



STATE OF CONNECTICUT

DEPARTMENT OF PUBLIC UTILITY CONTROL
TEN FRANKLIN SQUARE
NEW BRITAIN, CT 06051

DOCKET NO. 97-07-11PH02 DPUC INVESTIGATION INTO ISSUES ASSOCIATED
WITH THE UNBUNDLING OF NATURAL GAS
SERVICES BY CONNECTICUT LOCAL
DISTRIBUTION COMPANIES

November 13, 2002

By the following Commissioners:

Glenn Arthur
Donald W. Downes
John W. Betkoski, III

DECISION

DECISION

I. INTRODUCTION

A. SUMMARY

The Department of Public Utility Control (Department) adopts the proposed Settlement Agreement submitted by the Participants' on September 27, 2002. It calls for net shifted costs, related to capacity, to be eliminated by firm transportation customers, over a four-year period. Phase 1 has a \$0.30/mcf transition charge, Phase 2 has a \$0.34/mcf transition charge, Phase 3 will eliminate two-thirds of the net shifted capacity costs and Phase 4 will eliminate 100% of net shifted capacity costs on a going forward basis. The Settlement Agreement provides for the current level of reliability of gas service to be preserved. Local gas distribution companies (LDCs) will continue providing supplier of last resort (SOLR) services for at least the next three years and will continue to be responsible for the long term/supply capacity planning activities. The Settlement Agreement makes certain changes to the LDCs' tariffs regarding cashouts and imbalance trading. The Settlement Agreement allows the LDCs to continue to offer gas supply services for at least the four-year term of the Settlement Agreement. Finally, the Participants agreed in the Settlement Agreement that the public interest is served by vigorous retail competition on a level playing field with proper cost assignment in the supply of gas to customers.

B. BACKGROUND

Federal Energy Regulatory Commission (FERC) Order 636, dated April 8, 1992, prohibited interstate pipelines from selling both gas and transportation as a single product. It required the interstate pipelines to allow other gas owners to use interstate pipes, at FERC approve tariffs, to transport gas to LDCs and any other end-users. This change pushed the natural gas industry toward a more competitive structure with greater end-user choice and necessitated that the Department address issues relative to the newly formed competitive natural gas market place. On July 23, 1998, the Department issued a Decision in Phase I of the instant docket. In the Phase I Decision, the Department evaluated the adequacy of transportation tariffs as well as principles to guide further unbundling. The Department stated that "[i]t is the intent of the Department to explore, in greater detail, the issues involved in further unbundling in Phase II after the completion of the reopened rate cases [at that time]." Decision, p. 33. The Department established the Phase II proceeding to continue the investigation of issues associated with the unbundling of natural gas firm sales and transportation services by LDCs in Connecticut.

C. CONDUCT OF THE PROCEEDING

Pursuant to Sections 16-11 and 16-19e of the General Statutes of Connecticut (Conn. Gen. Stat.), the Department established the instant proceeding on its own motion as an uncontested matter. By letter dated October 29, 2001, the Department sent notice to previous participants from Docket No. 97-07-11PH01 to confirm participant status for Docket No. 97-07-11PH02.

By Notice of Request for Written Testimony dated December 4, 2001, the Department determined that the instant proceeding should be limited to the issues of capacity disposition (including both interstate pipeline and on-system peaking capacity) and the cost responsibility of that capacity. The Decision dated August 9, 2000, in Docket No. 99-03-28, DPUC Review of Natural Gas Companies Cost of Service Study Methodologies, page 15, stated that "[t]he Department has not explored mandatory capacity assignments, slice-of-system assignments, exit fees, transition surcharges or other approaches. The Department will address the issue of shifted and stranded costs in subsequent unbundling investigations." The Participants were directed to specifically address proposed methods to deal with these unresolved capacity and cost issues and to distinguish between existing and incremental capacity as it becomes needed in the state.

By Notice of Hearing dated May 7, 2002, pursuant to Conn. Gen. Stat. §§ 16-11 and 16-19e, the Department held a public hearing on this matter on June 10, 2002 at its offices, Ten Franklin Square, New Britain, Connecticut. The hearing continued at the offices of the Department on June 11, June 12, June 13, and July 30, 2002. A hearing was scheduled for September 26, 2002 that was cancelled and the record was closed.

From the bench, the lead commissioner instructed the Participants to work together to create a proposal addressing the issues of this Docket. On September 27, 2002, the Participants submitted a proposed Settlement Agreement for the Department's consideration. The Settlement Agreement is attached to this Decision and identified as Attachment SA. The Department issued a Decision in this matter on November 13, 2002. The Department did not call for written exceptions or oral arguments given that the issues were agreed upon in the Settlement Agreement.

D. PARTICIPANTS

The following entities participated in the docket: AllEnergy Gas & Electric Marketing Company, L.L.C. (AllEnergy); Amerada Hess Corporation; Bracewell & Patterson, L.L.P.; Columbia Group, Inc.; Connecticut Business and Industry Association; Connecticut Natural Gas Corporation (CNG); Duke Energy Trading and Marketing LLC; Energy East Solutions, L.L.C.; Iroquois Gas Transmission System (Iroquois); PanCanadian Energy Services (PanCanadian); Manufacturing Alliance of Connecticut, Inc. (MAC); Northeast Utilities Services Company (NUSCO); Office of Consumer Counsel (OCC); Office of the Attorney General (AG); Reliant Energy; Scasco, Inc.; Santa Buckley Energy (Santa Buckley); Select Energy, Inc. (Select); Tennessee Gas Pipeline (TGP); Algonquin Gas Transmission, Texas Eastern Transmission, LP; John & Hengerer, National Energy Marketers Association (NEMA), The Southern Connecticut Gas Company (Southern); and Yankee Gas Services Company, Inc. (Yankee).

II. DEPARTMENT ANALYSIS

A. DECISION BASIS AND EVALUATION CRITERIA

1. Decision Basis

Besides the statutory authorities under which the instant proceeding was established and conducted, the Department relied on the following statutes and precedents to evaluate the proposed Settlement Agreement. The Department can approve settlements "unless precluded by law." Conn. Gen. Stat §4-177(c). In fact, Conn. Gen. Stat. §16-19jj encourages the use of settlements in contested cases and proceedings. The Department has adopted many settlements in the past. See, e.g., Decision dated July 1, 1996, in Docket No. 92-11-11, Application of The Connecticut Light and Power Company to Amend Its Rate Schedules; Decision dated October 1, 1997, in Docket No. 92-02-19REO2, Application of the Yankee Gas Service Company for an Increase in Rates; Decision dated November 17, 1999, in Docket No. 99-08-30, Petition of the Office Of Consumer Counsel Regarding The Southern Connecticut Gas Company's Tax Revenues; Decision dated August 16, 1989, Petition Filed by the Office of Consumer Counsel Regarding Failure of The Connecticut Light and Power Company to Furnish Adequate Electric Service in the Town of Monroe.

In these contested proceedings, the Department employed consistent standards to evaluate those proposed settlements. These standards include the protection of the public interest and balancing the best interest of ratepayers and shareholders. Id.; Decision dated July 1, 1996 in Docket No. 92-11-11, p. 4. The Department has repeatedly stated that settlements are an efficient and fair method of disposing of contested matters. Decision dated October 1, 1997, in Docket No. 92-02-19REO2, p. 2; Decision dated November 17, 1999, in Docket No. 99-08-30, p. 3. However, a settlement must represent a fair and reasonable resolution of the issues. Decision dated November 17, 1999, in Docket No. 99-08-30, p. 3.

All of the Participants in this proceeding had the opportunity to participate in negotiating the proposed Settlement Agreement. The participants that signed the filed proposed Settlement Agreement are OCC, Yankee, Southern, CNG, AllEnergy, Select, Santa Buckley and Scasco (collectively, Signatories).

2. Evaluation Criteria

a. Reliability and Supplier of Last Resort

Supplier of last resort is defined as the function of supplying all customers with gas under statutory guidelines. The Department agrees with the principle that the reliability of Connecticut's LDCs is of paramount importance to the welfare of the customers and the natural gas industry in Connecticut. Settlement Agreement, p. 2. Prior to the advent of retail competition, LDC's were responsible for insuring that sufficient capacity was available to meet 100% of firm sales customer requirements on a design winter day. Historically, this requirement has been met with a combination of primary firm interstate pipeline capacity and on-site peaking resources such as liquefied natural gas (LNG) and propane. Since customer choice began in April 1996, LDCs

have continued their responsibility of insuring that 100% of firm customer requirements, both sales customers and transportation customers, can be met on a design winter day. This is referred to as the SOLR function. Throughout the proceeding, various alternatives to the SOLR function were explored, including having an entity other than the LDCs perform the SOLR function, utilizing interstate pipeline capacity that is not primary firm and setting the required level of capacity at something less than 100%.

According to the Settlement Agreement, over the next three years, the Signatories' have agreed that the LDCs will continue to provide the SOLR function and also continue to be responsible for long-term supply/capacity planning activities. Further, the Department should ensure that the LDCs recover their prudent costs associated with providing the SOLR function. The Signatories also stated that after the competitive market matures, the Department may wish to revisit the LDCs role in SOLR. The Signatories assert that if the Department modifies SOLR responsibilities in the future, such changes should be prospective and include the recovery of prudent costs associated with the LDCs providing the SOLR function. Settlement Agreement, p. 2.

The proposed Settlement Agreement states that the current level of reliability of gas service must be preserved and that the LDC's will continue to provide the SOLR function for at least the next three years. Settlement Agreement, p. 2. The Department interprets the "current level of reliability" phrase as meaning a 100% reliability standard utilizing primary firm interstate pipeline capacity and on-site peaking resources. As such, the proposed Settlement Agreement resolves these issues during the four-year term of the agreement. The Department finds that the Settlement Agreements' provisions regarding reliability are appropriate.

b. Shifted Costs

According to the Signatories, the proposed Settlement Agreement is designed to eliminate net shifted costs, associated with capacity, over a four-year phasing in period. Settlement Agreement, p. 2. During Phase 1, a \$0.30/mcf transition charge will be implemented in bills rendered to firm transportation customers on and after December 1, 2002 and would continue in effect for the succeeding twelve months. Settlement Agreement, p. 3. In Phase 2, there will be a \$0.34/mcf transition charge in bills rendered to firm transportation customers beginning December 1, 2003 and lasting for the succeeding twelve months. Settlement Agreement, pp. 3 and 4. In Phase 3, the Signatories have agreed to eliminate not less than two-thirds (2/3) of net shifted capacity costs effective December 1, 2004. The Signatories have identified a potential approach to accomplish this 2/3 objective. It is a mandatory assignment to each third party supplier or Marketer, subject to recall rights, of capacity held by the LDCs to cover approximately 50% of such Marketer's firm delivery requirements. In addition, a transition charge will be included in customer's bills rendered to firm transportation customers on and after December 1, 2004 and for the succeeding twelve months that will offset one-third of the remaining shifted capacity costs. Settlement Agreement, p. 4. The transition charge in Phase 1, 2 and 3 will benefit firm sales customers through the purchased gas adjustment (PGA). Settlement Agreement, p. 4. In Phase 4, the Signatories have agreed to attempt to develop a consensual solution that would be effective December 1, 2005 and would fully eliminate any capacity related shifted costs

that are remaining at the time in a manner that will maintain ongoing competition in Connecticut. Settlement Agreement, p. 4.

Shifted costs are capacity related and result from the SOLR function, which requires LDC's to hold sufficient capacity to meet the design winter day requirements of firm transportation customers. Under existing regulatory rules, the cost of this capacity is not borne by transportation customers but rather is "shifted" to the remaining sales customers.

The quantification of shifted costs, as they relate to capacity, was the subject of extensive debate throughout the proceeding. The proposed Settlement Agreement contains estimates of shifted costs for each LDC. Settlement Agreement, Attachments A, B, and C. The Signatories' provided a detailed description of the methodology used to make the calculations. Response to Interrogatory GA-21.

The Marketers state they have not waived their rights to question the LDCs estimates of these shifted costs and/or their methodology for computing these shifted costs in future proceedings. Settlement Agreement, p. 4. Additionally, the Signatories would continue to refine a shifted cost calculation methodology to determine the transition charge for year three of the Settlement Agreement. Response to Interrogatory GA-22. The Marketers state that the methodology used by the LDCs for determining these shifted costs has never been subject to a full regulatory review. It must be rigorously scrutinized in conjunction with a determination on SOLR and other offsetting LDC revenues from ancillary services, penalty charges and resale of the capacity. Response to Interrogatory GA-8.

Regarding the Marketer's concerns, the proposed Settlement Agreement does make a determination on SOLR, which is to leave it with the LDCs. Section II.A.2.b, supra. Additionally, the methodology described in GA-21 relies upon approved cost of service studies (COSS) principles as determined in the Decision dated August 9, 2000 in Docket No. 99-03-28. Further, the net shifted cost estimates contain not only offsetting adjustments for ancillary services, penalty charges, and resale of capacity, but also certain commodity cost savings. Response to Interrogatory GA-21. The Department concludes that the methodology used appears appropriate and provides a reasonable estimate of shifted capacity costs. Absent an alternative methodology approved by the Department in a subsequent proceeding, the Department will use this methodology to estimate these capacity related shifted costs for each phase of the four-year term of the Settlement.

c. Capacity Assignment

Capacity assignment is defined as the release of firm transportation rights to another party as authorized under FERC Order 636. To effectuate the elimination of two-thirds of net shifted capacity costs in Phase 3, the LDCs have agreed to a mandatory assignment to each Marketer, subject to recall rights, sufficient capacity held by the LDCs to cover approximately 50% of such Marketers firm delivery requirements. Relative to this capacity release, the Signatories agree that: (a) the capacity assignment should not be on a slice of system basis, (b) the assigned capacity should be reflective of the Marketer's customer load characteristics and (c) such capacity assignments

would require an adjustment to each LDCs current metrics and benchmarks to keep all of the LDCs whole in light of the reduced availability of supply assets that the LDCs would then have available. The Signatories assert that the Department should not require a "one-size fits all" solution in Phase 3 but rather permit the LDCs and Marketers to enter into voluntary arrangements in lieu of mandatory capacity assignments. These voluntary arrangements must meet the criteria of producing equivalent reductions in shifted capacity costs. This will benefit firm sales customers through the LDCs' PGAs and reliability would be protected under those arrangements. Settlement Agreement, p. 4.

The Department believes that the LDCs and Marketers are well suited to identify an efficient approach for capacity assignment and to subsequently develop an implementation plan. The Department recognizes that a significant amount of time and effort will be required to create a capacity assignment program. It would not be unreasonable to expect that once a capacity assignment approach is determined, an implementation plan could take approximately a year to put into effect.

The Department, however, is concerned that the proposed Settlement Agreement is not specific as to the dates that a proposed capacity assignment plan would be filed with the Department. The Signatories state that, regarding Phase 3, a proposal would be filed on a schedule that would permit implementation effective December 1, 2004. Response to Interrogatory GA-29. Further, if the Signatories were unable to reach agreement, they would so inform the Department. Then, the Department could determine how best to implement the Phase 3 objective of eliminating two-thirds of the capacity related shifted costs. Response to Interrogatory GA-29. Given that an implementation plan could take a year or more to develop, it would seem reasonable that the Signatories would need to agree upon an approach by June 2003.

As part of Phase 1, of the Settlement Agreement, the Signatories have agreed to initiate discussions pertaining to revisions in the LDC's tariffs. The proposed tariff changes would assist the LDCs in addressing new or revised ancillary services and streamlining operational terms. Following such discussions, but not later than June 1, 2003, the LDCs would file proposed tariffs with the Department and request that such tariff changes become effective contemporaneously with Phase 2. Settlement Agreement, p. 4. The Department will require that, as part of that filing, the Signatories will either provide an agreed upon approach to capacity assignment or indicate that an agreement could not be reached. If an agreed upon approach to capacity assignment has been reached, the Department will rule on its merits. If an agreement has not been reached, the Department will determine the appropriate course of action regarding capacity assignment as part of its ruling in that filing.

d. Cash Outs and Imbalance Trading

Cashout is an accounting function that places a dollar cost on the Marketers' imbalance volume with the LDCs. Monthly imbalance volumes are the calculated difference between the delivered quantity, which includes imbalance trades and the gas usage. These imbalances are calculated at the aggregated pool level. When an under delivery occurs, the Marketer purchases gas from the LDC. It is defined as a negative imbalance caused by a Marketer's delivered quantity to an aggregation pool being less

than the aggregation pool's cumulative gas usage over the month. Conversely, when an over delivery occurs, the LDC buys back the additional gas and credits the Marketer's account. It is defined as a positive imbalance caused by a Marketers' delivered quantity to an aggregation pool exceeding the aggregation pool's cumulative gas usage over the month.

The proposed Settlement Agreement provides for uniform treatment of cashouts by all three LDCs. It calls for the LDCs' tariffs to be modified (i) so as to permit any trades of equal and opposite gas quantities for pools on the same pipeline with the same balancing requirements by any Marketer with the application of tariff provisions related to standby service, balancing and cashout applying only to the post-trading positions of such Marketer and (ii) the calculation of daily cashout imbalances using a Gas Daily index appropriate for each pipeline and firm transportation pool. Settlement Agreement, p. 3. The Signatories chose Gas Daily since it is an industry-standard publication that provides timely and objective data as to gas commodity market prices. Response to Interrogatory GA-17. Yankee, Southern and CNG want to continue to use the cashout tiers approved in their respective tariffs. Response to Interrogatory GA-19. The intent of the Signatories in changing the cashout methodology was not to modify the existing tiers but rather to price cashouts at the gas commodity market index price. Response to Interrogatory GA-19. The Department believes that the application of trades for pools on the same pipeline having the same balancing requirements by any Marketer together with the application of tariff provisions related to standby service, balancing and cashout applied only to the post-trading positions of such Marketer will promote smaller cash out balances for a better working relationship between Marketers and LDCs.

The Department's intent is for the LDCs to use a tiered approach modeled after interstate pipelines similar to incremental block rates. The Department believes this cashout provision will bring about uniformity for the LDCs and Marketers in the state. This goal was stated in the Decision dated July 23, 1998 in Docket No. 97-11-01, Investigation of the Purchased Gas Adjustment Clause Charges or Credits filed by: Connecticut Natural Gas Corporation, The Southern Connecticut Gas Company and Yankee Gas Services Company. The Decision stated that "[t]he Department believes uniformity should also be a goal for all three LDCs in developing a cash out process. Uniformity will facilitate transactions with the large numbers of marketers." Decision, p. 21. The Department finds the proposal acceptable for cashouts and imbalance trading.

e. Competition

The Signatories agree that the public interest is served by vigorous retail competition on a level playing field with proper cost assignment in the supply of gas to customers. Settlement Agreement, p. 3. The Department believes that competition is an economic model that has shown great capacity to identify and maximize innovations and cost saving opportunities. In the natural gas market, there is now competition at the wellhead where once there was a totally regulated market; a largely regulated interstate pipeline market, and mixed distribution market.

The attempt of this Decision is to promote the primary goal of reliability; as well as to eliminate the capacity related shifted costs of that reliability. Once this is

accomplished, a more levelized playing field can exist between firm service customers and firm transportation customers. This levelized playing field also produces a more levelized playing field between those firm service customers who have the opportunity for alternate suppliers and those that do not.

III. FINDINGS OF FACT

1. Shifted costs, relating to capacity, will be eliminated in phases over a four-year period.
2. Phase 1 provides for a \$0.30/mcf transition charge to be paid.
3. Phase 2 provides for a \$0.34/mcf transition charge to be paid.
4. Phase 3 provides for the elimination of not less than two-thirds (2/3) of net shifted capacity costs effective December 1, 2004.
5. In Phase 3 to effectuate the elimination of two-thirds of net shifted costs the Signatories have agreed to a mandatory assignment to each Marketer, subject to recall rights, of sufficient capacity held by the LDCs to cover approximately 50% of such Marketers' firm delivery requirements.
6. The transition charge in Phase 1, 2 and 3 would benefit firm sales customers through the PGA.
7. In Phase 4, the Signatories have agreed to attempt to develop a consensual solution that effective December 1, 2005 will fully eliminate any capacity related shifted costs that are remaining at the time in a manner that will maintain ongoing competition in Connecticut.
8. The Settlement Agreement provides for uniform treatment of cashouts by all three LDCs.
9. The Settlement Agreement provides for the calculation of daily cashout imbalances using a Gas Daily index appropriate for each pipeline and firm transportation pool.
10. The Settlement Agreement calls for the LDCs' tariffs to be modified to permit any trades of equal and opposite gas quantities for pools on the same pipeline with the same balancing requirements by any Marketer with the application of tariff provisions related to standby service, balancing and cashout applying only to the post-trading positions of such Marketer.
11. The public interest is served by vigorous retail competition on a level playing field with proper cost assignment in the supply of gas to customers.

IV. CONCLUSION AND ORDERS

A. CONCLUSION

The terms of the proposed Settlement Agreement were the product of rigorous negotiations by and among the Signatories. The Signatories positions on these issues were well documented and stated to the Department throughout the course of the instant proceeding. As such, many provisions and figures incorporated in the proposed Settlement Agreement demonstrate a balance among the diverse positions of the Signatories and their respective interests. The Department hereby adopts the Settlement Agreement, incorporates it into this Decision by reference and concludes that it represents a fair resolution of the instant proceeding. This Decision is an efficient and fair method of disposing of this docket and is in the public interest. The Department will reopen each LDC's last rate case for the limited purpose of considering implementation of the Settlement Agreement.

B. ORDERS

For the following Orders, submit one original and fifteen (15) copies of the requested material to the Executive Secretary, identified by Docket Number, Title and Order Number.

1. No later than January 15, 2003, the LDCs shall notify the Department of the date the \$0.30/mcf transition charge, from Phase 1, has been implemented in bills rendered to firm transportation customers through the PGA.
2. No later than June 1, 2003, the LDCs will file proposed tariffs with the Department and request that such tariff changes become effective contemporaneously with Phase 2 regarding new or revised ancillary services and streamlining operational terms.
3. No later than June 1, 2003, the Signatories shall notify the Department of their proposed plan to eliminate not less than two-thirds (2/3) of net shifted capacity costs, from Phase 3, to be approved by the Department, or so notify the Department if an agreement cannot be reached.
4. No later than January 15, 2004, the LDCs shall notify the Department of the date the \$0.34/mcf transition charge, from Phase 2, was implemented in bills rendered to firm transportation customers through the PGA.
5. No later than June 1, 2004, the Signatories shall notify the Department of their proposed plan to fully eliminate shifted capacity costs, from Phase 4, to be approved by the Department, or so notify the Department if an agreement cannot be reached.

**DOCKET NO. 97-07-11PH02 DPUC INVESTIGATION INTO ISSUES ASSOCIATED
WITH THE UNBUNDLING OF NATURAL GAS
SERVICES BY CONNECTICUT LOCAL
DISTRIBUTION COMPANIES**

This Decision is adopted by the following Commissioners:

Glenn Arthur

Donald W. Downes

John W. Betkoski, III

CERTIFICATE OF SERVICE

The foregoing is a true and correct copy of the Decision issued by the Department of Public Utility Control, State of Connecticut, and was forwarded by Certified Mail to all parties of record in this proceeding on the date indicated.

Louise E. Rickard
Acting Executive Secretary
Department of Public Utility Control

Nov 13, 2002
Date

STATE OF CONNECTICUT
DEPARTMENT OF PUBLIC UTILITY CONTROL

DPUC GENERIC INVESTIGATION INTO ISSUES : DOCKET NO. 97-07-11PH02
ASSOCIATED WITH THE UNBUNDLING OF :
NATURAL GAS SERVICES BY CONNECTICUT :
LOCAL DISTRIBUTION COMPANIES : SEPTEMBER 26, 2002

SETTLEMENT AGREEMENT

Settlement Agreement by and among the Office of Consumer Counsel (“OCC”), Yankee Gas Services Company (“Yankee”), The Southern Connecticut Gas Company (“SCG”), Connecticut Natural Gas Corporation (“CNG” and, together with Yankee and SCG, the “LDCs”), AllEnergy Gas and Electric Marketing Company, LLC (“AllEnergy”), Select Energy, Inc. (“Select”), Energy East Solutions, Inc. (“EES”), Santa Buckley Energy (“SBE”) and Scasco, Inc. (“Scasco” and, together with AllEnergy, Select, EES and SBE, the “Marketers”). OCC, the LDCs and the Marketers will hereinafter collectively be referred to as the “Signators”.

WHEREAS, on April 1, 1996, the Department of Public Utility Control (“Department”) unbundled the transportation portion of regulated natural gas service to commercial and industrial (“C&I”) customers, which allowed those customers to buy firm transportation service separate from gas supply (“gas unbundling”);

WHEREAS, gas unbundling has allowed the C&I customers who have elected to buy firm transportation service (“firm transportation customers”) the opportunity to achieve lower gas costs;

WHEREAS, the reliability of Connecticut’s LDCs is of paramount importance to the welfare of the LDCs’ customers and the natural gas industry in Connecticut;

WHEREAS, the Department requires the LDCs to provide supplier of last resort (“SOLR”) services for their firm transportation customers, as well as for their other C&I customers and residential customers (“firm sales customers”) in order to ensure the reliability of gas supply in Connecticut;

WHEREAS, gas unbundling and SOLR services for firm transportation customers have given rise to cost allocation issues and the subsidization of firm transportation customers by the firm sales customers (“shifted costs”);

WHEREAS, the State of Connecticut has established a policy to encourage retail competition in the market for natural gas and to increase the number of natural gas suppliers providing natural gas in the state;

WHEREAS, the Signators believe that immediate elimination of all shifted costs would adversely affect retail competition among gas suppliers;

WHEREAS, the Signators agree that the shifted cost offsets contemplated in this Settlement Agreement will be reflected in the LDC's Purchase Gas Adjustment ("PGA") clauses and will represent no financial cost, benefit or risk to the LDCs; and

WHEREAS, the Signators believe that the public interest would be served by a phase-out of shifted costs in a way that ensures the reliability of gas supply in Connecticut, preserves retail competition and addresses existing subsidization of firm transportation customers by firm sales customers without exempting customers who have already switched to firm transportation service from bearing their share of SOLR costs.

NOW THEREFORE, the Signators agree as follows:

1. Overview of Settlement. Shifted costs will be eliminated in phases over a four-year period. Phase 1, to be implemented in bills rendered on and after December 1, 2002 and to remain in effect for twelve months, will include a \$0.30/mcf transition charge to be paid by firm transportation customers and which will benefit firm sales customers through the LDCs' respective PGAs. Phase 1 will also include certain operational changes by the LDCs more fully described in Section 5 below. Phase 2, to be implemented in bills rendered on and after December 1, 2003 and to remain in effect for twelve months, will include a \$0.34/mcf transition charge to be paid by firm transportation customers and which will benefit firm sales customers through the LDCs' PGAs. The Signators will attempt to augment the Phase 2 reduction in shifted costs by working together to design ancillary services that the LDCs would desire to sell and the Marketers would desire to buy, as more fully described in Section 6 below. Phase 3, to be implemented on December 1, 2004 for the succeeding twelve months, will eliminate two-thirds (2/3) of net shifted costs through the mechanism or mechanisms discussed in Section 7 below. Phase 4, to be implemented on December 1, 2005 will eliminate 100 percent of shifted costs on a going forward basis, as set forth in Section 8 below.

2. Reliability of Gas Service. The Signators agree that the current level of reliability of gas service must be preserved and that the LDCs will continue to provide supplier of last resort ("SOLR") services as they have in the past for at least the next three years and will continue to be responsible for long term supply/capacity planning activities. The Department should ensure that the LDCs recover their prudent costs incurred in performing the SOLR function. The Signators recognize that the Department may wish to revisit the question of SOLR responsibilities at a future date after the competitive market matures. The Signators reserve their rights to advocate a continuation of or a modification to SOLR rules, as the case may be, at that time. If the Department were to modify SOLR responsibilities at a future date, such changes should be prospective only, and should fully recognize, and permit recovery of, the prudent costs that the LDCs incur in decisions made to fulfill their SOLR responsibilities prior to such changes.

3. LDCs' Continuing Role in Gas Supply. The Signators agree that the LDCs should continue to offer gas supply services for at least the four-year term of this settlement.

4. Competition. The Signators agree that the public interest is served by vigorous retail competition on a level playing field with proper cost assignment in the supply of gas to customers.

5. Phase 1. (a) A \$0.30/mcf transition charge will be implemented in bills rendered to firm transportation customers on and after December 1, 2002 and will continue in effect for the succeeding twelve months. The transition charge paid by firm transportation customers will benefit firm sales customers through the LDCs' PGAs.

(b) The LDCs' tariffs will be modified (i) so as to permit any trades of equal and opposite gas quantities for pools on the same pipeline with the same balancing requirements by any Marketer with the application of tariff provisions related to standby service, balancing and cashout applying only to the post-trading position of such Marketer and (ii) the calculation of daily cashout imbalances using a Gas Daily index appropriate for each pipeline and firm transportation pool. Exhibit 1 to this Settlement Agreement provides an example of how the cashouts will be calculated under this provision. These tariff changes will take effect to coincide with the effective date on which firm transportation customers begin incurring the transition charge described in Section 5(a) above. In addition, the LDCs and Marketers agree to explore the potential to further reduce net shifted costs in the coming winter through ancillary services (e.g., voluntary standby service) that the LDCs would wish to sell to the Marketers and the Marketers would wish to buy from the LDCs and/or voluntary capacity assignment over this twelve-month period. Attachments A, B and C show the respective estimates of net shifted costs by Yankee, SCG and CNG, and how additional revenues from ancillary services such as standby service help to reduce net shifted costs, which will benefit firm sales customers through the LDCs' PGAs. The Signators have not waived their rights to question the LDCs' estimates of shifted costs and/or their methodology for computing shifted costs in future proceedings.

(c) Promptly after the implementation of Phase 1, the Signators will initiate discussions pertaining to the LDCs' tariffs in an effort to assist the LDCs in (i) developing new or revised ancillary services that the LDCs will wish to sell to the Marketers and the Marketers will wish to buy from the LDCs, thereby further reducing net shifted costs, which will benefit firm sales customers through the LDCs' PGAs and (ii) streamlining operational terms in their firm transportation tariffs. Following such discussions, but not later than June 1, 2003, the LDCs will file proposed tariffs with the Department and request that such tariff changes become effective contemporaneously with Phase 2. The Marketers and OCC shall have the right to participate in the proceeding in which the Department considers such proposed tariffs and to support or oppose them if they so choose. In addition, the Signators will begin discussions toward early resolution of the issues relating to Phase 3, as more particularly described in Section 7 below.

(d) The Marketers reserve the right to intervene in the LDCs' various proceedings before the Department for purposes of (i) advocating more favorable firm transportation tariff provisions and (ii) ensuring proper cost allocation, including, without limitation, advocating that the portion of the LDCs' uncollectible expense related to gas costs be properly reflected in the LDCs' respective PGAs. OCC reserves the right to participate in any such proceeding.

6. Phase 2. In bills rendered to firm transportation customers beginning December 1, 2003 and for the succeeding twelve months, the transition charge will increase to \$0.34/mcf, such transition charge to benefit firm sales customers through the LDCs' PGAs. In no event will the \$0.34/mcf transition charge be eliminated prior to implementation of the Phase 3 solution approved by the Department, as described in Section 7 below. In addition, the Signators will continue to explore the potential to further mitigate net shifted costs through voluntary capacity assignment and/or ancillary services that the LDCs would desire to sell to the Marketers and the Marketers would desire to buy from the LDCs and that will further reduce net shifted costs, thereby benefiting firm sales customers through the LDCs' PGAs.

7. Phase 3. (a) The Signators agree to eliminate not less than two-thirds (2/3) of net shifted costs effective December 1, 2004. The Signators have identified as a potential approach to accomplish that objective a mandatory assignment to each Marketer, subject to recall rights, of sufficient capacity held by the LDCs to cover approximately 50 percent of such Marketer's firm delivery requirements (thereby eliminating approximately 50 percent of shifted costs), plus a transition charge in bills rendered to firm transportation customers on and after December 1, 2004 and for the succeeding twelve months that will offset one-third of the remaining shifted costs, such transition charge to benefit firm sales customers through the LDCs' PGAs. The Signators agree that (i) the capacity assignment should not be on a slice-of-system basis, (ii) the assigned capacity should be reflective of the Marketers' customer load characteristics and (iii) such capacity assignment will require an adjustment to the LDCs' current metrics and benchmarks to keep the LDCs whole in light of the reduced availability of supply assets that the LDCs would then have available. Examples of such metrics and benchmarks that will require adjustment as part of mandatory capacity assignment include, without limitation, CNG/SCG's merger-enabled gas cost savings calculations and the LDCs' interruptible target margins. Mandatory capacity assignment may also require a further revisiting of standby and balancing provisions in the LDCs' tariffs in light of the reduced availability of supply assets that the LDCs would then have available with which to perform those functions.

(b) The Signators recognize that there are ways other than a mandatory capacity assignment to bring about the two-thirds reduction in net shifted costs and that in certain cases it may be possible for an LDC and Marketer to craft a more satisfactory arrangement that achieves an equivalent reduction in shifted costs. For that reason, the Signators agree that the Department should not require a "one size fits all" solution in Phase 3 but rather permit Signators to enter into other voluntary arrangements in lieu of mandatory capacity assignment (e.g., voluntary standby service, contracts for peaking and/or storage services, voluntary capacity assignment, etc.) if it can be demonstrated that such arrangements produce an equivalent reduction in shifted costs, which will benefit firm sales customers through the LDCs' PGAs, and that reliability will be protected under those arrangements.

8. Phase 4. The Signators agree to attempt to develop a consensual solution that, effective December 1, 2005, will result in the full elimination of any shifted costs remaining at that time in a manner that is consistent with maintaining ongoing competition in Connecticut gas supply.

9. Severability. All parts of this Settlement Agreement are interdependent and not severable. If this Settlement Agreement is not approved and accepted in full by the Department, no part of this Agreement shall be binding on, or deemed to be the positions of, any Participant.

10. Precedential Effect. It is the intent of the Signators that the provisions of this Settlement Agreement will apply only to and be binding only with respect to the matters that are the subject of this proceeding. No provision of this Settlement Agreement, nor any methodology or principle utilized herein, nor any of the positions taken herein by any Participant may be referred to, cited or relied upon as precedent in any other proceeding before the Department, or any other regulatory agency or before any court of law for any purpose other than the furtherance of the purposes, results and disposition of matters expressly governed by this Settlement Agreement

11. Support of the Settlement. The Signators agree to support this Settlement Agreement before the Department, and in any related legal proceedings or legislative inquiries or hearings, without reservation or condition.

12. Superseding of any Prior Agreements. This written Settlement Agreement constitutes the entire agreement among the Signators and shall supersede any other existing agreement among them, whether oral or written, with respect to the particular subject matter hereof.

13. Execution in Counterparts. Any number of counterparts of this Settlement Agreement may be executed and each shall have the same force and effect as the original.