

**STATE OF NEW HAMPSHIRE
PUBLIC UTILITIES COMMISSION**

DG 06-122

**ENERGYNORTH NATURAL GAS, INC. d/b/a
KEYSPAN ENERGY DELIVERY NEW ENGLAND**

Petition to Consolidate and Increase Short Term Debt Limits

Order Approving Settlement Agreement

ORDER NO. 24,824

February 29, 2008

APPEARANCES: Steven V. Camerino, Esq., of McLane, Graf, Raulerson, and Middleton, and Thomas P. O'Neill, Esq., Senior Counsel, on behalf of EnergyNorth Natural Gas, Inc. d/b/a KeySpan Energy Delivery New England; Meredith A. Hatfield, Esq., of the Office of the Consumer Advocate, on behalf of residential utility ratepayers; and Edward N. Damon, Esq. for the Staff of the New Hampshire Public Utilities Commission.

I. PROCEDURAL HISTORY

On September 1, 2006, EnergyNorth Natural Gas, Inc. d/b/a KeySpan Energy Delivery New England (EnergyNorth) filed a petition to consolidate and increase its short term debt limits. The petition stated that, as a result of Audit Staff's questions, the Company had become aware that its current level of short term debt exceeded the levels authorized by the Commission in *EnergyNorth Natural Gas, Inc.*, Order No. 23,593 (December 1, 2000), where the Commission authorized EnergyNorth to borrow up to \$15.5 million for fuel inventory purposes and \$21 million for other short term purposes. EnergyNorth requested authority to consolidate its existing short term debt limits and increase the aggregate level of the short term debt limit to \$125 million, the same limit previously established by the federal Securities and Exchange Commission (SEC). EnergyNorth recited several reasons for the higher level of short term borrowing, including increases in natural gas commodity prices and resulting higher working

capital needs and level of uncollectible accounts, decreases to its rate of return on invested capital and resulting reductions to the internally generated funds available to finance its ongoing operations, and utilization of short term debt to pay off substantially higher cost long term debt.

On May 2, 2007, the Commission issued an order of notice. On May 23, 2007, the Office of Consumer Advocate (OCA) entered an appearance on behalf of residential ratepayers pursuant to RSA 363:28. On June 7, 2007, a pre-hearing conference was held at the Commission and, on August 10, 2007, Staff filed a letter with a proposed procedural schedule and certain information requested by the Commission regarding EnergyNorth's capital structure. By secretarial letter dated August 23, 2007, the Commission approved the proposed procedural schedule.

On October 15, 2007, Staff requested a suspension of the procedural schedule, which the Commission granted by secretarial letter dated October 23, 2007. On January 4, 2008, Staff requested a delay in the hearing date to allow time for final negotiations and execution of a settlement. The Commission approved Staff's request in a secretarial letter dated January 14, 2008. On January 18, 2008, Staff filed a settlement agreement executed by EnergyNorth, OCA and Staff, with a request that the Commission accept it on a late-filed basis. A hearing on the settlement agreement was held as scheduled on January 22, 2008. As indicated at hearing, EnergyNorth submitted a late-filed exhibit on January 25, 2008.

II. SETTLEMENT AGREEMENT

The settlement agreement provides that, in order to address concerns raised by Staff and the OCA regarding the risk of higher debt costs associated with substantially increased levels of short term debt, EnergyNorth be authorized to borrow \$80,000,000 from KeySpan Corporation on a long-term basis. The loan would have a maturity date of April 1, 2035 and an interest rate of

5.803 percent, with the entire principal balance due at maturity. Further, EnergyNorth's short-term debt limits would be adjusted as follows:

A. For fuel financing purposes, EnergyNorth's short-term debt limit will be reestablished annually at a level equal to 30 percent of its total gas costs (i.e., the total of its direct and indirect gas costs) projected for the winter period. The short-term borrowing limit for fuel financing purposes would be set as part of EnergyNorth's winter period cost of gas filing each year, and would be in effect during the subsequent twelve-month period beginning November 1 and ending October 31. For the period through October 31, 2008, EnergyNorth's short-term debt limit for fuel financing purposes would be \$34,000,000.

B. EnergyNorth's short-term debt limit for purposes other than fuel financing will be reestablished annually at a level equal to 20 percent of its forecasted net plant for the next calendar year. The short-term debt limit for such purposes would be set as part of EnergyNorth's winter period cost of gas filing each year, would be based on the projected net plant for the end of the calendar year immediately following such filing (e.g, the level for November 1, 2008 to October 31, 2009 would be based on the projected net plant as of December 31, 2009), and would be in effect during the twelve-month period from November 1 through October 31 following such filing. For the period through October 31, 2008, EnergyNorth's short term debt level for purposes other than fuel financing would be \$41,000,000.

C. The establishment of these short term limits would not limit the right of EnergyNorth, Staff or any party to seek a modification of such limits in the future in accordance with applicable Commission procedures.

The settlement agreement states that one factor, among others, that contributed to EnergyNorth's high level of short-term debt for non-fuel purposes was its decision in 2004 to

redeem certain debt instruments associated with four longterm borrowings (referred to as the Redeemed Long Term Debt) that were outstanding at the time of KeySpan Corporation's acquisition of EnergyNorth. Under the settlement agreement, the call premiums associated with the repayment of the Redeemed Long Term Debt¹ would be included in EnergyNorth's cost of service for purposes of establishing rates. The call premiums would be amortized over a 30-year period beginning April 1, 2005. EnergyNorth would not earn a return on the unamortized portion of the call premiums.

For purposes of the base rate case filing contemplated by the settlement in Docket No. DG 06-107, in which the Commission approved the acquisition of EnergyNorth by National Grid plc, EnergyNorth's historical cost of debt would be adjusted on a pro forma basis to reflect the refinancing proposed by this settlement agreement.²

As the agreed-upon remedy for EnergyNorth's violation of Order No. 23,593 by exceeding its short-term debt limit, EnergyNorth would, in its winter period 2008-09 cost of gas filing, apply a credit of \$250,000 as a reduction to the costs collected by EnergyNorth for its residential low income assistance program through the local distribution adjustment charge. No portion of the \$250,000 or any attorney fees or other costs incurred in connection with the short term debt limit investigation and the settlement agreement would be considered by the Commission in fixing the rates or charges of EnergyNorth, except as expressly set forth above.

¹ At hearing, Staff indicated that certain unamortized issuance expenses are included in the calculation of the cost savings achieved from the 2004 refinancing and the cost of service in addition to the unamortized call premiums.

² EnergyNorth's capital structure and cost of debt will be as follows:

Item	Component Ratio (%)	Component Cost Rate (%)	Weighted Average Cost Rate (%)
Common Stock	50.00	TBD	TBD
Long Term Debt	<u>50.00</u>	7.02	<u>3.51</u>
Total	100.00		TBD

The settlement agreement and any order approving it is intended by the signatories as a final resolution of all matters relating to the investigation undertaken by the Commission in this proceeding. In particular, the remedies set forth in the settlement agreement, if adopted by the Commission, would be the exclusive and final enforcement action taken by the Commission regarding such matters, including EnergyNorth's violation of its authorized short-term debt level and its decision to redeem the Redeemed Long Term Debt, and EnergyNorth would not be subject to any additional penalties or disallowances relating thereto.

III. POSITIONS OF THE PARTIES AND STAFF

A. EnergyNorth

EnergyNorth stated that the settlement agreement is in the public interest for the reasons described by the Company and Staff witnesses. The Company indicated that it would file its upcoming base rate case with the figures that have been agreed to in the settlement agreement.

EnergyNorth filed the petition in order to address the violations of the Company's short-term debt limits. The Company stated that it sought the consolidation of the fuel and other short-term debt limits to provide the Company with greater flexibility and an increase in the short-term limit to reflect significant increases in the costs of gas, the Company's redemption in 2004 of the Redeemed Long Term Debt on a cost effective basis, and a low level of earnings.

EnergyNorth admitted that it violated the Commission's short term debt limits and that its financing filings to the SEC showed that the KeySpan organization was aware of them. The Company stated, however, that New Hampshire's requirements were apparently not communicated to the appropriate personnel. The Company tried to determine the original cause of the short-term debt limit violation in December 2000. However, it stated that despite much effort, it had not been able to determine the specific reason for the increase in short-term debt at

that time, other than finding that the increase was the settlement of a transaction between the Company and its corporate parent at the time, EnergyNorth, Inc. The Company assured the Commission that it has put in place processes to ensure that a violation of applicable short-term debt limits does not happen again.

Responding to Staff's concerns regarding EnergyNorth's level of short-term debt for non-fuel purposes and the Company's exposure to interest rate risks from short-term debt, the Company agreed to refinance the existing short term debt with an \$80 million unsecured long-term loan from KeySpan Corporation with interest fixed at 5.803 percent, due April 2035. The interest rate and the proceeds of this loan are derived from an existing loan that KeySpan Corporation had previously entered into in April 2005. Excess loan proceeds not used to pay off the Company's short-term debt would be invested in the Company's money pool. Because the loan is from the Company's parent, there will be no issuance costs.

When EnergyNorth refinanced its long-term debt in 2004 with short-term debt, it paid approximately \$8.6 million as call premiums in connection with redeeming the long term debt. EnergyNorth also had approximately \$1.3 million of unamortized issuance expenses related to the Redeemed Long Term Debt remaining on its books, costs which were to have been amortized over the remaining life of the redeemed debt. Inasmuch as customers received benefits from that redemption, including the postponement of a base rate increase resulting from reduced interest expense, the call premiums and unamortized issuance expenses will be amortized over the life of the new issuance. The amortization period is 30 years starting April 1, 2005. The amortization will take into account the 39 months that have elapsed since April 2005 and be used to calculate the cost of debt in the Company's upcoming base rate case. Including such amortization and the interest on the \$80 million loan, the Company's cost of debt will be 7.02 percent, with a capital

structure of 50 percent debt and 50 percent equity as agreed to in the merger settlement agreement in Docket No. DG 06-107.

Since the settlement agreement provides for the issuance of debt, at hearing EnergyNorth provided the applicable information required by N.H. Code Admin. Rules Puc 509.03 for financings.³ Among the items were a balance sheet and income statement as of September 30, 2007, the date following the National Grid plc-KeySpan Corporation merger through which the books had been closed, as adjusted for ratemaking purposes and reflecting the financial effects of the proposed new long-term debt. The pro forma balance sheet shows approximately \$311 million in assets, with goodwill removed, \$80 million in new long-term debt and no short-term debt. The statement of capitalization ratios shows a debt to equity ratio of 31 percent before the \$80 million loan and a debt to equity ratio of 49 percent afterward. Since the \$80 million loan is being proposed in connection with a settlement, the Company proposed that the Commission requirements for formatting a financing application be waived.

B. OCA

The OCA stated it fully supported the settlement agreement and requested that it be approved.

C. Staff

Staff also supported the settlement agreement as being in the public interest. Staff stated that it had carefully reviewed the circumstances of EnergyNorth's violation of its short-term debt limit and its redemption of long term debt in 2004 and that the settlement agreement addressed its concerns.

EnergyNorth retired approximately \$40 million in long term debt in 2004 and replaced it with \$50 million of short-term debt, including approximately \$10 million of call premiums.

³ In addition, a resolution from the board of directors authorizing the proposed financing was placed in the record.

Staff confirmed that this refinancing strategy had achieved interest cost savings for the Company until now. However, Staff stated that the Company had replaced fixed-rate debt with variable rate debt, thus increasing interest rate risk. Staff noted that while the Company received the benefit of the interest cost savings in the short run, if interest rates were to rise prior to the filing of a rate case or rates went up forcing the filing of a rate case, ratepayers would be asked to absorb the increased costs of the debt.

Staff was also concerned that the Company, in effect, diminished the Commission's authority to review the 2004 financing arrangements under RSA 369, including the purposes of the new short-term debt, when it violated its short-term debt limits in 2004. In Staff's view, the short-term debt limit prevents utilities from financing long-term assets with anything other than long-term debt and equity. Coupled with regulatory oversight over the issuance of debt and equity, this helps prevent utilities from making unwise decisions or manipulating their capital structure in a way that could jeopardize their long-term financial health or negatively impact ratepayers.

Staff further stated that it had some concern that extensive use of short-term debt in lieu of long-term debt might affect credit ratings. Staff explained that even though inter-affiliate money pool borrowings are considered short-term debt, in this case, the debt was not going to be paid within one year, if ever. Staff was concerned that the Company's financial ratios on which credit agencies and investors rely might be distorted.

Staff indicated that proceeds of the \$80 million in long-term debt to reduce short-term borrowings associated with the 2004 redemption will result in lower rates for customers than if the Company had not retired the long-term debt in 2004. By locking in favorable rates through

2035,⁴ the \$80 million in long-term debt will also reduce interest rate risk. Finally, according to Staff, the \$80 million in long-term debt will bring the Company's actual capital structure much closer to the 50-50 debt and equity hypothetical capital structure approved in the National Grid plc-KeySpan merger docket.

Staff noted that the settlement determines the weighted cost of debt to be used in the upcoming EnergyNorth rate case and resolves the issue of the recovery of the deferred costs related to the call premiums. Staff stated that since the calculated savings from the 2004 refinancing were net of the call premiums,⁵ it is appropriate that the Company be allowed to recover those costs as they resulted in a net savings to ratepayers.

Staff stated that the short-term debt limits established in the settlement agreement are consistent with the limits established in Order No. 23,593. Staff stated that the non-fuel short term debt limit of \$21 million was set at that level to reflect implementation of the environmental remediation recovery mechanism which requires EnergyNorth to pay remediation costs up front while recovering them over seven years without carrying costs. In 2000, the \$21 million represented nearly 20 percent of net assets. Since the environmental remediation recovery mechanism still exists, Staff stated that it is reasonable to maintain a 20 percent limit to meet those needs. By applying the percentage to the rate base on an annual basis, some flexibility is afforded.

The fuel financing short-term debt limit also allows some flexibility. Prior to KeySpan Corporation's acquisition of EnergyNorth in 2000, the Company had on several occasions filed

⁴ Staff noted that at the time of settlement discussions, the commercial paper rate on which the daily money pool rate is based was approximately 5.23 percent while the interest rate on the \$80 million in long term debt would be 5.803 percent.

⁵ The calculation also included the unamortized issuance costs.

for increases to the fuel inventory financing limits because of higher fuel costs. According to Staff, there is no reason to think that fuel cost volatility and increases will not continue.

Although the specific reason for the initial violation of EnergyNorth's short-term debt limits could not be determined, Staff stated that the \$250,000 credit to be provided under the local distribution adjustment charge was an appropriate remedy under the circumstances.

According to Staff, such circumstances included the Company's previous violations of Commission directives and requirements, such as failure to file reports and the re-filing of cost of gas filings and the change in the Company's thermal billing practices. Also relevant in Staff's view was the length of the Company's non-compliance and the circumstances regarding the timing and magnitude of the violations. Staff stated that three days after the short-term debt limits in Order No. 23,593 became effective the Company borrowed over \$42 million on a short-term basis from the money pool, more than double the \$21 million authorized for non-fuel short term borrowing. According to Staff, the Company was out of compliance with the non-fuel debt limit in every year other than 2003 and, in 2004, the Company exceeded the fuel financing short-term limit and has been out of compliance every year since except for occasional periods of time with respect to the fuel financing limit.

IV. COMMISSION ANALYSIS

As a preliminary matter, we are asked to accept the late filing of the settlement agreement. N.H. Code Admin. Rules Puc 203.20(e) states that settlements and stipulations must be filed no less than 5 days prior to the hearing except as provided in Puc 203.20(f), which allows acceptance of a late filed stipulation and settlement when that will promote the orderly and efficient conduct of the proceeding and will not impair the rights of any party to the

proceeding. In the absence of objections, and because the criteria in the rule have been satisfied , we accept the late filing.

N.H. Code Admin. Rules Puc 203.20(b) provides that the Commission will approve a disposition of any contested case by settlement if the Commission determines that “the result is just and reasonable and serves the public interest.” For the reasons set forth below, we find that the settlement agreement satisfies these standards and we therefore approve it.

One of the major issues to be decided is whether the result of the financing arrangements represented by the settlement agreement is reasonable and in the public interest. The Company proposed \$80 million of new fixed-rate long-term debt and increases to the Company’s variable rate short-term debt limits. At hearing and thereafter, the Company presented information substantially in compliance with the applicable requirements of Puc 509.03, governing petitions for authority to issue securities. While the settlement agreement does not comply with the formal, formatting requirements of the rule, *See, e.g.*, Puc 509:03(b), in the context of this settlement we waive such requirements.

The \$80 million of new long-term debt eliminates the risk of harm to ratepayers from possible increases to short-term interest rates. Even at a time of historically low interest rates in 2001, we expressed caution about over-reliance on variable rate long-term financing by utilities, *see Public Service Company of New Hampshire*, Order No. 23,841 (2001), 86 NHPUC 756, 761-762, and this proposal is consistent with that conservative approach. In addition, the fixed interest rate of 5.083 percent is favorable and no issuance costs will be incurred in connection with the new debt. Under the settlement agreement, a mix of fixed-rate long-term and variable rate short term debt, the customary situation for the other utilities we regulate, is re-established. For base rate purposes, the capital structure resulting from the financing arrangements, where the

actual debt to equity ratio will be 49 percent after the financing, is consistent with the hypothetical 50 percent debt-to-equity capital structure we approved for EnergyNorth in *National Grid plc*, Order No. 24,777(2007).

Regarding the proposed short-term debt limits, the Company would be allowed to incur up to 20 percent of its forecasted net plant for the next calendar year for non-fuel purposes, without obtaining specific Commission approval. As Staff noted, the \$21 million of non-fuel short term debt approved in *EnergyNorth Natural Gas, Inc.*, Order No. 23,593 (2000), for purposes of financing costs such as environmental remediation costs, represented nearly 20 percent of the Company's net assets in 2000. Thus, the proposed limit is consistent with the comparable amount of short-term debt we approved in that order. We agree with Staff that since the need for non-fuel short-term debt still exists, e.g., for environmental remediation costs are still being incurred, it is reasonable for EnergyNorth to maintain a 20 percent limit to meet those needs. In any event, the Commission will have the opportunity to review the amount of the limit each year in connection with the Company's winter period cost of gas filing and may make appropriate modifications to the amount of the limit.

The settlement agreement does not contemplate the use of non-fuel short-term debt to pay off long-term debt. Thus, if the Company anticipates using short-term debt to reduce or eliminate its longterm debt in the future, we would expect the Company to seek the Commission's approval pursuant to RSA 369.

The short-term debt limit for fuel purposes, which under the settlement agreement would not exceed 30 percent of the Company's total gas costs, is also reasonable. As Staff indicated, total gas costs, i.e., the total of the Company's direct and indirect gas costs, have increased since 2000 and remain volatile. Similar to the short-term debt limit for non-fuel purposes, the

Commission will have the opportunity to review the amount of the short-term fuel limit each year in connection with the Company's winter period cost of gas filing and may make appropriate modifications to the amount of the limit.

The settlement agreement resolves the issue of the recovery of the deferred costs related to the call premiums and determines the weighted cost of debt to be used in the upcoming EnergyNorth rate case. Amortization of the call premiums is appropriate in this case because incurrence of those costs resulted in proven net savings to ratepayers. See *Aquarion Water Company of New Hampshire*, Order No. 24,482 (2005). However, we remind the Company that the appropriate way to obtain approval for recovery of such costs is to apply to the Commission in advance of their incurrence for a determination that they are reasonable.

The other major issue to be decided is whether the \$250,000 credit to ratepayers through a reduction to the local delivery adjustment charge for the Company's violation of the short-term debt limits established in Order No. 23,593 is reasonable. Balancing the aggravating and mitigating factors involved in determining a proper remedy, we find that the amount of the credit is reasonable under the circumstances.

On the one hand, the Company's violation did not cause customers to pay higher rates. On the other hand, a substantial violation commenced almost immediately after Order No. 23,593 was issued in December 2000. In its petition for approval to participate in the KeySpan money pool to finance fuel inventory, filed with the Commission on November 8, 2000, the Company told the Commission that it "does not propose a change in those levels [i.e., the short term borrowing limits referenced in Order No. 23,593] at this time." While KeySpan Corporation had consummated the merger with EnergyNorth in early November 2000, the fact that a utility is under new ownership and management does excuse deviating from the

Commission's requirements. Utilities and their affiliated service companies are expected to know the Commission's requirements and to communicate them within the organization so that compliance is assured at all times.

In addition, violations continued for a significant amount of time after 2000 and through the time when the petition in this docket was filed. Apparently, the personnel at KeySpan responsible for managing EnergyNorth's debt levels had in mind the SEC-established short-term debt limit of \$125 million although, as the Company's SEC filings demonstrate, others at KeySpan were aware of the Commission's additional short-term debt limits. We also consider that EnergyNorth has violated Commission requirements in the past, most notably with respect to changing from the "wet" to the "dry" method for measuring the heat content of gas delivered to its customers in May 2001, without adjusting the per therm rate to reflect the increase in therms billed and without obtaining Commission approval, which caused the Company's customers to be overcharged. *See EnergyNorth Natural Gas, Inc.*, Order No. 24,572 (May 25, 2007).

The Company stated at hearing that it takes this matter very seriously and has focused on putting in place processes that ensure that a violation of the Commission's financing requirements does not happen again. We expect that those words will be backed by concrete actions undertaken consistently with the recent changes in management.

Based upon the foregoing, it is hereby

ORDERED, the settlement agreement is approved.

By order of the Public Utilities Commission of New Hampshire this twenty-ninth day of
February, 2008.

Thomas B. Getz
Chairman

Graham J. Morrison
Commissioner

Clifton C. Below
Commissioner

Attested by:

ChristiAne G. Mason
Assistant Executive Director & Secretary