

DG 05-080

NORTHERN UTILITIES, INC.

Review of Reasonableness of Proportional Responsibility Formula

Order Approving Settlement Agreement Modifying Formula

ORDER NO. 24,627

June 1, 2006

APPEARANCES: Seth L. Shortlidge, Esq., of Pierce Atwood LLP, and Patricia M. French, Esq., on behalf of Northern Utilities, Inc.; Rorie E.P. Hollenberg, Esq., of the Office of Consumer Advocate, on behalf of residential utility consumers; and Edward N. Damon, Esq., for the Staff of the New Hampshire Public Utilities Commission.

I. PROCEDURAL HISTORY

On April 20, 2005, Northern Utilities, Inc. (Northern), a public utility primarily engaged in distributing natural gas to approximately 50,000 customers in the seacoast areas of New Hampshire and Maine, filed with the New Hampshire Public Utilities Commission (Commission) a petition to convene a joint proceeding with the Maine Public Utilities Commission (MPUC) for the purpose of evaluating, on a forward looking basis, the continued reasonableness of the Proportional Responsibility allocation methodology (PR Allocator) approved in 1995 by the Commission¹, and by the MPUC for allocating capacity-related gas supply costs, also known as demand costs, incurred by Northern on behalf of its New Hampshire and Maine Divisions.²

¹ In *Northern Utilities, Inc.*, Order No. 21,882, 80 NHPUC 685 (1995), the PR Allocator was described as assigning “Northern’s total annual fixed demand costs to the individual months on the basis of the peak demand for each month, and then [allocating] the resulting assigned monthly fixed demand costs to each Division, New Hampshire and Maine, on the basis of firm sendout factors.” *Id.* at 686-687.

² On the same date, Northern filed an identical petition with the MPUC, which issued a Notice of Investigation dated May 4, 2005, in MPUC Docket No. 2005-273. (The matter of the implementation and fairness of the PR Allocator to Northern’s New Hampshire customers had been brought up in two Cost of Gas (COG) adjustment proceedings filed by Northern, *see Northern Utilities, Inc.*, Order No. 24,389 (October 29, 2004) and Order No. 24,460 (April 29,

On May 31, 2005, the Commission issued an Order of Notice requiring Northern to file testimony and authorizing joint technical sessions for reviewing the operation of the PR Allocator. On June 1, 2005, the OCA filed with the Commission a notice of intent to participate. There were no other intervenors in this docket.

On July 13, 2005 Northern filed with the Commission the direct testimony of Joseph A. Ferro, Manager of Regulatory Policy, and on June 16, 2005, Northern filed a supporting schedule to his testimony. On September 19, 2005, a technical session was held at Northern's Portsmouth office to discuss the PR Allocator. In attendance were representatives from the Commission staff (Staff), MPUC staff, Northern, OCA, Maine Office of Public Advocate, the Competitive Gas Suppliers and Select Energy, Inc.³ On October 4, 11, 24⁴ and November 1, 2, 9, 17, 18 and 21 2005, the parties to this docket and the related Maine dockets held settlement sessions to discuss and resolve the issues related to the structure and operation of the PR Allocator.

On November 23, 2005, Northern filed a Stipulation and Settlement (New Hampshire Settlement) with the Commission which was executed by Northern, Staff and the OCA. Among other things, the New Hampshire Settlement provided for the establishment of a Modified PR Allocator to commence on November 1, 2005, and resolution of the allocation of certain capacity-related costs incurred by Northern prior to November 1, 2005. Attached to the New Hampshire Settlement was a Stipulation and Settlement filed with the MPUC (Maine Settlement)

2005). In addition, on February 22, 2005, Northern had filed a petition in a related MPUC proceeding, Docket No. 2005-87, which included a proposal by Northern to institute a policy of mandatory capacity assignment in Maine. The Commission and the New Hampshire Office of Consumer Advocate (OCA) had moved to participate in that proceeding.)

³ The Maine Office of Public Advocate, Competitive Gas Suppliers and Select Energy, Inc. had intervened in the related Maine dockets.

⁴ During this time period, the Commission was conducting a proceeding regarding Northern's COG adjustment filing for the 2005-2006 Winter period in Docket No. 05-147. Staff, Northern and the OCA each filed direct testimony addressing the PR Allocator, the resulting cost allocation between the New Hampshire and Maine Divisions and the recovery of those costs. On October 31, 2005, the Commission issued Order No. 24,540 approving Northern's COG rates and addressing the PR Allocator in connection with Northern's COG filing.

which mirrored, in part, the New Hampshire Settlement.⁵ The Maine Settlement was executed by Northern, the Maine Office of Public Advocate, the Competitive Gas Suppliers, Select Energy, Inc. and Houston Energy Services Company, LLC.⁶ By their terms, the effectiveness of each agreement is dependent upon the approval of the other by the relevant state commission.

On December 22, 2005, the Commission issued a secretarial letter scheduling a hearing on the New Hampshire Settlement for December 28, 2005. On December 23, 2005, Northern filed an Addendum to the New Hampshire Settlement, providing for a Re-Entry Fee to be assessed firm sales customers that switch from capacity-exempt transportation service on or after July 1, 2006.

On December 23, 2005, the MPUC issued an order approving the Maine Settlement and Addendum, with several conditions: 1) Northern's reliability reserve must be allocated to the jurisdictions through the Modified PR Allocator; 2) the reliability reserve allocation methodology will be revisited, presumably during the Integrated Resource Plan (IRP) process, to develop a long-term methodology that more closely aligns cost responsibility with cost causation; and, 3) the MPUC would have the right to create a class of capacity-exempt customers that is similar to the class that exists in New Hampshire. The MPUC stated it would issue a second part to its order to explain its reasoning for approving the Maine Settlement and Addendum. The MPUC issued its Part 2 order on April 26, 2006.

On December 28, 2005, as scheduled the Commission held the hearing on the amended New Hampshire Settlement as scheduled. On December 30, 2005, the Commission orally

⁵ On December 2, 2005, Staff and the OCA filed with the MPUC their Pre-hearing Position Statement in support of the Maine Settlement. On December 16, 2005, the MPUC held a hearing on the Maine Settlement, at which Staff testified. On December 19, 2005, in response to comments made by the MPUC at the December 16 hearing, the Maine Office of Public Advocate filed with the MPUC an addendum (Addendum) to the Maine Settlement.

⁶ The MPUC Staff opposed the provisions of the Maine Settlement regarding the PR Allocator.

deliberated the matter of the approval of the amended NH Settlement, finding that the terms of the amended New Hampshire Settlement and the first two of the three conditions imposed by the MPUC represented a reasonable accommodation of competing interests and a fair resolution of the cost allocation dispute from New Hampshire's perspective. Regarding the third condition, however, concern was expressed about the potential breadth of the language contained in the MPUC's initial order. While the Maine Commission's language could be read as prospective in application and intending to create a rate class reciprocal with New Hampshire's, it was noted that if the language is construed otherwise, New Hampshire customers could be exposed to costs that are inconsistent with the New Hampshire Settlement.

In light of the foregoing considerations, the Commission orally approved the amended New Hampshire Settlement so long as the class of capacity-exempt Maine transportation customers created in Maine extends only to customers that elect firm transportation service on or after November 1, 2005, who were not previously firm sales service customers of Northern.

On January 5, 2006, the Maine Commissioner confirmed that establishing the third condition to its approval of the Maine Settlement was consistent with what the Commission "stated it would find agreeable, i.e. that membership in this class be limited to new transportation customers, starting 11/1/05, that never have been sales customers or were interruptible sales customers."

On February 8, 2006, Northern filed with the Commission certain tariff revisions to its Delivery Service Terms and Conditions, with an effective date of January 1, 2006, pursuant to the Commission's approval of the amended New Hampshire Settlement in Docket No. DG 05-080, *Review of Reasonableness of Proportional Responsibility Formula*, granted orally on December 30, 2005.

On February 24, 2006, Northern filed with the Commission a proposed Re-Entry Fee Bill Adjustment tariff sheet. On March 3, 2006, Northern filed with the Commission a proposed Capacity Reserve Charge rate adjustment tariff sheet, which was docketed separately in Docket No. DG 06-033. On March 17, 2006, Northern filed with the Commission revised Cost of Gas (COG) Clause tariff pages and, on April 12, 2006, Northern filed with the Commission further revised COG Clause tariff pages, all of which were docketed separately in Docket No. DG 06-038. On April 13, 2006, based on discussions with Staff regarding the revisions to the Delivery Service Terms and Conditions previously filed on February 8, 2006, Northern filed with the Commission modifications to the revised Delivery Service Terms and Conditions.

On April 26, 2006, the MPUC issued its Part 2 order, setting forth a full statement of its findings of fact and providing a more extensive discussion of the reasons for its Part 1 order. *See Northern Utilities, Inc.*, Part 2 Order in MPUC Docket Nos. 2005-87 and 2005-273. In accordance with the Commission's understanding of the third condition set forth in the MPUC's Part 1 order, the MPUC confirmed that it was the MPUC's intent that the third condition apply only to transportation customers who have become customers of Northern on or after November 1, 2005.

Regarding the second condition set forth in its Part 1 order, the MPUC stated it had conceptual problems with (1) how the amount of the capacity reserve is determined under the Maine and New Hampshire Settlements and (2) how the costs of the reserve are allocated between the Divisions. *See Northern Utilities, Inc.*, MPUC Part 2 Order, slip op. at 8. Regarding the first point, the MPUC found that if in the future Maine and New Hampshire were to have no capacity-exempt load, the 30 percent capacity reserve provision would dictate there be no reserve, which "overlooks the . . . need [asserted by Northern] to have some back-up for the

non-capacity-exempt transportation load and the sales load.” Regarding the second point, the MPUC indicated that one category of load appears to be driving the need for the reserve (*i.e.*, the capacity-exempt load) while capacity-assigned load (*i.e.*, the non-capacity-exempt transportation load and sales load) pays the associated costs. According to the MPUC, if Maine were to have all capacity-exempt load and New Hampshire all capacity-assigned load, “Maine customers would be responsible for causing the reserves under the 30% formula and New Hampshire customers for paying for them.” Although the MPUC expressed doubt as to whether the approach to the capacity reserve is appropriate in the long term, the MPUC stated that it was prepared to accept this aspect of the Maine Settlement given testimony from the parties confirming that the Maine and New Hampshire Settlements actually produce adequate back-up capacity and a fair allocation of costs.

On May 17, 2006, Northern filed revised COG Clause tariff pages to comply with Order No. 24,615 (April 28, 2006), approving Northern’s Summer Season COG rates. On May 19, 2006, Northern filed with the Commission further revisions to its Delivery Service Terms and Conditions. Included in this filing was a complete copy of Northern’s revised Delivery Service Terms and Conditions. On May 23, 2006, Commission Staff filed a memorandum with the Commission recommending Commission approval of the above-referenced tariff changes.

II. AMENDED NEW HAMPSHIRE SETTLEMENT

The amended New Hampshire Settlement is submitted to resolve issues related to several dockets (DG 05-080, DG 05-047, DG 05-147, DG 04-162, and DG 04-035). Review and approval of sections A through E of the Maine Settlement by the MPUC is a condition precedent to the New Hampshire Settlement and if the MPUC were to reject or modify any of these provisions, any Party or Staff may terminate the NH Settlement. The substantive terms of the

amended New Hampshire Settlement are described below:

A. Modified PR Allocator

1. Effective November 1, 2005, allocation of capacity-related costs between the Maine and New Hampshire Divisions shall be determined by the Modified PR Allocator, set forth below.
2. (a) The firm SENDOUT volumes in the Modified PR Allocator for the Maine Division shall be the aggregate of the Maine Division's total firm sales and fifty percent (50%) of the Maine Division's total transportation load. (b) The firm SENDOUT volumes for the New Hampshire Division shall be the aggregate of the New Hampshire Division's total firm sales and one hundred percent (100%) of the New Hampshire Division's capacity assigned transportation load. (c) The SENDOUT volumes for both Divisions shall be calculated using actual load data, adjusted for design-weather conditions, for the twelve month period ending six months prior to November 1 of the applicable year.
3. The Modified PR Allocator operates so that one hundred percent (100%) of Northern's prudently-incurred capacity-related costs are recovered and that all capacity release revenues and other capacity credits are reconciled.
4. Capacity assignment revenues paid by transportation customers in either Division shall remain in the Division in which they were generated and used to offset allocated capacity-related costs. The aggregate of capacity release revenues and all other capacity credits shall be allocated between the Maine and New Hampshire Divisions according to the Modified PR Allocator.
5. The Parties acknowledge that the certainty in market structure provided by the New Hampshire Settlement may provide Northern with new opportunities to maximize capacity release revenues. As a result, Northern has forecasted that it may be able to achieve up to \$1 million in capacity release revenues during the period November 1, 2005 – October 31, 2006, and that this amount will reduce the capacity-related costs for both Divisions. Northern will report to the Commission regarding its progress in meeting this goal as part of the 2006 IRP described below.

B. Allocation of Capacity Related Costs (5/1/2004–10/31/2005)

6. Northern shall credit the New Hampshire Division with \$700,000 in order to resolve all claims associated with the allocation of capacity-related costs under the PR Allocator prior to November 1, 2005. The credit will become effective immediately upon approval of the New Hampshire Settlement by the Commission and the Maine Settlement by the MPUC.

7. The \$700,000 credit shall be financed as follows: (a) Northern shall recover \$400,000, plus carrying costs, through a three-year reconciling surcharge assessed to Northern's Maine Division transportation customers. (b) Northern shall recover \$100,000 from Northern's Maine Division firm sales customers. (c) Northern will forego recovery of \$200,000 of deferred costs from Northern's New Hampshire Division.
8. The Parties and Staff agree that these provisions resolve all claims that have been or may be asserted related to past, present and future allocation, recovery and reconciliation of capacity-related costs and revenues between Northern's Maine and New Hampshire Divisions for any period prior to November 1, 2005.

C. System-wide Resource Planning and Reliability Reserve

9. Northern shall retain system-wide reserve capacity equal to 30percent of its total unassigned capacity (i.e., capacity-exempt) transportation load in its Maine and New Hampshire Divisions. For 2005-2006, the reserve equates to approximately five percent of system-wide design day demand. The establishment of a reserve capacity shall not be interpreted to constitute a supplier of last resort obligation on Northern's part for capacity-exempt customers.
10. For purposes of determining the reserve capacity, Maine Division unassigned capacity (i.e., capacity-exempt) transportation load shall equal 50 percent of the Maine Division total design day transportation load. The New Hampshire Division unassigned capacity (i.e., capacity-exempt) transportation load shall equal the New Hampshire Division grandfathered transportation load.
11. The Staff and the OCA recommend that the New Hampshire Division's share of the cost to maintain the reserve shall be recovered from non-capacity assigned customers.

D. Integrated Resource Plan Review

12. Northern shall prepare an IRP once every three years.
13. Northern's initial IRP shall be prepared and submitted to the Commission and the MPUC no later than June 30, 2006, in accordance with each Commission's applicable procedural rules.
14. Marketers on Northern's system will be notified as to the filing of its IRP.

15. The purpose of the IRP will be to keep the Commission and the MPUC informed of Northern's forward-looking system planning processes and plans. The Commission may provide a hearing process to review the IRP and may provide such advice or consent as is, in its discretion, deemed proper.
16. As part of its first IRP, Northern will present an integrated capacity plan to meet its supply obligations, consistent with the New Hampshire Settlement and the Maine Settlement, and explain the process for further or additional contracting or de-contracting of capacity resources to meet the terms of the New Hampshire Settlement.
17. The Parties and Staff recognize that the Commission may consider the level of the reliability reserve as part of the IRP review process. Should the Commission make determinations with regard to the size or structure of such reserve, the Parties and Staff agree that such determinations shall not take effect until the earlier of: 1) approval of equivalent modifications by the MPUC; or 2) the expiration of a nine (9) month period following the date of the order during which the Commission and the MPUC shall conduct joint proceedings for the purpose of coordinating consistent policies regarding the proposed modifications to the size and structure of the reserve.

E. In General

18. The New Hampshire Settlement represents the full agreement between all the Parties and Staff, and rejection by the Commission of any part of the New Hampshire Settlement constitutes a rejection of the whole.
19. The New Hampshire Settlement shall not be considered legal precedent, nor shall it preclude a party from raising any issues in any future proceeding or investigation on similar matters subsequent to this proceeding.
20. Nothing in the New Hampshire Settlement agreement is intended to restrict the Commission's jurisdiction to assign costs to customers allocated to the New Hampshire Division by the Modified PR Allocator or to set rates within the State of New Hampshire.
21. The New Hampshire Settlement may be amended or modified only in a writing signed by each of the Parties and Staff.

F. Addendum to NH Settlement

A Re-Entry Fee shall be assessed when a transportation customer, who is exempt from capacity assignment for all or a portion of its peak day requirement,⁷ requests firm sales service from Northern. Such a customer will be liable for payment of a 25 percent premium each month above Northern's monthly average cost of capacity of the current gas year (November through October) at the time the customer is accepted back to sales service. The 25 percent component of the monthly average cost of capacity will be applied, over the next twelve months, to the portion of that customer's peak day requirement that was exempt from capacity assignment under prior transportation service. The provision for the Re-Entry Fee will become effective on July 1, 2006 and will be assessed beginning with the customer's first billing month under firm sales service. All revenue generated by payments of Re-Entry Fees will flow through the Modified PR Allocator to be allocated between the Maine and New Hampshire divisions of Northern, just as Northern's capacity costs are allocated between the two Divisions.

III. POSITIONS OF THE PARTIES AND STAFF

A. Northern

Northern has discussed the adverse impacts on New Hampshire customers of the operation of the PR Allocator in other dockets, as indicated by the following summary in *Northern Utilities, Inc.*, Order No. 24,540 in Docket No. DG 05-147 (October 31, 2005), slip op. at 8-9:⁸

Mr. Ferro stated that after the Commission Staff and the OCA had raised with Northern New Hampshire's increasing allocation of capacity costs, it became apparent to Northern that there has been an inequitable allocation of costs to New Hampshire customers caused by the high levels of switching in Maine (compared to the situation in New Hampshire), which itself was attributed to the lack of capacity assignment in Maine. Recognizing the bias in the approved allocation methodology, Mr. Ferro testified that the cost allocation methodology "could be, and soon should be, modified to recognize capacity quantities

⁷ Under the current Delivery Service Terms and Conditions for each respective Division, the portion of firm peak day requirement that can be capacity exempt for a New Hampshire customer is 100% of such requirement, while for a Maine customer it is 50% of such requirement.

⁸ This information is properly part of the record in this docket in light of Staff's unopposed suggestion that the Commission take administrative notice of the related New Hampshire dockets as appropriate to reach a decision in this docket.

and associated sendout to certain Maine transportation load, so that the operation of the allocation process results in a fair assignment of costs between the two divisions.”⁹

Northern witnesses, Daniel P. Yardley of Yardley & Associates and Ronald D. Gibbons, Lead Regulatory Analyst of NiSource, Inc., testified at the hearing in support of the amended New Hampshire Settlement. Regarding the proposed Modified PR Allocator, Mr. Yardley explained that the Allocator looks at the cost responsibility of each Division and matches the allocation of the total costs to the responsibility of each Division. He stated that capacity-related costs are allocated based on the total firm sales load in each Division plus the transportation load that is assigned capacity and that revenues received from competitive suppliers for the capacity actually used by them are credited within each Division. Mr. Yardley indicated that the benefit of the Modified PR Allocator going forward is that Maine will for the first time bear the share of the capacity-related costs equal to the ratio of capacity costs assigned to them to total capacity costs.

Regarding the provision under which Northern credits the New Hampshire Division with \$700,000, Mr. Yardley noted that the Commission had set aside the question of final recovery from New Hampshire ratepayers of approximately \$900,000 in Northern’s capacity-related costs incurred beginning May 1, 2004.¹⁰ Of the \$900,000, \$500,000 will be recovered from Maine

⁹ Capacity assignment refers to the transfer of a portion of a utility’s pipeline, underground storage and peaking capacity rights and obligations to the suppliers of customers that switch from firm sales to firm transportation service. The capacity rights allow switching customers to increase the “firmness” of their third party gas purchases, subject to the utility’s right to recall the transferred capacity in the event of supplier failure. The capacity obligations require switching customers to pay the charges embedded in the underlying capacity contracts. *See* Exhibit 9i at 16. Capacity assignment is said to be mandatory when required by the regulator. New Hampshire’s policy since 2001 has been 100% mandatory capacity assignment. Maine did not have mandatory capacity assignment before the Maine Settlement; under it, beginning December 1, 2005, Northern will assign marketers serving Maine Division transportation customers Northern’s winter period underground storage and peaking capacity and associated supply equal to 50% of each customer’s total design day load.

¹⁰ This is separate from the approximately \$1.35 million in costs which the Commission directed Northern to exclude from recovery in connection with the 2005/2006 Winter period. *See Northern Utilities, Inc.*, Order 24,540 (October 31, 2005), slip op. at 16.

ratepayers and \$200,000 will be absorbed by Northern, with the balance recovered from New Hampshire ratepayers.

Mr. Yardley explained that under the New Hampshire and Maine Settlements, Northern would maintain a system-wide capacity reserve equal to 30 percent of its total unassigned capacity transportation load in its Maine and New Hampshire Divisions, which equates to approximately 5 percent of system-wide demand for 2005-2006. According to Mr. Yardley, the purpose of the reserve is to deal with the risk of upstream disruptions in delivery of Northern's gas supplies and failure of a competitive supplier to supply gas to end users. He stated that in Northern's view the reserve provides an important cushion but one that, balancing the cost and need for the reserve, does not cost an excessive amount.

The cost of maintaining the reserve (which will be allocated to the New Hampshire and Maine Divisions through the Modified PR Allocator) is estimated to be approximately \$1.4 million in 2005-2006, of which New Hampshire's share is estimated to be \$675,000. However, because the capacity for this reserve is currently available, Mr. Yardley noted that Northern has no need to enter into new capacity contracts at this time to provide for this reserve. Mr. Yardley indicated that the cost of the capacity reserve should be recovered from a broader group than its grandfathered customers because sales customers and capacity-assigned transportation customers benefit from the increased reliability that results from carrying such a reserve and because the capacity reserve maintains the competitiveness of natural gas service.

Mr. Yardley also testified that the New Hampshire Settlement provides for Northern to file an IRP every three years that will include a description of Northern's capacity planning process. In addition, the IRP will identify Northern's options regarding the acquisition of new

resources or the de-contracting of existing resources. The first IRP filing, scheduled for June 30, 2006, will also address the level and purpose of the proposed capacity reserve.

Regarding the proposed Re-Entry Fee, Mr. Yardley explained that in New Hampshire the Fee would apply only to transportation customers that are fully capacity-exempt and switch to firm sales service on or after July 1, 2006. The Fee will be levied monthly and will equal 25% of Northern's average cost of capacity for the month, to be charged over the subsequent 12 months. The purpose of the Re-Entry Fee is to compensate non-capacity-exempt customers for carrying capacity that is subsequently used to serve capacity-exempt customers who convert to firm sales service, according to Mr. Yardley.

Mr. Yardley indicated that the Re-Entry Fee is designed to address an inequity, namely, a transportation customer which has not had capacity assigned to it and, therefore, has not had to pay Northern's capacity costs has received a free benefit by having Northern back up its load. In his view, the Re-Entry Fee is a premium a capacity-exempt customer must pay to compensate all the remaining customers on Northern's system for holding capacity for its benefit. By contrast, he stated that the capacity reserve satisfies Northern's operational need to plan for potential disruptions of supplies to capacity-exempt transportation customers or to all other firm customers.

The first two conditions set forth in the MPUC's December 23, 2005 order approving the Maine Settlement were acceptable to Northern. Mr. Yardley also indicated that the third condition is satisfactory provided that it is limited to brand new customers and interruptible customers, either of which become firm transportation customers without having been firm sales customers. Northern stated it would be acceptable for the Commission to issue an order

conditioning its approval of the New Hampshire Settlement on an understanding which clarifies the third condition consistent with Staff's testimony.

B. OCA

The OCA's position regarding the reasonableness of the PR Allocator was presented by Mr. Traum in testimony submitted in Docket No. 05-147. His testimony was summarized in *Northern Utilities, Inc.*, Order 24,540 (October 31, 2005), slip op. at 11-12.

Mr. Traum stated that since the PR Allocator was approved by the Commission and the MPUC in 1995, transportation (i.e., customer choice) has developed differently in each State. In 2000, New Hampshire adopted a requirement of 100 percent mandatory capacity assignment for sales customers who migrated to transportation service while Maine did not. Mr. Traum stated that many Maine customers who migrated took advantage of the lack of mandatory capacity assignment, as a result of which the PR Allocator is no longer equitable to Northern's New Hampshire customers.

In summary, Mr. Traum stated that the OCA strongly supports the amended New Hampshire Settlement because it assigns costs to the cost causers. He noted that it relieves New Hampshire ratepayers of significant costs and acts to create additional value which helps Maine firm sales customers at the same time.

C. Staff

Staff's position regarding the reasonableness of the PR Allocator was presented by Mr. McCluskey in testimony submitted in Docket No. 05-147. As summarized in *Northern Utilities, Inc.*, Order 24,540 (October 31, 2005), slip op. at 13-14, that testimony states, in relevant part, that:

.....when the MPUC authorized all C&I customers to switch from firm sales to transportation service, effective November 1, 1999, it did not require those customers to

pay the fixed capacity costs incurred by Northern to serve those customers. According to Staff, the decision not to require switching customers to pay their fair share of fixed capacity costs has encouraged significant numbers of firm sales customers in Maine to switch to transportation, which in turn has led to shifting costs to the New Hampshire Division.

Mr. McCluskey stated that New Hampshire's share of the total fixed capacity costs has risen from approximately 47% just prior to the adoption of the MPUC's expanded transportation policy in 1999 to 57% for the twelve-month period ending April 2006, resulting in a \$1.35 million cost shift in just the 2005/2006 Winter period alone. . . .

Mr. McCluskey averred that, in his view, the PR methodology no longer achieves the goal of an equitable allocation of capacity costs. Mr. McCluskey pointed out that Northern recognizes that fact, as evidenced by Northern's testimony in Maine Docket No. 2005-480. In that proceeding, according to Mr. Ferro, discussions had taken place in Docket No. 2005-087 on the continued reasonableness of the PR Methodology, prompted by 'the increasing awareness of the parties that the New Hampshire Division allocation factors were increasing due to declining Maine Division firm sales load.'

In this proceeding, Mr. McCluskey explained that the Modified PR Allocator included in the New Hampshire Settlement will take into account, for the first time, a portion of Maine's transportation load when determining each Division's cost responsibility. As a result of that change, he expects New Hampshire's share of capacity costs in 2005-2006 to fall from 57 percent under the existing PR Allocator to about 48 percent under the Modified PR Allocator, a savings of approximately \$2.5 million. Mr. McCluskey also noted that this annual saving plus the \$700,000 credited to New Hampshire for the historic period May 2004 through October 2005 far exceeds the \$200,000 of historic costs that New Hampshire agreed to absorb in order to reach settlement.

Regarding the proposed capacity reserve, Mr. McCluskey noted that the amended New Hampshire Settlement does not require a decision on how the costs of the reserve should be collected from New Hampshire customers. According to Mr. McCluskey, that issue should be addressed after Northern has filed a revised tariff to collect New Hampshire's share of reserve costs together with arguments supporting its preferred cost recovery method. At that time, Staff

would explain why it believes recovery from capacity-exempt transportation customers only is appropriate.

On the issue of the Re-Entry Fee, Mr. McCluskey contended that it is not double counting to charge capacity-exempt customers that return to sales service a Re-Entry Fee while at the same time collecting the cost of the capacity reserve from the same class inasmuch as the Re-Entry Fee is intended to address the situation where a capacity-exempt customer returns to firm sales service on a permanent or semi-permanent basis. Collection of the reserve cost, however, is intended to address potential unauthorized and temporary use of system gas.

Regarding the MPUC condition creating Maine's right to establish a capacity-exempt class of Maine transportation customers, Mr. McCluskey stated that it could be interpreted to include customers that were either new load customers or interruptible sales customers many years ago. If so, that would be inconsistent with the understanding expressed by Staff and Northern when questioned on this issue by the Maine Commissioners during the hearing on the Maine Settlement. Mr. McCluskey also testified that such an interpretation could adversely impact New Hampshire's allocated share under the Modified PR Allocator. In order to avoid this outcome, Mr. McCluskey stated that the capacity-exempt class in Maine should be limited to new load or interruptible sales customers that elect transportation on a going forward basis.

IV. COMMISSION ANALYSIS

Based on the testimony of Northern, OCA and Staff, it is reasonable to conclude that with the introduction of transportation service in Maine and New Hampshire and the adoption of different policies on the recovery of costs incurred to serve transportation customers in each Division, the PR Allocator no longer produces a fair and reasonable allocation of the capacity-related costs. There has been no dispute that the PR Allocator as implemented by Northern fails

to recognize that Northern incurs capacity costs to backstop transportation customers in Maine. As a result, Maine has been allocated too little and New Hampshire too much of the common capacity-related costs. Accordingly, we find that the capacity costs that Northern seeks to recover from New Hampshire customers through its COG filings are no longer the result of a cost allocation methodology that is based on sound cost causation principles. Moreover, because the extent of the cost shift is now significant, as demonstrated by the change in New Hampshire's annual allocation factor over the past several years,¹¹ we find that the PR Allocator no longer achieves the "just and reasonable" ratemaking standard required under RSA 378:7.

The primary purpose of the amended New Hampshire Settlement is to establish a cost allocation method to replace the discredited PR Allocator. A change in the formula for allocating fixed capacity costs impacts the costs assigned to each State and, unless both commissions agree to a common allocation methodology, could result in Northern being unable to fully recover its costs. The Maine Settlement, combined with the Addendum and the conditions imposed by the MPUC, resolve the capacity cost allocation issue as well as other ancillary issues to the satisfaction of the signatories of the Maine Settlement and the MPUC. We find the amended New Hampshire Settlement to be fair and in the public interest, for the reasons discussed below.

The primary issue resolved in the amended New Hampshire Settlement is the allocation of capacity costs, both historical and prospective. Northern argued in its 2005/2006 Winter period COG proceeding that those costs, which were incurred for the benefit of both New Hampshire and Maine customers, have been lawfully allocated between the Divisions under the PR Allocator approved by both Commissions in 1995.

¹¹ See Exhibit 7 at 7-8.

Since the issue of the reasonableness of the PR Allocator was first raised, Northern has either deferred or recovered an estimated \$900,000 of capacity-related costs from New Hampshire customers allegedly incurred for the benefit of Maine transportation customers. The amended New Hampshire Settlement resolves that issue by crediting New Hampshire customers with \$700,000, to be financed by Maine customers and Northern stockholders. While New Hampshire customers must absorb the remaining \$200,000, we find that this payment constitutes a reasonable accommodation of the dispute over application of the PR Allocator prior to November 1, 2005. The record shows that under the Modified PR Allocator, costs will be allocated to the Maine Division based not just on the loads of firm sales customers but also on fifty percent of the loads of transportation customers. This is appropriate because Northern is obligated under the Maine Settlement to have on hand sufficient capacity to serve fifty percent of the peak load of Maine transportation customers.

While the percentage of fixed capacity costs assigned to the New Hampshire Division will fluctuate from year to year, Staff estimates that New Hampshire's allocated share under the Modified PR Allocator will be substantially reduced compared to the levels experienced in recent years. In 2005-2006 alone, this will reduce New Hampshire's allocated capacity cost by about \$2.5 million. Similar savings can be anticipated in future years provided relative sales and transportation loads do not change dramatically.

The amended New Hampshire and Maine Settlements establish a capacity reserve equal to thirty percent of Northern's total capacity-exempt transportation load. The parties agree that the reserve will protect firm sales customers and non-capacity-exempt transportation customers from the risks of third party supply disruptions to capacity-exempt transportation customers. Northern also argues that firm sales customers and non-capacity-exempt transportation

customers would benefit from the reserve if Northern's pipeline or storage supplies are curtailed. We find that the proposal to create a capacity reserve is in the public interest because it addresses a reliability concern related to potential third party supply disruptions to capacity-exempt transportation load, which in turn is likely to negatively impact reliability to all other customers.

Staff and the OCA have stated that the cost of the reserve should be borne solely by the capacity-exempt customers, whereas Northern believes all firm customers stand to benefit from the reserve and therefore all customers should share in the cost. Northern stated its intent to make a tariff filing when and if the capacity reserve is approved by the Commission and the MPUC. How the cost of the reserve will be recovered will be addressed in Docket No. DG 06-033.

As part of the amended New Hampshire and Maine Settlements, Northern will file an IRP on or before June 30, 2006, and every third year thereafter. The IRP will contain a description of Northern's gas supply and capacity planning, including decisions it expects to make with respect to acquiring incremental resources or renewing or de-contracting resources. The IRP process will also provide an opportunity for the Commission and MPUC to jointly review the level and cost of the capacity reserve and, if appropriate, eliminate the reserve altogether. We find this proposal to be reasonable.

The Addendum filed with the Commission establishes a Re-Entry Fee applicable to a capacity-exempt transportation customer switching to firm sales service on or after July 1, 2006. While the Re-Entry Fee does not ensure that a capacity-exempt customer will be able to return to firm sales service (if, for example, there is insufficient capacity to serve them), that customer will pay a monthly premium for a period of one year in the event such a customer is provided firm sales service. The revenues generated from this Fee will be allocated between the Divisions

based on the Modified PR Allocator. The Re-Entry Fee is intended to compensate firm sales and non-capacity-exempt transportation customers that had been paying for capacity which Northern would use to serve the capacity-exempt customers electing to return to firm sales service. Or, in the event Northern acquires additional capacity to serve those customers and the incremental capacity is more expensive than the system average capacity cost, the Re-Entry Fee would serve to offset that additional cost. The Re-Entry Fee is appropriate because it addresses an existing subsidy enjoyed by capacity-exempt customers. Capacity-exempt customers have a six-month grace period, until July 2006, in which to switch to firm sales service without incurring the Re-Entry Fee. We note that New Hampshire's capacity-exempt customers were provided notice of the proposed Re-Entry Fee prior to the hearing but did not respond to the notice or participate in the hearing.

The MPUC conditioned its approval of the amended Maine Settlement on, among other things, its right to create a group of capacity-exempt customers similar to the class that exists in New Hampshire. Specifically, a new customer that had not previously received firm sales service or an interruptible sales customer that switched directly to transportation service could be classified as capacity-exempt. We find the condition to be reasonable and acceptable so long as the class of capacity-exempt transportation customers created in Maine extends only to customers that elect firm transportation service on or after November 1, 2005, and which were not previously firm sales service customers of Northern. This would limit the class in Maine in the same way that the class of capacity-exempt customers is limited on a going forward basis in New Hampshire. Because such customers are classified as capacity-exempt in New Hampshire, the condition avoids placing Maine at a competitive disadvantage when seeking to attract new business. This result is consistent with the understanding of Staff and Northern regarding the

change to the Maine Settlement consented to during the MPUC's hearing. We also understand that this result is acceptable to the MPUC. The other two conditions imposed by the MPUC in the first part of its order represent a reasonable accommodation of competing interests and promote a fair resolution of the cost allocation dispute from New Hampshire's perspective.

The amended New Hampshire Settlement expressly provides that it is not intended to "restrict the Commission's jurisdiction to assign costs to customers allocated to the New Hampshire Division by the Modified PR Allocator or to set rates within the State of New Hampshire." Accordingly, New Hampshire retains its traditional ratemaking authority under the NH Settlement. In addition, the amended New Hampshire Settlement does not by its terms bar the Commission from modifying New Hampshire's transportation policies in the future should it choose to do so in the exercise of its discretion.¹²

Based on Staff's memorandum filed on May 23, 2006, we will accept Northern's proposals for revising its Delivery Service Terms and Conditions and its COG Clause tariff provisions in order to comply with and implement our approval of the New Hampshire Settlement on December 31, 2006.

In closing, we note from past experience the importance of good communication regarding events that may affect the operation of the Modified PR Allocator. As these events are expected to be within Northern's knowledge or to become known to Northern soon after they occur, we require Northern to keep the Commission informed on an on-going basis regarding any and all future changes to its implementation of the Modified PR Allocator and any future

¹² We note that in testifying before the MPUC on December 16, 2005, Staff indicated to the MPUC that it is possible that the Commission may revisit its transportation policy in the future. Exhibit 10 at 32-33. Similarly, we do not understand that the MPUC would be barred by the amended Maine Settlement from modifying Maine's transportation policies.

changes in sales and transportation volumes in the two States that could materially affect the costs allocated to New Hampshire under the Modified PR Allocator.

Based upon the foregoing, it is hereby

ORDERED, that the amended New Hampshire Settlement Agreement entered into by Northern, OCA and Staff is **APPROVED** subject to the limitations set forth above regarding Maine's right to create a capacity-exempt class; and it is

FURTHER ORDERED, that Northern keep the Commission informed on an on-going basis regarding any and all future changes to its implementation of the Modified PR Allocator and any future changes in sales and transportation volumes in the Maine and New Hampshire that could materially affect the capacity-related costs allocated to New Hampshire under the Modified PR Allocator.

By order of the Public Utilities Commission of New Hampshire this first day of June, 2006.

Thomas B. Getz
Chairman

Graham J. Morrison
Commissioner

Clifton C. Below
Commissioner

Attested by:

Debra A. Howland
Executive Director & Secretary