportionment of such costs should be based on actual tests, not computer simulations.[1]

Underlying this issue is the fact that BNYCP is required to reimburse Brooklyn Union for the cost of adding compression facilities, looping, or other system reinforcements to the inlet line to the utility's LNG plant if the following conditions are met: (i) there is a drop in the inlet gas pressure of at least 8 psig; (ii) the drop occurs "prior to the first day of August following the second anniversary of the Commencement Date" of the agreement; and (iii) the drop results "solely from the delivery of gas to the customer at the facility." BNYCP's reimbursement is capped at $2 million. The BNYCP agreement sets forth a description of the test procedure and formula to be employed to determine BNYCP's contribution, if any, to an LNG plant inlet pressure drop.

The proposed DA has parallel provisions, but there are two significant differences: the provisions would be triggered if there is <u>any</u> pressure drop at the LNG plant inlet, and NYCEG's reimbursement would be capped at $510,000.

In a footnote in the draft DA, Brooklyn Union explains that the threshold was written into the BNYCP agreement "in consideration of the combined cost savings from the peaking service and direct contribution to system costs exceeding $6,000,000 per year." Brooklyn Union's reference to the "peaking service" provided for in the BNYCP agreement has rekindled a controversy that should have been extinguished by the April Order, and NYCEG accordingly objects to the exclusion of the 8 psig threshold from its own DA. NYCEG contends further that "[t]he argument that the higher absolute dollar amount of BNYCP's

[1] April Order, p. 21.

direct contribution justifies special treatment is illogical because the absolute values are directly and linearly related to the gas volumes being flowed through the system," explaining that "with both customers paying identical contributions per dth, neither can be said to be benefiting Brooklyn Union more than the other."[1]

With the passage of time, this issue has lost some of its importance. At a time when NYCEG was claiming its plant would come on line "prior to the first day of August following the second anniversary of the Commencement Date" of the BNYCP agreement, NYCEG was concerned that Brooklyn Union would charge NYCEG to correct a 3 psig drop, thus forestalling a net 8 psig drop due to BNYCP's operation until after that deadline. The BNYCP deadline will pass next August 1.

NYCEG should absorb costs necessary to correct a 3 psig pressure drop, if actual tests, rather than computer simulations, demonstrate that such an expenditure is warranted.

Penalty for Brooklyn Union Breach

The draft DA contains a penalty for Brooklyn Union's breach--failure to deliver gas beyond the maximum duration of interruption--equal to the penalty in the BNYCP contract. NYCEG would (i) double the amount of that particular penalty; (ii) add a requirement for a pro-rata credit of demand charges; and (iii) require Brooklyn Union to pay its reasonable legal fees if (as allowed by the DA) NYCEG sought an injunction compelling Brooklyn Union to end a breach and deliver gas. NYCEG argues that, as an alternative to a doubled penalty and demand charge credit, the DA should permit it to sue for consequential damages.

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[1] NYCEG contends that the formula for measuring the pressure drop caused by its plant is "rigged." Brooklyn Union explains in response that the DA and formula are written as if the test would be conducted while the plant's gas consumption ran from zero to full volume. The DA can be rewritten, and the formula will provide for "scaling up" if, for example, the test is to be conducted between two intermediate levels of consumption. NYCEG's Brief, p. 9.

NYCEG believes that the BNYCP penalty is "unreasonably low," and argues that the DA's penalty "must be high enough so that if Brooklyn Union decides to breach, its exposure to NYCEG will be fully compensatory."[1]

Brooklyn Union responds that NYCEG has offered no consideration for penalties or relief that are not comparable to those provided for in the BNYCP contract. Brooklyn Union alleges that NYCEG's cost exposure in the event of breach would be minimal, because NYCEG's air permit would allow it to burn oil (and thus generate electricity for sale) for 31 to 56 days over and above the 19 full days of interruption provided for in the DA.

If Brooklyn Union failed to deliver gas beyond the maximum duration of interruption to NYCEG it would almost surely be due to the fact that system considerations precluded such sales (otherwise Brooklyn Union would arbitrarily be forgoing revenues that benefit it and its ratepayers, and would be subject to a revenue imputation if a revenue deficiency were alleged). However, Brooklyn Union's position does not take into account the fact that oil would have to be burned and that it may be appreciably more expensive than gas. To that extent the NYCEG modification is acceptable.

Pipeline Obligations

The DA provides, in pertinent part, that NYCEG will "cause" each pipeline delivering NYCEG-owned gas to Brooklyn Union "to maintain and operate, at no cost to the Company, a measuring station properly equipped . . . ." NYCEG argues that the provision is unnecessary, because it believes adequate measuring equipment is already in place. Brooklyn Union responds that the provision is a "boilerplate" term that properly requires NYCEG, as the pipeline customer, to obtain assurance from the pipeline that gas will be properly measured (i.e., the pipeline is a "third party" that is not bound by the DA).

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[1] Id.

There is no satisfactory reason for NYCEG, as the pipeline customer, to avoid its responsibility to assure that deliveries of its gas are measured properly.

Indemnification

The DA §13.1 contains separate recitations of the indemnification obligations of "Customer" and "Company." The recitations are nearly identical; the major difference is that the recitation of Brooklyn Union's obligation states that its liability is limited by a general provision in its tariff.

NYCEG proposed to consolidate the separate recitations into one "mutual" recitation, but in doing so it omitted the reference to the tariff's liability limitation. Accordingly, Brooklyn Union does not support NYCEG's proposal.

It is unclear why NYCEG failed to incorporate the tariff's liability limitations. It has been endorsed by us and should be incorporated into the recitation of indemnification obligations.

Regulation

The DA §17.1, recites the following:

> This Agreement and the respective obligations of the parties hereunder are subject to valid laws, orders, rules and regulations of duly constituted authorities having jurisdiction; provided however, that nothing in this Agreement bars either party from challenging in court the validity or enforceability of any law, rule, order, or regulation that purports to change the terms and conditions of this Agreement.

NYCEG contends that the DA needs "stronger language evidencing the parties' mutual intent to shield the contract from

regulatory interference."[1] Accordingly, NYCEG proposes the following changes:

1. The following sentence, to be inserted at the beginning:

   The rates, terms and conditions for service specified herein are prescribed by the Commission, and shall remain in effect for the term of this Agreement, and shall not be subject to change through application to a governmental authority absent the agreement of both Company and Customer.

2. Insert the words "only those" before the word "valid" in the original first (would-be second) sentence.

3. Insert the phrase "that specifically change terms and conditions of this Agreement" after the word "jurisdiction."

Brooklyn Union responds that the original language, from the BNYCP agreement, is a "material term" that "properly recognizes the potential impact of future legislative and regulatory actions, and provides each party the right to challenge what it considers to be an adverse action." Brooklyn Union contends further that DA §17.2 "provides a balanced option for termination should such actions fundamentally alter the economic expectations of the parties."[2] Finally, the utility denies that NYCEG's proposed changes reflect their "mutual intent" and opposes them.

The proposed changes are not justified and will not be endorsed because it is unrealistic to believe that a common interest will exist to motivate both parties to challenge a law, rule, or other action that may affect the agreement between the parties.

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[1] NYCEG's Brief, p. 10.

[2] Brooklyn Union's Reply Brief Concerning DA Issues, pp. 10-11.

Remedies for Default

The DA provides, in pertinent part, that if a party in default of the DA fails to cure its default within 30 days, the party may suspend its performance after receiving any necessary regulatory authorization. NYCEG proposed that the deadline be eased to allow the defaulting party to commence the cure within 30 days, where completing it will require more than 30 days.

The DA provides further that termination for default is without prejudice to NYCEG's right to receive any gas it delivered to the company but did not receive (although entitled to receipt) before the "time of termination." NYCEG proposed to tack on a provision stating that termination would also not prejudice NYCEG's right to take service under any applicable tariff.

Brooklyn Union opposes both changes on the grounds that they "alter default remedies material to the balance of risks assumed by the parties to the BNYCP contract" and are "unsupported by consideration."[1]

The proposed amendments are not approved. The first might be acceptable were the time for curing the default capped. The second provides NYCEG a benefit it might otherwise not be entitled to depending on the nature of the default.

Assignment of DA

The DA provides generally that neither Brooklyn Union nor NYCEG may assign rights or obligations under the DA without prior written consent of the other party. The exception is that either party may, "without the other party's consent and without relieving itself of its obligations, assign, pledge, mortgage, or encumber its interest in this Agreement as security for the obligations or indebtedness of the assignor."

NYCEG would include, in the exception, assignment of the DA to an affiliate. Brooklyn Union opposes NYCEG's proposal, arguing (as it did with respect to similar proposed amendments to

[1] Ibid., p. 14.

the PA and FCRA) that the purpose of the general provision is to preclude unilateral assignment of "this unique discounted contract" to "third parties."[1]

Consistent with our determination above under the caption of Assignment of the PA, Brooklyn Union's position is rejected.

Curtailment

Brooklyn Union and NYCEG have agreed to DA §14.5, which sets forth (in pertinent part) the following curtailment sequence, should a force majeure event prevent Brooklyn Union from delivering gas to or along the interconnection main:

1. Interruptible customers, including NYCEG to the extent its load is interruptible.

2. Temperature-controlled customers.

3. NYCEG, to the extent Brooklyn Union is entitled to interrupt firm deliveries to NYCEG under the DA.

4. Firm customers, which would include NYCEG once Brooklyn Union had exhausted all other rights to interrupt NYCEG.

This provision is inconsistent with our short-term curtailment procedures. The needs of core customers, i.e., those without alternatives, must be recognized as being interrupted after NYCEG and other similarly situated customers. Clause No. 4 must be modified to reflect this.

Daily Nominations

The DA states that NYCEG may change a daily nomination of gas if (among other means) NYCEG arranges for a confirmed

[1] Ibid., p. 15.

nomination or changed nomination with "another transporter"[1] at a "Receipt Point acceptable to the Company." NYCEG proposes that the adverb "reasonably" be inserted before "acceptable." Brooklyn Union rejects this proposed change because of the potential impact on system reliability and integrity.

Because deference must be given to concerns about system reliability, this provision is not adopted.

Verification of Measuring Equipment

The DA provides that the accuracy of measuring equipment must be verified by the operator of that equipment at reasonable intervals, and that, upon request, a party's verification must be conducted in the presence of a representative of the other party. NYCEG has proposed that such other party be given ten days' notice before a verification is performed. Brooklyn Union objects to this proposal because it is not the operator and the agreement of the parties cannot bind the operator.

Since Brooklyn Union is not the operator of the measuring equipment, it would be inequitable to impose a condition upon it concerning an operation over which it does not exercise control.

Receipt Points

The DA states that "[t]he Receipt Point(s) shall be the points specified in Exhibit 1 to this Agreement, at which points the Company shall receive gas for Customer's account in quantities not to exceed the stated maximum quantity for each such point unless otherwise mutually agreed." NYCEG would delete the word "stated," insert the word "daily" after "maximum," and

[1] A "Transporter" under the DA is "Transcontinental Gas Pipeline Corporation . . . and/or such other interstate pipelines as are interconnected with the New York Facilities System at points of receipt of gas hereunder that are agreed to and accepted by the Company from time to time." Thus, "another transporter" means a pipeline other than a Transporter.

insert the phrase "stated on such Exhibit" after the word "quantity." Brooklyn Union considers these proposed changes unclear and unnecessary.

There is no obvious reason for this amendment and no adequate explanation has been given to support its adoption. Accordingly, it will not be adopted.

State Administrative Procedure Act

A prior State Administrative Procedure Act (SAPA) notice of proposed agency action relating to this matter was used and a new notice was not issued because it was anticipated that the parties would negotiate a settlement of their dispute and further action by us would be unnecessary. A settlement, however, was not achieved.

Postponing a decision to accommodate the notice and comment period of SAPA would delay New York City Energy Group's proposal to develop a steam generation facility in New York City and thus potentially lessen the benefits of the transition to a competitive electric market. Therefore we are prescribing the terms of the agreement on an emergency basis under §202(6) of SAPA. We find that immediate adoption is necessary for the preservation of the general welfare and that compliance with the advance notice and comment period of §202(1) of SAPA would be contrary to the public interest.

CONCLUSION

The issues presented to us for resolution have been decided herein and should be incorporated in the contract to be drafted by the parties and submitted to us within 45 days of this opinion and order.

The Commission orders:

1. Within 45 days of the date of this opinion and order, The Brooklyn Union Gas Company and New York City Energy Group shall submit to the Commission a contract for gas

transportation service reflecting the determinations in this opinion and order and the attachment.

2. This opinion and order is adopted on an emergency basis under §202(6) of the State Administrative Procedure Act for the reasons noted above.

3. This proceeding is continued.

By the Commission,

(SIGNED) DEBRA RENNER
Acting Secretary

ATTACHMENT

Minor Modifications to the PA[1]

The PA provides generally that NYCEG and Brooklyn Union may agree to extend the deadline for meeting a condition, within 30 days of that deadline, "if the party primarily responsible for satisfying such condition is continuing to proceed diligently and in good faith to satisfy such condition." NYCEG has proposed to modify the general provision so that it would not be invoked when failure to meet a condition results from "reasons of force majeure." Brooklyn Union suggests that this proposal is redundant. To the extent it is not, this provision is otherwise reasonable.

The PA states that "[a]ll written notices shall be deemed sufficiently given when hand delivered, transmitted by confirmed telecopier or mailed by United States registered or certified mail . . . ." NYCEG proposes to include delivery "by a nationally recognized overnight courier." Brooklyn Union agrees with NYCEG's proposal. (Brooklyn Union has agreed to a similar modification to the FCRA proposed by NYCEG.)

The PA refers to assignment of the PA "as provided for in the Consent and Acknowledgement attached hereto as Exhibit 'D' . . . ." NYCEG proposes to substitute the words "substantially in the form of" for "attached hereto as." Brooklyn Union agrees with NYCEG's proposal.

The PA would authorize "the party not required to satisfy [a] condition" to terminate the PA on 60 days' notice, should the deadline for satisfying the condition (either as originally established or as modified by agreement of the parties) be missed. The provision would apply to "any of the conditions precedent set forth in paragraph 1." NYCEG points out

[1] In this section, and the corresponding sections pertaining to the FCRA and DA, editorial corrections raised by the parties are not discussed unless the uncorrected text would be substantively different from the apparent intention of the parties. These corrections should be reflected in the parties' final agreement.

that one of those conditions is the deadline for our approval, which NYCEG opposes; should that condition be retained, NYCEG argues, "it should not be made the subject of a unilateral satisfaction obligation." Brooklyn Union agrees with NYCEG's position.

Minor Modifications to the FCRA

1. Calculation of Reimbursed Costs

NYCEG initially contended that three factors, or "loadings," that would be applied to Brooklyn Union's direct construction costs to calculate total reimbursable costs were not sufficiently explained. NYCEG asked that Brooklyn Union or the Commission "validate the accuracy of those figures and the appropriateness of their intended applications." Brooklyn Union's response explained the loadings, and the joint NYCEG/Brooklyn Union letter of September 21, 1998 states that the factors "are not in issue, subject to final Commission review."

The factors are as follows:

1. Indirect cost loading: The loading factor, 66% of direct labor costs, reflects Brooklyn Union's Distribution Department's indirect costs (vacations, leave, payroll taxes, injuries and damage, life and health insurance, pension costs, distribution tools, and work loading). Brooklyn Union states that its "normal loadings for Company labor on construction projects" range between 150% and 170% of direct labor costs.

2. Federal income tax on customer-funded plant: The loading factor of 28.4% of plant costs "represents the net FIT liability incurred by [Brooklyn Union] on receipt of the contribution in aid of construction."

3. Stores loading: A loading factor of 15% "represents indirect costs associated with the acquisition and handling of materials, equipment, and supplies (e.g., storage/warehousing; purchasing, accounting, inspection)" that does not change materially from year to year.

2. Interconnection Facilities

The FCRA states that Brooklyn Union will "design, construct, furnish and own" a new gas main. NYCEG initially proposed that Brooklyn Union examine the feasibility of "refurbishing" an in-place spur line that has been abandoned for 25 years. By agreement of the parties, NYCEG has withdrawn that proposal.

NYCEG, however, has proposed modifications to the descriptions in the FCRA and the DA of Brooklyn Union's delivery point. In its response to NYCEG's proposed modification of the DA, Brooklyn Union states that "[t]he revision appears to be yet another NYCEG modification to the proposal's ever-changing delivery point," but then states that "[n]o change [to the language of the agreements] is needed at this time," because "a final commitment to a project at or near the Brooklyn Navy Yard can be accomplished in the process for development of the FCRA."

Finally, NYCEG proposed three editorial changes to the description of the interconnection facilities on page 3 of the FCRA. One change, substituting the word "Facilities" for "Main," is accepted by Brooklyn Union. Two others, deleting the words "and furnished" and "furnish" have been neither accepted or rejected, and have not been discussed by the parties.

3. Other

NYCEG and Brooklyn Union agree that NYCEG's obligation under the FCRA to reimburse the utility for costs incurred applying for governmental authorizations and obtaining materials and equipment be limited to reimbursement of "actual and reasonable" costs.

NYCEG and Brooklyn Union agree that the latter's health and safety plan procedures should apply to NYCEG, Brooklyn Union, and contractors. The FCRA would have required compliance with NYCEG's procedures (which probably do not exist).

NYCEG and Brooklyn Union agree that a party seeking to be excused for nonperformance under the FCRA because of a force

majeure event must notify the other party within five business days after the event occurs. The FCRA initially provided for a 14-day notice period.

The list of force majeure events[1] includes "inability to obtain necessary governmental authorizations and permits applicable to the proposed construction." NYCEG proposed to insert the adjective "unforeseeable" at the beginning of this item. Brooklyn Union has not commented on that proposal.

Minor Modifications to the DA

The DA originally stated that gas "tendered" by NYCEG to Brooklyn Union had to be used by NYCEG and could not be resold. NYCEG and Brooklyn Union now agree that the proper term should be "delivered."

NYCEG and Brooklyn Union agree that the term "Receipt Point" in §5.1 of the DA should be plural.

NYCEG and Brooklyn Union now agree that NYCEG's minimum bill will be for an annual transportation volume of 3,468,000 dt, and that the credit against the minimum for Brooklyn Union's non-performance due to breach or force majeure should be calculated using a daily volume of 9,501 dt.

NYCEG and Brooklyn Union have agreed to a variety of editorial changes concerning the allocation of the franchise tax assessed on the interconnection main. Brooklyn Union has not commented on NYCEG's proposal to change the reference to "installed book cost" to, simply, "book cost."

When Brooklyn Union learns of "governmental authority plans likely to require [facilities] relocations," it agrees that it should notify NYCEG promptly. The parties agree as well that Brooklyn Union should make a reasonable effort to give NYCEG 30 days' notice of the need to relocate facilities, the scope of the work required, and the estimated cost of the work. Brooklyn Union has not commented on NYCEG's proposal to add language obligating Brooklyn Union to use reasonable efforts and cooperate

[1] FCRA, p. 18.

with NYCEG to mitigate NYCEG's costs in connection with such relocations. Nor has Brooklyn Union commented on NYCEG's proposed addition of the word "reasonable" before the word "cost" in the passage requiring Brooklyn Union to provide "a statement setting out the cost of all such work." However a stipulation entered into on September 21, 1998 resolved this issue between the two parties.

The DA states that Brooklyn Union will cooperate with NYCEG in securing project financing for its facility, and that NYCEG will reimburse Brooklyn Union for all reasonable third-party costs (including reasonable legal fees) incurred by Brooklyn Union in providing such assistance. NYCEG proposes to add language stating that the third-party costs must have been incurred at NYCEG's initiation. Brooklyn Union has not commented on this proposal.

NYCEG agrees that it should bear the costs of removing liquids from delivered gas. It also agrees that if it refuses to receive gas from Brooklyn Union after gas quality deficiencies downstream from the meter are discovered, the penalty for breach of contract will apply to all quantities of gas refused by NYCEG until Brooklyn Union corrects the deficiencies.

NYCEG proposed language changes to Exhibit A to the DA that Brooklyn Union interpreted as contrary to the parties' agreement. The parties now state that "[t]here is no disagreement."

In the list of financing exceptions, NYCEG would insert the phrase "hypothecate for security" before the word "or" and the word "otherwise" before the word "encumber." Brooklyn Union has not specifically responded to these proposals.

Escalation Factor

The DA states that the initial demand and commodity charges be escalated annually by a factor equal to 68% of the

annual change in the GNP Escalator.[1] The first adjustment date set forth in the DA is January 1, 1999, and the change in the GNP Escalator would be measured by dividing the index number "for the third calendar quarter in the calendar year immediately preceding the current calendar year" by the index number "for the quarter ended September 30, 1998." The provision for escalation applies as well to the flat rates for pre-commencement interruptible deliveries and deliveries in excess of the maximum daily quantity.

NYCEG proposes that the first adjustment date be changed to January 1, 2000. NYCEG did not make a corresponding change to the quarter whose index would be the denominator in the escalation rate change factor (the quarter ended September 30, 1998). NYCEG has also proposed a simplified restatement of the full contract escalation formula.

Brooklyn Union accepts the restatement of the formula, based on NYCEG's representation that the change effects no substantive change in the formula.

[1] Specifically, the Gross National Product Implicit Price Deflator published quarterly by the U.S. Department of Commerce (1992 = 100).