

STATE OF NEW HAMPSHIRE

Inter-Department Communication

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AT (OFFICE): NHPUC

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SUBJECT: Proposed Rule Change – Puc 1604.07(t)

TO: Commissioners

Summary

Utility rates provide for the recovery of working capital requirements; the capital cost to fund the timing difference between the receipt of revenues and payment of expenses. When filing for a rate increase, Puc 1604.07(t) allows a utility to calculate the timing difference based on a detailed lead/lag study (review of revenue and expense components that create the financing requirement) or use of a formula based on the utility's billing cycle. Determining the working capital based on the billing cycle formula is inexact and for large utilities can have a substantial impact on the revenue requirements, many times the cost of performing a lead/lag study. Staff recommends a rule change to require utilities with gross revenues in excess of \$10,000,000 to file a lead/lag study when petitioning for a rate increase.

Background

Utilities are allowed to recover working capital; cash needed to support the delay in receipt of revenues relative to the payment of costs. The amount to be collected is a function of the delay which can be determined with the aid of a lead/lag study, a systematic procedure to determine the average number of days investors supply working capital to operate the utility.

Natural gas distribution and supply rates include working capital requirements based on a net lag determined through a lead/lag study filed by the utility in support of a proposed increase in delivery rates. The net lag used in determining the EnergyNorth and Northern delivery rates are 14.08 and 4.58 days, respectively. The net lag for EnergyNorth and Northern supply rates are 14.27 days and 9.25 days, respectively. The EnergyNorth and Northern lead/lag studies used in determining those lags were performed by outside consultants at a cost of \$20,738 and \$32,800, respectively.

In its current rate filing (DG 14-180), EnergyNorth has proposed delivery rates with a working capital requirement based on a net lag of 45 days. The 45 days is not based on a

lead/lag study but was calculated using a formula set forth in Puc 1604.07 Contents of Filing Requirement Schedules, section (t):

A utility shall describe on a document entitled "Schedule 3A – Working Capital", its working capital, based on a detailed lead-lag study or a formula based on the length of ½ of the utility's billing cycle plus 30 days.

EnergyNorth's use of a 45 day net lag to determine working capital, rather than the 14.08 day net lag based on the results of a lead/lag study, increases the annual revenue requirement by approximately \$320,000.

For utilities with limited resources, such as small water companies, use of the formula as a means to control rate case expenses may be appropriate. One of the components in determining the working capital requirement is a utility's annual O&M expense; therefore the working capital requirement for a small utility will be limited and may not justify the cost of a lead/lag study. For larger utilities the working capital requirement is a significant expense, well in excess of the cost to perform a lead/lag study.

Recommendation

Puc 1604.07(t) should be changed to require utilities with gross revenue in excess of \$10,000,000 to file a detailed lead/lag study when requesting a rate increase. There are currently seven New Hampshire utilities with gross revenues in excess of \$10,000,000, three of which filed a lead/lag study in the rate petition on which current rates are based.

Puc 1604.07(t) should be changed to read:

A utility shall describe on a document entitled "Schedule 3A – Working Capital", its working capital, based on a detailed lead-lag study. Utilities with gross revenues of less than \$10,000,000 may use a formula based on the length of ½ of the utility's billing cycle plus 30 days.