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THE BROOKLYN UNION GAS COMPANY d/b/a KEYSPAN ENERGY DELIVERY NY
One MetroTech Center
Brooklyn, NY 11201

January 27, 2005

Hon. Jaclyn A. Brilling, Secretary
New York State Public Service Commission
Three Empire State Plaza
Albany, New York 12223-1350

Re: Case 99-G-1469
Merchant Function Back Out Credits

Dear Secretary Brilling:

In its recent order in the Unbundling Track of Case 00-M-0504,[1] the Commission directed utilities to file competitive service rates and revenue recovery mechanisms based on embedded cost studies the companies prepared for new rate proceeding filings or filings to extend existing rate plans. August Unbundling Order at 40. The current tariffs of The Brooklyn Union Gas Company d/b/a KeySpan Energy Delivery New York and KeySpan Gas East Corporation d/b/a KeySpan Energy Delivery Long Island ("KeySpan" or "Companies") have merchant back out credits (and transition balancing accounts) that are set to expire on May 31, 2005. KeySpan files herewith revised tariff leaves that extend the existing merchant back out credits and the associated transition balancing accounts until November 1, 2006.

The proposed tariffs, to become effective June 1, 2005, are as follows:

KEDLI:	Seventh Revised Leaf No. 72 To Schedule for Gas Service, P.S.C. No. 1-GAS
KEDNY:	Eighth Revised Leaf No. 334 Ninth Revised Leaf No. 403 To Schedule for Gas Service, P.S.C. No. 12-GAS

[1] Case 00-M-0504, *Proceeding on Motion of the Commission Regarding Provider of Last Resort Responsibilities, the Role of Utilities in Competitive Energy Markets, and Fostering the Development of Retail Competitive Opportunities--Unbundling Track*, "Statement of Policy On Unbundling And Order Directing Tariff Filings" (August 25, 2005) ("August Unbundling Order").

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Procedural History

In October 1999, KeySpan was among the first utilities to file a restructuring plan pursuant to the Commission's directives in the Gas Policy Statement.[2] Among the plan elements in the Joint Proposal approved by the Commission were merchant function back out credits of $.21 for KeySpan Energy Delivery New York and $.19 for KeySpan Energy Delivery Long Island, and transition balancing accounts that would serve as a lost revenue recovery mechanism to protect KeySpan shareholders from unavoidable costs reflected in the back out credits of migrating customers.[3] The Joint Proposal contemplated that the merchant function back out credits would shortly be replaced by unbundled service rates approved in the Unbundling Track of Case 00-M-0504. Joint Proposal at 8. By its own terms, the Joint Proposal expired November 30, 2003.

On September 30, 2003, the Companies filed tariff leaves to extend the merchant function back out credits and transition balancing accounts beyond the expiration of the Joint Proposal, until May 2005. By then, KeySpan anticipated that the Unbundling Track of Case 00-M-0504 would have concluded, and the back out credits could be replaced with new unbundled service rates approved by the Commission in that proceeding. On November 25, 2003, the Commission approved the Companies' tariff leaves extending the merchant back out credits and transition balancing accounts until May 2005.

The Unbundling Track of Case 00-M-0504 did not proceed as the Companies had anticipated. Instead of reviewing individual utility cost studies and determining unbundled rates in the Unbundling Track, the Commission decided in the August Unbundling Order to implement unbundled rates in the context of individual utility rate proceedings or rate plan extensions. *Id* at 38.

The Companies' Plan Going Forward

KeySpan is evaluating its position regarding its next rate proceeding. Pursuant to the Commission's Orders, new back out credits will have to be based on a comprehensive embedded cost of service study. KeySpan has not performed an embedded cost of service study since 2002. The 2002 study was an abbreviated study, consistent with the Commission's requirements in the Unbundling Track, and is now stale, as it was based on calendar year 2001 costs. The Companies are reviewing their entire operations to assess whether full rate proceedings are warranted. This review entails the operations and financial outlook of both KeySpan utilities, as well as a myriad of other issues, including the preparation of a comprehensive program to foster the development of retail energy markets, as the Commission has directed.

The Companies will not have a comprehensive cost of service study prepared in time to calculate unbundled supply rates to replace the back out credits that expire in May. Rather than have the existing credits expire, the Companies propose to extend the

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[2] Cases 93-G-0932 and 97-G-1380, *Policy Statement Concerning the Future of the Natural Gas Industry* (November 3, 1998).

[3] Case 99-G-1469, *Petition of The Brooklyn Union Gas Company and KeySpan Gas East Corp. for a Multi-Year Restructuring Agreement*, "Order Adopting Terms of Gas Restructuring Joint Proposal" (May 23, 2002). The Joint Proposal attached to this Order is referred to herein as the Joint Proposal.

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existing back out credits until November 1, 2006. By November 30, 2005, the Companies will file with the Commission comprehensive cost of service studies, accompanied by either full rate proceedings or a request for extensions of the Companies' existing rate plans. In either case, the Companies will, on the same date, file their plans to foster the development of retail energy markets. With the retail access plan, KeySpan will file unbundled service rates and revenue recovery mechanisms to replace the existing merchant back out credits and transition balancing accounts. Whatever form the Companies' November 2005 filing takes, KeySpan expects that its resolution and the approval of new unbundled service rates will approximately coincide with the November 2006 date it requests for an extension of the existing merchant function back out credits. In the meantime, the Companies propose to maintain the status quo, and allow customers to continue to enjoy the benefit of the merchant function back out credits.

Effect on Retail Competition

KeySpan maintains that if these proposed revised tariff leaves have any effect on retail competition, it will be a salutary one. As stated, the existing merchant back out credits are $.21 for KeySpan Energy Delivery New York and $.19 for KeySpan Energy Delivery Long Island. The last time the Companies calculated competitive service rates for the supply function, those rates were $.11 and $.09, respectively, based on the streamlined embedded cost studies filed in May 2002.[4] While those studies are now out of date, the Companies do not expect that competitive supply service rates based on up-to-date cost studies will differ markedly from the rates based on the 2002 study. The proposed tariff leaves also maintain the transition balancing accounts that have funded unavoidable costs included in the merchant back out credits, and have been linked to them from their inception.

The Companies respectfully request that their proposed revised tariffs be allowed to go into effect so that customers can continue to have the benefit of the existing merchant back out credits while the Companies assess next steps and work to comply with the Commission's August Unbundling Order.

Very truly yours,

Catherine L. Nesser

Cc: Service List, Case 99-G-1469

[4] Filed in Case 00-M-0504—Unbundling Track. These costs included an unbundled merchant supply cost and the unbundled cost of storage.