STATE OF NEW HAMPSHIRE

PUBLIC UTILITIES COMMISSION

October 26, 2005 - 9:35 a.m.
Concord, New Hampshire

RE: **DG 05-147**
NORTHERN UTILITIES, INC. - N.H. DIVISION:
Cost of Gas Factor for the Winter Period of November 2005 through April 2006.

PRESENT: Chairman Thomas B. Getz, Presiding
Commissioner Graham J. Morrison
Commissioner Michael D. Harrington

Diane Bateman, Clerk

APPEARANCES: **Reptg. Northern Utilities, Inc.:**
Seth L. Shortlidge, Esq.
Patricia M. French, Esq.

Reptg. Residential Ratepayers:
Rorie Hollenberg, Esq.
Office of Consumer Advocate

Reptg. PUC Staff:
Edward N. Damon, Esq.

Court Reporter: Steven E. Patnaude, CCR

ORIGINAL

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P R O C E E D I N G S

CHAIRMAN GETZ: Good morning. We'll open the hearing in docket DG 05-147, concerning Northern Utilities. On September 14, 2005, Northern Utilities filed with the Commission its cost of gas rates for the period November 1, 2005 through April 30, 2006, and its Local Deliver Adjustment Clause rates and certain supplier charges for the period November 1, 2005 through October 31, 2006. As of the date of filing, this estimated impact of the proposed firm sales cost of gas and revised surcharges on a typical residential heating customer's winter bill would be an increase of 15.5 percent from last winter's rates.

The Commission issued an order of notice on September 21 setting a hearing, which was subsequently rescheduled to this morning. And, I'll note for the record that the affidavit of publication is on file with the Commission.

We'll take appearances please.

MR. SHORTLIDGE: Good morning again, Mr. Chairman. Seth Shortlidge, Pierce Atwood, representing Northern Utilities. Accompanying me today is Patricia French, also of Northern Utilities, Joe Ferro, Chico DaFonte, and Ron Gibbons. Thank you.

CHAIRMAN GETZ: Good morning.

CMSR. MORRISON: Good morning.

CMSR. HARRINGTON: Good morning.

MS. HOLLENBERG: Good morning. Rorie Hollenberg and Ken Traum, here for the Office of Consumer Advocate.

CHAIRMAN GETZ: Good morning.

CMSR. HARRINGTON: Good morning.

CMSR. MORRISON: Good morning.

MR. DAMON: Good morning, Commissioners. Edward Damon, for the Staff. And, with me today are Bob Wyatt, Stephen Frink, and George McCluskey.

CHAIRMAN GETZ: Good morning. Any preliminary matters, before we hear from the Company's witnesses?

(No verbal response)

CHAIRMAN GETZ: Hearing nothing, then, Mr. Shortlidge.

MR. SHORTLIDGE: The Company calls Mr. Ferro and Mr. DaFonte.

(Whereupon **Joseph A. Ferro** and **Francisco C. DaFonte** was duly sworn and cautioned by the Court Reporter.)

JOSEPH A. FERRO, SWORN

FRANCISCO C. DaFONTE, SWORN

DIRECT EXAMINATION

BY MR. SHORTLIDGE:

Q Good morning, Mr. Ferro.

A (Ferro) Good morning.

Q I'm going to show you a document entitled the "Prefiled Testimony of Joseph A. Ferro". Did you prepare this document or did you have this document prepared at your direction?

A (Ferro) Yes, I did.

Q And, is this your truthful testimony as if it were presented today?

A (Ferro) Yes, it is.

MR. SHORTLIDGE: I'd ask that the testimony of Mr. Ferro be marked as "Exhibit 1".

CHAIRMAN GETZ: Be so marked.

(The document, as described, was herewith marked as **Exhibit 1** for identification.)

BY MR. SHORTLIDGE:

Q And, good morning, Mr. DaFonte.

A (DaFonte) Good morning.

Q I'm going to show you a document entitled the "Prefiled Testimony of Francisco C. DaFonte". Is that your truthful testimony as if it were -- or, was this document prepared by you or under your direction?

A (DaFonte) Yes, it was.

Q And, is this your truthful testimony, as if it were presented here today?

A (DaFonte) Yes, it is.

MR. SHORTLIDGE: I would ask that the testimony of Mr. DaFonte be marked as "Exhibit 2".

CHAIRMAN GETZ: Be so marked.

(The document, as described, was herewith marked as **Exhibit 2** for identification.)

BY MR. SHORTLIDGE:

Q Now, Mr. Ferro, I'm going to show you a document entitled "Northern Utilities, Inc. Revision to Proposed Cost of Gas Adjustment for the Winter Period". Could you identify this document for the Commission.

A (Ferro) Yes. This is the Company's filing of its revised proposed cost of gas for the winter period November 1, '05 through April 30th, '06. And, this has been revised to reflect the latest gas prices based on the NYMEX.

MR. SHORTLIDGE: I would ask that the revised filing be marked as "Exhibit 3".

CHAIRMAN GETZ: Be so marked.

(The document, as described, was herewith marked as **Exhibit 3** for identification.)

MR. SHORTLIDGE: Does the Bench have copies of the revised filing?

CHAIRMAN GETZ: I don't think everyone has. Give us two.

MR. SHORTLIDGE: Mr. Chairman, would you like us to wait a second until Commissioner Harrington returns or should we continue?

CHAIRMAN GETZ: I think you can continue with the direct.

MR. SHORTLIDGE: Okay.

BY MR. SHORTLIDGE:

Q Mr. Ferro or Mr. DaFonte, do you have any modifications to your testimony at this time?

A (Ferro) I do not.

A (DaFonte) I do not either.

Q Mr. Ferro, would you mind briefly summarizing the cost of gas filing and the associated proposed rate changes?

A (Ferro) Certainly. For the record, I just want to say, my name is Joseph A. Ferro. My business address is 300 Friberg Parkway, Westborough, Massachusetts. And, I'm the Manager of Regulatory Policy for Bay State and Northern Utilities. The revisions to the cost of gas that were filed on October 19, 2005 were simply to reflect the latest NYMEX gas prices. And, secondly, to, and in connection with those NYMEX prices, update the Company's cost of inventory gas that it will send out this winter. And, this update reflected not only the latest gas prices based on the NYMEX, but the actual activity of inventory gas through the latest actual months of -- through September '05.

Q Mr. Ferro, could you describe for the record the proposed rate adjustments and the bill impacts that will result as a result of those bill adjustments or rate adjustments?

A (Ferro) Certainly. To do that, I would turn the attention to what is labeled "Revised" -- "Rev 1" in the bottom right-hand corner of the document Exhibit 2, which is after the cover letter and motion and explanatory document. And, that would be "Twentieth Revised Page 38" and "Twentieth Revised

Page 39", the Company's tariff sheet. And, very, very briefly, I just want to say that the Company has forecasted its customers' demand for this winter period of approximately 36.8 million therms. To satisfy those therms, the Company has projected to send out gas supplies from -- natural gas supplies from Canada and from domestic sources from the Gulf Coast, has projected to bring back -- bring from underground storage facilities gas supplies, and has other supplemental supply sources to satisfy that demand, and that resulted in costs for the winter period of 47,875,058.

When you divide the forecasted demand of the 36.8 million therms by those dollars, the Company has come up with a unit cost of gas to charge its customers of $1.30.01. And, since that's the average cost of gas, that's the rate the Company is proposing to charge its residential customers. And, then, based on ratios that were determined in the Company's last rate proceeding, the $1.30 per therm average that's charged to residential customers turns into a 95.01 cent per therm rate for the high load factor or also considered Low Winter Commercial/Industrial classes. And, then, applying the ratio that pertains to the High Winter or low load factor Commercial/Industrial customers, the rate -- the $1.30 rate turns into $1.4073 per therm.

That concludes my summary.

Q Thank you, Mr. Ferro. I believe early on in your summary you perhaps erroneous referred to "Exhibit 2", which is the testimony of Mr. DaFonte. Did you, in fact, mean to refer to Exhibit 3, which is the revision letter?

A (Ferro) I'm sorry, Yes. Thank you for correcting me, Counselor. That's correct, that's Exhibit 3. And, I also was remiss in not completely responding to your question, and referring to what certainly is on everyone's mind in this winter, and that's the bill impacts. And, if I could turn to -- it's labeled "Rev 71" in the bottom right-hand corner, which is the third last page of the document. This document shows a typical residential heating customer profile. And, when I say "typical residential heating", it's not necessarily the average use of our residential heating customer, but really it represents a single family home that use gas for virtually all its appliances, that is space heating system, water heating, cooking, and clothes drying. And, this customer, this single family home customer uses 1,250 therms a year, of which 932 therms fall in the winter period November through April. This 932 therms in the winter apply to the Company's current base rates and the proposed cost of gas versus last year's cost of gas that it charged, shows that a customer, this type of customer this winter will be paying $262.74 more this winter. And, that 262 -- that 262.74 is approximately $43 or is $43.79 a month. That's a 19.55 percent increase over the residential total bill of last year. This bill impact analysis shows that that hypothetical customer this year will be paying $1,606.97 for a six month bill. Last year, that same customer paid $1,344 for that six month bill.

Q That's a pretty significant increase. Would you mind describing for the Commission perhaps some of the -- briefly describing some of the underlying reasons for the increase in the cost of gas this year?

A (Ferro) Certainly. One way to do that is to refer to two pages prior to the page we were on, Rev 68. And, that shows the variance analysis of the actual cost of gas we charged last year versus the cost of gas we're proposing this year, and the last column shows the rate impacts -- the components of the rate impact. And, to no one's surprise, the main component of the 27.83 cent per therm increase to the cost of gas this year versus last year is the commodity costs. Because you can see halfway down on this page, again in the last right-hand column, the commodity effect of the proposed cost of gas this year versus last year is 26.18 cents.

So, at risk of saying the obvious, the volatile, rapidly increasing gas prices is virtually the entire reason for the increase in the customer's bill this winter.

Q Now, Mr. Ferro, I know you've been involved with some of the low-income proceedings before the Commission. Could you describe for the Commission some of the actions the Company has taken to mitigate some of the potential rate hardship associated with this large increase, especially for the Company's most vulnerable customers?

A (Ferro) Well, certainly, the Company has undertaken an outreach -- outreach efforts to ensure customers of us working with them to work out ways of paying their bills this winter, by all means, making sure customers continue to receive reliable service. And, as usual, we tell customers that, if they have any problems, they certainly can seek reasonable payment arrangements. We have the Budget Payment Plan, where they do not have to pay the actual amount billed each month, but rather a flat, level amount. But, in addition to the -- sort of the turning up of those, what I consider more standard outreach efforts, the Company has also, in conjunction with the Commission directive and the Commission Staff's effort, have opened up a Residential Low-Income Discount Program. Where it has sought, through fuel assistance information, customers who can get on the Residential Low-Income Discount rate, which is a rate that is 50 percent less than the base rate of the regular residential rate. And, that 50 percent discount off the base rate results in approximately a 15 percent reduction or discount off the total bill. And, so, the Company has begun signing up customers on this Residential Low-Income Program?

In this filing, the Company has calculated a Residential Low-Income Discount amount that it expects to experience that it's recovering through its Local Delivery Adjustment Clause, the LDAC. And, it shows that, in that schedule, that the

Company is anticipating approximately -- approximately a thousand customers taking advantage of this Residential Low-Income Discount rate.

Q Thank you, Mr. Ferro. Mr. DaFonte, would you mind briefly summarizing your testimony.

A (DaFonte) Sure. As Mr. Ferro has done, I would first like to state my name for the record. My name is Francisco C. DaFonte. I am employed by NiSource Corporate Services as Director of Energy Supply Services for Northern Utilities, Bay State Gas, and Northern Indiana Public Service Company. My business address is 300 Friberg Parkway, Westborough, Mass.

To summarize the testimony, basically, what we've tried to do in the testimony is summarize the resource utilization for the past winter period of 2004-2005. Along with that, we've forecast the anticipated resource utilization for this upcoming Winter of 2005-2006, and have discussed the results of the hedging program for the past winter, as well as what we anticipate going forward.

Q Thank you, Mr. DaFonte. Would you mind taking a few minutes to briefly describe for the Commission the way the Company designs its supply portfolio?

A (DaFonte) Sure. The Company primarily focuses the design of the portfolio on the supply diversity and resource diversity. By that I mean that the Company looks at all of its -- all of the alternatives available to it out in the marketplace, attempts to access as many production areas as possible, so as to avoid having too much reliance on any one supply basin or resource. With that, obviously, the Company includes an economic study to determine which resources fit the needs of our customers in the most efficient manner, along with the reliability factor. We contract for firm primary delivery point capacity, such that those paths that are contracted for would not be curtailed in the event of a restriction in the upstream interstate market.

The Company also looks at flexibility of some of its resources, including in that a lot of underground storage, which is filled in the summer period for use in the winter, and optimally fits the load profile of its customers, who are much more heat-sensitive and require more supply in the winter period, obviously, than in the summer period. And, so, the Company looks at various factors, in terms of designing its portfolio, but, overall, it does have a very reliable and diverse portfolio.

Q Thank you. I've noticed, and I'm sure everyone else in the room has, there have been numerous concerns expressed by the media and trade press regarding reliability, the availability of gas supply and transportation capacity this winter. What actions has the Company taken to ensure that it can provide all its customers with reliable service?

A (DaFonte) As I mentioned earlier, the Company's portfolio design essentially includes the diversity factor that I mentioned. And, with that, that creates less of a reliance on any one particular supply basin. In this case, a lot of the discussion centered around the potential disruptions of supply in the Gulf area, particularly, the Louisiana and East Louisiana sections of the Gulf Coast. The Company's supply portfolio is only reliant on those affected areas to the volume of about 6,000 decatherms a day, which is about five percent of its design day requirements, and about ten percent of its total winter supply requirements.

So, the Company, relatively speaking, is in very good shape with respect to any of the potential supply disruptions that may be forthcoming this winter period, and has much more of a reliance on underground storage through Canada and also has access to the Sable Island supplies in eastern Canada as well. But, for this winter period, the portfolio is in good shape. The supplies we contract for are on a firm basis. And, as I mentioned earlier, the capacity that we hold is a primary delivery rights capacity that ensures that curtailments, other than *force majeure* events, will not take place.

MR. SHORTLIDGE: Thank you. I'm going to have a couple questions regarding the testimony of Mr. McCluskey and Mr. Traum. I don't know if it makes sense at this point to mark those as exhibits, pending their admission on the stand?

CHAIRMAN GETZ: Is there an objection to basically hearing rebuttal testimony at this time?

(No verbal response)

CHAIRMAN GETZ: Okay. Hearing no objection, then, Mr. Shortlidge, you can proceed.

MR. SHORTLIDGE: I'd simply ask that the Commission mark the testimony of Mr. McCluskey as "Exhibit Number 4" for purposes of identification and clarity of the record.

CHAIRMAN GETZ: Be so marked.

(The document, as described, was

herewith marked as **Exhibit 4** for identification.)

MR. SHORTLIDGE: And, similarly, I'd ask that the Commission mark the testimony of Mr. Traum as "Exhibit 5", for purposes of identification and clarity of the record.

CHAIRMAN GETZ: It will be so marked.

(The document, as described, was herewith marked as **Exhibit 5** for identification.)

BY MR. SHORTLIDGE:

Q Now, Mr. Ferro, have you had the opportunity to review Exhibit 4 and 5, the testimony submitted by Mr. Traum and Mr. McCluskey?

A (Ferro) Yes, I have.

Q Could you briefly describe your understanding of the proposals contained in Mr. Traum and Mr. McCluskey's testimony?

A (Ferro) Certainly. Mr. McCluskey is proposing that we, in addition to deferring the estimated allocated costs in question for the prior winter, to also defer the estimated allocated costs based on the forecast of capacity costs for this upcoming winter. So, to defer an additional amount and remove out of the cost of gas calculation this upcoming winter.

Mr. Traum seemed at first, I think, to be proposing the same thing, as he makes a statement that "these costs should be charged" -- "recovered from Maine customers". But I do find it even a bit more concerning and problematic that, and I'm sure Mr. Traum can correct me, but it seems as though he's proposing that the costs should not even be deferred, that they just should be removed, without consideration of them being recovered possibly from any division. And, which leads me to just make my opening statement about all of this and about this issue.

That Northern certainly has prudently incurred these capacity costs over the years. And, they have -- including right up to date. And, have the authority, by way of the Proportional Responsibility Methodology Allocation approved by the two state commissions to recover 100 percent of its capacity costs. And, so, ultimately, the Company strongly feels that these costs should be and need to be recovered from its ratepayers.

Q Thank you, Mr. Ferro. Just so the record is clear, and I believe this was part of your answer, the

Company did propose a deferral of some costs. Which costs were those?

A (Ferro) Right. The Company has agreed to, with the Commission staff, to defer the estimated allocation of costs associated with capacity -- capacity related to the loads of certain transportation customers in Maine for the prior periods of the Summer 2004, the Winter -- the Winter 2004-2005. And, the Winter 2004-2005 is a dollar amount that's reflected in the Company's proposed cost of gas calculation in its tariff sheet of roughly $692,000.

Q And, also to clarify the record, how does that proposal differ from what is included in Mr. McCluskey's testimony?

A (Ferro) Right. That differs in the sense that, in addition to removing the prior period estimated costs, based on the actual capacity costs incurred for this Winter '04/05, Mr. McCluskey is recommending to also remove from this cost of gas the estimated allocation of costs for this forecasted period, this Winter 2005-2006. So, the difference is that Mr. McCluskey's proposal or recommendation is to remove estimated costs for two winters in this one cost of gas calculation, Winter '04/05 and the forecast Winter '05/06.

Q Thank you. Now, having reviewed Mr. McCluskey's testimony, could you provide some specific comments on some of the statements made by Mr. McCluskey in his testimony?

A (Ferro) Certainly. In reviewing Mr. McCluskey's testimony, I'd first make note of Page 2 of his testimony, where he does mention the estimated costs of $1.35 million that is the responsibility of Maine customers. And, again, he recommends to remove these from the Winter '05/06 costs therefore in this cost of gas calculation. It is important to note that, based on the approved PR allocation methodology, the responsibility of these estimated costs currently fall in the New Hampshire Division and to be recovered from New Hampshire customers. It certainly will take a resolution between the two divisions and their respective state commissions to change the allocation process and/or the acknowledgement of a change in the cost responsibility of each division.

That said, the Company believes the allocation process could be, and soon should be, modified to recognize capacity quantities and associated sendout related to certain Maine transportation load, so that the operation of the allocation process results in a fair assignment of costs between the two divisions. In fact, this is exactly what the Company has been working hard to accomplish with its filing of its terms and conditions and associated capacity assignment, and other delivery service provisions with the Maine Public Utility Commission. And, certainly, through its many hours of settlement discussions with all the intervening parties in the other dockets that Mr. McCluskey cites, the other intervening parties being the New Hampshire -- in addition to the New Hampshire Staff, the New Hampshire Consumer Advocate, competitive suppliers, competitive gas suppliers, known as "CGS", Select Energy, and another competitive gas supplier, the Maine Public Advocate, and, of course, the Maine Staff. And, we've been working hard, in fact, we're at critical stages of the settlement process to come to some resolution. And, hopeful that we will come to a resolution, and such a resolution would result in modifying the allocation of costs, certainly for this upcoming winter.

The second comment I want to make on

Mr. McCluskey's testimony relates to on Page 9 of his testimony. And, just to paraphrase, Mr. McCluskey states that "the New Hampshire grandfathered load really imposes no costs on Northern, because it does not plan for serving such load, and that essentially is not the case with respect to the Maine firm transportation load."

First, I think we should note that, although the Company believes it has an obligation to accept Maine firm transportation customers back to sales service, or to serve them in the event of supplier failure, the precise or the full level of costs imposed on Northern to fulfill this obligation needs to be resolved in the other proceedings among all the parties, and is yet to be determined.

Further, and in the meantime, I just really need to point out that the PR allocation is designed to reflect the firm sendout of customer requirements that are directly met by the Company's capacity. Heading into a winter, or a gas year, like this winter, the Company identifies the capacity that it needs and directly assigns to customers in the upcoming months. Such capacity is not in connection with grandfathered transportation load. And, just a clarification on what costs may the Company be imposing for these other transportation customers, short term and long term, is of issue.

Another section of Mr. McCluskey's testimony I'd like to comment on is on Page 10. And, again, to paraphrase, take the liberty of paraphrasing Mr. McCluskey's testimony, he states that there's "ample precedent to estimate the apparent impact of the allocation of the upcoming capacity costs to New Hampshire associated with the Maine transportation customer load."

I respectfully disagree with Mr. McCluskey that a "precedent" has been established to do this. On the contrary, to date the Company has agreed to defer the estimated impact of such allocated costs associated with the actual costs of the previous year, as I stated in answering counsel's direct examination.

In fact, this winter the cost of gas filing reflects the removal of this and deferral of the Winter 2004-2005 allocated costs of that $692,000 figure I gave you. The Company has agreed to defer these allocated costs for the prior period, essentially, as a good faith gesture that it has, and will continue to, work diligently to resolve this issue among all parties.

I also want to comment on Page 11 of Mr. McCluskey's testimony. And, again, paraphrasing, that "the Company should have anticipated Staff's recommendation", i.e. the recommendation of deferring and pulling out of the cost of gas calculation of the forecasted costs, "and seek recovery in Maine in advance of this proceeding." At risk of repeating myself, the Company only had reason to expect the request to defer the allocated costs associated with the prior period costs, because that's what we've been doing. Moreover, Northern again has been working hard to revise the operation of the allocation process to address this impact of cost allocation.

With respect to the '05/06 Winter costs that are in question here, any change of the allocation factors that come out of the other dockets through settlement certainly can and will be reflected in the Company -- a Company revision to its cost of gas. And, as everyone knows, the Company looks to revise its cost of gas every month, primarily based on NYMEX prices and actual experience to date. And, the other element here certainly could be and will be any change in the PR allocation methodology and resulting PR allocation factors going forward. So, that would be a more timely, precise, and reasonable approach to reflecting a revision to allocated costs to the New Hampshire Division this winter.

Q Thank you, Mr. Ferro. Just so the record is clear, when you're referring to "joint proceedings between Maine and New Hampshire", are you referring to New Hampshire Docket Number 05-080 and Maine Docket Number 2005-273, both started as a result of the Company's request for joint hearings filed in March or April of this year?

A (Ferro) Yes, I am. And, also, at least indirectly, in connection with the other docket in Maine under which the Company filed its proposed terms and conditions, including many provisions to facilitate capacity assignment and unbundling provisions, and my memory is not real clear, I should know the number right away, but I think you could help me out with that docket number.

Q Absolutely. Would you be referring to Docket Number 2005-87?

A (Ferro) Yes, I would.

Q All right. And, would that docket have been opened in February of 2005?

A (Ferro) Yes. And, you just prompted me to just reiterate that the Company tried to fully address this apparent inequity in its allocation of costs based on, you know, recent and latest market conditions, by filing a comprehensive change in its terms and conditions in the State of Maine to address this issue head on.

Q Thank you. Now, I know that many of us in the room have already been deeply involved in these proceedings, but, for the benefit of the Commission and the record, could you very briefly describe the purpose of the PR allocator, what it does, and some of the history underlying it?

A (Ferro) Certainly. The PR allocator, and most of this will be really reiterating what Mr. McCluskey put in testimony, because I don't disagree with how he has characterized the PR allocator calculation. But the PR allocator came into being in 1995, when the Company sought approval from both Commissions, and, in fact, it was contingent upon both Commissions approving a revised means of allocating fixed capacity costs between the two divisions, to really essentially recognize the requirements of securing capacity to serve its immediate firm requirements.

Prior to that, the allocation between the two states for capacity costs, as well as commodity costs, were essentially based on and reflected firm sendout volumes only. And, that's fine to allocate variable commodity costs, but not quite fair in assigning a level of fixed capacity costs, because capacity costs are -- capacity is planned for, based on the Company's peak -- peak level requirements. And, so, you secure a level of capacity to meet load during highest demand periods. So, the Company had, with its help from its cost consultant, who had brought forward in many jurisdictions the Proportional Responsibility allocation methodology for allocating various types of costs, to both Commissions, and, essentially, as Mr. McCluskey states in his testimony, and accurately, as I said, the Proportional Responsibility allocation methodology recognizes each month's utilization of certain resources. And, based on that utilization of the month's resources, it develops weighting factors for the months. Such that, when you have annual fixed capacity costs, you allocate the costs to each month based on these weighting factors. And, just for a brief example, for instance, the month with the lowest capacity utilization or the resource utilization, say, is the month of August. In that month of August, the level of the percentage of utilization is divided by 12, so that every month gets a percentage of that, of that level of capacity. And, then, it's like building a pyramid and you're just layering each month's capacity resource utilization until you get to the peak month, which that has, obviously, the highest weight.

Nonetheless, after we do this, we're allowed to put costs in each month based on these weightings. And, then, we take the sendout allocation factor between the two states and allocate costs in those months. So, for instance, if the State of New Hampshire has a higher need for capacity or for that resource, in the month of January, and January is the month that it has the lion's share of the costs, or certainly more costs than any other month, then that would serve to provide -- result in a higher allocation factor to New Hampshire in my example than Maine. So, it does put weightings in the month, and then apply sendout factors between the two states. I might add that all of this calculation is being done based on a design year requirement. And, what we mean by "design year", is the Company looks at the coldest experience in the last 25 years, so a 1-in-25 probability of experience. And, that's how the Company plans its capacity resources, to provide reliable service to all its firm customers.

So, this is the methodology we came up with. Both Commissions not only approved it, but acknowledged that this was a better way, a fairer way to assign capacity costs. And, so, that was in 1995.

And, as we proceeded, both states, at different times, opened up their system for transportation service. And, I can't really recall or identify which state had more transportation load at which time, but New Hampshire had transportation load in the late '90s, and so didn't Maine start having transportation load in the late '90s. But there were no capacity assignment rules at that time. And, the Company employed its PR allocation methodology based on its firm sales requirements, because all the transportation load was not being assigned capacity.

So, there was sort of -- I look at this as an "ebb-and-flow" type of situation, where, depending on what's happening in one state or the other, one state may have been adversely affected by the fact that customers switched from sales service to transportation service, while, at the same time, Mr. DaFonte, the Company, in general, can't instantaneously tailor his portfolio to match that he no longer needs to plan for or provide capacity to these customers who just recently switched from sales service to transportation service.

Well, along comes, and I'm flashing forward a little bit, March of 2000, and we had an extensive unbundling proceeding in New Hampshire. I might add, conducted very effectively and efficiently by the Commission staff. The Company participated and the suppliers participated. And, we ended up with a capacity assignment rule that any customers who switched after March 14, 2000, switched, I say, from sales service to transportation service, would have to take the Company's capacity. And, the customers prior to that were what we called "grandfathered", as Mr. McCluskey said in his testimony. And, "grandfathered" means that they don't have to take our capacity. So, the customers who have to take our capacity imposed a requirement on Mr. DaFonte that he had to acquire or maintain capacity to assign to these customers.

On the other hand, in Maine, nothing had happened. No capacity assignment rules, even though there were a lot of discussion and the Company pointed out its position, that feels that the fairest way to implement customer choice is for mandatory capacity assignment, like we have in New Hampshire.

Well, I talked about this "ebb-and-flow". Who knows who got affected how up to this point? And, in fact, after that point still, I know I was somewhat unaware of, you know, what was going on with the impact. It was still ebb-and-flow in my mind. But then it became apparent, and partly by -- mostly by the OCA and the Commission staff bringing to our attention, that there's no longer ebb-and-flow, in my wording. It was sort of like a biased flow, a biased flow of a cost impact to New Hampshire customers, because there was a lot of switching from sales service to transportation service in Maine, without any capacity assignment.

And, so, the allocation factor started increasing in New Hampshire, because the firm sendout requirements in Maine kept dropping, while, in New Hampshire, they were more stable, they were moving, but they were not dropping as much. And, so, I consider that somewhat of a biased flow against New Hampshire, because of no capacity assignment rules in Maine.

And, so, however, we're operating the PR allocator as designed, as authorized, but we all want to do what's fair, equitable, what's right. And, that's why we advanced this issue through a comprehensive filing in Maine, and have been banging out for many hours a settlement. And, in particular, a settlement that recognizes that some of the transportation load in Maine should be treated as firm sendout requirements in this allocation process, to kind of get this thing back in balance, and, in fact, maybe even, in some of the numbers we were looking at, you know, bring the allocation factors much -- noticeably higher in Maine and lower in New Hampshire.

And, so, that I think brings you up to date with how all this has gone on for the past ten years. And, I do want to make it clear that the

Company, on one hand, you know, has incurred these capacity costs prudently. But, on the other hand, recognizes the apparent inequities of this biased flow going on, and would like to correct it, just like the Maine Staff and the Maine OCA would like it corrected.

Q Thank you, Mr. Ferro. Just so the record is clear, the analysis that you just provided is really based on having lived through the events and being able to look back with 20-20 hindsight. There was no way that the Company could have reasonably predicted or knew about these events occurring before they actually occurred, is there?

A (Ferro) That's correct. I mean, as I said, it was, you know, ebb-and-flow, not really understanding or noticing any significant impact. So, we had -- we had very little cause or reason to jump on this issue well before we did.

Q And, just so we're clear, you've been working with this over the past year, but prior to that you had no knowledge that this was occurring?

A (Ferro) That's correct.

Q All right. You've mentioned that -- You mentioned "negotiations". Without getting into the substance of those negotiations, could you just briefly describe for the Commission where we stand with regard to negotiations between the parties right now?

A (Ferro) Yes. I think we're really on the razor edge of the settlement discussions. The Company has two days of settlement discussions scheduled for next week, November 1 and November 2, and aims to, as well as I think most of the parties, to really come down to a concrete resolution to the many issues involved in this -- in those proceedings. And, that it's critical that we stay the course.

And, I do get concerned with, quite frankly, in this proceeding, possibly sort of interrupting or putting us a little bit off pace to the movements that we are planning on having next week to try to nail down the resolutions to these issues.

Q Would you say, with the negotiations that are ongoing right now, and the number of parties involved, is there some risk that any decision by this Commission that changes the *status quo* could have an unintended consequence with regard to the negotiations that are happening, whether for the Company or for another party?

A (Ferro) Well, I think that is a possibility. The answer, I guess, in short, is "yes", in that any additional imposition or, use kind of a slang word, the heat put on the Company could change the dynamics of settlement discussions next week.

Q And, let me ask you this. If the parties were to reach a resolution, which hopefully will happen next week, is there anything in your mind that would prevent that resolution from immediately being implemented in New Hampshire?

A (Ferro) No.

Q Now, just getting back, and I know you mentioned that there may be a difference between Mr. Traum's testimony and Mr. McCluskey's testimony, we'll explore that later, do you have more significant concerns if Mr. Traum's testimony is interpreted as "the Commission should disallow these costs immediately"?

A (Ferro) Yes. As I said up front, if I'm interpreting Mr. Traum's testimony correctly, and I may not, I find his suggestion more problematic than Mr. McCluskey's. Mr. McCluskey, I believe, and I don't mean to be interpreting their testimony for them, but Mr. McCluskey is proposing to defer these costs, and by way of his suggestion -- proposal, tells me that he does recognize that these costs are recoverable; the question is "from whom?" Mr. Traum's testimony seems to take it an extra step, or at least an extra half step, and suggests that "I don't care what you do with the dollars, just stop recovering them right now here." And, that's problematic for the Company. As I said, the Company has -- should have the right to recover 100 percent of its prudently incurred costs, and that's what we have before us.

Q Oh, Mr. Ferro, Ms. French actually just pointed out to me that perhaps in one of your previous questions -- or, answers, you indicated that we were "interested in settling with the Maine Commission Staff and the Maine parties". You really meant to say "the New Hampshire parties and the Maine parties", didn't you?

A (Ferro) I did. I did. I meant to say that the New Hampshire Staff and the New Hampshire OCA is, obviously, a critical party to the proceedings. And, I think I misspoke that, when I'm saying that the desire to correct the inequities, I think I incorrectly said "the Maine Staff and the Maine OCA", which doesn't exist, and I really meant to say "the New Hampshire Staff and the New Hampshire OCA".

MR. SHORTLIDGE: Great. Thank you very much. No further questions.

CHAIRMAN GETZ: Ms. Hollenberg.

MS. HOLLENBERG: Thank you. One moment please.

(Atty. Hollenberg conferring with Mr. Traum.)

CHAIRMAN GETZ: Off the record for a moment.

(Brief off-the-record discussion ensued.)

CHAIRMAN GETZ: Back on the record.

MS. HOLLENBERG: Good morning.

WITNESS FERRO: Good morning.

CROSS-EXAMINATION

BY MS. HOLLENBERG:

Q I think my first question is for Mr. DaFonte. And, you testified on direct about some of the issues that are causing the increase of commodity costs this winter. I was just -- And, you testified about your portfolio being very reliable and diverse. And, I just would ask you, is it a correct statement to say that you're confident that your supply for firm sales customers is secure for this winter?

A (DaFonte) Yes. I'm confident that the portfolio that we've put in place to serve those sales customers is reliable. I cannot unequivocally state that there won't be interruptions of some sort. Those are -- They're never predictable. But, as I stated earlier, what we know today and where we perceive the highest risk of supply loss for this upcoming winter, we have very little exposure to that. So, we believe that the sales customers will certainly be served in a reliable fashion. But, again, you know, events of *force majeure* certainly cannot be predicted. But we feel very confident that sales customers will be served reliably.

Q Thank you. Has, and I direct this to either one of you, has Northern taken any steps to confirm the security of the capacity and supplies of its firm transportation customers?

A (DaFonte) Northern does not have access to the information relative to how retail marketing companies piece together their portfolio or where they're sourcing their supplies. Those are generally very confidential issues that suppliers do not want

to discuss with the utility.
Q So, Northern has no information at this point about the -- about the security of the supplies for its third party transportation customers?
A (DaFonte) We do not. You know, again, we plan under the assumption that those supplies will be delivered. And, certainly, under our -- under the New Hampshire tariff, we are not obligated to take customers that are grandfathered back to sales service.
Q How about in Maine?
A (DaFonte) In Maine, our understanding is that we are obligated to provide firm service to all firm customers.
Q What is the --
A (Ferro) And, I might add that that, still on that same question, just add a couple of things. One is, of course, what Mr. DaFonte said, is the Company's position, and, of course, that is somewhat up for debate in the proceedings we have mentioned earlier between all the parties.
The other point I want to make in this line of questioning is that what we call "grandfathered load", and just for the reasons that Mr. DaFonte said to the OCA, does pose some concerns

for the Company with respect to reliability on our system. Even though the New Hampshire tariff states that we are not obligated to provide service to them, in the event that their supplier fails or if the supplier just leaves and they want to go back to sales service, we've got to make sure we have sufficient capacity and resources to serve them. It doesn't preclude a situation that a grandfathered customer just pulls from our system on a peak day, even though it has no right to gas supply, and creates a reliability issue or concern to a downstream residential customer or any other customer. And, I don't -- and, by no means am I being critical to the New Hampshire Commission regarding those provisions, because supplier-of-last-resort and dealing with reliability on the system is an issue that, at least I find, and I think the Company finds, to be one that has not been effectively resolved or addressed in our state commissions throughout New England. And, that is making certain that or having a contingency plan, in the event that the "perfect storm" almost happens, in that we have a peak day, and these grandfathered customers pull from our system when their suppliers don't bring supply up for them.

And, so, Mr. DaFonte would love to know that these grandfathered customers have firm primary rights onto our system, so that it's not going to get interrupted on a peak day. But the reality is two-fold; one is, he doesn't know, but worse than that, two is, we strongly suspect that they don't have primary rights for all their requirements. And, so, this is also a key issue, supplier-of-last-resort, that we're talking about in these other dockets. And, I implore the New Hampshire Staff to take note, and hopefully we can apply or revise any necessary revisions to the provisions in New Hampshire to address reliability issues related to grandfathered load. Because there's a decent amount of grandfathered load in New Hampshire. And, such, you know, a suggestion, just in general terms, there be some sort of reserve capacity on the system that allows us to be in position to cover the unexpected.

Q What, in your opinion, is the likelihood of third party suppliers failing, in light of market conditions this winter?

A (Ferro) That's a good leading question. I'm sorry.

A (DaFonte) Well, again, as Mr. Ferro had stated earlier, the fact is that we do not know whether suppliers, these retail suppliers have firm -- primary firm capacity to our city gate. We suspect that they do not for all of their requirements, and that certainly is a concern to us, given the fact that there will be less supply in the marketplace this year than in previous years, due to the impacts of the hurricanes in the Gulf Coast. And, so, there is a concern there.

And, there's also a concern in how Northern responds to these potential supply shortfalls. In that, as Mr. Ferro stated, these firm transportation customers are connected to our system. Therefore, whether their supply shows up or not, they're most likely going to just continue to take gas, until we physically go out and shut them off, which is not a logistical possibility, in terms of getting out there in a, you know, in a time frame that would prevent any kind of disruptions to other customers on our system. We do not have an ability to remotely shut these customers off. It means having someone drive out to the location and physically shut these customers off.

That's further complicated by the FERC rules governing pipeline nominations. And, that is that suppliers/shippers on a pipeline essentially have up until about 6:00 p.m. of the existing gas day to revise nominations. So, it would be difficult, and certainly would create liability for Northern, to go out and shut a customer off prematurely, before the last opportunity is available to the shippers to bring up additional gas supplies. And, certainly, by that time, the horse has already left the barn, if you will. And, that's a concern. We just don't have the ability to shut these customers off real-time.

And, it's further complicated by the fact that these customers are in pools oftentimes. So, if a marketer delivers, you know, 50 percent of their requirements to a pool, we don't know if we should apply that 50 percent across the board to all customers in the pool, or if that -- or if that marketer intended that one customer in that pool should take the curtailment 100 percent and others not. And, that's, again, part of where the liability for the Company comes in, that we go and shut off a customer, and the marketer comes back and says "you shouldn't have shut that customer off. It should have been this other customer you should have shut off."

All of those things together create some, you know, some instability in the planning process, and certainly in how we look at the potential for supply failures and system disruptions for Northern customers this winter. As we stated earlier, we are very comfortable with our supplies. You know, we know where the supplies are coming from, we know what suppliers we're dealing with. We deal with very credible suppliers, producers, who have been suppliers to us in the past, and do not have any credit issues. Credit is another issue that is out there as well. And that, when you're dealing with $15 gas prices, a small retail marketer is going to have a tougher time getting credit from suppliers, because of the, again, the fact that they're a much smaller entity, and having to make a much greater cash commitment can jeopardize their credit commitments, you know, from the suppliers.

So, those are all factors, and, you know, again, a long-winded answer, but the fact is we don't really -- we don't really know what kind of reliability we're looking at on the part of retail marketers, but it's a concern to us.

MS. HOLLENBERG: Excuse me for one moment please. Thank you.

(Short pause.)

BY MS. HOLLENBERG:

Q Okay. I just have a couple more questions. And, I believe these are appropriately directed to Mr. Ferro. You testified on direct about the, for lack of a better word, what I'd call the "capacity cost issue" in this case. And, would you agree that the capacity costs in dispute are attributable to Maine transportation customers?

A (Ferro) What I have and will agree to is that the pot of capacity costs that are being allocated between the Maine and New Hampshire Divisions, some of them are -- can be attributable to or associated with certain transportation load on the Maine system or in the State of Maine. So, in that sense, I think we, "we" being the parties to these proceedings, have honed in on and identified that as the source of this perceived inequity.

Q And, is it your position that the New Hampshire Commission is without authority to require Northern to assign capacity costs, other than through the current PR formula, which also has to be used in another state?

A (Ferro) It's my understanding --

MR. SHORTLIDGE: Excuse me. I think I'm just going to object, to the extent that calls for a legal conclusion. To the extent Mr. Ferro wants to answer from his understanding of Company position and his understanding of the issues in the docket, that's fine. But, to the extent that this answer could be considered a legal answer regarding the Company's position, I'm going to object.

MS. HOLLENBERG: And, my response is that Mr. Ferro did testify on direct, and I don't have his exact wording, but I believe he represented that the PR formula was what needed to be worked on between the two Commissions, and it needed to be approved by both the Maine and the New Hampshire Commission. So, I was just trying to get at that question.

CHAIRMAN GETZ: Well, I think your response is consistent with Mr. Shortlidge's position. So, we will take the response as not offering a conclusion of law by the witness, and he may give his understanding of the issues.

BY THE WITNESS:

A (Ferro) It's my understanding that the Company is operating its allocation process from what I view as a contract between the New Hampshire Commission and the Maine Commission. I said earlier, and it's very critical to point out again, that any allocation methodology, and the one that we're under right now, was, is, and should be contingent upon both state commissions signing onto that methodology. And, in fact, as I said, that's what we have today. We have a contract between, the "we", all of us, but certainly that there's a contract between the New Hampshire and state (Maine?) Commissions with respect to allocating costs. Any unilateral -- I say "unilateral", any change in one, from one state commission, would unfairly create a very real risk of trapping costs and not allowing the Company to recover the prudently incurred costs that it incurs to operate its integrated system to serve both Maine and New Hampshire customers.

Q Is it your position that, so long as the PR formula remains in effect, that New Hampshire customers are responsible for the costs that are possibly attributable to Maine customers?

A (Ferro) That's not the desired result, but, unfortunately, my answer is a definite "yes".

MS. HOLLENBERG: Thank you. I have no other questions. Thank you very much.

CHAIRMAN GETZ: Okay. Then, before we turn to Mr. Damon, let's take a brief recess.

(Recess taken at 10:46 a.m. and the hearing reconvened at 11:02 a.m.)

CHAIRMAN GETZ: Okay. We're back on the record. Mr. Damon.

MR. DAMON: Thank you.

BY MR. DAMON:

Q The first series of questions I would just pose to the panel. And whoever wants to answer these questions, please do so. Mr. Ferro, on Page 8 of your testimony, you noted that domestic supply purchases will be on a "short-term, in other words, a monthly or a daily basis, for the upcoming winter." Would you please explain why that is true and explain the significance of the term "short-term"?

A (DaFonte) I'll take that one. When we say "short-term", we basically refer to "less than one year". And, typically, it's winter only, and it can be daily, monthly, or winter term. And, we say, in terms of applying it to the domestic supplies, it is simply because we don't have any long-term domestic contracts currently in the portfolio. We do have two Canadian contracts that are long-term, but those will be expiring within the next two years. And, so, as those expire, we will, in turn, contract on a short-term basis once again for the supply piece.

The capacity is long-term. The capacity piece is really the critical component, because that is what governs the reliability aspect, in terms of what, you know, we're getting into the city gate. So, as long as we hold the capacity, then it gives us the ability to go out and acquire a supply from the lowest cost and most reliable supplier at that time.

Q Do you include the Canadian supply, when you talk about the domestic supply purchases?

A (DaFonte) No. We just -- Domestic is purely, in this context, it's really Gulf Coast supplies.

Q Does the acquisition of short-term supplies, as you've just described, does that represent a change in the Company's thinking about how to acquire supplies in the future?

A (DaFonte) No. We've, you know, we've been doing short-term contracting for the better part of the last seven or eight years. Just after the FERC's

Order 636, with the, essentially, unbundling of the upstream commodity and transportation on the interstate pipelines. There was a notion in the industry that most companies followed, in terms of the procurement of supplies, where the company -- most companies again were new to this, contracts were generally a little bit longer term, and there was a premium associated with those longer term supplies. As the market developed, the shorter term supplies became more common, and premiums were not charged by these suppliers.

So, essentially, it's the -- the competition essentially determined what the contracting practices would be, particularly for us. We looked at that and were not willing to pay the premium, given the reliability that we did see for some of those short-term supplies.

Q Has the Company experienced any *force majeure* curtailments from its suppliers in the aftermath of the Hurricanes Katrina and Rita?

A (DaFonte) Northern had some minor disruptions, generally speaking, it was maybe for one day. But, typically, for the purposes of summer storage refill, those refills were not disrupted. So, it was very,

very minor, and when I say that, it is probably less than a thousand decatherms that was disrupted.

Q Does the Company anticipate any domestic supply disruptions or shortages this winter?

A (DaFonte) We do not foresee any disruptions related to our portfolio. Again, very difficult to anticipate a *force majeure* event, but, given what we know today, as far as the production losses in the Gulf Coast, we believe that we have sufficient supplies, whether from other locations in the Gulf or from other supply basins, to ensure that all customers will have reliable supply.

Q Does the Company's filing in this case include a schedule that indicates the sources of supplies and which of those supplies are indexed -- and which of those supplies are index priced?

A (DaFonte) The Company does have schedules that indicate which supplies are indexed. I believe it may be redacted. But, essentially, all the domestic purchases are indexed, and there are some Canadian supplies that are also indexed.

A (Ferro) And, these schedules, Mr. Damon, are provided in, under my testimony, in the tab labeled "Gas Cost Exhibits".

Q Of the indexed price supplies, can you tell us what percentage is hedged?

A (DaFonte) Out of those indexed supplies, we have approximately 42 percent of those supplies were hedged. That equates to about 16 percent of total requirements for Northern. When combined with the physical hedges associated with underground storage, LNG and propane, that equates to about a 77 percent total hedge for the Northern New Hampshire sales customers.

Q And, can you tell us what percentage of Northern's New Hampshire Division's winter supply needs are made up of underground storage supply?

A (DaFonte) Yes. Approximately 61 percent of those, the requirements, are going to be met through underground storage, and LNG as well.

Q And, if you haven't answered this question already, could you tell us what percentage of Northern's New Hampshire Division's indexed price supplies is hedged for this coming winter?

A (DaFonte) I believe I answered it. That was 42 percent of the 39 percent.

Q In your view, would it be safe to say that Northern's New Hampshire Division cost of gas rate for the winter period is well protected from market price volatility?

A (DaFonte) I think, you know, on a relative basis, it certainly is insulated from significant price increases. Nevertheless, you know, again, it's 77 percent, with the magnitude of the price increases, certainly, it may have some impact going forward, depending on what type of increase we see. But, I think, again, relatively speaking, yes, a 77 percent hedge is extremely good protection for the sales customers of New Hampshire.

Q Thank you. My next questions really relate to this PR issue that we've been talking about this morning. Mr. Ferro, could you please help define the terms that -- the term "firm sendout", when it's used in connection with the PR formula, both as it relates to the volumes in New Hampshire and in Maine as well? What volumes are included in that term in each state?

A (Ferro) Certainly. I believe I mentioned earlier that the PR allocation methodology is operated such that it reflects the Company's capacity, the capacity needed to provide to specific customer groups in the upcoming months going forward. And, with that basis, firm sendout is linked, obviously, to those customer groups. The "firm sendout" is defined as "those volumes associated with the requirements of customers who use the Company's capacity month-to-month and throughout that season, and therefore is -- and therefore includes firm sales customers in both divisions, and any transportation customers who the Company needs to assign capacity to." And, those customers are also referred to as "non-grandfathered customers". And, the non-grandfathered customers to date only exist in the New Hampshire Division.

Q Okay. So, the volumes related to the Maine transportation customers are not included in the firm sendout calculations?

A (Ferro) That is correct. And, because going forward, in this month of November, Mr. DaFonte does not have to have specific capacity directly to provide to those transportation customers for them to meet their requirements.

Q Now, the PR formula goes through a series of steps that, to my mind, are fairly complicated mathematically. But, at any rate, at the end of it all, the formula ultimately derives a set of annual allocation factors, as I understand it, regarding the allocation of fixed capacity costs between New

Hampshire and Maine, is that correct?
A (Ferro) That is correct.
Q Yes.
A (Ferro) And that those fixed allocation factors stay in effect for one year, November through October.
Q Okay. How do those annual allocation factors differ from the commodity allocation factors that are shown in your filing? And, I think they're -- some of them at least are shown on Page 16.
A (Ferro) Certainly. And, you are right. On Page 16 of the Company's original filing, which I believe is Northern Exhibit 1. And, in that exhibit, Page 16, you see the allocation factors as they are applied to allocated commodity costs.

CHAIRMAN GETZ: Excuse me, Mr. Ferro. Are we referring to 16 of your testimony?

WITNESS FERRO: It's Page -- no. I'm sorry. It's Page 16 of the schedules attached to my testimony.

CHAIRMAN GETZ: Okay. Thank you.

WITNESS FERRO: The tariff page will be Page 1, and then Page 16, and, if you do have tabs in your copy, would be behind the "Allocation Exhibits". That's the tab.

CONTINUED BY THE WITNESS:

A (Ferro) And, this schedule reflects the Company's forecast of sendout to satisfy firm sales and non-grandfathered transportation customers based on normal weather. And, maybe I need the question read back, or I'm just answering more than what you've asked. In contrast, the firm sendout allocation factors for the PR allocation methodology is the sendout associated with firm sales customers and any non-grandfathered customers, just like this schedule, but based on a design winter scenario, instead of normal weather.

BY MR. DAMON:

Q Okay.

A (Ferro) I might add that this is the Company's forecast. Its forecasted demand in this filing reflects a one percent growth in demand. The PR allocator firm sendout volumes reflect the actual requirements experience from the previous May through April, adjusted for design winter conditions.

Q Going back now to the annual allocation factors that are in use in connection with the PR methodology, am I correct that those factors are shown on Page 17 of the filing, the next page, over in the right-hand column, under -- in rows 17 and 18?

A (Ferro) You are correct.

Q Okay. And, would you explain, in sort of a summary way as best you can, how does the Company use those annual allocation factors to help establish cost of gas rates for the upcoming period forecasted capacity costs?

A (Ferro) Certainly. These capacity allocation factors on line 17 and 18 are used to apply to the forecasted capacity costs for this upcoming winter to be assigned to each division.

Q Okay. And, if we go back in the filing to Page -- Pages, let's say, 10 and 11, that's where these allocation factors are applied to determine the demand costs, is that correct?

A (Ferro) That's correct. As you can see on line 48, of that, of Page 10, is the 57.17 percent, that's used to derive the allocated costs below, related to fixed capacity costs to New Hampshire.

Q Okay. So, that, just to take as an example, that 155,576 figure, which is in line 50, underneath, in the first column for November, that represents 57.17 percent of the total cost of that capacity, is that correct?

A (Ferro) Yes. For that month, if you took 155,576, and divided by 0.5717, you would get the total Tennessee Gas Pipeline demand costs for that one month.

Q Thank you. Now, could you tell us how the annual allocation factors operate in the reconciliation of fixed capacity costs that are actually incurred in the past period?

A (Ferro) Right. The reconciliation of costs for the past period, in this case, in the case of this filing, November '04 through April '05, would be reflecting the PR allocation factors that were approved and reflected in the previous winter's filing, the November '04 through April '05 filing. I don't know off the top of my head what those allocation factors are, but I want to say something like 52.77 percent for New Hampshire, since those numbers have been flying around pretty frequently in the last few weeks. But it's those percentages that are used to record actual costs to each division. It's this percentage that would be used to apply to November 2005 actual costs to allocate between the two divisions and going forward, December '05, January '06, *etcetera*.

Q Is it true to say that the actual dollar costs of capacity allocated to New Hampshire and the amounts actually collected in New Hampshire for capacity are reconciled, and then carried forward into the upcoming period as either as an over- or undercollection?

A (Ferro) That is true. Like any cost reflected in this filing, they are reconciled by way of determining the actual costs, comparing them with the actual collections, the difference between the under-/overcollection.

Q And, is it also true to say that the annual allocation factor itself is not trued up as part of the reconciliation process?

A (Ferro) That is absolutely correct.

Q Is it true to say that the new cost of gas rate, let's say, for the upcoming period, reflects, in part, the interstate allocation of fixed capacity costs for the reconciliation period?

A (Ferro) I'm sorry. Could you repeat that question?

Q Okay. Is it true to say then that the new cost of gas rate that's reflected in this filing is, in part, reflected or, in part, reflects the interstate allocation of fixed capacity costs for the reconciliation period?

A (Ferro) To the extent that the reconciliation is rolled in to or incorporated into this filing. However, I might add or point out that this filing, recall, does reflect an estimated amount of $692,000 that has been deducted out, that essentially is reversing or revising the application of those allocation percentages to those actual costs of last year.

Q Could you briefly explain how the PR formula operates when off-system capacity sales or releases or capacity refunds are made?

A (Ferro) Certainly. The model and process that's designed to allocate these costs between the two divisions is that the PR allocation factors, which allocate the costs between the two divisions, are also used to allocate the capacity release revenues between the two divisions.

Q Turning to your testimony on Page five, Mr. Ferro, in line 11, you refer to "unallocated capacity associated with customers that have selected Northern's Maine Division's transportation service". What did you mean by that term "unallocated capacity"?

A (Ferro) What I meant is that, by identifying the requirements of the transportation customers of Maine. And, when I say "requirements", the design day requirements, also known or converted to the Total Contract Quantity, or TCQ, that is referred to in the New Hampshire terms and conditions. That design day requirement of the transportation customers does not bring with it allocated, assigned capacity. So, I'm sorry, I don't think I answered your question. I answered another question that wasn't asked of me. Your question was, "What do I mean by the unallocated capacity associated with customers?"

Q Yes. And, am I correct in reading that, that you're referring to capacity that's not assigned to Maine transportation customers or are you thinking about some other different concept there?

A (Ferro) No. What I'm referring to there is, and, again, I'm talking, as part of a discussion with Staff or the Staff has noted, that the capacity costs that are put into the total Northern bucket is being assigned to each division. Some of those costs are not being allocated to customers, direct transportation customers who have selected transportation service on the Maine system, hasn't been allocated to them, because they haven't been assigned yet.

Q Okay. Thank you. Now, on Page 6 of your testimony, in line 21, you talk about the "$100,623 that is assessed to be associated with the capacity requirements of Maine customers who have switched from firm sales to transportation service after March 14, 2000".

A (Ferro) Excuse me, what page are you on?

Q Page 6.

A (Ferro) Page 6, line -- okay, I thought you said "line 6". I'm sorry.

Q Now, the New Hampshire Staff understands that that $100,000 of costs relates to the 2005 Summer period that were agreed to be deferred. And, we're understanding that based on the letter agreement that was entered into evidence in the Summer 2005 period. I just want to make sure that we're all talking about the correct period here, because in some other places in your testimony you talk about this as a "2004 Summer period cost".

A (Ferro) I believe, subject to check, the $100,000 figure that I'm stating was agreed upon in the Summer

'05 proceeding, but related to Summer '04 costs.

Q Okay. And, I appreciate that, because I think in your allocation exhibit -- no, I think the reconciliation page, you show the $100,000 figure is calculated there, and it is a 2004 Summer cost. But is it -- was that number for the 2004 period used as a proxy for the Summer 2005 deferral?

A (Ferro) Excuse me. Yes, for this -- Well, no, I thought it was for discussion purposes that that was the impact for the Summer '05 also. But, again, subject to check, I believe that the Summer '05 cost of gas calculation reflected a reduction of $100,000 only, which was the Summer '04 estimation of this impact of allocated costs. I don't think there was both the Summer '04 and the proxy Summer '05 as two deductions to the Summer '05 cost of gas calculation. Again, subject to check, because you're making me pause a little bit like I might have missed something.

Q Yes. Well, the reason I asked this question is, when I was reading your testimony, I had in mind that -- one thing that these related to the Summer 2005 period, and then I see that you are referring to the Summer 2004. And, I just wanted to --

A (Ferro) That's correct.
Q -- try to clear that up for the record.
A (Ferro) That is correct.
Q Going down further on Page 6, you state that the Company "is requesting through this filing, for the parties to enter into a similar agreement to defer the Winter of 2004-05 capacity costs of 692,273." Is it sufficient that the Commission itself agrees that that deferral is appropriate or does it, for some reason, does the Company need Staff's agreement for that deferral?
A (Ferro) The Company does not need Staff agreement for that deferral, it's in its filing. And, if the Commission approves the filing, the Company will just include those costs in a deferred account, until they're resolved.
Q Does the Company need any magic language in the Commission order relating to that deferral?
A (Ferro) Certainly, the Company needs to account for this properly, to set up a regulatory asset, that these costs are deferred for future recovery, and that it's pending the resolution of how those dollars are going to be recovered.
Q Okay. Just a couple of questions about the $692,000

credit that's reflected in this filing on the tariff page, I believe it's 39, which is Page 2 of the filing.

A (Ferro) Correct.

Q That amount is an amount that was actually collected that applies to the 2004-2005 Winter period, is that correct?

A (Ferro) That is the estimated amount that would apply to the November 2004 - April 2005 Winter period.

Q And, is the effect of that credit basically to defer the recovery of those costs?

A (Ferro) That is correct.

Q And, one last question on this. Is this amount included in the reconciliation, as part of the reconciliation demand cost figures that are shown in the "Reconciliation" tab, which is found on Pages 132 through 157, and, particularly, I guess Pages 145 and 146?

A (Ferro) I'm sorry. That is correct. And, to be specific, going back to the tariff, Page 2, the tariff sheet, we had calculated a prior period under collection, it says "over collection", but it's a positive number, it's an under collection, of $507,255. And, we have offset that under collection that you refer to in the reconciliation filing by 692,273 to defer for the time being. And, so, essentially, it results in the netting of those two numbers as what's being reflected in this cost of gas with respect to the prior period. So, essentially, it's a credit of roughly $185,000, instead of a debit or a charge of $507,000.

Q I believe that you said that the Company had agreed with Staff to defer the shifted costs for the Winter 2004-2005 period. What is the basis for your statement that there is an "agreement for the winter 2004-2005 period"?

A (Ferro) Certainly, on one hand, the establishment of the $100,000 for the Summer '05 related to the Summer '04 being deferred, was, which was an agreement, was the basis for my taking a liberty of calling it another "agreement". And, I only hesitate in that I wasn't sure if we actually had some direct discussion on that, too. But, nonetheless, we could leave it at that, that I was using that as a precedential agreement, if you will, and also being sensitive to the ongoing negotiations in the other docket, and that it's not resolved yet. So, we'll do what we agreed to do in the prior cost of gas proceeding.

Q Thank you very much. I believe that you also said that the term "firm sendout" in the PR methodology relates only to firm sales customers or firm customer groups that use the Company's capacity, rather than customers or customer groups that caused the Company to incur capacity costs. Can you confirm whether that understanding is approved by the -- or, has been approved by the Commission?

A (Ferro) The Company -- What was approved by the Commission is the operation of the PR allocation methodology that reflects the Company's requirements in the upcoming winter period, or the upcoming gas year, to make capacity available, or more than "make capacity available", dole it out, use it to satisfy the requirements of certain customers. And, therefore, it was not a change in that approach by -- for certainly reflecting non-grandfathered requirement as part of firm sendout, because, in fact, those capacity requirements were being provided by the Company in the upcoming period. I think there's a little confusion in that, and I tried to touch upon it I think in my direct examination, that there is some sense of capacity costs that relate to all transportation customers, whether they're grandfathered in New Hampshire or they're not taking capacity in Maine. And, in general terms, I agree with that, and I have agreed with that, and I think Mr. McCluskey has said that. But that is more general and on the long term. It's for planning. And, so, Mr. DaFonte has to make sure that, if customers need his assets to keep afloat, that he's going to have sufficient resources on hand to do that. That doesn't mean that he has the amount of capacity necessary to satisfy the TCQ or design day requirement of all transportation customers. In fact, he has a lot -- he needs, in my opinion, a lot less than that. And, so, I think that's where the confusion is.

The non-grandfathered requirements absolutely definitively are required -- are requiring the Company to provide a capacity level to meet their design day requirement. These other transportation customers have some need, imposes some need of the Company, but certainly not (a) an immediate or directly going into this winter, and (b) not a full -- not nearly a full level of capacity to meet their design day requirement.

Q I'm looking at what the Commission has authorized or talked about in terms of the PR methodology. Clearly, the Commission approved the PR methodology in its 1995 cost of gas order, correct?

A (Ferro) Correct.

Q Yes. Do you happen to recall if the Commission, since that time, has either approved any changes to the methodology or provided any clarifications to the methodology in its orders, just from the orders that you can remember?

A (Ferro) No. I will just say that, by way of Commission approval order in its cost of gas filings, it is approving the operation of the PR methodology every season.

Q In your direct testimony, and I think in response to questions from the OCA, you have talked about a contract between the New Hampshire and the Maine Commissions or between the states regarding the recovery of these fixed capacity costs. Do you remember that testimony?

A (Ferro) I do remember that.

Q Okay.

A (Ferro) And, I also remember that the Chairman told me to go ahead and answer the question, even though I'm not a lawyer.

Q Appreciate that. But, going back to 1995, let me state my understanding of what the Company did, and then you can tell me if that's -- if that's different from your recollection. But my understanding was that Northern independently approached both the Maine and New Hampshire Commissions with a proposal for an improved PR methodology or a PR methodology that improved the ability to accurately assess costs between the states in 1995. And, that that proposal was contingent on the other state approving the changes. Is that how you remember that?

A (Ferro) That is distinctly how I remember that. That's absolutely correct, yes.

Q And, so, I am not aware that there is a document that -- itself that is entitled an "agreement" or a "contract" between the states or between the Commissions that would -- that would be for the allocation of these fixed capacity costs. Are you aware -- there's no single agreement or a contract document that says that. I appreciate that the argument is that there is an agreement, but, in terms of a contract document, there's no document like that, is there?

A (Ferro) Well, I'll give you a response, definitely a nonlawyer response, from a regulatory and a rate guy. And, that is, I always look at tariff provisions and orders as a substitute for an individual contract to lay out service for customers or to establish rules to calculate costs or design and develop rates. And, so, I have many times referred to tariff provisions or provisions by way of regulatory directives as a substitute for or a form of contractual arrangements.

Q Okay. But that is a "substitute for contractual arrangements" between the Company and its customers in one state?

A (Ferro) With respect to the rates that are being governed by the tariff, that's correct. I'm just saying that there are tariff provisions that govern how you will calculate costs. There are orders that govern how you calculate costs, orders that approve tariffs. We have orders here that govern how we calculate and allocate costs. In that regard, it's not much different than tariffs that govern rates and costs to specific customers. It's to more general customers across state jurisdictions that I feel is similar to or in lieu of a contract.

Nonetheless, this is a response from a nonlawyer. But, you know, one could -- one could take this from a legal perspective that it is maybe, instead of "in lieu of a contract", it is a contract. I'm not -- I'm just telling you how I see it.

Q Okay. I understand your testimony this morning or the upshot of some of your testimony this morning is that, basically, you agree that the PR methodology -- the current PR methodology should be changed to include the Maine transportation volumes. Is my understanding of your testimony correct?

A (Ferro) Your understanding is correct in that I believe that an equitable resolution to allocating costs between the two divisions is to reflect certain -- reflect load, certain load and capacity requirements of certain transportation customers or a certain level of transportation customer requirements from Maine. And, that would seem to be a reasonable, fair resolution to designing or resolving an equitable allocation of costs between the two divisions.

Q But when you say this, I would conclude, and I would ask you if you would agree with me, that the current methodology is unreasonable?

A (Ferro) I said a "reasonable resolution". "Unreasonable" is not the word I would use to the current situation, in that it's reasonable insofar as it's being governed by a PR methodology that has been approved by the two state commissions. I feel that all parties should acknowledge that the intended or the preferred allocation of costs between the two divisions is something different than what's going on right now. And, so, I refer to it as a "reasonable resolution". I don't refer to the PR methodology as we're operating today is just an unreasonable tool or an unreasonable allocation process.

Q But, if we step back from the existence of this PR methodology, which was approved in 1995, and just look at the current situation from a common sense point of view, from that point of view, would it not be fair to say that the current methodology is operating in an unreasonable way?

A (Ferro) You know, I had said earlier about --

MR. SHORTLIDGE: Excuse me. I didn't understand -- I couldn't tell the difference between the first and the second question. So, maybe, and, Joe, I don't know if you were having the same problem, but if counsel could be asked to perhaps clarify the question. It sounds like the exact same question repeated again, but --

CHAIRMAN GETZ: Well, let me try this. It seems to me that you're taking the position, Mr. Ferro, that the PR methodology, as it was established, was reasonable at the time. But is it your position now that it's producing unfair results, and that there's a potential for the Company to have a position where there's trapped costs that it can't recover? Is that it?

WITNESS FERRO: Well, up to the last statement, that was a very fair characterization of what I've been saying. Certainly, the -- whether one state Commission changes the PR allocation methodology from what the other state is using, or costs are being deferred and not allowed to be recovered, then that does create trapped costs that, obviously, the Company feels is unwarranted and unfair.

I was saying that the -- when I gave the "ebb-and-flow" characterization, it seemed to be reasonable to address the biased result of the PR allocation methodology, due to the transportation load in Maine causing a reduction to Maine firm sendout. And, so, my position is that I prefer, I would like to, and I intend to work to a final resolution that makes the PR methodology unbiased or results in an unbiased flow of costs between the two divisions.

So, when we use the word "reasonable", I'm looking for a reasonable resolution. I don't want to characterize the PR methodology as an "unreasonable" methodology. It is -- I am suggesting that I feel there's an inequity going on here currently that's causing more costs to be allocated to New Hampshire than what New Hampshire is deserving of, what New Hampshire is creating on the system.

CHAIRMAN GETZ: And, I guess there are some witnesses who would take the position that would be "unreasonable". But I may have not helped the situation, but, Mr. Damon, you have follow-up?

MR. DAMON: Yes. Thank you.

BY MR. DAMON:

Q And, Mr. Ferro, you suggested or implied several times that "a settlement is imminent". And, I'd like to know, without getting into the specifics of the negotiations, I mean, what's the basis of your statement about that or your characterization?

A (Ferro) It's hard to answer that question without getting into specifics. So, I'll do my best. But, first and foremost, the Company really plans on making sure that everyone's feet are put to the fire in this these two days of sessions, and that make clear that, without a final resolution to this, that certain stakeholders are going to be harmed without a resolution and going forward with litigating all the issues. And, so, in that regard, I feel that a resolution is imminent.

Q Okay. That's your hope and your opinion?

A (Ferro) I'd like to think it's a little stronger than an opinion, that certain stakeholders, in addition to Northern, but even more so than in Northern's case, need to resolve these issues real soon.

Q Mr. Ferro, this morning you alluded generally, I think, to a concern for the possible impact, and I think it was an adverse impact or possible adverse impact on the negotiations, of a Commission order in this proceeding that would basically follow the course or the recommendation suggested here by the OCA or the Staff. And, could you be more specific about that, because I guess I'm not certain what you were referring to here?

A (Ferro) Yes. And, I may not be able to get too much more specific, other than that it only serves -- it only is reasonable to suspect that, if another element is thrown into the negotiations, and that the Company has both a contentious issue with one of the intervenors, in this case, two of the intervenors, the New Hampshire Staff and the New Hampshire OCA, and feels a little bit more pressure on this matter, that the other intervenors in the case, the other parties, will behave differently than they otherwise would. And, as I said, I think we have intervenors who have a big stake in assuring a resolution to this real soon. And, I want them to still feel that, that strong need.

Q And, one last question. So, I take it then that it's not a threat from Northern that this would disrupt the negotiations?

A (Ferro) That it's not a threat that Northern would suspend its efforts to resolve the case and all the issues.

MR. DAMON: Thank you. No further questions.

CMSR. HARRINGTON: I have a few.

BY CMSR. HARRINGTON:

Q Okay. Getting back off of this capacity issue for a second, just on a few other issues. One of the gentlemen had stated I think there was -- that hedging was something in the 70 percent level or something. And, I guess what I'm looking for is, given the volatility of the market this year, and not only from price, but possibility of supply, and the fact that there's still another month left in the hurricane season, and, hopefully, nothing like that will happen, but it is possible. What additional steps have you taken this year to ensure, one, that there's adequate supply? And, two, that the costs are somewhat reflective of your filing, in that, and I know these are NYMEX prices from -- predicted today, but that the price that you actually sell the gas for in February and March is somewhat reflective of these prices that are being filed? I guess there's two questions there.

A (DaFonte) Yes. I think, from a price stability perspective, the fact that 77 percent of our anticipated supplies are essentially fixed, that will certainly tend to dampen any adverse impact of further price run-ups. By the same token, you know, prices could certainly come down as well, which would still mean that we have 77 percent essentially fixed, and so the costs will again be stabilized. And, that's the goal of the plan. So, from that perspective, we think that further price run-ups will be muted, relative to, you know, the actual price run-up in the wholesale marketplace.

As far as, you know, taking additional steps, one thing that we have done is we've sent letters to the retail marketers, inquiring as to whether they foresee any problems with their supplies, as to whether they anticipate sending customers back to sales service, any insight that they could give us into some of their planning and maybe their concerns. And, to date, we have not really heard back from anyone relative to any problems that they may be having.

Although, certainly, in the Massachusetts jurisdiction, we have had some customers, that were actually grandfathered customers in Massachusetts, turn back to sales service. So, we see that there may be a -- maybe a pattern evolving, where the tight supply and capacity for this winter may be causing marketers to shift their economic focus to whether or not the utility's capacity starts to make sense. And, at least one marketer has mentioned that to us, that the capacity that the utility holds now is more economic, based on the price run-ups that they have seen.

And, so, those are some of the things

that we've done. But, again, I think the portfolio is structured such that it does take into consideration some of these concerns. As Mr. Ferro stated earlier, you know, we think that, because of the unknowns that are out there, and especially with respect to retail marketers' supplies, you know, we certainly would prefer to have some sort of reserve contingency capacity, if you will, for those types of events. And, you know, not to mention, you know, the events such as a hurricane, and, you know, more recently, last week TransCanada had to shut down their feed into PNGTS as a result of a wash-out up in Quebec and had exposed pipes.

So, those are things that happen, and probably will continue to happen, that we certainly do not have any control over. We've done everything that we possibly can to secure the most reliable capacity out there. And, then, it becomes a function of the market and, you know, events that are certainly out of our control.

Q Okay. Thank you. Getting onto the -- and maybe you kind of mentioned there, the idea that you were discussing earlier on transportation only customers could still pull gas from the system, even if their supplier was not providing gas at that particular time, and you mentioned the fact that this was a -- not an automatic shut-off, you would have to manually send people out. Just backing up on that concept a little bit, how are you even made aware that that's occurring? How do you become cognizant that they're drawing gas out the system, which they would do every day, but, at the other end of the pipeline somewhere, whoever they paid to put the gas in isn't doing it?

A (DaFonte) That's a good question. The process that we use, we basically, for our daily metered customers, we basically look at the nominations that marketers make on behalf of those customers. And, what we typically do is, we'll look at the nominations and how they compare maybe to the prior day, if you will. So, if we see a significant reduction, then that might lead us to question whether or not their full supply is coming up. And, typically, what happens is, and this will help us in some events, the pipelines will show nominated volumes and then scheduled volumes. And, sometimes there's a discrepancy in the two. One is, what's the marketer trying to bring up? And, then, what did the pipeline approve for that particular shipper? And, so, if there's a discrepancy there, that shows that there's some sort of curtailment. And, that would, you know, essentially raise a red flag for us, and we would be concerned, start to make some phone calls to the retail marketing community.

But the problem is, we don't have any real-time metering of these customers either. So, even if there's a drop in the nomination, it may be because, legitimately, a customer, maybe a process load customer may be off for some reason, maybe they have dual fuel customers that may have switched to oil or another alternate fuel. But it does become difficult. And, that's why it's a concern to us, because there isn't really a, you know, a feasible way to monitor some of these customers and to ensure that they, in fact, aren't taking gas if their supply doesn't show up. But it's -- you know, that's another detail and another complication to try to, you know, monitor that situation.

Q So, it would be fair to characterize it as some type of a manual reactive system, it's certainly not proactive at all?

A (DaFonte) Yes, it would be very difficult to be proactive in that respect, yes.

Q Okay. Getting onto the capacity issue, or just I'm a little confused on some of the numbers here, so I'm just trying to get this a little bit straight. Maybe we can start by agreeing on one thing. On Page 8 of Mr. McCluskey's testimony, he says that "Northern estimates, in 2005-2006 alone, the increase in New Hampshire's allocation percentage will cost customers an additional 1.5 million", that's on the top of Page 8, "of which 1.35 million is allocated to the Winter period." Just for a starting point, is that correct, Northern agrees, and do you agree that this 1.35 million would be additional allocation to New Hampshire during the winter period?

A (Ferro) Not necessarily. The 1.35 million, in any kind of calculation using the methodology that the Company has used in the past, does not really mirror what ultimately will result in any PR allocation change. And, that is, this calculation of 1.35 million is based on a design day requirement of transportation load. And, ultimately, as I explained the PR allocation methodology, it's not based on design day, it's based on putting dollars in monthly buckets, and then taking firm sendout, and the change will -- there will be a different number. This is just an estimate.

Now that you brought that up, too, I wasn't clear as to reconcile the annual dollars of 1.5 and the winter dollars of 1.35. I thought that the summer period would be about $100,000. And, so, there's a little bit of difference there. But, again, the point is that this is an estimate, based on just information we have right now. But this will not be the ultimate dollars that hopefully get fleshed out in a resolution of the proceeding.

Q But this I guess would be an estimate of "worst case scenario", based on design weather?

A (Ferro) Well, not necessarily "worst case scenario", because even the design day analysis, the way it would work, might allocate -- might identify costs that are a little less than ultimately gets fleshed out. So, I think that is the highest number I've seen, though, but it's just an estimate.

Q Okay. But, for working purposes, an estimate that we could use?

A (Ferro) That's correct.

Q Okay. Going on along that same, we'll get back to that number in just a second, I thought you had testified earlier that the -- included in the filing was already, or I guess not included in the filing, removed from the cost of gas was the $692,000 that was from Summer '04, Winter '04/05?

A (Ferro) The 692 was from Winter '04/05.

Q Okay. So, it did not include Summer '04?

A (Ferro) Correct.

Q Okay. I thought that's what you had said.

A (Ferro) The Summer '04 $100,000 figure was included in the Summer '05 cost of gas proceeding in front of the Commission.

Q So, then, if we use like the estimate of 100 -- of 1.35 million, and you have included removal of 692,000 of that?

A (Ferro) That's correct.

Q So, then, we're looking at somewhere around a difference here of about 658,000, between what the Company is proposing and what Mr. McCluskey proposed, is that --

A (Ferro) No, that's not quite accurate.

Q Okay.

A (Ferro) The Company, accepting the $1.35 million estimate, it is true that, for the past two winters, we've had an accumulated impact of $692,000, which is also an estimate, and the 1.35 million. And, we are disagreeing with the entire 1.35 million here, because we have in the past waited for the actual period to end, and then defer an estimated amount and reflected in the revised cost of gas. So, we did that with the 692.

Mr. McCluskey has recommended that, "not only are we doing that, but let's look ahead and also remove 1.35 million." So, the Company is suggesting let's do one at a time. Let's do, you know, the prior period reconciliation, the impact of the prior period reconciliation of these allocated costs should be reflected in the cost of gas filing here. And, the Staff is recommending that an additional 1.35 of looking forward gets deducted from this particular cost of gas filing.

Q All right. I told you I was confused by this. So, I think I've got it a little bit straighter now. So, the Company is talking about deferring the -- what's already been rung up, if you will, from '04/05 Winter, which is the 692. And, then, the Staff is saying, "let's take the 692 and true it up, but also let's bring in the estimate of what's going to be brought in for this upcoming winter"?

A (Ferro) You are correct.

Q Okay.

A (Ferro) And, in fact, in that exchange I had with Mr. Damon, there was sort of an agreement between the Company and the Staff to defer 692. And, so, that's right. We're all in agreement with the 692. We're not in agreement to reflect the 1.35 in this cost of gas proceeding.

Q And, the 692 is incorporated in the rates you propose?

A (Ferro) Absolutely. On Page 2 of the filing -- of the schedules, in the tariff sheet.

CMSR. HARRINGTON: Thank you. That's all the questions I have.

CHAIRMAN GETZ: Redirect, Mr. Shortlidge?

REDIRECT EXAMINATION

BY MR. SHORTLIDGE:

Q Let's see. Just a couple of things. First, Mr. Ferro, this was a while ago, but I think you were talking about whether there was any index in the filing as to the gas costs that are indexed to the market. Do you recall that?

A (Ferro) Obviously, not.

Q It was a long time ago. But would I be correct in saying that there's a tab in the filing referencing "Gas Cost Exhibits"?

A (Ferro) Yes. I'm sorry, yes.

Q Okay. And, on Page -- and that's where you would find this, specifically on Page 11 or -- yes. Yes, Page 11 of the filing. That would be -- anyway, the exhibit you were referring to is in this "Gas Cost" -- is in the tab reference "Gas Cost Exhibits", correct?

A (Ferro) Yes. I think, when I was referring to schedules, and I think both Mr. DaFonte and I were both answering the question, was "where in this filing", or in this -- "do you show in this filing the sources of gas supply, the various sources of gas supply?" And, I said "it is in my testimony, in the "Gas Cost Exhibits" section.

Q And, actually, I probably misled you. The tab is actually referenced as "Supplier Prices", in the Page Number 23. Could you turn to that page and make sure that that's the correct page that we should be referring to?

A (Ferro) That's the confidential schedule?

Q Well, this is in the regular filing. It would indicate that it's redacted. And, it's been provided

in an unredacted form in the confidential material.
A (Ferro) I have that in front of me, yes.
Q Okay. But that's the -- that would be the correct schedule that folks should look to?
A (Ferro) Yes. That's the -- That's the schedule that shows the NYMEX price and the index pricing for our commodity rates.
Q Okay. Now, you might also recall, and I hate to, because we're going to go back a little bit, that you and Mr. Damon were having a discussion back and forth about whether the Company and the Staff had agreed or whether you had indicated in your testimony that you had agreed to defer the $692,000 in costs?
A (Ferro) Yes.
Q Could I point you to Page 6 of your testimony, and line 25. And, specifically, could you read the sentence there, beginning "The Company needs to".
A "The Company needs to, and is requesting through this filing, for the parties to this Winter 2005-2006 cost of gas proceeding to also enter into a similar settlement agreement to defer the Winter 2004-2005 capacity costs of $692,273."
Q So, in making that statement, you weren't alleging that an agreement had already been made. You were

just simply saying that "the Company was open to such an agreement", and had reflected those costs, the removal of those costs in this filing?

A (Ferro) That's correct.

Q Now, we've had some discussion about the ability to shut off a customer when supply -- when we have a supply problem or reliability problem. And, Mr. DaFonte referenced the shutdown of the TransCanada system. I was wondering, Mr. DaFonte, if you could just quickly follow up on that and explain to the Commission whether or not gas continued to flow on the PNGTS line after the shutdown of the compressor station or was --

A (DaFonte) Gas was curtailed. There was no gas that was going into the PNGTS system. So, therefore, they did curtail all nominations that anybody had on PNGTS. There was gas coming into the joint facilities from Sable Island, but that was it. And, if you didn't have the Sable Island supply, then you weren't going to get the gas.

MR. SHORTLIDGE: All right. I think that finishes us up.

BY CMSR. HARRINGTON:

Q I just had one more follow-up question, going back to this whole thing with the 692, and make sure I've got this clear. That was the costs from -- that were, I guess, rung up last winter, and now we're going to incorporate them in this winter's cost of gas?

A (Ferro) Correct. And, that's consistent with how prior period actual costs are reflected in the next year as a true-up. And, that's why the reconciliation dollars is part of this filing.

Q Now, in your testimony, you mentioned what was done in the summer cost of gas agreement. What about last winter's? Was there a similar true-up last winter that would have included the Winter of '03/04?

A (Ferro) There was not, because, for lack of a better phrase, the clock started ticking on this issue with the Summer '04 costs, not the Winter '03/04 costs. And, it would have been associated with the Winter '03/04 costs that would have been reflected in the Winter '04/05 filing.

Q So, what you're proposing then or the Company is proposing is to continue the same true-up method that was used during this past summer filing, to apply that same methodology to the winter filing?

A (Ferro) Precisely.

CMSR. HARRINGTON: Thank you. That's

all I have.

CHAIRMAN GETZ: Is there anything further for these witnesses?

MR. SHORTLIDGE: Nothing further.

CHAIRMAN GETZ: Then, the witnesses are excused. Thank you. Ms. Hollenberg, is Mr. Traum ready to take the stand?

MS. HOLLENBERG: Yes. Thank you.

(Whereupon **Kenneth E. Traum** was duly sworn and cautioned by the Court Reporter.)

KENNETH E. TRAUM, SWORN

DIRECT EXAMINATION

BY MS. HOLLENBERG:

Q Mr. Traum, would you please state your full name and your business address for the record.

A Sure. My name is Kenneth E. Traum. I'm the Assistant Consumer Advocate for the State of New Hampshire. And, our office is located at 21 South Fruit Street, Suite 18, here in Concord, New Hampshire.

Q Thank you. You prefiled testimony in this docket?

A Yes, I did.

Q And, I'm showing you a document entitled "Testimony of Kenneth E. Traum", dated October 18, 2005. Is this a copy of your testimony?

A Yes, it is.

Q And, is this testimony true and accurate to the best of your belief and knowledge?

A Yes, it is.

MS. HOLLENBERG: Thank you. I'd ask that -- Oh, I guess this has already been marked for identification as Exhibit 5?

CHAIRMAN GETZ: Yes.

MS. HOLLENBERG: Do the Commissioners need copies?

CHAIRMAN GETZ: All set.

MS. HOLLENBERG: Thank you.

BY MS. HOLLENBERG:

Q Could you please summarize your testimony.

A Certainly. Just like the Commission is concerned about the consumer bills this winter, as evidenced by the recent EAP proceedings and the generic meetings on bill affordability, the OCA is extremely concerned, too. The demands on consumer funds are creating a, I'll use the term that Mr. Ferro did, a "perfect storm" on them. In this particular docket, the OCA believes it is appropriate to reduce these cash demands on consumers by the $1.3 million that has been discussed quite a bit.

What I demonstrated in my testimony is that the Company is incurring capacity costs for Maine transportation customers, but the PR formula does not allocate those costs to the cost causer. Still the Company is seeking to recover in this CGA period the 1.3 million from its New Hampshire customers, which represents costs of capacity for Maine transportation customers. The OCA simply feels that that's inequitable and should not be allowed to occur. I'm only talking about the 1.3 million, to clarify a question Mr. Ferro had started with.

Q Thank you. And, do you have any responses to the testimony -- testimonies of Mr. Ferro or Mr. DaFonte this morning?

A Certainly. But, at the same time, I'll say that I completely agree with Mr. Ferro that there is a biased flow against New Hampshire, and that's the core issue, a biased flow. And, so, the issue becomes "what to do about that biased flow?" Mr. Ferro was putting hopes on a multiparty, multistate negotiations as the way it's going to be resolved. The OCA is a very active participant in those proceedings. And, unfortunately, I do not share his optimism. And, I do not believe that this Commission should await a breakthrough from those settlement talks. If they occur, that's wonderful. But I don't think we can rely upon them.

Instead, this Commission has to do something to halt this biased flow against New Hampshire. And, what I've always heard in my activity here at the Commission, as a nonlawyer, is that this Commission is not bound by your prior orders. And, what I'm looking at specifically is the 1995 order on which the Commission changed the allocation methodology, and it changed it to more accurately assign costs to the two divisions. That's what I think you have to recognize now. Does it still accurately assign costs to the two divisions? I think it's very clear from Mr. Ferro's testimony, from mine and Mr. McCluskey's, that, no, it's not fair anymore.

So, who's going to, absent a settlement resolution, whose going to stop this, this biased flow? Why should the Maine Commission do it? I think it's up to you to take the first step along that line.

The Company recognizes that they're in a tough spot, and I can appreciate that. They feel they incurred the costs prudently, they felt that they had an obligation as supplier-of-last-resort in Maine. That's something to be determined between the Company and Maine's laws. But they're trying -- the Company has tried to cover themselves. One way they have tried to do that is, on October 7th, they sent a letter into the Maine Commission, in which they reserved their right to seek recovery of certain demand-related gas costs that are currently in dispute related to the allocation of these costs between Northern's Maine Division and Northern's New Hampshire Division. I'd have no objection to the withdrawal of the $1.3 million here and the Company reserving its right to seek recovery in the future.

But I think we've heard that there's probably not much right to seek recovery, it's inappropriate those costs are being incurred for Maine customers, not for New Hampshire customers.

I think that completes my comments on the rebuttal testimony.

MS. HOLLENBERG: Thank you. I don't have any other questions at this time.

CHAIRMAN GETZ: Mr. Damon.

MR. DAMON: Yes. One, one question.

CROSS-EXAMINATION

BY MR. DAMON:

Q This morning Mr. Ferro summarized what he thought the gist of Mr. McCluskey's testimony and your testimony was. And, he described, as I understand it, a difference, a difference that he understood. And, that is that Mr. McCluskey was recommending deferral of the forecasted costs for the upcoming winter, where you were recommending removal of those costs without consideration of further recovery from any division. Do you accept that characterization of the differences between your and Mr. McCluskey's testimony?

A I think that's fair. I simply stated that they should be removed from the filing. I was silent on with regards to reservation of rights or deferral. To me, "deferral" carries a connotation that's closer to "the Company has the right to recover in the future", and I am uncomfortable. I don't think the Company should have the right to recover all of that $1.3 million in New Hampshire.

MR. DAMON: Thank you.

CHAIRMAN GETZ: Mr. Shortlidge.

MR. SHORTLIDGE: Thank you. I was hoping to be saying "good morning", Mr. Traum, but, unfortunately, it's "good afternoon". Also, since I promised Mr. Eaton we'd get ourselves out of here by 1:00 p.m., so he could have his hearing this afternoon -- or, 2:00, okay, we have more --

THE WITNESS: I'm delighted to tell you it's now 2:00.

MR. SHORTLIDGE: All right. Well, I was going to say, "in the interest of time, I was going to try to be brief", and I think I still will be.

BY MR. SHORTLIDGE:

Q Just so the record is very clear, what you have testified to is that you are requesting that the Commission deny recovery from New Hampshire ratepayers of the 1.36 or 1.346 million referenced in your testimony?

A I'm saying that, as far as the CGA rate that should be billed to customers for this winter, it should exclude that $1.3 million. But I also added that I don't have any problem with the Company seeking to reserve its right to seek recovery in the future, but not to go as far as to say they should be allowed to defer those costs.

Q Okay. So, in reserving that right, it would be reserving the Company's ability to bring arguments before this Commission or any other commission, as to why those costs should be recovered, either in New Hampshire or Maine?

A That's correct.

Q Thank you. Now, just so we -- because I actually had the same confusion that Commissioner Harrington was having, regarding the 1.346 versus the 692,000 in the filing. To be clear, your recommendation is that the Company not recover approximately $2 million in New Hampshire. You would combine the 692,000 included in the filing, with the 1.3 million?

A The only point I took issue with in the filing was the 1.3 million. And, I recognize that the filing had already excluded the other number.

Q Now, I appreciate your viewpoint on the negotiations. Is it true that there are two days of negotiations scheduled next week?

A Yes.

Q And, do you have any reason to believe at this point that there's no likelihood that those negotiations will succeed?

A Yes.
Q And, what's the basis for that?
A I'm not sure if I'm getting into a confidential area here.
Q Without discussing the substance, are you aware of anything that absolutely prevents the negotiations from succeeding?
A The inflexibility on the part of some other party or parties.
Q So, from your point of view, we may, in fact, be wasting our time next week? Is that your testimony?
A Unfortunately, yes. But the OCA will still participate, and, hopefully, we'll reach a resolution, but I guess I'm not optimistic.
Q Now, are you -- I assume you're aware that there is another docket opened before this Commission to consider the reasonableness of the PR allocator?
A The docket you're referring to is the one the negotiations relate to?
Q Yes. In Docket Number 05-080?
A Yes.
Q And, if the negotiations were to fail next week, is there any opportunity for the OCA or any other party to come in in that docket and seek the same relief

that they are seeking here?
A No. In terms of the cash flow impact on consumers, this Commission will be, I assume, will be approving the CGA rate within a week, which the consumers will then be paying in.
Q Well, would there be anything to prevent the Commission from changing that CGA rate in the future as a result of a finding in the 05-080 docket?
A If it were to happen quickly enough, and the Company were to waive any rights that it was changing something within the normal trigger.
Q Now, if the Commission were to agree with the Company's filing and to simply defer the 692,000, is there anything that would prevent the Commission from next year backing out the 1.3 million, if, in fact, that is the correct amount?
A The Commission, I believe, could do that, but, in the interim, the consumers that are being hard hit by all of the other cost increases right now for this winter will be out an additional $1.3 million.
Q Have you made any estimates as to what type of bill impact removing that $1.3 million would have?
A No, I have not.
Q Now, if there was a finding that the PR allocator

was, in fact, unreasonable as a result of 05-080, could the Commission immediately back out that money upon that finding?

MS. HOLLENBERG: I'm going to object at this point, because I believe that that calls for a legal conclusion from my witness.

MR. SHORTLIDGE: I'll accept that.

BY MR. SHORTLIDGE:

Q And, just to the extent that you've -- that understanding you're not a lawyer, do you have any feeling as to whether there would be any policy reason why the Commission could not simply back out the money from this cost of gas docket, based on a finding in a future docket?

A I guess it's the time that's at issue here. That customers may be out of pocket of the 1.3 million before the other docket is resolved, if it's even resolved in the future.

Q Now, Mr. Traum, would you mind turning -- do you have the full copy of the filing, Exhibit 1?

A Yes, I do.

Q Would you mind turning to the tab labeled "Reconciliation".

A I have it.

Q And, there's a copy of a letter in here with my signature, your signature, and Mr. Damon's signature. Could you please describe what this letter is?

A If you could give me a moment.

Q Okay.

(Short pause - witness reviewing document.)

BY THE WITNESS:

A It's basically a letter dated April 12, 2005, deferring -- suggesting a deferral of $100,000, and providing parties the opportunity to work with the Maine Commission Staff and the Maine Consumer Advocate's office, to resolve the cost-shifting problem. And, that sort of is consistent with what I'm saying here. That was April. That was six months ago, and we really haven't made any progress.

BY MR. SHORTLIDGE:

Q There's been some discussion back and forth in these proceedings about a "settlement agreement" or a "settlement letter". Is it your understanding that this is the letter that folks are referring to, with regard to the Summer '04/05 -- the Summer '04 gas costs reconciling into the Summer '05 period?

A I believe that's correct.

Q And, is it your understanding that this letter agreement required that the Company defer recovery of the Summer '04 gas costs associated with this, with the PR allocator concerns in the '05 period?

A I also, again, believe that's correct.

Q What has changed since the date of this letter that makes this resolution unacceptable for the OCA in this docket?

A Well, like I had started in my summary of my direct, and I talked about the "perfect storm" of costs coming down on the heads of New Hampshire ratepayers, the customers, that's a concern that the OCA shares with the Commission in other proceedings. That's occurred. Time. I mean, this letter was six months ago. We thought we would quickly, after that, be able to sit down and resolve the issue. I don't see any resolution in the near future. The level of the dollars of costs are increasing significantly.

Q Let me take you back in time to 1995. Do you agree with the testimony that the PR allocator was presented to both Commissions, and that the request was that both Commissions approve the PR allocator?

A I would agree that the proposal was provided, I think concurrently, to both Commissions, and this

Commission approved it, I guess, subject to the Maine Commission also approving it, because it more accurately assigned the costs to the two divisions.

Since 1995, as I believe Mr. Ferro has explained, transportation has become a major issue. And, whereas this Commission has gone to mandatory capacity assignment, you know, which the Company supported, and at that time it is my understanding the Company was also going to bring that concept to Maine, so that the two states could be on an equal footing again; Maine didn't move. Maine has a different structure. And, because of that difference, we're paying a disproportionate and a biased share of the costs. We didn't realize the magnitude of the dollars, and apparently the Company didn't realize the magnitude of the dollars until just a couple of years ago, when myself and the New Hampshire Commission Staff started pushing to get more clarification from the Company on just what the impact was.

Q Mr. Traum, you referred to Maine having a "structure" for capacity assignment or a lack thereof. Is it your understanding that Maine has actually adopted rules regarding capacity assignment or have they simply opened a docket and then failed to do anything further?

A I may have misspoke there. I believe you're correct. My understanding, as an outsider from Maine, is that the Company had made a filing, and the Maine Commission had opened a docket, and I think that's where it stands. And, it's stood that way for years.

Q Now, would you agree with the assertion that the Company is truly concerned with the issues associated with the PR allocator?

A Now they are.

Q And, do you have any reason to believe that the Company is not taking all appropriate action to ensure that the PR allocator is being -- is modified?

A I would again say, I think, today, they are. Whether they should have done things sooner is another issue. It's not the question you asked, though.

Q It also strikes me that, if you have an agreement where costs are being allocated between several parties, in this case, two states, and the agreement becomes unfair, you really need both parties to agree to modify that agreement. Wouldn't that be your sort of practical understanding of how things should work?

A If we're talking hypothetically, if one party is getting an unfair advantage from the existing agreement, why should they readily change that.

Q Would one of the reasons be because both parties benefit from the total system planning that occurs?

A Both -- Northern plans for the system jointly, and that's -- Northern has always said that is a benefit, it's a benefit equally to Maine and New Hampshire. So, I don't know why New Hampshire should be paying an unfair proportion of those costs.

Q And, if New Hampshire were to need a disproportionate amount of the capacity that's been purchased, is there anything right now that would prevent New Hampshire from taking more capacity than Maine or Maine taking more capacity than New Hampshire?

A I'm not sure I understand your question.

Q Since Northern plans for a total system, and has purchased capacity for the total system, is there anything that prevents New Hampshire, or, for that matter, Maine, from taking advantage of all that capacity or some portion of that capacity on any given day?

A I guess the difference between the two states is, in New Hampshire, we're certainly paying 100 percent for our firm sales customers. We've got one traunch of transportation customers in New Hampshire 100 percent paying for capacity assignment, so they're paying 100 percent. The other traunch of transportation customers in New Hampshire, per tariff, the Company is not supposed to back them up, as I understand. In Maine, it's a totally different situation.

Q Well, let me ask you about this. We've spent a lot of time today talking about reliability. And, did you hear Mr. DaFonte describe the instance where a customer might pull gas through the system without the ability of the Company to shut that customer off?

A Yes, I did.

Q And, in pulling that gas, doesn't the entire system -- doesn't all the Company's capacity ensure that the system remains reliable, regardless of whether that customer is located in New Hampshire or Maine?

A It does. What you're ignoring is that, let's call it the tariff differences between the two states, the Company would have the right, I believe, per tariff, to pull the plug, so to speak, on the grandfathered transportation customers in New Hampshire, if they had to for reliability purposes. And, I'm not sure, I don't think they do in Maine.

Q But is it a fair assertion that the -- that the capacity that the Company has acquired for the entire system benefits both states *vis-a-vis* reliability?

A It benefits both states, certainly, but we're paying more for that benefit than Maine.

MR. SHORTLIDGE: I think that's it.

CMSR. HARRINGTON: Yes, I had a couple of questions.

BY CMSR. HARRINGTON:

Q Back to my original confusion again, I just want to make sure. Maybe I misunderstood what you said. The OCA is suggesting that the 1.35 million not be included in the cost of gas rates for this upcoming winter, is that correct?

A Yes.

Q Okay. But you're not objecting to the inclusion of the 692,000 that would have been from last winter, that's rolled in there as well?

A The only issue I took with the Company's filing was the 1.3 million.

Q Okay. The one -- let's say that happens. What is it -- this is a real cost. So, somebody has to pay it. So, what -- can you kind of walk me through the scenario of the 1.35 million is denied, so, then what happens?

A Well, from my viewpoint, to the extent they are prudently incurred costs, they were prudently incurred to serve customers in Maine, to backup customers in Maine. They should be -- The Company should be pursuing recovery of those costs in the State of Maine.

Q So, that's what you envision would happen then, they would just -- they would go and try to recover the costs from Maine?

A And, that's certainly what I think they should do. And, in the letter that Patricia French sent to the Administrative Director at the Maine Commission, they were reserving their right to do exactly that.

Q And, what if Maine were to deny those costs? What would you envision happening then? I'm just trying to walk through the scenario.

A Sure. Well, either the Company could roll over and accept that, or they would litigate it in some court.

CMSR. HARRINGTON: Thank you. That's all I had.

CHAIRMAN GETZ: Ms. Hollenberg, redirect?

MS. HOLLENBERG: No thank you.

CHAIRMAN GETZ: Then, the witness is

excused. Thank you. Mr. Damon.

(Whereupon **George R. McCluskey** was duly sworn and cautioned by the Court Reporter.)

GEORGE R. McCLUSKEY, SWORN

DIRECT EXAMINATION

BY MR. DAMON:

Q Please state your name and business address for the record.

A My name is George McCluskey. And, my business address is 21 South Fruit Street, Concord, New Hampshire. And, I work for the Public Utilities Commission.

Q I'm going to show you a document dated October 21st, 2005, this is a cover letter and attachments regarding testimony of yourself that was filed with the Commission. Is that a true and accurate copy of the testimony that was filed in this docket?

A It is.

MR. DAMON: I'm going to give this to the Clerk, because I think she needs a copy for the record.

BY MR. DAMON:

Q Referring to Exhibit 4, do you adopt that testimony as your sworn testimony in this proceeding?

A I do.

Q Was it prepared by you or under your direct supervision?

A Yes, it was.

Q Do you have any corrections to the testimony that you filed?

A Yes, with regard to Page 10. It's actually in the question itself. It states that "In Order Number 24,389, in Docket Number DG 04-162, the Commission authorized the collection of Winter 2004-05 cost shift through Northern's Winter 2004-05 cost of gas, but reserved Staff's right to request a refund." On reviewing the order, the order actually reserves Staff's rights with regards to the Winter Period 2003-04.

However, as being discussed this morning, there was a letter agreement entered into between the parties to the Summer 2005 CGA, which actually, among other things, it reserved Staff's rights with regards to recovery of costs of shifted -- what I will call "shifted costs", shifted capacity costs, back to the Summer of 2004. And, the Commission actually approved that letter agreement.

And, as a result, the Staff's rights with regard to the Winter of 2004-05 are actually reserved through the letter agreement, rather than through the Order Number 24,389.

Q And, any other corrections?

A Maybe if you remind me. Is there anything else?

Q Not that I know of.

A Okay. No, I think that's it.

Q Okay. Mr. Ferro, on direct examination, characterized your testimony in so many words, I guess, as that you are "recommending deferral of the forecasted costs for the upcoming winter period". Actually, you use slightly different words from that. I think you used the word "removal" of the costs pending, I believe, the outcome of the DG 05-080 docket?

A That's correct.

Q I'd just like to ask you to comment on whether or not his characterization is one that you agree with or do you mean by your recommendation something different?

A Yes. I think we're very close, but I purposefully did not use the word "deferral". Although we have used that word, I believe, in the letter agreement, I was advised by people with accounting backgrounds here, that the term "deferral" is essentially, if approved by the Commission, gives the Company a right to recover those dollars at a subsequent period.

And, what I am recommending here is that the Commission first require the removal of the costs from the upcoming Winter 2005-06 rate, and have the ultimate recovery in New Hampshire be subject to the outcome of docket 05-080. So, if the outcome of that docket is that the current methodology is reasonable, then they would essentially recover all of the removed costs. If the outcome is that a revised method would be adopted, then the actual recovery in New Hampshire would depend on the details of that new revised methodology. And, one would assume that any costs not recovered in New Hampshire, the Company would seek to recover those in Maine. But that's the reason for not using the word "deferral".

Q Your testimony refers to a cost shift forecasted for the upcoming period of $1.35 million, correct?

A That's correct.

Q And, on what information did you base that estimate?

A As I stated in my testimony, the estimate of the 1.35 million cost shift is based on a methodology developed by the Company. And, the actual -- the actual calculation reflected in Exhibit GRM-2 is actually based on a data response that the Company submitted, I believe, in this proceeding, --

Q Okay.

A -- for the period of 2005-06.

Q Okay. Let me show you a data request, excuse me, Request Set Number 1, Response 3. And, ask you if that is the data request that you were referring to on which you relied to prepare your testimony?

A Yes, that is the data response from Mr. Ferro.

MR. DAMON: I would ask that this be marked. And, I have extra copies I can pass out to people.

CHAIRMAN GETZ: It will be marked for identification as "Exhibit Number 6".

(The document, as described, was herewith marked as **Exhibit 6** for identification.)

BY MR. DAMON:

Q Okay. Just for the record, would you just summarize your understanding of that response.

A The response to the data request, Mr. Ferro applies the methodology which was used in a prior proceeding, and updates it for the calendar year 2005-06. And, based on that calculation, he is estimating that, again, it's an estimate, but it's based on -- it's my understanding that this is the Company's best estimate of the cost shift to New Hampshire, as a result of the fact that transportation customers in Maine are not assigned capacity costs, and those costs are subsequently allocated to both New Hampshire and Maine sales customers. And, he calculates that, for the year 2005-06, the New Hampshire portion of the shifted costs would be $1.5 million. And, the Winter 2005-06 portion of that amount would be $1.35 million, approximately.

Q Do you consider those figures to be accurate?

A Accurate, given that it's an estimate, I would say I believe that the figure is a reasonable estimate, based on the methodology that's adopted. There are certain elements in the calculation that I could get into, if necessary, that would suggest that the estimate, this actually understates the costs assigned to -- that should be -- let me say that again. I think arguments could be made that the estimate of $1.5 million understates the costs that are shifted to New Hampshire. But I believe that, for these purposes, it is a reasonable estimate to use in this case.

Q And, could you be a little more specific about the reasons why that estimate might understate the true nature of the shifted costs?

A Yes. The calculation excludes, on Line 2, what's called "Maine" -- what the calculation does is it estimates an equivalent Maine grandfathered load, although that term "grandfathered load" is not used in Maine, but the calculation estimates an equivalent grandfathered load for Maine, and does not attribute that cost to that load. And, in testimony submitted in the Maine unbundling proceeding, I've argued that it's inappropriate to do that, because, as the Company has indicated today, the Company is required to do backup, and hence incur costs for all of Maine transportation load, and not just the non-grandfathered load. So, I think, in doing that, he's actually understated the estimate of the cost shift in New Hampshire. Regardless of that, for the purpose of this proceeding, I think the 1.35 is reasonable.

Q Okay. There has been discussions about the nature of the $100,000 deferred cost amount, and the period, I guess, to which they believe to apply. And, you've heard Mr. Ferro describe that he thinks that it applies or he understands it to apply to the 2004 Summer period and is carried forward through the reconciliation in the 2005 period. Just so the record is clear on this, what is your understanding of the period to which that $100,000 applies to?

A My understanding of the letter agreement that was entered into is that the Company was removing $100,000 of capacity costs from the 2005 Summer period. Hence, it was removing $100,000 from the estimated costs for the Summer 2005 period. The $100,000 was developed not based on this calculation, but based -- for that period, but based on an estimate of the shifted costs for Summer 2004. And, what we agreed to do was to use that estimate as a proxy for the costs that were shifted in Summer 2005. And, so, we took that estimate. And, my understanding of the agreement was that we were taking $100,000 out of the Summer 2005 CGA. And, I believe the Commission's order approving the letter agreement actually says that.

Q You have heard Mr. Traum express some degree of pessimism about the state of the negotiations. And, I would ask you whether you share those views or do you -- or are your views closer to those of Mr. Ferro?

A Well, I would say that I'm always hopeful that a settlement will be achieved. And, certainly, the Commission Staff, along with the OCA, and I'm sure the Company as well, will be working hard to achieve an agreement over the next few days next week. But I have to say that I think there's a considerable risk that we're not going to achieve that objective. And, I base that on some of the positions taken during the discussions that we've had. I can't get into what those positions are, and the parties that hold those positions. But I can say that there's a significant gap between the positions that we are advocating and the positions that other parties are advocating. So, there's a lot of work to be done in those two days next week in order to reach an agreement. So, I think there's a considerable risk that we will fail at this point.

Q Mr. McCluskey, why are you recommending removal of the winter period shifted costs pending the outcome of the 05-080 docket, instead of recommending recovery, with reserving the right to adjust that, the amounts recovered, pending the outcome of the docket?

A Could you give me that question again.

Q Why are you recommending removal of the shifted costs for this upcoming winter period, pending the outcome of the joint proceeding, rather than recommending recovery, with the reservation of rights to adjust the rates in the future?

A Primarily, for two reasons. I believe that the evidence presented today in my testimony, in the testimony of Mr. Traum, and also various statements made by Mr. Ferro on direct, is sufficient to support an initial finding by the Commission that the PR methodology, as currently constructed, is flawed. And, that the flaw is causing the improper assignment of costs to New Hampshire. That's the first point. And, therefore, to recover those improperly assigned costs in rates would be to recover what I consider to be unreasonable costs, and hence they would fail to meet the usual standard of "just and reasonable rates" in New Hampshire.

Second, the temporary recovery of these questionable costs in New Hampshire would unnecessarily add to the burden on New Hampshire customers at this time of unprecedented high costs.

So, effectively, we would be increasing the burden that most customers are going to incur over the current winter period. And, so, it's absolutely the wrong time to be recovering questionable costs, in my view.

Q You heard Mr. Ferro's comment this morning about the possible unintended consequences resulting from a Commission order that would be consistent with your recommendations. And, you heard him further explain that in response to questions that I asked. Did you hear anything in that discussion that would cause you to change your recommendation that you've made in your prefiled testimony?

A No. I know that several of the parties certainly don't like the positions that we're advocating. And, I don't think anything that I've said today is going to change that. I believe, hopefully, we, at the end of the day, we can come to an agreement that is satisfactory to those parties and addresses potential litigation risk that they may have going forward. But, no, I don't think the Commission approving a lower rate in this proceeding is really going to have an impact on the outcome of the settlement discussions.

Q Did you have any other thing that you want to add to your comments?
A No, not at this point.
MR. DAMON: Okay. No further questions.
CHAIRMAN GETZ: Ms. Hollenberg?
MS. HOLLENBERG: No questions for this witness. Thank you.
CHAIRMAN GETZ: Mr. Shortlidge.
MR. SHORTLIDGE: Yes. Thank you.
BY MR. SHORTLIDGE:
Q Just before we -- before we get started, just to clarify, your recommendation is that the Company defer -- or, reserve the right to recover in a future proceeding $1.35 million, is that correct?
A If that is consistent with the outcome of the docket DG 05-080, then that's correct.
Q Is that 1.35 million in addition to or is it a substitution for the $692,000 that was proposed by the Company in the filing?
A Those two costs are totally separate. In my view, they are unrelated. What that $692,000 is, it relates to the Winter 2004-05 period. What actually happened in that proceeding is that the Company, even though that amount relates to an estimated shift of

costs from Maine to New Hampshire, the Company was allowed to recover those costs. And, so, they received revenues to cover those costs. What the Company has proposed to do, as part of the reconciliation in this proceeding, is to say, I think, because those costs are subject to the final outcome of 05-080, they have decided, without an agreement from -- with the Staff, to give back those dollars, to credit those dollars. And, that credit will be reflected in the lower rate for the 2005-06 CGA. That cost is unrelated to the $1.35 million. The items are totally separate. The 1.35 relates to a going-forward cost projection that the Company -- that we estimate is the cost shift for a going-forward period. One is a historic cost, the other is a going-forward cost.

Q That's actually very helpful. Let me understanding your understanding of the letter agreement. The $100,000 referred to in the letter agreement is, in your view, a going-forward cost, correct?

A That's correct, yes.

Q But it's based on a projection that is tied to the previous period's actual alleged cost shift?

A That's correct. It was based on an estimate by

Mr. Ferro of the cost shift for that Summer 2004 period.

Q So, to be consistent, if we were to take the letter agreement and move it forward to today, you would actually be recommending that we took the $692,000 that were projected -- that we estimate from the prior period, and use that as a projection against the future period, is that correct?

A No. To me, bringing in the $692,000 totally confuses things. To respond to your question, if we were to take the model that was developed for the Summer of 2005, where we took out $100,000 of future costs, that is exactly what we are proposing to do for this proceeding. To take -- The figure is much larger, because it's a winter period, and there's been more cost shifting going on. The equivalent figure for the future period is $1.35 million. So, our proposal is perfectly consistent with our understanding of the agreement struck through the letter agreement, and the Commission's approval of that.

Q Just so I understand, was the $100,000 developed by a forward-looking projection, a calculation similar to how you've calculated the 1.35, or was it based on a historic estimate?

A It was, as I've said, it was based on an estimate for a prior period. But we agreed to use that estimate as a proxy for the costs shifted for the Summer of 2005.

Q But the 1.35 is not based on an estimate for an historic period, is that correct?

A That is correct. It's based -- It's a forward-looking cost estimate.

Q Now, on Page 2 of your testimony, at line 19, you state that "$1.35 million of fixed capacity costs that are the responsibility of Maine customers." Do you see that, that line?

A Yes, I do.

Q When you state that those "capacity costs are the responsibility of Maine customers", are you making a legal assertion there or are you simply stating that, from a fairness perspective, they should be the responsibility of Maine customers?

A Well, certainly, I'm not making an -- not offering a legal opinion. I'm not a lawyer. But, without doubt in my mind, the Company has incurred costs to back up the transportation customers in Maine. That there's no question about that. The Company has stated that many times in different proceedings. But, it has

[Witness: McCluskey]

not, for various reasons, been able to recover those costs from those customers. As a result, those costs stay in the capacity cost pool and get allocated between the two states. And, our share of that is the $1.35 million. So, I think my language is appropriate. These costs were incurred for the benefit of those transportation customers, but have been shifted to other players.

Q Mr. McCluskey, what's your understanding of the way Northern plans its system and plans for system reliability between New Hampshire and Maine?

A Well, Northern does it on a total system basis. So, it plans to have sufficient capacity to meet the loads of certain groups of customers. And, those are, on the New Hampshire side, it's all their firm sales customers, plus what are called their "non-grandfathered" firm transportation customers. On the Maine side, it's all their firm sales customers, plus all of their transportation customers. Northern has testified that it believes it has an obligation to back up all of its transportation customers in Maine. And, as a result, it has to acquire capacity, in the event those customers return to sales service. So, that's how it establishes -- maintains reliability, by acquiring sufficient capacity to meet the design day loads of those four groups of customers.

Q Just so we're clear, is it your understanding that Northern enters into contracts for pipeline company capacity to serve individual customer groups in either state or does it do so on a systemwide basis?

A It does it on a systemwide basis.

Q As a result, if tomorrow, for instance, a new large company came into being and situated itself in New Hampshire, is there -- would there be a different allocation of capacity as a result of that, of that activity between the states?

A You said "allocation of capacity". You talking about capacity costs or --

Q No, just allocation of capacity. There's a certain amount of capacity available for the entire system. Obviously, some serves Maine, some serves New Hampshire.

A Yes.

Q If New Hampshire acquired a new large company tomorrow, would more of that capacity be allocated to New Hampshire?

A I don't believe there is any allocation of capacity.

Northern would -- Certainly, Northern's planning, clearly, if a customer came on line tomorrow, it's going to be too late to acquire capacity to serve that load. It would have to meet that load out of its existing resources. So, from a planning standpoint, it would have to plan to meet projected load, and that projected load might include such a customer coming on line. But it would do that planning for the total system, rather than for New Hampshire or Maine individually.

Q If that event were to occur, would some of the capacity that supposedly is being used to backstop the Maine transportation customers, would that be used in the near term to serve that customer?

A You're saying, if the existing capacity were to be used to supply a new load?

Q Yes.

A What would happen, if that was a -- if that was a firm sales customer? More of the capacity costs would be allocated to New Hampshire over some subsequent period. That load, the inputs that determine how the costs get allocated would change, and, presumably, New Hampshire's inputs would be higher than they otherwise would be, and, hence, they

receive appropriately a higher allocation of costs, because the mechanism is designed based on cost causation. It's appropriate for that to happen.
Q But, setting aside the cost allocation right now, just on a pure "how does the gas get to the customer?" Because Northern has the firm capacity available in Maine, that capacity can also be used to serve New Hampshire customers, correct?
A Could you give me that question again.
Q Set aside the question of cost causation and cost allocation. You've stated that New Hampshire plans it on a systemwide basis.
A Northern does.
Q Northern does. I apologize. As a result of that, regardless of where the capacity is needed, it can be used by Northern, whether it's in New Hampshire or Maine, is that right?
A That's correct, yes.
Q Okay. Now, taking one step forward into the cost allocation issue, is it your understanding that Northern has acquired any new capacity to serve Maine transportation customers?
A Yes. It's my understanding that the last increment of capacity was added after transportation was, in

fact, on Northern's system. And, hence, it would take into account, in its planning for new resources, the existing and expected future transportation loads. So, it would have to take that into account in making any resource acquisition decision.

Q But was the resource acquired solely to serve the Maine transportation load?

A Not solely. As I've indicated, all resource decisions are based on an integrated system basis, and, hence, they are there to meet any incremental growth in load, which could include growth on the New Hampshire and/or Maine systems.

Q Just so the record is clear, what resource were you referring to when you stated that Northern had acquired resources since the adoption of transportation service in Maine?

A I believe it's called "Wells replacement resources".

CHAIRMAN GETZ: I'm sorry, what was that?

THE WITNESS: Wells replacement.

CHAIRMAN GETZ: Wells.

(Short pause.)

MR. SHORTLIDGE: I apologize for that.

BY MR. SHORTLIDGE:

Q Mr. McCluskey, if a new customer were to come into New Hampshire, is it your understanding that that customer would be, a new transportation customer, would that customer be grandfathered or not?

A A "new transportation customer" you said?

Q Yes.

A Would this customer be switching from firm sales or would it be coming -- would it --

Q No, this is a brand new customer.

A New business?

Q Yes.

A New business. It's my understanding that they would be categorized as a "grandfathered customer".

Q And, if they were categorized as a "grandfathered customer", what would Northern's obligation be to provide last resort service to that customer?

A They would have no obligation.

(Short pause.)

BY MR. SHORTLIDGE:

Q Mr. McCluskey, and I apologize again for the -- in the situation where you have the grandfathered customer, the Company does not have to plan to have -- supply that customer with supplier-of-last-resort service, is that correct?

A In New Hampshire, yes.

Q But that customer is still there, and if that customer were to go off line, and we've had this discussion before, as a result of the inability of New Hampshire to shut down that customer, it would still take some capacity at that point to serve them, correct?

A There certainly is a risk that even a grandfathered customer could fall back onto the system and impact the reliability to other customers. That's right.

Q And, at that point, New Hampshire benefits from that capacity, correct?

A Excuse me? Benefits from what capacity?

Q If the customer ends up falling back, New Hampshire benefits from the capacity?

A "From what capacity?", is my question. I am not sure what capacity you're referring to.

Q From the unassigned capacity, the capacity that's not being used in either Maine or New Hampshire at that instant.

A Well, I'm not sure, if you're suggesting that this customer could come back on the system and stay there? I don't believe it could do that. It could fall back on a temporary basis, and it -- we have had this discussion before, and, in my view, that risk, which is a real risk, should be addressed through the tariff, through a penalty or some kind of charge. That potential of risk should not be taken into account in determining what the appropriate cost allocation mechanism should be.

Q Now, Mr. McCluskey, you indicated previously that you were not hopeful regarding the settlement negotiations, is that correct?

A I did not say that. I said, "I believe there's considerable risk that we fail to achieve our objective."

Q I apologize. You did, in fact, indicate that you remained hopeful, but you are correct. Is there anything to lead you to believe that it is an absolute certainty that negotiations will not result in a settlement next week?

A No. Some of the positions that people are advocating could simply be a part of the negotiation process. But, if those are real positions, as I have indicated, there is a considerable gap between us and them. And, I don't see them being closed. There are several issues that we -- it's not just a single issue. There are several issues that we have on the table, some of which are just rejected out of hand. And, if that continues to be the position of those parties, then we will not have a settlement.

Q If settlement negotiations were to fail, is there anything that would prevent this Commission from moving forward with docket 05-080 and considering all the issues associated with the PR allocation at that point?

A No. In fact, that's how I expect this to play out. If the negotiations fail, then we'll have to develop a schedule for the remainder of the proceeding. And, then, it comes down to clearly, if -- based on our opinion, the Commission can change the allocation methodology without the consent of the Maine Commission, then, eventually, we will get to a position where the Commission issues a decision on what it believes is an appropriate allocation mechanism.

If the outcome is dependent on a joint agreement, as you appeared to indicate, then we may never get resolution. It would have to go elsewhere in order to resolve that.

Q Doesn't, though, your recommendation that the Commission make a determination regarding the

1.35 million and the recovery of that 1.35 million, in this docket, prejudice the results of the resolution of the 05-080 docket?

A I don't think so. We're simply asking the Commission to, based on the record in this proceeding, to make an initial decision on the reasonableness of the current cost allocation mechanism. The actual final mechanism and the dollars flowing between the Company and its customers, in both divisions, will be determined by the outcome of that proceeding.

Q Let me just explore that, so I understand it fully. You're suggesting that this proceeding should decide on the reasonableness of the cost recovery, and that the 05-080 docket only decides what the PR allocator may look like in the future? Is that what I understood you to say?

A No. I'm saying that the Commission can make a determination in this proceeding that the cost allocation method, as currently constructed, is flawed. I've argued that, and I believe Mr. Ferro has agreed with that. So, what's to stop the Commission making that initial determination. Otherwise, if it agrees with that position, then it will be effectively approving the recovery, for some period, costs that were not the responsibility of New Hampshire customers.

Q And, if it made that determination, what would prevent the Commission from ordering the Company to refund those costs to New Hampshire customers?

A Would prevent them? In total? Is that your question or --

Q Let's say, in 05-080, the Commission reached the determination that you seek to have it reach. What would prevent the Commission at that point from ordering the Company to refund the costs, the $1.35 million to customers at that point?

A Oh. They could do that. So, you're suggesting that you recover it up front, and then be ordered to refund. Is that what you -- is that your question?

Q Yes.

A There's nothing to prevent the Commission doing that.

Q Let me ask you this. When you were asked a question about the difference between a "deferral" and "reserving the right to recover", you indicated that the problem was that, from an accounting point of view, a deferral allows the Company to put it on the books. Is that, in layman's terms, what --

A Even though I'm not an accountant, my understanding is that, if the Commission approves the deferral, that gives the Company the right to recover those costs in the future. And, my concern with that is that the future recovery of the costs is not yet known. That the amount to be recovered in New Hampshire will be decided by another proceeding. So I'd rather use the word "remove" the costs initially, and determine later where those costs should be recovered. I'm not advocating that Northern should not receive 100 percent of those costs. That's not my position. And, any costs that are appropriately allocated to New Hampshire out of that 1.35, I believe Northern should recover 100 percent.

With regard to the other costs that I have no control over, I don't have any control, of course, here, I can just advise the Commission on what to do. But that will be the determination by the Maine Commission as to what is appropriate for recovery.

Q Understanding that you're not an accountant, have you talked with or consulted with any of the accounting staff regarding the impact on Northern associated with your proposal?

A Yes. I had a discussion, you're talking about the

cash flow impact?
Q Actually, no. The impact of requiring a write-off of the amount, of the 1.35 amount.
A We did not discuss a write-off. It's not my recommendation that the Company write these costs off.
Q So, it's your assertion that your proposal would not require the Company to write off the costs?
A I didn't say that. I said, "we did not discuss the write-off."
Q But you, if your proposal resulted in the Company having to write off the costs, would you still support it?
A I haven't given that any consideration.
Q Now, we've had a lot of discussion today about "system reliability", about "suppliers" and "resource planning". Doesn't the impact on company cash flow affect its ability to purchase supply?
A Not necessarily. There could be a reduction in cash flow, but the Company can still meet all of its expenses.
Q But wouldn't a reduction in cash flow potentially affect suppliers' interest in dealing with the Company?

A From a credit standpoint?
Q From a credit standpoint.
A Potentially. As to the magnitude, I don't -- I'm not aware that that would be a significant factor.
Q Have you performed any analysis as to whether or not there would be any impact associated with that?
A With regard to credit?
Q With regard to credit.
A No.
Q And cash flow.
A Credit or cash flow?
Q The credit impacts of a cash flow reduction to the Company.
A No, I haven't.
Q Mr. McCluskey, do you remember Mr. Ferro's discussion regarding the "ebb-and-flow of benefits between the two states"?
A I remember the term "ebb-and-flow". Benefits? I view it more a "unidirectional flow" to New Hampshire, as opposed to an "ebb-and-flow".
Q But, prior to this, prior to this period that we're discussing today, you've made no analysis whether historically benefits flowed to or from New Hampshire?

A That's correct.
Q And, going forward, there are events that could occur in Maine, such as a large number of supplier defaults, or otherwise, that could send the flow of benefits and the allocation of costs back in favor of New Hampshire?
A Not if the methodology were to be revised to reflect cost causation. And, that is what we are trying to achieve here. There would only be a misallocation of benefits, to use your term, with the current methodology.
Q But isn't it true that, if certain events were to occur in Maine and certain events were to occur in New Hampshire, you could see the benefits associated with the PR allocator flip right around, and perhaps at that point it might be the Maine Commission that was driving towards having the PR allocator modified?
A Well, I really can't comment on that vague hypothetical. If you give a hypothetical, and I'll try and figure out how the benefits would shift. But you haven't even -- what changes do you have in mind that would cause that?
Q Let's say that we have -- we have what we've been discussing, which is a historic -- or to use Mr.

Traum's word a "perfect storm", where you had tight capacity and tight supply. That puts suppliers in distress. Suppliers default, and a large number of Maine transportation customers return to firm sales. At the same time, you have limited problems in New Hampshire, because of the more limited number of suppliers and the greater grand -- and the size of the capacity exempt load. At that instance, during this winter, in which we made a projection that $1.3 million of benefits will erroneously, in your words, or allegedly will be shifted from Maine to New Hampshire, we could have a complete flip-around, and there could be benefits that were shifted from Maine back to New Hampshire.

A I don't agree with that. If there were to be a significant number of transportation customers in Maine revert back to firm sales service, for an extended period, you're not talking about -- I assume you're not talking about in a matter of days?

Q No.

A You're talking about an extended period. Then, what would actually happen is their firm sales service loads would be reflected through the current methodology. And, you wouldn't get a switch-around, as you're saying. You would simply get a change in the net result.

Q But, at that point, the estimate of $1.3 million could be completely wrong?

A It could be different. That's correct.

MR. SHORTLIDGE: I think that's it. Thank you.

BY CMSR. HARRINGTON:

Q Yes. I'm still trying to get some of these figures straight and exactly what we're doing here. So, maybe we can kind of back up in time a little bit. And, I'll be referring to testimony of Mr. Ferro, on Page 6. He talks about "The Company needs to, and is requesting through this filing, for the parties of this Winter '05/06 COG proceeding to also enter into a similar settlement agreement to defer Winter '04/05 capacity costs of $692,000." So, to start with, in the Winter '04/05, was that $692,000, to the best of your knowledge, was that included in the cost of gas?

A Yes.

Q Okay.

A The Company was allowed to recover that estimated cost shift during that period.

Q Okay.

A And, it has subsequently decided to return those dollars through the reconciliation mechanism in this proceeding.

Q Now, that's the part I have some more of a question on. When you say "return", they use the word "defer" the cost. Does that mean that they have now taken this $692,000 and subtracted it off of their costs, so that that's that much less that they need to collect during the Winter of '05/06?

A It's my understanding, they're using the term "credit". That they are saying "we will credit you in this Winter 2005-06 period $692,000." However, they do want to reserve their rights to come and look for that amount of dollars, or some portion of it, dependent on the outcome of the 05-080 proceeding.

Q Okay. So, in the case of "deferring" here means "not absolutely get it back, but they may be able to recover it in the future"?

A They definitely want to reserve the right to argue that they should be able to recover that, a portion of it or all of it, in New Hampshire.

Q And, the 1.35 million now, what they're doing -- what they're requesting this year is that that cost, which represents -- I know it's a different, it might have been calculated a different way, but it represents the same source of costs. There's money that's being inappropriately charged to New Hampshire. The Company is saying that, for this year, they want to, as last year, include the cost, except this year it will be 1.35 million, instead of the 692,000, as it was last winter, is that correct?

A That's correct.

Q Okay. And, what then? Next winter they come out and say "Well, now, we're going to take the 1.35 million out and give you credit for it"? I'm trying to -- I'm not following the logic of this in and out of the costs.

A That's a good question. In the Company's filing, they don't say what is going to happen after the dollars are recovered, but I'm not sure whether I heard Mr. Ferro indicate that they would credit that amount back through the reconciliation for Winter of 2006-07. I believe I heard him say that, but the Company -- I don't believe that is part of the Company's filing. They simply want to recover the dollars at this point.

Q And, as part of this filing, they could have chosen not to give credit of the 692,000 from last year and

kept that money?
A Yes.
Q Okay.
A There was no agreement that they had to credit those dollars.
Q So, theoretically, if they had done that then, from a cash flow point of view, they would be not looking at losing 1.35 million, but the 1.35 million, less the 692,000, which they would be allowed to keep?
A Yes. How you actually do the accounting for cash flow purposes, whether you can actually mingle dollars from a prior period with a future period, I don't know. But, yes, they would actually -- the impact on net cash flow for the winter period would be as you suggested, that's correct.
Q And, the agreement from last spring, which was to defer the $100,000, now what's the status of that money, when you say they deferred, they deferred $100,000 in that reconciliation letter?
A My understanding is that they didn't recover it, and the final recovery, if any, is subject to the outcome of 05-080.
Q So, it's sort of, as someone used the term, they "reserved their right" to try to get it back later?

[Witness: McCluskey]

A Correct. Correct.
Q Okay. And, what you're suggesting then is for the 1.35 million, they reserve their right to get it back later?
A That's correct.
Q And, I guess part of my confusion comes from the last year, the 692,000, was it allowed to be included in the cost of gas?
A Yes.
Q And, now, it's the Company, on their own volition, has come forward and said "we want to credit that 692,000, but reserve the right to get it back later"?
A Right. that's why I said "mixing the 692 --
Q Right.
A -- with the 1.35 confuses the issue." Leave that. That's a separate treatment of costs that the Company has proposed in this proceeding.
Q But, for this winter, they are saying, for that same source of costs, the 1.35 million, the price has gone up, they're saying "Let's not allow us to recover this later. Let us recover it this winter." That's what they're requesting?
A The Company is, with regard to the 1.35, yes.
Q All right. I think I finally got that straight.

Okay. Hopefully, we've kind of got that straightened out. The questions that were being asked earlier, and I'm not sure if this is something that can be answered in a reasonable amount of time, but it appeared what the Company was alluding to was that there was some benefit for New Hampshire, because of the capacity backup that was required in Maine, so that they could be the supplier-of-last-resort to customers up there. Is there any benefit to New Hampshire because that required capacity backup is there for Maine?

A There could be on a short-term basis; on a long-term basis, no. You see, Maine requires the Company to back up 100 percent of the -- what's called the "design day demand" of those Maine transportation customers, on the event that they should return to sales service. So, there's no way that New Hampshire could use that capacity on a long-term basis, because the Company needs it, in the event those customers return.

On a short-term basis, yes. If customers, say, the grandfathered customers in New Hampshire return, then, clearly, the Company would utilize any excess capacity it's got on its system, rather than go out and buy incremental capacity. They couldn't do that on a long-term basis.

Q Okay. And, just one more, returning to this money from -- that's being charged to New Hampshire that you feel should have been charged to Maine. What we've discussed so far was, from last winter, there was $692,000 that was included in the cost of gas that, in this filing, the Company is crediting back in again, but they want to reserve the right to collect later. There was the last spring's agreement for $100,000 to not collect $100,000 from Summer '05. And, so, that's -- now that's 792,000 and some change. Then, there's the 1.35 million, which is anticipating will be charged this winter, which the Company's position is they ought to be able to collect it on an ongoing basis through the cost of gas, and the Staff's position is that they should wait and collect that at a later time. Is there any other years back there? Do we have anything from Winter of '03/04 or Summer of '03 or is that the net sum of what we're dealing with here in these costs?

A There's one other period, and that applies to the Summer of 2004. The letter agreement that was entered into with the Company restricted our ability to go back prior to Summer of 2004. If you'll recall, the Company has, for that period, recovered the estimated shifted costs for the Summer of 2004, but we've reserved our right to come after that, once the 05-080 proceeding is completed. Prior to that point, even though cost shifting was happening, it was happening at a lower level. But, we've -- because we recognized what was going on too late, costs for prior periods have been fully reconciled, we felt that we were unable to go back any further than the Summer of 2004.

Q Do you remember what the amount was for that?

A For the period of Summer 2004?

Q That's correct.

A That's approximately $100,000.

Q And, that 100,000 then was actually collected, but we've reserved our right to get it back from the Company for the ratepayers of New Hampshire?

A Correct.

CMSR. HARRINGTON: Okay. Certainly were consistent there, weren't we? That's all I have. Thank you.

CHAIRMAN GETZ: Redirect, Mr. Damon?

MR. DAMON: Could I have one moment with the witness? Thank you.

(Atty. Damon conferring with the witness.)

CHAIRMAN GETZ: Mr. Damon.

MR. DAMON: Just one question.

REDIRECT EXAMINATION

BY MR. DAMON:

Q I believe one of Mr. Shortlidge's last questions had to do with the possibility of Maine transportation customers returning to sales service in Maine and its possible impact on a cost shift to New Hampshire. Would you like to elaborate on your view of that situation?

A Yes. I believe I said in response to that question that, if Maine transportation customers do come back to sales service, that would clearly impact the allocation of costs, because it would impact the inputs that are used in that calculation. And, I'm not sure whether I said it would impact the $1.35 million. If I did, I was in error in saying that, because the cost allocation, the inputs that are used for the 2005-06 calendar period, are based on historic inputs from last year. And, hence, any change that went on in this winter period would impact the cost allocation percentages next year, and not this year. And, hence, it would have no impact on the $1.35 million.

MR. DAMON: Thank you.

CHAIRMAN GETZ: Okay. That appears to be all for this witness. You're excused. Thank you, Mr. McCluskey. Is there any objection to striking identifications and entering exhibits as full exhibits?

MR. SHORTLIDGE: No.

CHAIRMAN GETZ: Hearing no objection, we'll enter them as full exhibits. Are there any other matters to address, before we hear closing statements?

(No verbal response)

CHAIRMAN GETZ: Okay. Hearing none, then we'll begin with Ms. Hollenberg.

MS. HOLLENBERG: Thank you. As the Commission has heard repeatedly over the last couple of weeks, the Office of Consumer Advocate is concerned about the rising costs of energy, including the rising costs of natural gas, and the impact that such high costs will undoubtedly have on residential ratepayers. However, the OCA recognizes that the circumstances contributing to these rising costs, circumstances over which the local distribution companies, like Northern, have little or no control over. High prices, high commodity prices are the reality all over the country, and indeed the world these days. In part, the OCA sees Northern's CGA for Winter 2005-2006 as reflective of this reality.

However, the OCA cannot agree with or recommend approval of Northern's recovery of capacity costs attributable to Maine transportation customers. To do so would be to agree with and recommend that New Hampshire customers continue to subsidize the Maine transportation market. To do so would be to recommend and agree with that, the imposition of unjust and unreasonable costs on New Hampshire ratepayers.

In light of Northern's position that New Hampshire customers are responsible for these costs, so long as the PR formula remains in effect, the Office of Consumer Advocate has significant concerns about any delay in this Commission's adjudication of the continued viability of the PR allocator in DG 05-080. The OCA disagrees with any suggestion that this Commission continues to stay its hand in order to allow negotiations with the parties in the Maine dockets to play themselves out. The OCA is not optimistic that these negotiations will result in any recovery of past shifted capacity costs. Also, a finding of this Commission that the PR allocator is no longer acceptable going forward does nothing more than state the obvious, and may even incent a global resolution how these costs are allocated in the future. Thank you.

CHAIRMAN GETZ: Mr. Damon.

MR. DAMON: Thank you. I'd like to address my remarks to three areas. First, I want to say a few things about the three motions for protective order that have been filed. And, I'll say those briefly. The first motion was dated September 14th, and that regarded or sought protection for certain information in the Update Model Delivery tariff. And, the Commission has traditionally granted protection for that in the past, and, certainly, that is -- to that extent the Staff has no objection.

It's a little unclear to Staff at the moment as to whether or not any that information has been filed as part of the Commission tariff. And, to that extent, I think, though, the Commission ought to be very careful about ordering the confidentiality or protective treatment for a publicly available tariff or a tariff that should be publicly available by statute.

On the second motion dated September 29th, that regarded certain information in

Northern's original filing. To the extent that that motion asked for protective treatment for information that was actually included in the filing, in the public information that was actually included in the filing, or that it seeks to protect information that has been publicly disclosed elsewhere, the Company -- the Staff would recommend that it be denied.

That motion was followed by another motion, October 19th, and that was an amended motion for protective order. And, to the extent that that motion resurrects the requests made in the September 29th motion, Staff would have the same position on that. In other words, if this information has been publicly disclosed elsewhere, the Commission, in Staff's view, ought not to be trying to protect it now. But, to the extent that the amended motion seeks to protect information in the revised filing that is not otherwise publicly disclosed, the Staff would have no objection to that.

Regarding the cost of gas filing itself, Staff has reviewed the demand and supply forecasts and recommends approval of the proposed rates, with the exception, however, of the $1.35 million of forecasted shifted costs that Mr. McCluskey has testified about. In Staff's view, the inclusion of those, of that amount, in the rates to be charged this winter would result in the Commission having to approve rates that are unjust and unreasonable, and for the reasons that Mr. McCluskey has testified to.

But, in other respects, the supply plans and the demand forecasts are consistent with those that Northern has filed in previous winter periods, and which the Commission has approved. Staff believes the supply portfolio is sufficiently diversified to provide reliable service through the winter period, and Staff notes that Northern does incorporate various tools to provide price stability. And, in addition, Staff notes that there will be, of course, a reconciliation of the actual costs.

So, Staff's recommendation would be to request Northern to file a recalculation of the rates with the removal of the $1.35 million at this time. And, that is all, you know, pending the outcome of this other docket.

CHAIRMAN GETZ: Thank you. Mr. Shortlidge.

MR. SHORTLIDGE: Thank you, Mr. Chairman. Just as an initial comment, Staff has not filed any objection with regard to the motions regarding confidentiality treatment. So, it's a little hard to respond to Staff's supposed objection at this point. Simply put, the Company is attempting to protect confidential material regarding the -- regarding the cost it pays to suppliers. We're trying to ensure that that protection is uniform between the two states. As a result, there has been an amended motion filed, to ensure that the entire -- what needs to be protected is protected, and what does not need to be protected is not protected. But, without looking at it on paper, I have a tough time commenting on Staff's comments.

Going to the substance of this case, I appreciated Staff's comments regarding Northern's supply and reliability. Northern has gone out of its way to ensure that it has capacity and supply resources to provide its customers with both reliable supply of gas and gas at a price which is not volatile. How does Northern do that? It does that by operating a unified system between Maine and New Hampshire. It does that by carefully analyzing and acquiring capacity over a long period of time for both states' operations.

That brings me to the heart of this case, which is the PR allocator. Because Northern operates a combined system, Northern has to find a means, and the states have to find a means, of allocating costs between the states.

Initially, there was an allocation formula that was used by both states. In 1995, Northern felt that we could do better. We proposed a new allocation formula, which became today's PR allocator. What we're talking about right now is whether or not that allocator should be changed unilaterally in this docket. This Commission already has a docket open, DG 05-080, to discuss those exact issues. What is being requested by the OCA and the Staff is to go one step further, and before there's been any resolution with regard to the reasonableness of the PR allocator, its continued usefulness, or what should be implemented as a modification, to prevent Northern from collecting costs which it prudently incurred.

Now, I don't have to say this, because everyone in the room knows it. Northern is a small company. Our total New Hampshire non-gas revenues are approximately $50 million. So, when we're talking about three-quarters of a million dollars, which is what Northern has agreed to defer, to not seek recover from its customers, we're talking about Northern placing a significant good faith deposit on the table to say that Northern is going to work its hardest to reach agreement with the New Hampshire parties and the Maine parties and to get this to a resolution as fast as possible.

What the Staff is asking for is for the Commission to go beyond that three-quarters of a million dollars that Northern has agreed it's been very willing to defer. They are asking for this Commission to require that Northern defer more than $2 million of recovery from customers, pending a decision on a variety of dockets. I'm not an accountant, and, unfortunately, we don't have an accountant in the room to testify to this. However, the way in which the Commission takes any action to defer cost recovery or to reserve rights regarding cost recovery can have a significant impact on a Company's ability to account for those costs. And, if it is done incorrectly, it can force the Company to take a write-off of $2 million, which would put the Company in significant jeopardy. It would also result in the Company's credit being significantly impacted. Which, in turn, affects the Company's ability to contract and receive the supply resources that we so -- that we've all discussed is needed.

With all that said, I would also say we have gone through this and we've discussed in great detail why Northern's combined system offers all its customers in both states the benefit of reliable service. There is no contract out there that says one piece of capacity should go to Maine or one piece of capacity should go to New Hampshire. If New Hampshire needs that capacity tomorrow, it will serve New Hampshire. If it's needed in Maine, it will serve Maine. And, all we're talking about is how we allocate for costs.

It's a classic contract example. You have two parties, they arrived at an agreement, actually, three parties, ten years ago. That agreement doesn't make sense anymore. You have two choices. You can either throw up your hands, walk out of the room and say "look, I'm not interested in contributing or sticking with my agreement". Or, you can work it out among the parties and say "look, we're two sovereign states both with interests in ensuring reliable gas service for our customers, and we want to reach agreement on this." Northern believes that that's what's going to occur next week. In fact, Northern is very hopeful that that's what's going to occur.

And, Northern hopes the Commission takes no action prior to that of those negotiation sessions that would impact positively, negatively, or in any way, the ability of the parties to reach an agreement. Thank you very much.

CHAIRMAN GETZ: Let me address the confidentiality issue. I think, given the timing of the objections, we would segregate the treatment of the confidentiality questions from the treatment of the cost of gas issues. If you want to respond in writing to Mr. Damon's points or discuss with Staff, we will have a separate order to deal with the confidentiality issues.

And, I want to go around the room one last time to try and get some clarity in my mind about the $659,000 issue. Basically -- the $692,000, from '04/05 Winter. In your closing and previously you've taken the position that you could have included those costs for collection in Winter '05/06. But you decided to defer recovery, but your position is that you're entitled to recovery. Is that accurate?

MR. SHORTLIDGE: That's accurate.

CHAIRMAN GETZ: And, I'd then turn to the Consumer Advocate, either Ms. Hollenberg or Mr. Traum, who is still under oath, of course. What is your position with respect to the Company's position that they could have included the $692,000 in this year's winter cost of gas and that they are entitled to recovery of those costs?

MR. TRAUM: I guess I'd say that they have voluntarily opted not to seek recovery in this winter period, so we didn't object to their not seeking recovery at this point in time.

CHAIRMAN GETZ: But what they are proposing is to defer recovery to next winter. Is your position that they're entitled to recovery of those costs next winter? Or, let me -- take the time element out of the question. Do you agree with their position that they're entitled to recovery of the $692,000?

MR. TRAUM: I would say that would be subject to the Commission's determination of the PR method through docket 080 or wherever.

CHAIRMAN GETZ: Okay. And, the same question for Staff.

MR. McCLUSKEY: I believe your question was "are they entitled to recovery?" Remember what the Company is doing. It's proposing to credit those dollars. What they could have done was not have the credit, hence the costs to be recovered in this upcoming winter would be higher by the amount of $692,000. So, they have already recovered them, and they are proposing to credit them.

If you're asking "what's our position on their proposal to credit them?" We are certainly agreeable to the insertion in the Commission's order which says that "they have the right to seek to reverse that credit at some future date".

CHAIRMAN GETZ: One last opportunity for the Petitioner.

CMSR. HARRINGTON: Could you maybe just help me out a little bit here as well, because --

MR. SHORTLIDGE: Sure.

CMSR. HARRINGTON: -- because it seems as if I thought what Mr. McCluskey said was accurate, that you collected the money last winter, and now you're seeking to credit it onto this winter's costs. But it seems like what you were agreeing to was that you were going to collect them this winter, and now you've chosen not to. So, if you could make it real clear as to which one you're actually doing?

MR. FERRO: And, I'm still under oath, too.

CHAIRMAN GETZ: Yes, you're still under oath.

MR. SHORTLIDGE: He's the expert, so I'll let him do the talking.

MR. FERRO: Mr. McCluskey is accurate, that we had projected our cost to recover last year for the '04/05 Winter, and it's estimated that $692,000 of that, those capacity costs that we recovered, is associated with this debate about the allocation between the two divisions. So, we, consistent with what we thought the $100,000 of Summer '05, which was based on a Summer '04 calculation at least, we offered up as a settlement to continue to reduce going forward the cost of gas in that manner.

What has unfolded here today, and in rebuttal testimony, is that all of a sudden we have two winters being deducted from our one cost of gas, one winter cost of gas rate. And, so, that's like a double whammy on the Company. We have the 692, and now we have an estimated 1.35. That's what we find problematic. It's a compromise or a -- a not-so-palatable of an event, just to reduce it by one winter, it hits cash flow. But to hit two winter portions of this debateable allocation of costs becomes even more problematic.

In short, we have 692, plus 1.35, or $2 million of costs being deducted from the cost of gas this winter, that suggests that we're going to fall $2 million short of our recoverable dollars.

CMSR. HARRINGTON: But the 692 is being -- was proposed as a voluntary deduction by the Company, before you realized that the 1.35 million was also going to be proposed by Staff and the OCA?

MR. FERRO: Yes. First -- And, certainly, my testimony suggests that the 692 was an offer, a settlement offer with the Staff, and, certainly, was offered without knowing that there was going to be a proposal of also deducting forecasted costs out of the same cost of gas rate.

CMSR. HARRINGTON: I think we have it straight.

MR. SHORTLIDGE: If I could just also add and point everyone's attention to Page 6 and 7 of Mr. Ferro's testimony. Where he states "The Company needs to, and is requesting through this filing, for the parties to this winter 2005-2006 COG proceeding to also enter into a similar settlement agreement to defer the Winter 2005" -- "2004-05 capacity costs of $692,273." Most importantly, "Absent such an agreement the Company would seek to remove this credit from the indirect gas costs and recover this amount in the upcoming Winter 2005-06 period."

That clearly shows that the Company was simply putting this on the table as a voluntary effort to resolve this. We are still willing to defer recovery -- or, to credit customers with that amount. We do not believe it's appropriate to then go and credit customers with an additional $1.3 million.

CHAIRMAN GETZ: All right. Thank you very much. We will close the hearing and take the matter under advisement.

(Whereupon the hearing ended at 2:12 p.m.)