

Filed Session of October 22, 2003
Approved as Recommended
and so Ordered
By the Commission

JACLYN A. BRILLING
Acting Secretary
Issued and Effective October 24, 2003

STATE OF NEW YORK
DEPARTMENT OF PUBLIC SERVICE

October 7, 2003

TO: THE COMMISSION

FROM: OFFICE OF GAS AND WATER – GAS RATES
OFFICE OF ELECTRICITY AND ENVIRONMENT – RATES & RETAIL
CHOICE

SUBJECT: CASE 95-G-1037 - Petition of Consolidated Edison of New York, Inc.
for Approval of Proposed Changes to the Method of Determining the
Interdepartmental Transfer Credit Applicable to Natural Gas used in
Consolidated Edison's Generation of Electricity.

CASES 03-G-0759 and 03-S-0760 – Tariff filings by Consolidated Edison
Company of New York, Inc. to revise its method of pricing gas used in the
company's steam and steam-electric generating stations.

SUMMARY OF
RECOMMENDATION: Staff recommends approval of the filings.

SUMMARY

Consolidated Edison Company of New York, Inc. (Con Edison) filed tariff
revisions to its gas and steam tariff schedules, P.S.C. Nos. 9 and 3, respectively, to
implement a change in methodology for purchasing and recording interdepartmental gas
used for steam and steam-electric generating stations. The company currently purchases

gas separately for its gas and steam business units. It now proposes that all gas be purchased by its gas supply department. The company estimates that the proposed changes will reduce volatility in the steam business' cost of gas and should result in savings for its electric, gas, and steam customers. Staff has reviewed the company's filings and supporting work papers. The proposed changes are reasonable and should yield benefits for all Con Edison customers. The filing is unopposed and it is recommended that the proposed changes to the company's tariffs be approved.

BACKGROUND

Prior to 1996, the gas department procured natural gas for the steam and electric departments, as well as for the company's gas customers. A "share-the-savings" methodology was employed to apportion the benefits of displacing fuel oil with natural gas in the company's generating facilities between the electric and steam departments. The methodology was modified in 1996 to allow those departments to purchase gas directly from the market in lieu of using gas department supply.¹ At that time, it was believed that the separation of the procurement function would allow the electric and steam departments to better compete with other electric generators who purchased gas from competitive markets. The company established a "Fuel Resources Section", separate and independent from the gas department, that purchased in excess of 100 billion cubic feet of gas per year to meet steam and electric needs.

Con Edison has since divested its electric generating facilities. It has also reorganized its operations, merging the functions of some departments and eliminating others. It reports that all of its procurement functions reside in its Energy Management group, with the Electricity Supply Department procuring energy and capacity and gas for

¹ Case 95-G-1037, Petition of Consolidated Edison of New York, Inc. for approval of proposed changes to the method of determining the interdepartmental transfer credit applicable to natural gas used in Consolidated Edison's generation of electricity; Untitled Order (issued April 24, 1996) and Untitled Order (issued September 16, 1996). (1996 Orders)

the company's steam business and the Gas Supply Department procuring gas for its gas distribution customers.

Proposed Changes

Con Edison believes that synergy benefits for its customers can be created by recombining the gas procurement functions for its gas and steam business units. To achieve these benefits, the company seeks reversal of the 1996 Orders and permission to transfer the procurement and pricing of natural gas for the company's steam and steam-electric generating facilities back to the Gas Supply Department. It further proposes to modify its gas tariff to: (1) recognize commodity costs allocated to the company's steam and electric customers in the calculation of its firm gas sales customers' monthly commodity costs; (2) include in the Non-Firm Revenue Credit, which accrues to the benefit of firm gas customers, net revenues derived from the use of excess interstate pipeline capacity for gas supplied to the company's steam and steam-electric plants; and (3) provide steam and electric customers a share of refunds of excess charges paid to suppliers (e.g., pipeline refunds) for winter season capacity used by its steam business.

The pricing methodology resulting from the proposed tariff changes will allocate excess gas from the gas department for the steam department's use, and permit additional gas purchases from the marketplace when the gas department's supply is insufficient to meet the steam department's needs. It will not, however, alter the pricing associated with the use of the company's local gas facilities to deliver gas to the steam and steam-electric plants. The pricing methodology will allocate existing electric/steam pipeline capacity (60,000 Dt/day on Iroquois and Transco/MarketLink) to the steam business. Steam capacity requirements above the 60,000 Dt/day will no longer be purchased directly in the market but will be supplied with seasonally available gas department capacity, subject to recall if needed for gas customers. The supplemental capacity will be seasonally priced--the summer (April – October) price will be equivalent to the market value of capacity and the winter (November – March) price will be determined using the weighted average cost of capacity, which is the same price provided

to gas marketers. The commodity will be priced at the gas department's weighted average cost less market area storage gas, and any city gate purchases for the steam and steam-electric plants will be allocated to the steam business. The gas department will also provide balancing service up to 12 Mdt/day; balancing above that amount would be subject to imbalance charges and cash outs. To fully effectuate its proposed changes, Con Edison also proposes to amend its steam tariff schedule to clarify that the average cost of fuel, as defined for purposes of computing the monthly fuel adjustment charge, includes hedging costs.

Projected Customer Benefits

Con Edison estimates that the proposed pricing arrangement will provide approximately \$3.1 million in savings for its gas customers and about \$1.5 million in savings for its electric and steam customers in the first year of operation of its repowered East River Generating Station (East River Station).¹ These gas customers' savings are derived from added value contributed by the steam business that the company would not otherwise receive in making that capacity available in the market, and from contributions by the steam business for load following balancing service. The electric and steam customers' savings are derived from winter supplemental capacity provided at the company's weighted average cost of capacity (in lieu of possibly higher market prices), and gas commodity at the company's adjusted weighted average cost of commodity gas, in addition to cost optimization of steam's gas requirements through hedging, balancing and capacity utilization.

The company contends that the steam business' use of the gas business' off-peak excess capacity should make it easier for the gas business to "recall" that capacity when needed to meet its firm gas customers' needs (in comparison to transactions with unaffiliated third parties). The company notes that its changes in the use of excess capacity will not reduce the pipeline capacity it makes available to gas marketers serving

¹ Current estimates place the completion date for this project in the fourth quarter of 2004.

firm customers in its service territory because the marketers' requests will be given priority to the steam business' requests, as provided for in its Capacity Release Service.

PUBLIC NOTICE

Notices of the company's proposal, and of its proposed tariff changes, were published in the State Register on June 4, 2003 and July 9, 2003. No comments were received.

DISCUSSION AND CONCLUSION

Con Edison's divestiture of its electric generating facilities coupled with lower gas supply needs obviate the need to continue separate gas procurement units for its gas and steam businesses. In addition to eliminating unnecessary duplication of resources and effort, the rejoinder of the units should result in annual savings for all of the company's customers. Also, under normal weather conditions, the gas business has excess seasonal capacity which it releases and often sells at a discount on the open market. The company's proposal will permit its steam business to purchase some or all of this excess capacity, and the commodity, at rates equitable to both gas and steam customers, effectively providing gas and steam customers with benefits that they would not otherwise realize. It is likely to give the company's procurement department greater flexibility in negotiating deals and securing favorable prices for capacity and commodity. It will also permit the steam business to take advantage of the gas department's hedged gas commodity supply to reduce the volatility of its gas costs. For all of these reasons, countermanding the 1996 Orders and allowing Con Edison to consolidate its gas purchasing operations into one department and approving the other changes to the company's gas tariff are reasonable proposals.

The corresponding changes to the company's steam tariff, which would permit Con Edison to include hedging costs as part of the average cost of fuel in determining the monthly fuel cost adjustment, will reduce the volatility of the steam

business' gas costs. Therefore, those changes are reasonable and should be approved. Staff also concurs with the company's argument that the proposal will reduce third party credit risks because it will increase the amount of capacity released and acquired between the gas and steam businesses, thereby limiting the number and size of third party transactions.

The basis for Con Edison's estimate of customer savings was examined and found to be a reasonable estimate of the benefits in 2005 when the East River Station commences commercial operations. Staff's analysis of the company's proposal further indicates that, based on current market conditions, customers will continue to realize benefits in excess of \$4 million beyond 2005. In 2004, staff estimates the benefits will be approximately \$3 million.

Finally, the proposed change will not alter the current priority of gas capacity allocated for gas customers or released to gas marketers. The allocations priority will be: (1) all firm sales and firm transportation (gas retail program) customers; (2) all interruptible sales customers; (3) the company's steam and steam-electric generating facilities on an interruptible (fully recallable) basis. This effectively ensures that the company will be maximizing gas sales for the benefit of its gas customers.

The integration of the gas procurement function into a single department introduces new complexities that did not exist when each department purchased its supply needs independently. To ensure the proper operation of the company's revised procurement and pricing methodology, the company should provide Staff with the written operational and allocation procedures that the company's gas purchasing department will use for the procurement and allocation of natural gas for its gas, steam and electric departments. Con Edison should also maintain readily available records that demonstrate and reconcile purchases and their allocations so that they may be used, in part, to support the company's annual reconciliation of gas department gas cost filed with the Commission.

RECOMMENDATION

It is recommended that:

1. The Commission countermand its April 24 and September 16, 1996 Orders in Case 95-G-1037 that required Consolidated Edison Company of New York, Inc. to separate the gas procurement functions for its gas and steam/electric businesses.
2. The Commission approve Consolidated Edison Company of New York, Inc.'s proposal to merge all of its gas procurement functions into one department, as specified in its May 14, 2003 filings in Cases 03-G-0759 and 03-S-0769 and subject to the conditions set forth in the body of this Memorandum.
3. The tariff amendments listed in Appendix I be allowed to become effective.

Respectfully submitted,

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CASES 95-G-1037, 03-G-0759 and 03-S-0760

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Filings by: CONSOLIDATED EDISON COMPANY OF NEW YORK, INC.

Amendments to Schedule P.S.C. No. 9 – Gas

Third Revised Leaf No. 162
Fifth Revised Leaves Nos. 157, 164

Received: May 14, 2003 Effective: August 1, 2003*

Amendment to Schedule P.S.C. No. 3 – Steam

Thirtieth Revised Leaf No. 14

Issued: May 15, 2003 Effective: August 1, 2003*
Received: May 15, 2003

*Postponed to November 1, 2003 by S.P.O. 03-G-0759SP2 and S.P.O. 03-S-0760SP2

S.A.P.A. 03-G-0759SA1– State Register – June 4, 2003

S.A.P.A. 03-G-0759SA2– State Register – July 9, 2003

S.A.P.A. 03-S-0760SA1 – State Register – June 4, 2003

S.A.P.A. 03-S-0760SA2 – State Register – July 9, 2003

Newspaper Publication: June 16, 23, 30, July 1, 2003