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Comments

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May 29, 2007

VIA HAND DELIVERY

The Honorable Jacyln A. Brilling
Secretary
State of New York Public Service Commission
3 Empire State Plaza
Albany, New York 12223-1350

RE: Case 07-G-0299, In the Matter of Issues Associated with the Future of the Natural Gas Industry and the Role of Local Gas Distribution companies – Capacity Planning and Reliability

Dear Secretary Brilling:

Enclosed on behalf of New York State Electric and Gas Corporation and Rochester Gas and Electric Corporation, are an original and ten (10) copies of Reply Comments in the above-referenced proceeding.

Respectfully submitted,

Elizabeth W. Whittle /sp

Elizabeth W. Whittle
Counsel to
New York State Electric & Gas Corporation and
Rochester Gas and Electric Corporation

Enclosures

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ORIGINAL

BEFORE THE
STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

Case 07-G-0299 - In the Matter of Issues Associated with the Future of the Natural Gas Industry and the Role of Local Gas Distribution Companies – Capacity Planning and Reliability

REPLY COMMENTS OF NEW YORK STATE ELECTRIC & GAS CORPORATION AND ROCHESTER GAS AND ELECTRIC CORPORATION

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Counsel to
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REPLY COMMENTS OF
NEW YORK STATE ELECTRIC & GAS CORPORATION AND
ROCHESTER GAS AND ELECTRIC CORPORATION

Pursuant to the March 14 Notice issued in the above-referenced proceeding, New York State Electric & Gas Corporation ("NYSEG") and Rochester Gas and Electric Corporation ("RG&E") (hereinafter jointly referred to as "the Companies") hereby file these Reply Comments to the Comments filed by various parties in this proceeding. The Companies are encouraged that there appears to be wide-spread consensus to implement a mandatory capacity assignment model for retail access in New York. The Companies believe that the underlying differences in positions are resolvable and will allow prompt implementation of the program. In support of these Reply Comments, the Companies assert as follows:

I.

BACKGROUND

On March 14, 2007, the New York Public Service Commission issued a Staff White Paper on Capacity Planning and Reliability ("White Paper") for comment. A component of the White Paper is a straw proposal developed by Staff that outlines a process for transitioning to a retail access program that would employ mandatory capacity assignment from the Local Distribution Company ("LDC") to the Energy Service Companies ("ESCOs") serving retail customers in the LDC service territory.

On May 18, 2007, the Companies filed Comments in this proceeding. In their Comments, the Companies generally support the straw proposal described in the Staff White Paper. The Companies note that capacity assignment by the LDC to the ESCOs provides these ESCOs with the firm capacity necessary to serve customers and better enables the availability of sufficient firm capacity at the LDC citygate in order to serve all core customers even in the event the ESCO leaves the LDC market area.

As indicated in their Comments, the Companies support a mandatory capacity assignment model for all "core customers" as that term is defined in the Commission's Opinion No. 94-26. [1] In transition to this mandatory capacity assignment model, the Companies do not believe that indefinite grandfathering, as proposed by the Staff in the straw proposal, is necessary. Once the current underlying pipeline contract between the ESCO and the interstate pipeline expires, so should the rights to serve customers using third party/non-LDC capacity. In the same vein, if an ESCO sells or otherwise transfers its customers to another ESCO, the use of firm interstate transportation capacity released to that replacement shipper should only be grandfathered until the termination/expiration of the underlying pipeline contract. If an ESCO only possesses a transportation contract with a 5 month term, the ESCO would immediately be required to obtain a contract with a 12-month capacity requirement, and that contract would not be grandfathered.

To establish an end date to the transition to a mandatory capacity assignment model, the Companies proposed in their Comments that there should be a date certain by which this transition is complete. By November 1, 2009, all human needs and aggregation customers should be subject to mandatory capacity assignment. By November 1, 2011, all other core

1 Case 93-6-0932, Restructuring of the Emerging Competitive Market, Opinion No. 94-26 (issued December 28, 1994).

customers should take capacity via mandatory capacity assignment.[2] Finally, the Companies support the straw proposal that would require capacity be held (during the transition period) or assigned, for twelve months.

Many other parties also filed comments. In all but one case, parties support generally the straw proposal as it relates to the adoption of a retail program based on a mandatory capacity assignment model.[3] What separates comments are details such as: (1) the customer group to which mandatory capacity assignment will apply; (2) the scope of grandfathering; and (3) term and scope of capacity releases. A number of parties sought clarification of components of the straw proposal.

The Companies will not respond in these Reply Comments to each comment of each party. Instead, the Companies will reply to certain positions raised and address why the Companies' overall proposal as expressed in its Comments and as clarified herein is best adapted to the circumstances that exist in the markets today and for the foreseeable future.[4] To be sure, the reliability issues addressed in the White Paper and straw proposal are not, as the National Energy Marketers Association ("NEM") asserted, a "red herring rooted in vertically-integrated utility lore."[5] Reliable service requires that natural gas be deliverable to the citygate on a primary firm basis. In light of the Federal Energy Regulatory Commission's ("FERC's") policies and rules that permit flexible use of transportation capacity, the only way to keep natural gas coming to the LDC citygate on a firm primary point basis is for the LDC to hold the capacity

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2 See Comments at p.16.

3 Only Shell Trading Gas and Power Company ("Shell Trading") opposes the mandatory capacity assignment model.

4 The fact that the Companies do not respond to a comment does not mean that it opposes or supports the issue raised.

5 NEM Comments at 2.

and release it, retaining recall and rights of first refusal ("ROFR") to the appropriate LDC citygate. It is a fact, not a red herring.

II.

ARGUMENT

A. Mandatory Capacity Assignment Should Apply to All Core Customers

The Companies believe that the mandatory capacity assignment model must apply to all core customers, as core customers have been defined by the Commission in Opinion 94-26. It is these core customers that the LDC must be prepared to serve. UGI Energy Services, Inc. ("UGI") does not support a mandatory capacity assignment model that would require mandatory capacity release for "larger commercial and industrial customers, interruptible customers or dual fuel customers of any type at this time."[6] Multiple Intervenors ("MI") appears to desire a program where commercial and industrial customers that otherwise would be core can "choose the level of service on the interstate system that best fits their complex needs."[7] MI also suggests that MI's constituents not be responsible for any stranded costs resulting from any transition to the new model.[8]

The inclusion of all core customers in the mandatory capacity release model is important to better enable LDCs to provide reliable service to customers behind the citygate. If a customer has no alternative fuel, it is reliant on the LDC's service to deliver natural gas. MI acknowledges in its comments that many of its members are core customers. MI then argues that MI's members should be able to remain core customers on the LDC system, yet bring third party

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6 UGI Comments at 2.

7 MI Comments at 3.

8 *Id.*

capacity to the citygate on a secondary, not primary, basis.[9] MI admits that its members utilizing secondary capacity in this way "run[] the risk of not getting gas to the LDC system."[10] Yet, MI asserts that these customers may "assume this risk." What MI seeks is a fundamental change in the services provided by the LDC. Currently under the Companies' Tariff, an ESCO utilizing secondary firm capacity to the LDC citygate for a customer must affirmatively acknowledge that the customer is "subject to interruption"[11] if secondary deliveries are not available at the citygate. MI would seek to modify the Tariff and long-standing LDC operations and treat ESCOs and MI members as if they had primary point capacity delivered to the citygate.

With respect to transition costs, fundamental principles of cost causation may result in assessment of costs to MI members' that may arise in the transition to a mandatory capacity assignment program. It isn't clear that there will be any such costs, but if there are any, no group of customers should be declared in advance to be immune.

Finally, it would be improper for MI's members to be able to, on the one hand, be considered a customer eligible for protection in the event of curtailment, while, on the other hand seek to step away from the service obligations afforded to core customers on a daily basis. MI members who are core customers should be treated the same as every other core customer on the LDC system.

The Companies agree with UGI that dual fuel and interruptible customers need not participate in a mandatory capacity model.[12] They do not meet the definition of core customer.

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[9] MI Comments at 5. MI states, "...a customer characterized as "core" at the distribution level should continue to be permitted to choose between secondary firm or primary firm at the upstream pipeline level without jeopardizing its "core" status."

[10] *Id.*

[11] RG&E Tariff, PSC 16-Gas, Leaf No. 127-30.

[12] UGI Comments at 2.

However, as noted by the Companies and others, it is imperative that the mandatory capacity assignment model and the overall retail access program be fair, evenly applied and non-discriminatory. The best way to enable reliable supplies to reach the LDC citygate for all core customers is to make such customers subject to a mandatory capacity assignment model. Moreover, as noted by National Grid, should circumstances require, such mandatory assignment could extend to upstream transportation contracts.[13]

B. The Commission Should Adopt the Companies' Transition Mechanism In Lieu of the Grandfathering Proposal in the Straw Proposal

Most of the comments submitted address in one way or another, the scope and breadth of the Staff's straw proposal to grandfather existing ESCO capacity arrangements. On the one hand, some comments support extensive grandfathering of existing marketer capacity rights, including expansion of capacity rights to account for load growth (UGI), while others support a narrow grandfathering mechanism (KeySpan). In between are proposals to allow an ESCO to elect to transfer capacity along with its customers when exiting the market (UGI), to requiring the ESCO to do so if it transfers customers (Hess). The Companies submit that their proposal to transition to a mandatory capacity assignment model is superior to that proposed in the Straw Proposal. As proposed in Comments, the Companies would require ESCOs to transition to mandatory capacity assignment at the earlier of the expiration date of the existing transportation contract or November 1, 2009 for all human needs and aggregation customers, or November 1, 2011 for all other core customers.[14] Any ESCO with contracts that extend past 2011 could be addressed on a case by case basis. ESCOs with primary firm contracts with 5 month (not 12 month) terms would transition immediately to the mandatory capacity assignment model.

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[13] National Grid Comments at 4.

[14] Companies' Comments at 16.

To allow for unlimited and unfettered grandfathering will create two classes of ESCOs – those with and those without grandfathered capacity. This two class system will, at a minimum, create a perception that one class of ESCO has a competitive advantage over the other could discourage the entry of new marketers to the program, reducing the options of customers. Of course, it is natural for ESCOs possessing transportation contracts to want to hold onto them in case it turns out that holding this grandfathered capacity provides a competitive advantage. However, an orderly transition to mandatory capacity assignment is the right thing for the entire market.[15]

In contrast, allowing an ESCO to increase its capacity holdings as its load grows, as promoted by UGI (at 3), would never result in the transition to mandatory capacity assignment, could discourage entry of new ESCOs and would not provide for the necessary reliability. Such a situation could also further increase capacity constraints on the interstate pipeline systems. As described in more detail in Section D below, in order to develop additional incremental capacity, the project must have adequate market support. ESCOs generally are not willing or able to contract for capacity for terms necessary to support an incremental project. Thus, the LDC should be the entity to contract for capacity and release it to support retail access. Hess promotes grandfathering at the volumetric level served by the ESCO and would reduce the grandfathered level of capacity to the extent customers are transferred to another ESCO or return to utility service.[16] This approach, so long as all customers would transition to mandatory capacity assignment upon the earlier of the expiration of the transportation contract or the transition periods discussed above would not be inconsistent with the Companies' position.

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15 *See also*, filed by National Fuel Gas Distribution at 3

16 Hess Comments at 3.

C. The 12 Month Capacity Requirement from the Staff White Paper Should Be Implemented

A number of parties take issue with the Staff White Paper and straw proposal that would require ESCOs to obtain by release capacity on a twelve month basis. The Companies support the straw proposal in this regard. However, the Companies believe there is some confusion with this requirement. Many LDCs have programs today where the ESCO contracts with the LDC on an annual basis, but takes release of capacity on a monthly basis. This is how the Companies' programs work. Release of capacity on a monthly basis allows the ESCO to more closely tailor its capacity needs to its load. This same monthly release program would remain, however, the capacity would be released to the ESCO monthly on an annual basis and the cost responsibility would follow on an annual basis. ESCOs would be free to use the capacity that it has obtained on a secondary basis so long as primary point capacity is maintained to the citygate, providing the same flexibility available to ESCOs today. In contrast to Hess (at 7), it is the Companies' position that in order to be grandfathered capacity, the capacity must be supported by a contract for 12 months of capacity.

D. Whatever Program is Implemented Must Be Fair, Non-Discriminatory and Neutral to Create a Level Playing Field for All ESCOs

The Companies support implementation of a mandatory capacity assignment model that is fair, non-discriminatory and neutral to all ESCOs so that all ESCOs seeking to serve customers obtain LDC capacity in an impartial manner. The Companies' proposed transition period process is an orderly way to transition to a mandatory capacity assignment model. Certain proposals and comments made by some parties do not appear to be designed with the same goal in mind. The Companies' concerns will be mentioned briefly.

First, the New York Energy Marketers Coalition ("NYEM"), comprised of Interstate Gas Supply of New York, Inc., Vectren Retail, LLC and Commerce Energy, Inc., filed comments that not only seek radical changes to the retail access program that are clearly beyond the scope of this proceeding, but also suggest that the LDC should not be permitted to pursue any optimization efforts other than the release of capacity to ESCOs.[17] While the Staff in the White Paper note that other proposals as alternatives to the straw proposal will be considered if supported, NYEM does not address directly the straw proposal or the findings in the White Paper.

Instead, NYEM promotes, for example, the view that LDCs should exit the merchant function entirely and adopt an Ohio LDC's retail model for all New York LDCs.[18] While it is always interesting to learn how individual LDCs in other states address retail access issues under that state-implemented retail access legislation, it is simply naïve at best to assert that this model is appropriate for all LDCs in New York.

Setting aside the lack of specificity in the comments to support such a result, NYEM does not acknowledge some of the fundamental differences in the operational characteristics of East Ohio Gas from LDCs in New York. NYEM ignores the complicated and web-like delivery systems that exist in many LDC territories like NYSEG, where capacity from certain pipelines serve discrete areas of the NYSEG service territory. NYEM does not address the various issues that affect LDCs in upstate and downstate markets. With respect to NYEM's position that the LDC should not be permitted to engage in any optimization efforts, leaving that activity solely to ESCOs,[19] the Companies believe that will lead to additional costs for customers. If, as NYEM asserts, "pipeline and storage assets should be carefully managed by all parties as the property of

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17 NYEM Comments at 3.

18 NYEM Comments at 5.

19 NYEM Comments at 4.

the consumer"[20] why shouldn't the LDCs manage those assets in a cost effective way, while remaining in compliance with FERC's interstate capacity release rules and while releasing capacity to ESCOs for their use? In any event, the NYEM comments raise issues that are well beyond the scope of this proceeding and must be considered unsupported for purposes of the White Paper.

Second, Shell Trading takes issue with the White Paper and views changes to the retail market programs described in the Staff straw proposal as unnecessary. According to Shell Trading, the need to ensure deliverability of firm transportation capacity to the citygate for reliability should not be a concern because new natural gas resources will be available by virtue of various proposed interstate pipeline projects and because FERC may change some of its capacity release rules in the future.[21] Shell's lack of concern should not be shared by the Commission.

To be sure, there are a number of proposed pipeline projects on record at the FERC. However, because a pipeline company has a FERC certificate, there is no guarantee that the pipeline project will be built. As Shell Trading, a developer of pipeline and LNG projects through affiliated companies, is aware, nearly all projects certificated by FERC are, at a minimum, delayed, and in many instances, never built. There are many reasons for this - - sometimes environmental concerns cannot be overcome, there may be extensive litigation over routes with landowners, or it may be that the project does not have adequate market support. In the LNG area, while there are a number of proposals for LNG development on the east coast, none has proceeded easily through the regulatory process and, in at least one instance, Congress

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[20] NYEM Comments at 4.

[21] Shell Trading Comments at 4-5.

has enacted legislation preventing re-construction of a bridge that must be raised in order for LNG tankers to navigate the waterway, effectively preventing the project from proceeding as proposed. Reliance on these projects to ensure deliverability of natural gas to LDCs is a unwise way to proceed and ignores the practical realities of pipeline development.

In addition, it may be that a mandatory capacity assignment methodology *helps* the development of additional capacity. LDCs have the regulatory mechanisms in place to be able to contract for capacity on a long-term basis. ESCOs, with contracts that are generally of shorter-term duration, cannot make the assurances that pipelines require in order to move forward with large infrastructure projects. If, as Shell Trading asserts, an LDC must "bid to win"[22] firm primary point capacity to the citygate, that fact sends market signals as to the value of the capacity, which, if circumstances are right, will encourage the development of incremental capacity, if the market requires additional capacity. Thus, Shell Trading's assertions that the Commission should do nothing but await new pipeline construction or LNG market development should be rejected.

In this same vein, it is not wise to await a decision by FERC to change its rules. The proceedings underway to which Shell Trading refers (at 9) seek modest changes/clarifications to the capacity release rules to allow entities engaging in portfolio management activities to understand what they can and cannot do under FERC's regulations. This clarification is necessary in light of FERC's new civil penalty authority obtained from Congress in the Energy Policy Act of 2005. While a few commenting parties in that FERC proceeding suggested that the shipper must have title policy should be abandoned, just as many said it should not be. In the meantime, FERC continues to assess multi-million dollar civil penalties for violators of its

22 Shell Trading Comments at 4.

policies. Awaiting FERC action that may or may not come is not a viable means to ensure that deliverable, primary point capacity is available at the LDC citygate in New York.

III.

CONCLUSION

The Companies support the White Paper and related straw proposal as it relates to the transition to a mandatory capacity assignment model. The Companies do not support grandfathering as proposed by Staff, but have proposed a viable and rational transition mechanism that works more effectively to transition all ESCOs to the same model in an efficient way with a minimum of disruption. The Companies support the straw proposal as modified by their Comments and Reply Comments submitted herein and ask that the Companies adopt a mandatory capacity assignment model as proposed by the Companies. Also, the Companies ask that, in adopting an Order in this proceeding, the Commission clearly state that prior Commission policies/Orders regarding capacity assignment are superseded by the Commission's

Order in this case. Doing so will minimize confusion in the market and facilitate development of LDC tariffs and procedures.

Respectfully submitted,

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Dated: May 29, 2007

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing comments on each person listed on the active party list maintained by the Commission in this proceeding.

Dated in Washington, DC this 29th day of May, 2007.

Elizabeth W. Whittle /ap

Elizabeth W. Whittle