STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

At a session of the Public Service Commission held in the City of Albany on February 19, 2003

COMMISSIONERS PRESENT:

William M. Flynn, Chairman
Thomas J. Dunleavy
James D. Bennett
Leonard A. Weiss
Neal N. Galvin

CASE 02-G-0858 – Tariff Filing by National Fuel Gas Distribution Corporation to establish a "Partnership for Distributed Generation" pilot program.

ORDER APPROVING DISTRIBUTED GENERATION PILOT PROGRAM WITH MODIFICATIONS

(Issued and Effective March 20, 2003)

BY THE COMMISSION:

INTRODUCTION

On June 21, 2002, National Fuel Gas Distribution Corporation (National Fuel or the company) filed tariff leaves which would permit it to loan (advance) ratepayer funds to customers to defray the cost of installing distributed generation[1] (DG) equipment at their facilities. The advances would be recovered from participating customers, with interest, by allowing National Fuel to retain all incremental transportation revenues produced by such customers (instead of sharing those revenues with

[1] Distributed Generation applications for individual customers as used herein generate electricity in the 500 kW to 1 MW range primarily from engines, although smaller applications could come from micro turbines and fuel cells.

ratepayers). In some cases, the advances would also be recovered by additional payments from the participating customer.

We directed that a proceeding be instituted to consider the issues relating to gas transportation rates for DG applications[2] and to gather data relevant to the formation of those tariffs.[3] The DG order also invited submissions of pilot programs and, thus far, National Fuel is the only respondent.

Tariff Filing

National Fuel sees DG as a potential market that could increase gas sales. However, the payback[4] for typical DG applications for small customers in the company's territory is estimated to take up to seven years or more, and that may be too long to be attractive. National Fuel therefore proposes to supply a financial advance that would limit a customer's initial capital outlay and result in a three-year payback level. Customers would be required to execute a payment agreement to secure the advance. The company believes that its endorsement and involvement with the DG process, combined with a shorter payback period, will attract customers to the pilot program.

The company expects to serve DG customers under its existing transportation tariff, S.C. No. 13. Currently, revenues from customers receiving service under S.C. No. 13, above an

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[2] A separate order will be issued on DG gas transportation rates.

[3] Case 02-M-0515, Gas Transportation Rates for Distributed Generation Technologies, Order Instituting Proceeding (issued May 14, 2002)("DG Order").

[4] The economics of DG generation are driven by the capital cost of the equipment, gas costs, maintenance expenditures on the equipment and electric standby rates for participants, which stay attached to the electric grid, or the cost of redundant equipment for stand-alone applications.

imputed amount, are allocated 90% to core gas customers and 10% to the company. National Fuel proposes to retain all incremental transportation revenues associated with service to DG customers and to impose charges on those customers in excess of tariff ceiling rates, if necessary, to enable it to recover the advances.

The pilot program would have an initial term of five years, with an annual cap of $2 million per year over the five-year period for a total exposure of $10 million. National Fuel's proposed advance per customer is estimated to be in the range of $50,000 to $150,000. There is no time limit proposed for the customer to pay back the advance.

National Fuel seeks Commission approval to expense the one-time facility "advances" in the year that they are incurred and to include the expenses in the earnings sharing requirements contained in the Joint Proposal rate plan[5] under which the company is currently operating. Finally, the company anticipates that the pilot will provide information that will be of value in developing future DG programs. It is expected that the pilot will:

- document and verify project economics
- demonstrate DG systems reliability
- develop DG equipment "best practices"
- measure customer acceptance and awareness
- evaluate electric interface issues
- introduce to the local trades the design, engineering and construction of DG facilities

By a series of postponements, the effective date of the proposed tariff leaves enumerated on Appendix I has been extended to March 22, 2003.

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[5] Case 00-G-1858, National Fuel Gas Distribution Corporation - Order Adopting Terms of Joint Proposal (issued April 18, 2002).

COMMENTS

Comments on the filing were received from Buffalo-Niagara Partnership, BCS Incorporated, and the County of Erie Department of Environment and Planning. All commenters expressed support for the filing and stated that DG would promote New York's ongoing efforts to reduce the cost of doing business in the state.

DISCUSSION

Distributed generation can play an important role in the state's energy profile, but the economics of these systems and customer doubts about their reliability have precluded general acceptance by the public. The pilot program's most important contribution to potential development of DG applications may be a demonstration of the reliability of the systems. Contributions and technical advances by manufacturers, Energy Service Companies, and other participants would also enhance development of the industry.

National Fuel references the State Energy Master Plan in support of its petition citing the Plan's finding that DG applications can have laudatory statewide benefits as well as individual customer benefits. DG also can increase gas throughput on the company's system. If successful, fixed utility costs would be spread over a greater usage volume and the resulting lower unit costs would redound to the benefit of gas ratepayers and shareholders.

However, there are some downsides to National Fuel's DG proposal as the program is now structured: ratepayers will not see any financial benefits from the pilot program until the financial advances are repaid, anywhere from seven or more years into the future; and all the risk of non-performance by participants falls upon the ratepayers.

We envision a DG pilot program that meets the following objectives: it does not place unreasonable demands on core

customers; and it provides a sharing of risks between customers and the company. The company's proposal falls short of meeting these objectives.

The overarching deficiency in the filing is that the pilot program presents too much risk for the ratepayers. That risk could be significantly reduced if the National Fuel pilot proposal is modified as follows:

- The ratepayer's contribution to the program must be limited to the exclusion of incremental revenues due to the DG installation (defined as any revenues over current revenues from the customer) from the 90/10 transportation revenue sharing mechanism. The sharing discontinuance will be in effect until such time as the customer has paid back the amount of the advance from National Fuel, or the term of the agreement, whichever is sooner, at which point sharing shall be resumed.

- The current tariff rate caps must not be modified to pay for the contributions. However, if additional revenues in excess of those provided by tariff rates are necessary, the conditions of payment will be the subject of a separate contract between the company and the customer.

- All expenses and incremental revenues associated with the pilot must be excluded from any plan to share excess earnings until the reimbursement for the advance is complete.

- Separate gas service lines for DG usage will not be required. However, metering must be installed which will permit the incremental usage by the DG unit to be separately identified from other customer applications.

- Advances to DG customers must come from shareholder, not ratepayer, funds.

- The risk of customer non-payment must be assumed by National Fuel's shareholders, and not its ratepayers.

- The contract term for the return of the capital advance must be limited to six years or less.

- The term of the program must be limited to one that is more consistent with a pilot program, such as three years.

- Capital advances to customers must be limited to a total of $3 million over the three years; this should fund an estimated 30 projects.

- Rates for the DG applications, i.e., for the incremental volumes, must be fixed for the term of the contract.

- The company must collect, analyze, and provide program data to the Commission contained in the attached Appendix II. The data should be provided on an annual and/or as-needed basis to the Commission, as determined by the Commission.

- The DG applicant must pay for any necessary system upgrades.

CONCLUSION

We anticipate benefits to the statewide energy portfolio from DG applications and therefore approve the program, with the modifications discussed above. While customers not participating in the program will lose the benefit of the foregone incremental revenues, which would not occur without the pilot, all will benefit if National Fuel is allowed to spread its fixed costs over a broader base.

National Fuel's proposal, as modified above, would provide a step toward an understanding of the role that distributed generation may play in the state's energy future. The New York State Energy Research & Development Authority (NYSERDA) is funding currently DG pilot applications to garner information on the impacts of DG applications on electric utility systems. National Fuel shall work with our staff and NYSERDA to coordinate its DG

activities and information gathering. National Fuel shall also collect, analyze, and report to the Commission the information outlined in Appendix II.

The Commission orders:

1. National Fuel Gas Distribution Corporation is authorized to either:

a. file further revisions on or before March 21, 2003, to become effective on not less than one day's notice on a temporary basis on or before March 22, 2003 incorporating the modifications discussed in this Order; and to collect, analyze, and provide program data listed in Appendix II on an annual or as-needed basis to the Commission; or

b. file a supplement to become effective on not less than one day's notice on March 21, 2003 canceling the amendments listed in Appendix I.

2. The requirement of Public Service Law §66(12)(b) requiring newspaper publication of the amendments directed in Ordering Clause 1 is waived.

3. This proceeding is continued.

By the Commission,

(SIGNED) JANET HAND DEIXLER
Secretary

SUBJECT: Filing by NATIONAL FUEL GAS DISTRIBUTION CORPORATION

Amendments to Schedule P.S.C. No. 8 – Gas

Original Leaf No. 148.6
First Revised Leaf No. 220
Second Revised Leaf No. 240
Third Revised Leaves Nos. 84, 249
Fifth Revised Leaf No. 208
Tenth Revised Leaf No. 3

Received: June 21, 2002 Effective: September 23, 2002*

*Effective date postponed to March 22, 2003 by S.P.O. 02-G-0858SP4.

S.A.P.A. 02-G-0858SA1 – State Register – July 17, 2002

NEWSPAPER PUBLICATION: August 13, 21, 27, September 4, 2002

Reporting Requirements

1. Documentation and Verification of Project Economics

   National Fuel will collect data on equipment costs, operation and maintenance costs and displaced electrical/thermal costs to calculate the actual customer payback achieved. These actual costs will be compared to the estimated pro-forma costs and the results will be used to further refine the analysis on projects.

2. Evaluation of Performance and Impact of DG System on Electric Utility

   National Fuel will analyze the economic impact of the electric standby tariffs on DG project economics. National Fuel will also monitor the interconnection and interface process with the electric utility in order to assist future DG customers and streamline the process.

3. Demonstration of the Reliability of DG Systems

   National Fuel will monitor the performance of the DG systems to develop a profile of the availability of DG systems, as well as frequency of planned vs. unplanned outages. This will be used to develop a better understanding of DG reliability.

4. Development of DG Equipment “Best Practices” Procedures

   National Fuel will monitor the installation of DG systems to document the installation process and establish “best practices”. The company will share the results with installation contractors to improve installation procedures for future installations.

5. Introduction of DG to Interested Parties

   National Fuel will assist in introducing DG and associated technologies to local trades, design engineers, mechanical/electrical contractors, ESCOs, and including service companies. Educating these entities on the features and benefits of DG will further encourage advancement of DG in western New York.

6. Measurement of Customer Acceptance and Awareness

National Fuel will survey key personnel from each customer installation to determine customer satisfaction with the DG project and identify any area of concern or weakness in the design, installation, and operation process. This will be used to improve future installations, and increase the awareness of these issues for prospective customers.

7. Collection of Load Data

National Fuel will collect and analyze load data to determine if the existing S.C. No.13 rate structure is effective for DG applications.