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April 6, 1998

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98-G-0122
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Hon. John C. Crary
Secretary
New York State Public Service Commission
Three Empire State Plaza
Albany, New York 12223-1350

Re: Case No. 98-G-0122 - Proceeding on Motion of the Commission to Review the Bypass Policy Relating to the Pricing Case No. 98-G-0122 of Gas Transportation for Electric Generation

Dear Secretary Crary:

Enclosed please find for filing in the captioned proceeding, the original and ten copies of the Comments of Indeck Energy Services, Inc.

Respectfully submitted,

READ AND LANIADO, LLP

By:


Craig M. Indyke

CMI/klh
Enclosures

cc: All Parties

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STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

Proceeding on Motion of the
Commission to Review the Bypass
Policy Relating to the Pricing
of Gas Transportation for
Electric Generation

Case No. 98-G-0122

COMMENTS OF INDECK ENERGY SERVICES, INC.

On January 30, 1998, the New York State Public Service Commission (the "Commission") initiated a proceeding to consider issues relating to the pricing of gas for electric generation,¹ including the Commission's current Gas Bypass Policy Statement ("Bypass Policy").² Indeck Energy Services, Inc., ("Indeck") an electric generator and gas purchaser, welcomes the opportunity to comment on the inter-relationship between pricing gas transportation and the development of electric competition.

OVERVIEW OF CURRENT POLICY

The Commission's existing Bypass Policy encourages Local Distribution Companies ("LDCs") and combination electric/gas utilities (collectively "the utilities") to rely upon pre-existing gas transportation contracts with a select few generators, and transfer mechanisms among an

¹ Case 98-G-0122 - Proceeding on the Motion of the Commission to Review the Bypass Policy Relating to the Price of Gas Transportation for Electric Generation, Order Instituting Proceeding and Technical Conference (January 30, 1998).

² Case 90-G-0379 - Proceeding on Motion of the Commission to Investigate the Impact of Bypass by Gas Cogeneration Projects, Statement of Policy Regarding Rate Treatment to be Afforded to the Expansion of Gas Service into New Franchise Areas (March 6, 1991); Case 90-G-0379, Clarification of Statement of Policy Regarding Bypass of Local Distribution Companies by Large Volume Users (August 12, 1991).

incumbent's affiliated gas and electric generation units, to thwart the emergence of robust electric competition. For electric competition to emerge successfully, the Commission must establish pro-competitive natural gas transportation pricing policies that ensure a gas market characterized by equal and open access for essential bottleneck elements.

As a result of the evolution of the gas and electric markets from monopoly to competition, pre-existing arrangements have created a playing field that favors certain generators over others. Under the Commission's current Bypass Policy, the utilities are allowed to file and utilize transportation tariffs that provide for a variety of rates and individually negotiated contract rates with end-users that would otherwise bypass the distribution system.³ The Bypass Policy notes that, "negotiated contracts at similar terms shall be available to all similarly situated customers."⁴ In a subsequent clarification of the Bypass Policy, the Commission determined that contract terms may vary to the extent the difference has a rational basis, whether in cost measurement, non-cost considerations, value-of-service or other considerations, and that comparability of customers and contacts can only be addressed on a case-by-case basis.⁵ In addition, the Commission further clarified its Bypass Policy to state that a departure from the tariff, thereby affording the end-user pricing flexibility (*i.e.* individual negotiation), is only permitted where bypass of the LDC is a real possibility.⁶

³ Case 90-G-0379, Statement of Policy Regarding Rate Treatment to be Afforded to the Expansion of Gas Service into New Franchise Areas, at pp. 19-21 (March 6, 1991).

⁴ Id. at p. 19.

⁵ Id. at p. 4.

⁶ Case 90-G-0379, Clarification of Statement of Policy Regarding Bypass of Local Distribution Companies by Large Volume Users, at p. 2 (August 12, 1991).

Thus, the ability or the real possibility of bypassing the local distribution system became a qualifying criterion for a customer to obtain access to more favorable and individually negotiated transportation rates.

Such a policy is not adequate given the Commission's desire to create a new regime based on a competitive marketplace. The existing Bypass Policy does not support competition because it creates the opportunity for the utilities to enter into secret anti-competitive deals, below-market affiliate deals, and deals that unfairly discriminate among similarly situated electric generators.

The present policy also gives the utilities the power to delay and to refuse to negotiate with a potential electric generation competitor based on the fact that an otherwise viable new entrant cannot meet the sometimes arbitrary utility criteria showing that a possibility of bypass exists. A potential competitor denied admission to lower gas transport prices is severely disadvantaged in the generation market. Moreover, even if a new entrant meets the utility's "bypass" negotiation threshold, the fact that the terms, prices and conditions arising out of other negotiations may not be publicly available provides the negotiating utility with undue bargaining power and an ability to discriminate against certain generators.

New entrants cannot negotiate effectively with the LDC or combination utility, which has an incentive to preserve the monopoly-rent profits derived from transportation services to non-affiliated or non-utility units. As a result, a potential new entrant's gas transportation costs are likely to be more costly than the price that incumbent utility generators are paying.

The current regulatory regime directly encourages such harmful discrimination,

introducing unwanted distortion into the electric generation marketplace.

These concerns are not hypothetical. As competitors have begun to explore their options, they have increasingly recognized that they face the potential for discrimination.

One such example is Indeck-Corinth's experience with Niagara Mohawk Gas. Upon information and belief, Niagara Mohawk Gas interrupted the Indeck-Corinth plant's gas supply during January, 1997 without interrupting other similarly situated non-core customers with service contracts containing similar interruption provisions.⁷

Another recent example of potential discrimination that can arise out of the inter-relationship of the Bypass Policy and electric competition is the City of New York Energy Group's ("NYCEG") complaint against the Brooklyn Union Gas Company ("Brooklyn Union"). NYCEG requests a Commission order requiring Brooklyn Union to: 1) cease its discriminatory and unlawful practices against NYCEG; 2) cease demanding unreasonable rates and terms for gas transportation service; and 3) negotiate and execute a gas transportation contract that is substantially in conformance with Brooklyn Union's agreement with other similarly situated customers.⁸ This complaint was apparently initiated as a result of NYCEG's belief that Brooklyn Union had refused to negotiate with NYCEG.

⁷ Case 97-G-0136 - Complaint of Indeck-Corinth Limited Partnership Against Niagara Mohawk Power Corporation Concerning the Legality and Propriety of Certain Interruptions of Gas Service, Complaint, ¶ 23 (January 31, 1997). While the Commission has not yet ruled upon Indeck's complaint, it illustrates that situations can arise where discrimination by the utility in gas transportation availability and price among emerging competitive generators can have significant consequences for the emerging electric market.

⁸ Case 97-G-0388 - Complaint of New York City Energy Group Against the Brooklyn Union Gas Company Concerning Gas Service to New York Energy Groups' Proposed Cogeneration Facility, Ruling on Motions, pp. 3-4 (July 30, 1997).

Given these examples and the Commission's goal to achieve a robust competitive market for all types of electric generators a new policy that negates the potential for discrimination by the utility is necessary. Section 65 of the Public Service Law ("PSL") expressly prohibits undue discrimination among similarly situated customers by gas corporations. Section 65(3) states:

No gas corporation. . . shall make or grant any undue or unreasonable preference or advantage to any person, corporation or locality, or to any particular description of service in any respect whatsoever, or subject any particular person, corporation, or locality or any particular description of service to any undue burden or unreasonable prejudice or disadvantage in any respects whatsoever.⁹

Modification of the Commission's policies to facilitate electric competition by reducing the potential for undue discrimination, as proposed by Indeck, would be fully consistent with the statute.

Any new policy must address the fact that unfettered individual negotiations regarding gas transportation presents a barrier to market entry that new entrants cannot cure without Commission intervention.

While new entrants are attempting to overcome the utility's dilatory tactics, the incumbent electric generators, in combination with the LDC's affiliates, can secure customers and market share.

A system of transportation tariffs and pricing rules should be established that does not discourage consideration of new projects relative to existing generation units. The pricing rules should also not lead to the creation of new electric generation load pockets.

⁹ N.Y. Pub. Serv. Law § 65(3) (1989 and Interim Supp. 1997-98) (emphasis added).

The Commission's Bypass Policy is simply no longer appropriate for the electric generation market. It is, in fact, anti-competitive. Without a revised Bypass Policy and increased availability of similar gas transport rates for similarly situated generators the Commission's goal of achieving robust competition in the electric market will be undermined. Electric rates will be needlessly higher.

INDECK'S PERSPECTIVE AND PROPOSAL

Two immediate options are available to the Commission to ensure that the emergence of electric competition becomes a reality.

The Commission could: (1) order utilities to implement new rate designs using cost-based rates for gas transportation to electric generators; or (2) establish now a postage-stamp rate to serve as a standard baseline offer that could be supplemented with individual negotiations. Negotiation-based rates, however, must be available to all parties, not just to those parties that can only meet the often times arbitrary bypass criteria of the utility.

While a fully developed cost-based rate design option has benefits for overall policy development, it may be inferior, in some respects to a proposed postage-stamp option. A cost-based rate design option could involve the creation of a new rate design with an open, transparent pricing scheme designed from scratch. This scheme would include all new rates for all service and generation loads and it could preclude individually-negotiated "bypass" rates, if it were viewed as the exclusive rate offering. This approach could create a level playing field but could be so cumbersome and time consuming that it would thwart a timely and much needed revision to the current Bypass Policy.

Thus the second approach, the one favored by Indeck, involves the creation of a standard gas transporter tariff derived generally from marginal or incremental cost-based guides which could then be supplemented by negotiations regardless of an electric generator's ability to demonstrate a real possibility of bypass. All provisions of the new contract (without any redaction) should be filed as public documents. This approach is beneficial to both the emerging competitive gas and electric market, as it avoids negative impacts such as a higher price of electric power for consumers. It also reduces the potential for stranded costs when auctions are held to disaggregate the existing utilities into multiple competitive utility generators.

Parties would be free to negotiate higher or lower rates than those offered in the standard tariff using predetermined factors. Examples of the type of factors that could be utilized include: 1) desired reliability of service (i.e. degree of firmness); 2) class of service; 3) size of generator; and 4) pressure requirements.

All negotiated rates would be posted on an open access system as public records. This would ensure that all parties have sufficient information to negotiate the best possible contractual arrangement. Inequitable deals between affiliates, and others not negotiating at arms length, would be eliminated by the bright light of public disclosure and deterred by the utility's knowledge that subsequent carriers will seek to obtain the same favorable terms.

Disclosure of all rates would also lead to industry scrutiny of the pricing practices of the utilities. Excessive demands and price gouging would be eliminated by the open comparison of how services are priced-out. In short time, utilities would need to

improve their price and service offerings or face the prospect of being completely displaced by interstate pipelines operating under national policy and regulation or, in the alternative, losing overall business to states with more responsive price regulation.

The proposed requirement that individually negotiated rates for gas transportation among competitive providers be made public as an element in the transition to competition is not a new concept. For example, in the telecommunications industry, the Commission has required negotiated interconnection agreements pursuant to Section 252 of the 1996 Act be circulated to predetermined public service lists and be filed for the benefits of all other telecommunications carriers seeking interconnection, services or network elements.¹⁰ To prevent market inequity from developing, the Commission required that all negotiated or arbitrated agreements be made publicly available, thus guaranteeing that all emerging competitors had access to information on the types of available arrangements. By the blending of tariff regulation, public disclosure and market forces, the Commission is moving to eliminate a bottleneck monopoly structure (interconnection). The process proposed by Indeck to deal with the vestige of the monopoly bottleneck at issue (the utility's control over gas transport), if adopted by the Commission, would also work in a similar fashion to allow the emergence of true competition in the electric generation market.

In addition, Indeck proposes that utilities be allowed to keep all, or substantially

¹⁰ Cases 94-C-0095; 95-C-0657; 91-C-1174; 93-C-0103 - Proceeding on Motion of the Commission to Examine Issues Related to the Continuing Provision of Universal Service and to Develop a regulatory Framework for the Transition to Competition in the Local Exchange Market; Proceeding on the Motion of the Commission Regarding Comparably Efficient Interconnection Arrangements for Residential and Business Links, Notice of Procedures for Implementing Sections 251 and 252 of the Telecommunications Act of 1996 (June 14, 1996).

all, revenue from incremental load rather than passing those revenues exclusively back to utility consumers. This would shift the focus of utilities from revenue maximization to the maximization of throughput on the system, thereby enhancing efficiency.

INDECK'S RESPONSE TO SPECIFIC POLICY ISSUES

To further address the specific issues identified by Staff, this portion of the comments mirrors Staff's suggested outline.¹¹

1. Modification to Existing Commission Policy

In order for the competitive solution found by Indeck to be effective, the Commission's policies regarding gas transportation to electric generators must be modified to make the development of competition the foremost goal. First, the existing requirement that a bypass alternative exist as admission to the gas transportation price negotiation process must be eliminated. Second, all negotiated rates must be posted on an open access information system so that all significant terms and rates are a matter of public record. Third, the Commission should adopt a stated policy goal of maximization of system utilization by the utilities. To further this goal, utilities should be allowed to retain all, or substantially all, of the revenue they generate from providing transportation service to electric generators, except as generation loads, where preexisting contracts, regulatory settlements or showing arrangements are in place.

2. Value-of-Service Pricing

¹¹ Case 98-G-0122, Recommended Outline for Comments (March 6, 1998).

Value-of-service pricing is a vestige of monopoly pricing which should be discontinued. Electric generators would be allowed to negotiate higher or lower prices than the standard tariffed rate depending on the desired service but value-of-service pricing, which extracts monopoly-rents would be eliminated. During negotiations, certain factors would be used to establish prices other than the tariffed rate. Those factors include, but are not limited to: (1) desired reliability of service (e.g., firmness of service); (2) class of service; (3) size of generator; and (4) pressure requirements. Ultimately, however, an entrant could insist that cost of service principles be the guiding force underlying price outcomes.

3. Applicability of Policy

In terms of rates and service offerings, the policy would be applied equally to all electric generators. The revenue stream from pre-existing service, however, would be treated differently for existing generators and new generators. The revenues would be passed through to the ratepayers using current ratemaking practices. For new generation, the utilities would keep the revenue stream as an incentive to complete new deals. This should eliminate the current problem of utility's refusing to negotiate.

4. Impact on Core Electric and Core Gas Customers

In its recommended outline, Staff has asked how PSL Section 66-d would limit the Commission's options. PSL Section 66-d states that:

[t]he Commission, upon its own initiative or upon application by a natural gas producer or a consumer of natural gas in any year and after notice and hearing shall, upon such terms and subject to such conditions as the Commission considers just and reasonable, have the authority to order any gas corporation to transport or contract with others to transport gas under contract for sale by such producer or owned by such consumer provided that, the Commission finds that

the gas corporation has available capacity, that no undue burden shall be placed upon the gas corporation or its ratepayers and that the ability of the gas corporation to render adequate service to its customers is not impaired.¹²

This law would not limit the Commission from implementing Indeck's proposal, as it would neither unduly burden the gas corporation or its ratepayers nor impair the ability of the gas corporation to render adequate service to its customers. Rather, the proposal would ensure that electric generators, as customers of the gas corporations would be treated on a non-discriminatory basis.

5. Portability

The transfer prices for utility services to the electric generators of combination utilities should be portable if they are controlled by an existing approved Commission contract or settlement when generating plants are auctioned by the utility. However, the transfer prices should only be available for the specific term of the settlement or agreement.

6. Criteria for Similarly Situated Generators

In order to determine whether generators are similarly situated the following criteria should be used: (1) location of the generator on the system; (2) size of the generator; (3) availability; (4) same class of service (e.g. firm, quasi-firm); (5) proximity of utility on the system; (6) size of load; (7) owner of the upstream transportation rights; (8) whether the utility is receiving peak shaving service; and (9) presence or absence of load balancing requirements.

In addition, these elements should have specific levels or definitions so that

¹² Pub. Serv. Law § 66-d (1989 and Interim Supp. 1997-98).

industry-wide standards and commonly accepted similarities and differences in transportation services can be refined and understood. Together with publicly disclosed rates and contracts, similarly situated generators will quickly be able to identify and defend against discriminatory price and service proposals.

7. Treatment of Lost Revenues from Gas Load

The lost revenues from gas load displaced by energy from the electric generator should not be required to be factored into the development of the rate. This would not be a sound general ratemaking policy.

TARIFF V. NEGOTIATION

1. Compatibility of Individually Negotiated Contracts

As stated above, the plan proposed by Indeck is based on the principle that electric generators and utilities would be able to negotiate a higher or lower price than the standard marginal cost guided tariffed rate for transport prices. In order for individually negotiated contracts to be compatible with the development of a competitive, non-utility, electric generation industry, the tariffed rate must function as a standard default or back-stop rate. This rate could be supplemented by open access prices set by individually negotiated contracts.

2. Maximization of Revenue

The rates should be set to encourage maximization throughput, not revenues.

The utilities would be given an incentive to complete deals and maximize throughput if they were permitted to keep the revenues from the contracts with generators of incremental load. Existing contract and settlement terms, if applicable, would be allowed to continue until expiration when the new policy would apply.

3. Standard Tariffs and Unitized Prices

A standard tariff should be developed for electric generators, which would establish marginal-cost guided postage-stamp transportation rate(s). When negotiating differences from the tariff rate, the following items should be taken into account but not specifically unitized: (1) location on the distribution system; (2) maximum daily quantity; (3) minimum annual quantity; (4) interruption criteria; and (5) term of rate. In addition, balancing provisions and peaking services should be consistent on a tariff basis but not factored into the standard tariff prices.

4. Tariffs and Negotiations

As stated above, a system using both tariffs and negotiations can and should be pursued by the Commission.

5. Necessity of Tariffed Rates

A tariffed rate and a system to post negotiated rates is necessary to ensure open access. A tariffed rate would ensure a competitively neutral option for all potential electric generators, but could be too inflexible to account for differences between customers. A system that posts negotiated rates will ensure that all generators who are similarly situated

have the same pricing options. It will also disclose to all market participants the market place characteristics in the state.

PRICING/TECHNICAL

1. Rate Schedules

The standard rate schedule should not provide for various degrees and priorities of interruptibility, peaking services, balancing services and pricing conditions for location differentials. Peaking services and balancing provisions should be consistent on a tariff basis.

Parties would be free, however, to negotiate higher or lower prices than the tariffed rate based on any of the considerations mentioned above.

2. Offer of Gas Peaking Services

An LDC should not be forced to accept an offer of gas peaking services. However, peaking services should be offered only on standard contract terms.

3. Gas Peaking Services When Utility Exits Merchant Market

If the utility exits the merchant business, renegotiation of any peak shaving agreements would solely be the utility's responsibility.

4. Gas Balancing Services

The LDC should be free to offer balancing services to generators. The terms

for balancing services should be established in a standard offer tariff.

CONCLUSION

Given the Commission's stated policy to move toward competition in the electric market, the Commission should adopt the new and pro-competitive policies proposed by Indeck in these comments for the gas market. Indeck strongly supports the modification of the Bypass Policy to allow individual negotiations on gas transport rates for electric generators regardless of bypass availability. Such negotiations should be backed-up by a Commission mandated standard tariff offering by the utility for gas transport. The tariff will provide a fall-back option and a baseline for negotiating gas transportation service, a service that has retained its monopoly nature. Parties would be free to negotiate higher or lower rates than the standard tariff rates based on the various factors mentioned in the discussion above. All negotiated rates and terms would be posted on an open access system as public records so that no competitor would be disadvantaged. Revenues from incremental load could be retained by the utility. Overall, this new process would minimize the potential for negative impact on existing gas customers while furthering the Commission's stated policy goal of encouraging robust, self-sustaining electric generation competition.

Dated: April 6, 1998

Respectfully submitted,

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cc: All Parties