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N.H. PUBLIC UTILITIES COMMISSION

May 25, 2007

Via Hand Delivery
Ms. Debra A. Howland
Executive Director and Secretary
New Hampshire Public Utilities Commission
21 South Fruit Street, Suite 10
Concord, NH 03301

Re: DG 07-033, Northern Utilities, Inc. 2007 Summer Cost of Gas

Dear Ms. Howland:

Enclosed for filing with the Commission in the above-referenced docket please find an original and 7 copies of Northern Utilities, Inc.'s brief which is submitted pursuant to Order No. 24,743 (April 27, 2007) and in accordance with the Secretarial Letter issued by you on May 23, 2007 in the above-captioned docket and in Docket No. DG 07-050.

Please let me know if there are any questions about this matter. Thank you.

Very truly yours,

S S Geiger
Susan S. Geiger

cc: Service List
Enclosure

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STATE OF NEW HAMPSHIRE
BEFORE THE
PUBLIC UTILITIES COMMISSION

NORTHERN UTILITIES, INC.	)	Docket DG 07-033
Summer 2007 Cost of Gas Adjustment	)	
Staff's Proposed Change in Calculation of	)	
Cost of Gas Adjustment Mechanism	)	

BRIEF OF NORTHERN UTILITIES, INC.

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I. INTRODUCTION

In Order No. 24,743, the New Hampshire Public Utilities Commission ("Commission") provided an opportunity for the parties to submit briefs to address issues raised by the Staff of the Commission ("Staff") during the Commission's review of Northern Utilities, Inc.'s ("Northern") 2007 summer cost of gas adjustment ("COG"). Northern Utilities, Inc., Docket DG 07-033, Order No. 24,743 (April 27, 2007) at 9.

Staff seeks to change the way the cost of gas adjustment ("COG") mechanism, specifically the manner in which interest is calculated on the monthly under- or over-collection balance of Northern's actual recoverable gas costs.[1] Northern opposes any such change. Staff has (1) not proven that the current COG results in rates that are unjust or unreasonable; (2) not proven that the current COG results in an over- or double-recovery of interest expense; (3) proposed changes to the rates that would result in Northern failing to recover the carrying costs associated with the actual costs it incurs monthly in funding volatile gas commodity purchases on behalf of its customers throughout the winter months; and (4) not demonstrated that there is a calculation of a billing lag in the COG. Northern requests, therefore, that the Commission reject Staff's attempt to alter the COG.

II. BACKGROUND

The COG is a long-standing mechanism that provides Northern recovery of

[1] By Secretarial letter dated May 23, 2007 in this docket and in DG 07-050, the Commission has indicated that it intends to open a separate docket to deal with Staff's issue relating to the interest rate to be applied to both Northern's and KeySpan's supply-related working capital. Accordingly, pursuant to the directive in that Secretarial letter, that interest issue is not addressed herein.

prudently-incurred commodity purchases made on behalf of customers. Exh. Northern-4 at 2. Northern's Maine Division and Northern's affiliate, Bay State Gas Company ("Bay State"), each have a COG that provides for the same recovery of prudently incurred costs, and particularly allows for the same interest calculation on the monthly balance of under- or over-collections as is provided for in the COG mechanism for Northern's New Hampshire Division. Id. Moreover, this COG mechanism of recovering all prudently incurred gas costs, with an interest calculation on the monthly under- or over- collection of actual gas cost, is the same for all other gas utilities in Massachusetts and New Hampshire, each having been approved by the respective state commission for over 30 years. Id. In particular, all these mechanisms allow for the recovery of prudently-incurred costs associated with purchased gas, gas inventories and gas production resources and the recovery or pass-back of carrying costs resulting from the monthly imbalance created by the difference between the incurrence (being charged by suppliers) and collection (charging customers) of such gas supply costs. Exh. Northern 4 at 3.

The COG for the Northern-New Hampshire Division, the Northern-Maine Division and Bay State have been in operation since the early 1970s to track fluctuating purchased gas, capacity and production costs, rather than recovering such costs at a test year level in base rates. Tr. 4/23/07 at 84-85; Exhibit Northern-4 at 3. The need or purpose for the COG, in tracking variable costs, was to avoid earnings fluctuations, i.e., revenue erosion or windfall gains, caused by events beyond the Company's control. Id. The COG was designed to, and has always, matched revenues with expenses over which

Northern has no control. Tr. 4/23/07 at 85. The clause has always included the tracking of carrying costs on the fluctuating monthly under-or over- collections of commodity gas costs. Tr. 4/23/07 at 84; Exh. Northern-4 at 3. The monthly under- or over- collections is based on the actual supplier-metered gas costs and actual metered (or in other words, "as-billed") collections. Id.

The working capital expense associated with purchased gas costs has also been recovered by Northern, and by the other gas utilities, throughout the years that the COG has been in place. When this Commission completed its restructuring of the gas industry and the corresponding unbundling of gas rates in Docket DG 00-046, it moved all of the revenue requirement associated with gas supply and its working capital expense (as opposed to distribution service) out of base rates and into the COG. Tr. 4/23/07 at 85. The "indirect gas costs" that were moved from base rates into the COG included, inter alia, an allowance for working capital which is recovered as a percentage of purchased gas costs. See Northern Utilities, Inc. Revenue Neutral Rate Redesign, DG 00-046, Order No. 23, 674 (April 5, 2001) and Northern Utilities, Inc. Petition for Rate Change, DG 01-182, Order No. 24, 075 (October 28, 2002). This transfer from base rates to the COG did not (and still does not) change or impact the purpose and need for recovery. The Company's rates continually and permanently fund a portion of its gas supply costs associated with any lag between customers paying their bills and Northern paying suppliers and pipelines for their invoiced charges. These costs are covered by the Company's working capital and are reimbursed to the Company at its weighted average cost of capital, which appropriately reflects its rate of long-term debt.

III. STAFF'S POSITION

Staff argues that the costs of timing differences in gas cost recovery result in an over-collection. Exh. Staff - 5. Staff suggests that the Commission, in effect, restart the 30-year old COG and replace the "as-billed" method of determining revenues with a calculation that requires the Company to recognize or accrue revenues, approximately half of which it has not yet even billed. In other words, Staff's method will take costs actually incurred by Northern based on suppliers' and pipelines' metered volumes and associated invoices and match them in time with revenues, approximately half of which would be based on volumes not yet metered or billed by the Company.

IV. STANDARD OF REVIEW AND BURDEN OF PROOF

Because Staff is seeking a change to the long-standing methodology for calculating the COG which has been repeatedly accepted in Commission orders over the years, Staff is essentially seeking to set aside those orders. As such, Staff bears the burden of proving by clear preponderance of the evidence why and how the current COG is unjust and unreasonable. See, e.g., Appeal of Verizon New England, 153 N.H. 50, 889 A.2d 1027 (2005); In re Campaign for Ratepayer Rights, 145 N.H. 671, 766 A.2d 702 (2001). In addition, because this issue has been raised through a Staff complaint, Staff bears the burden of proving the truth of any factual proposition by a preponderance of the evidence. Admin. Rule Puc 203.25. This burden is not Northern's. Conclusive evidence, the kind that is necessary to change the Commission's precedent, is that which excludes the truth of any other hypothesis than the one attempted to be established. Grafton County Electric Light & Power Co. v. State, 77 N.H. 490, 93 A. 1028 (1915), citing 1 Stark. Ev. 453. Staff has failed to exclude or negate the truth of any facts underlying Northern's position, or the position itself. However, Northern *has* explained why Staff's hypothesis is incorrect and how it will deprive Northern of recovery of actual costs and revenues in its gas cost collection. The current method of calculating COG rates reflecting the recovery of interest based on as-billed revenue is reasonable because the end result is reasonable: the COG produces a reasonable rate to recover purchased gas, gas inventory and gas production costs. See, Federal Power Comm'n v. Hope Natural Gas Co., 320 U.S. 591, 603, 64 S.Ct. 281, 88 L.Ed. 333 (1944).

The methodology for calculating the COG has been approved twice a year in exactly its same form for many, many years. There is regularity and a reasonable end result. In approving the COG, the Commission has been making findings of fact as to the method and manner of costs Northern has been collecting for its purchased gas, gas inventory and gas production needs. The findings of fact of the Commission are presumed lawful. Appeal of Public Service Co. of New Hampshire, 130 N.H. 285, 295 (1988). Accordingly, Staff must demonstrate clearly that the factual standards employed and reviewed in prior COG approvals were factually incorrect. However, nothing at all has changed. The COG methodology to determine actual carrying costs on gas cost under- and over-collection and to calculate the resulting COG rate has produced what the Commission has determined to be reasonable determination of actual carrying costs in the past and it continues to produce reasonable rates for the COG in this case. As Northern is definitely not overcompensated by the current COG methodology, Tr. 4/23/07 at 89, the COG rates calculated using the long-standing methodology should be determined by the Commission as just and reasonable. Moreover, so long as the resulting rates are within the zone of reasonableness (which, as a decrease from the prior period rates, they clearly are) the Commission may approve the rates irrespective of the methodology used to derive them. See Appeal of Campaign for Ratepayers Rights, 145 N.H. 671, 676 (2001). It is also noteworthy that Staff has not calculated specific COG rates that it believes are more just or more reasonable than those presented by Northern and which have been substantiated through the Company's work papers and testimony.

Northern and its customers and shareholders should be entitled to rely on the regularity of the Commission's Orders and the procedures and standards under which the Company's filings are reviewed. The Company's practices which have been reviewed and repeatedly accepted by the Commission should not be changed absent a clear demonstration that the rates produced are unjust or unreasonable. Staff has failed to make that demonstration in this case. It is not Northern's burden to demonstrate that the rate methodology – deemed to be just and reasonable and without question for over 30 years – is suddenly *not* unjust *nor* unreasonable. Quite simply, Staff has failed to justify why it seeks to change the well-established COG mechanism that is so integral to the stability of Northern's billings and revenues, particularly during the critical winter months.

V. DISCUSSION

A. Staff Misapprehends Northern's Calculation of Working Capital and Because of this, Makes a Recommendation to the Commission that, if Adopted, would have Confiscatory Effect

Staff's Report asserts that Northern is compensated twice for a 15-day billed revenue lag through Northern's working capital calculation and its collection of interest on over-under recoveries. Exh. Staff 4 at 5. Staff's analysis is simply wrong and shows a misunderstanding about the way Northern created its lead-lag study, from which the recovery of working capital expense associated with gas costs is derived.

Northern's working capital calculation is derived from the lead-lag study submitted in and approved by the Commission in Northern's 2001 base rate proceeding. Tr. 4/23/07 at 87; Northern Exh. – 4 at 7. The lead-lag study and accordingly, the resulting working capital calculation, measures average, annual customer and Company behavior in order to determine the Company's average, annual working capital needs. Id. The purpose of Northern's lead-lag study is to identify the primary criteria driving cash working capital requirements. As practicable, Northern used its books and records to measure the payment behavior of key drivers to obtain reasonable net lead and lag days. The net days were then applied to the appropriate components of Northern's purchased gas, gas inventory and gas production cost of service to obtain a reasonable level of cash working capital to include for recovery of the related carrying costs. More details used in measuring cash working capital, whether used for distribution service or for the cost of gas mechanism, creates a "false precision" that engenders litigation and brings little customer benefit. Exh. Northern-4 at 13.

Importantly, a lead-lag study does not contemplate or reflect, nor can be adjusted for, the timing differences experienced every month between Northern reading its customers' meters and billing for the associated actual gas consumption and Northern's suppliers reading their meters and billing Northern for the actual gas purchased. These differences are a direct result of the monthly (approximately 30-day periods) volumetric differences between billing cycle month meter readings and calendar month meter readings included in suppliers' and pipelines' invoices. Such a monthly difference in volumes and associated collections versus costs is particularly broad in the transitional month from the summer to winter gas seasons. Id. Northern's 2001 lead-lag study did not attempt to reflect timing changes, volumetric changes in gas use, or other unpredictable changes in the marketplace. Tr. 4/23/07 at 87 (from month-to-month, volumes vary significantly). Northern's working capital factor does not compensate Northern for the large variations in monthly volume and price that occur between the billing cycle and calendar month metering and billing of gas use for summer or winter seasons as compared to the average. Rather, it is the calculation for interest on deferred gas cost collections which compensates Northern for those swings. See, Tr. 4/23/07 at 87 (gas companies have temperature sensitive load). Together, all of the mechanisms in the approved COG method reasonably compensate Northern for: (a) its average working capital needs for the test year level, or long-term difference between Northern's customer payment behavior and its payments to suppliers and pipelines; and (b) carrying costs associated with the monthly volumetric changes and price impacts, particularly throughout the winter season, that impact collection and cost levels throughout the year. Id.

In Northern's view, this is why the COG was initially constructed in such a way as to enable gas utilities to receive interest on the timing difference between actual supplier and pipeline invoiced charges, i.e. gas costs, and its metering and billing of customers' usage, which is characterized as "collections" or "recoveries" even though they do not represent payments received for such billings. It is important to note that this interest calculation reflects 30 days of costs and "collections" (billings) and thus does not reflect or compensate for the lag days used to determine the working capital expense. This working capital expense recovery provision, on the other hand, is designed to capture the difference of Northern paying supplier and pipeline invoices and receiving customer payments. In sum, working capital captures the difference in payment behavior, while the interest on the monthly deferred gas cost balances tracks the actual gas costs charged to Northern by suppliers and pipelines versus the actual gas metered and billed to customers. Tr. 4/23/07 at 87.

Northern's lead-lag study is appropriate. Cash working capital is that portion of working capital, excluding inventories, that is needed to finance the time period between receipt of payment for utility service and the disbursements required to render that service. Exh. Northern-4 at 8. A lead-lag study measures, in number of days, customers' behavior in paying their gas bills from receipt of service (the revenue lag). Id. The sum of the 15.2 days for meter reading and 29.14 days for collection produced the 44.34 revenue lag approved by the Commission in DG 01-182.

Northern's study also measures in number of days associated with the Company's average behavior or activity in paying its expenses (the expense lead). Id.[2] The net difference in days is used to calculate the investor capital needed to support this long-term or systemic administrative operational requirement. Exh. Northern-4 at 9. The study does not comprehensively measure the dollar value of the Company's bills rendered or bills received. Using an approach that is simpler and easier to verify while producing reasonable results, Northern's working capital study determined average daily revenue by taking annual per book revenue and dividing it by the number of days in the year. Exh. Northern-4 at 10.

Because of this, Staff is incorrect in arguing that Northern recovers interest expense twice for the timing differences associated with purchased gas, gas inventory and gas production cost collections. The derivation of average daily revenue appropriately determines an average. Average daily revenue is then used to derive the 6.33 net lag days that represent average customer payment behavior. As Mr. Ferro stated, Northern's calculation of average daily revenue does not reflect the volume and associated revenue lag on a monthly basis irrespective of customer payment behavior. Id. The mismatching due to the manner in which Northern purchases gas from suppliers as customers use the

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2 The Expense Leads particularly the Gas Purchase Lead (39.48) were calculated in a similar manner and were measured from the midpoint of the service period to the date paid to determine average Company behavior in paying its vendors. Exh. Northern-4 at 12. For gas costs, all invoices for the test year were analyzed. *Id.*

gas commodity (incurring costs for the Company through this use) and the way that the Company meters and bills customer gas use each month, or in other words, the mismatch each month of the associated metered and as-billed supplier and pipeline costs and customer revenues, is an under/over collection for gas utilities that in reality generates the need for recovery of carrying costs on that monthly under/over collection balance. Tr. 4/23/07 at 89 (no net lag days are reflected in Northern's calculation of interest on the over and under collection.)

Staff is completely incorrect that any double collection takes place. As Mr. Ferro's sworn testimony provides:

> "The interest on over- and under-collection balances captures something entirely different [than that] captured by the lead/lag study and the resulting working capital expense. One captures the difference in payment habits, the other captures the actual operations of the Company's gas cost activity, sales and associated revenues [as compared with] sendout and associated cost."

Tr. 4/23/07 at 95-96.

In view of the foregoing, Staff's position should be rejected.

B. Replacing As-Billed with Accrued Revenues Would Cause Northern to Under-recover its Legitimate and Prudently Incurred Gas Costs

Staff incorrectly claims that a 15.2 lag day is built into Northern's interest on under/over collections because Northern bills its customers and receives payments throughout a month. To correct this perceived inequity, Staff recommends the Commission replace "as billed" revenues with Northern's accrued revenues for the purposes of calculating the interest on over- and under-recoveries.

Staff's recommendation would cause Northern's shareholders to support customer payments and expenses incurred by the Company to serve those customers. Northern is entitled to recover interest on actual costs and revenues. "Actual" is the amount recorded by the Company at the end of the month for everything it has either billed out to its customers or has been charged by its vendors, both of which are based on actual meter readings and associated bills/invoices. Tr. 4/23/07 at 92. At the end of each month, Northern has only read the meters and billed customers for (on average) a half month of that month's gas costs. Exh. Northern-4 at 11. As Mr. Ferro explained, Cycle 1 customers will not even be billed for 29 days of that month's consumption until early the next month. Exh. Northern-4 at 17. The 30-year old approved COG calculation, in using actual billing month sales and revenues appropriately applies actual gas cost collections to actual calendar months. Id. It is therefore inappropriate to replace the COG billed revenue method of calculation with accrued revenues[3] because Staff's calculation includes fictitious revenues (i.e. revenues that have not actually been received and are determined based on an estimation routine to "calendarize" sales and associated gas cost collections). Tr. 4/23/07 at 92-93. Staff is recommending to advance each month

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[3] Staff claims that the electric companies Unitil, National Grid and PSNH have accepted accrual accounting under Commission-approved settlements for default service and transmission rates. Northern contests any comparison between its COG and the electric company adjustment rates. Moreover, Northern cannot find any discussion by the Commission of movement from "as billed" to accrued revenues in the Commission dockets approving these settlements and has no way of verifying these claims since none of these settlements or the records behind them have been entered by Staff into the record in this proceeding. Staff's assertions about them have no evidentiary basis and have not been demonstrated to be the same as the COG. Nor has Northern had the opportunity to question the electric companies on their settlements or whether Staff's assertions are accurate. Finally, acceptance of accrual accounting by the electric companies for a different mechanism, if true as part of a settlement, is not relevant, precedential nor binding on Northern. Settlements are categorically infirm to establish precedent.

Northern's gas cost collections through this estimate for the purpose of calculating interest, which would misrepresent that Northern has use of its customers' gas cost billings, which in turn would derive artificial interest income that Northern would be required to credit or pass-back to customers through the COG. Further, Staff's recommendation of implementing the interest calculation based on accrued revenues would essentially require Northern, in the first month of the season in which such a change is implemented, to reflect one and one-half months of "collections" matched against one month of costs. The one and one-half month of revenues would be the one-half month of pro-rated billing month collections associated with the previous season's calendar month and one full month of accrued calendar month collections of the current season. The conjuring of these "collections" would further misrepresent Northern's use customers' billing amounts that, in turn, would generate an inappropriate and artificial level of interest income owed to customers. See Tr. 4/23/07 at 92-93.

As stated earlier, Northern's working capital recovery provision does not even attempt to compensate Northern for the carrying costs associated with the differences between calendar month supplier invoiced gas costs and as-billed customer gas cost charges, but rather is designed to just capture the difference in Northern's payments to suppliers and pipelines as compared to payments made to Northern by its customers. Northern's calculation of interest or carrying costs related to the monthly balance of under- or over- collections serves as a proper complement to this test year net lag days and resulting working capital recovery as the monthly interest calculation does not incorporate any net lag days. Every month the interest calculation reflects 30 (or 31) days of actual purchased volumes and associated gas costs and 30 (or 31) days of actual billed volumes and associated gas cost collections. Tr. 4/23/07 at 88 (30 days of revenues are matched with 30 days of costs). While the net lag days belong in the lead-lag study and resulting working capital calculation, any mismatch in actual costs and revenues due to the "lag" in billing volumes as compared to purchased or sendout volumes properly belong in the calculation of interest on the monthly under- or over-collections. Tr. 4/23/07 at 94 (the deferred gas cost calculation in the CGA captures the volume lag, which non-gas utilities do not experience). Therefore no over-recovery exists.

Staff argues Northern's monthly revenues should be advanced (or "accrued") because billing month revenues on average have been billed to its customers 15 days ago. Exh. Staff-5. However, as Mr. Ferro explained, Northern is only billing for (on average) 15 days of service for that month: 1-day for cycle 1, 2 days for cycle 2, and so on, until the end of the month, where service collections would be 30 days for cycle 21. Exh. Northern-4 at 17. For the other one-half month of revenues, Northern is billing for (on average) 15 days of service for the previous month. Exh. Northern-4 at 11. The combination of these actual 15-day billings of previous and current months are reflected in Northern's calculation of interest on the monthly under- or over-collection balance.

As Mr. Ferro argued, in the real world and in Northern's calculation of its working capital needs, it is "as-billed" information from the Company's books and records that is used to measure the customer behavior (which drives the need for working capital), and this actual billing activity is analyzed on an annual basis to determine the average daily lag of the associated payment. Unbilled (or "accrued") receivables and revenue are not used by the Company because the accrued revenues methodology improperly matches (or mismatches) revenues that the Company *has not received* against a full month of *actual costs*, and therefore does not compare "apples to apples". *See* Exh. Northern-4 at 16-17. The billing month method, historically and precedentially approved by the Commission for 30-years, properly matches monthly actual (billed) costs with actual (billed) revenues. Tr. 4/23/07 at 88. Accordingly, Staff's proposed change is wrong, unwarranted and should be rejected.

VI. CONCLUSION

Staff has continued to demand that Northern justify an existing just and reasonable method of operating the COG mechanism associated with calculating interest on monthly under- and over-collections based on actual billed costs and collections, incorrectly attempting to shift the burden of proof on this issue to Northern. In fact it is Staff that must demonstrate by a clear preponderance of the evidence that the Commission's prior orders were wrong and that a change is warranted. Staff has failed to carry this burden. In addition, Staff has failed to demonstrate that the COG rates proposed by Northern in this docket, and which result from the long-standing methodology that Staff seeks to change, are either unjust or unreasonable.

For all the reasons set forth in Exh. Northern-4, in Northern's in-hearing testimony held April 23, 2007, and in this brief, Northern respectfully requests that the New Hampshire Public Utilities Commission reaffirm the computation of the Cost of Gas and deny and dismiss the multiple changes proposed by Staff as inappropriate for natural gas distribution utilities.

Respectfully submitted,

NORTHERN UTILITIES, INC.
NEW HAMPSHIRE DIVISION

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