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May 11, 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.
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 response to the Commission's request for information on the source and cost of funding for the company's supply-related working capital. This information is provided pursuant to Order No. 24,743 (April 27, 2007) which sought the information from Northern's Director of Finance. Because no such position exists within Northern Utilities, Inc., this information is being provided by Ms. Kelly Humrichouse, Northern's Director of Rate and Regulatory Services, as she is very familiar with the subject matter, and therefore able to respond.

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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Northern Utilities, Inc.
New Hampshire Division
DG 07-033
Commission Request from
Order No. 24,743 at 9
Responsible: Kelly Humrichouse
Director, Rate and Regulatory Services

Request: Provide information on the source and funding for Northern's supply-related working capital. The response is due by close of business May 11, 2007. To the extent the source of funding is not the Money Pool, the respondent must explain why not and provide the actual cost.

Response: Strictly from a corporate finance perspective and excluding regulatory considerations, NiSource recognizes two alternative sources of working capital funding. The primary source of funding would come from cash flow from operations. To the extent cash flow from operations were insufficient to fund a subsidiary's working capital requirements, the source of such borrowing needs for eligible participants is from the NiSource Money Pool.

While the Money Pool interest rate on borrowings always reflects a composite rate based upon NiSource Finance Corp.'s external bank borrowings, Northern's participation in the Money Pool was established under terms that acknowledge that the interest on working capital for supply-related borrowings, by and large the most significant borrowings in any year, reflects Northern's average weighted cost of capital. The Money Pool agreement requires payment in full on demand by all eligible participants. To the extent that the cost of borrowing from the Money Pool does not adequately reflect the permanent nature or constant base level of the borrowing needs of supply-related working capital nor the regulatory risk associated with the participant's recovery of the amounts borrowed in full, it may be necessary to review the appropriateness of the participant's continued participation. The Money Pool has not yet faced this exact question regarding whether such a change in a participant's regulatory construct related to recovery of costs of borrowing from the Money Pool could impact its participation in the future.

Financing supply-related working capital is not easily simplified, as Staff seems to want to do. Financing decisions for Northern, as well as the other NiSource LDCs -- each of whom are eligible participants in the Money Pool, consider many factors depending on the utility purpose for the funds, such as effectively targeting long-term sources of funds in support of rate base treatment, an acceptable debt/equity ratio and ameliorating short term constraints. In 2006, Northern generated approximately 250% of its annual net income in the 1st financial quarter – this calendar year front-end loaded recognition of long-term capital is typical of the NiSource distribution companies and typical from year to year. Internally-generated funds such as these can be considered at a cost of the stockholder's return on equity, but in any instance, the continuing nature of this front-end loaded, winter sensitive, sourcing of funds is primarily driven by the Commission-approved rate design applicable to Northern's temperature-sensitive and/or seasonal sales volumes. Moreover, using an "indirect flow of funds" or "cash flow from operations" method of analysis, Northern's 1st quarter capital expenditures are at a cost reflective of Northern's capital structure, or at a cost representing the return on Northern's long-term held assets.

Another point to consider is that in reality, Northern's supply working capital does not appear in fact to be derived solely from its short-term borrowings. Northern's books reflect that Northern's short-term debt balance dropped from December 2005 to March 2006 by $9.1M. However, the increased use of funds related to gas costs over accounts receivables, or net gas costs, during this same period was $8.1M.

By urging the Commission to reject the Staff's overly simplistic analysis of the "actual cost" of interest on gas cost related working capital, Northern points out that internally-generated funds, both long term and short term in nature, are commingled. Moreover, these funds are used simultaneously to support both long-term and short-term needs. They are used to pay down financing or to provide a return to the shareholder. Timing of the nature and reliance upon either funding source varies, depending upon the well-known cyclical expenses of a natural gas distribution company as well as other variables.

In addition, there is complexity in quantifying an "actual cost" associated with a particular funding need. For instance, the cost of capital associated with sourcing of net gas costs over receivables varies, making it an improbable task to assign or stream funds to any particular use. Long-term and short-term funds are commingled from a use perspective: excess "long-term" funds are available at the beginning of the year. This is consistent with Northern's working capital analysis. The method used and theory behind the lead/lag concept used for gas costs that has been established by the Commission assigns a "permanent" or long-term piece of gas costs to rate base. This recognition has been used at Northern for many years. Long-term financing is targeted to balance rate base, but this is not done on a daily, weekly, or even monthly basis. As a result, the internally generated funds are used in various ways during any given month or quarter.

The persistent use of internally-generated funds, rather than short term borrowings, can be demonstrated by an example. The long-term portion of net gas costs assigned to rate base during Northern's last rate case, DG 01-182, was $0.5M in a period when gas purchase expense was $35M. Gas expense has since increased to $53M – proportionately, the $0.5M assigned as long-term would now be $0.8M. An evaluation of net gas cost versus accounts receivable month end balance for each month in 2006 produced, depending on the period analyzed, generates uses of funds from a high of $24.3M to a low of $0.8M. Under both of these approaches of determining funding needs, this minimum use of funds, and updated portion of annual net gas costs assigned to rate base, indicates a long-term funding cost need of $0.8M. Conversely, the remaining amounts of gas cost funding that do not reflect this long-term working capital need can be considered short-term and indeed this is another acceptable method of balance sheet analysis in the determination of appropriate sourcing of assets.

Considering Northern's use of all its available funds for all its operations throughout the year and the rate making aspect of its funding needs, the use of a short-term rate to determine working capital expense associated with gas costs is inappropriate.