STATE OF NEW HAMPSHIRE
PUBLIC UTILITIES COMMISSION

DG 09-095

ENERGYNORTH NATURAL GAS, INC. d/b/a NATIONAL GRID NH

2009 Cast Iron/Bare Steel Replacement Program Reconciliation

Order Approving Revised Distribution Rate

O R D E R N O. 24,996

July 31, 2009

APPEARANCES: Thomas P. O'Neill, Esq., on behalf of EnergyNorth Natural Gas, Inc., d/b/a National Grid NH; Matthew J. Fossum, Esq. and Edward N. Damon, Esq., for the Staff of the Public Utilities Commission

I. PROCEDURAL HISTORY

On May 18, 2008, EnergyNorth Natural Gas, Inc. d/b/a National Grid NH (National Grid or Company) submitted to the Commission its fiscal year 2009 (April 1, 2008 – March 31, 2009) annual cast iron/bare steel main replacement (CIBS) program results and reconciliation filing pursuant to the terms of the National Grid/KeySpan merger settlement agreement approved by the Commission in Docket No. DG 06-107. *See National Grid plc, et al.*, Order No. 24,777, 92 NH PUC 279 (July 12, 2007). On May 20, 2009, National Grid filed a supplemental report to its 2009 fiscal year CIBS program. According to the filing, in order to recover the costs of the CIBS program the Company sought to increase its annual revenue requirement by $314,318, by increasing in its distribution rates effective July 1, 2009.

On May 21, 2009, the Commission issued an order of notice setting a hearing on the matter for June 24, 2009. On June 19, 2009, Staff filed a letter advising that issues had arisen requiring further discussions and requesting a delay of the hearing. The Commission rescheduled the hearing for July 13, 2009. As a result of this change, the Company agreed to forego one month of revenue from the CIBS program and to have any new rate become effective on August 1, 2009.

On July 8, 2009, Staff and National Grid filed a settlement agreement stating that they had resolved the issues referenced in the June 19 letter. No other parties intervened in the docket.

II. BACKGROUND OF CIBS PROGRAM

The CIBS program was established as part of the National Grid/KeySpan merger settlement agreement approved by the Commission in Order No. 24,777 (July 12, 2007). The program is aimed at accelerating the replacement of cast iron and bare steel pipes used in the National Grid distribution system since those pipes were determined to be the ones most likely to leak or fail. *See id.* at 63.

As part of the program, National Grid annually submits to Staff for review and comment its plan for the replacement of cast iron and bare steel pipes for the coming fiscal year. *See id.* at 27. Following review by Staff, as well as technical sessions between Staff and the Company, National Grid is to take all reasonable steps necessary to carry out the terms of the proposed plan, subject to reasonable deviations. *See id.* at 28, 30. Each proposed plan is supposed to contain a prioritized list of pipes to be replaced based upon the age and condition of the pipe as well as other relevant factors. *See id.* Moreover, any pipes replaced pursuant to the CIBS program are, generally, counted separately from those requiring replacement as part of public works projects, or those replaced as part of the gas main encroachment policy. *See id.* at 27-28. Thus, the "discretionary" pipe replacements under the CIBS program are separated from the "non-discretionary" pipe replacements under other Company policies.

National Grid is to track actual expenditures made pursuant to the CIBS plan and reconcile those expenditures with those in the proposed plan at the end of each plan period. *See id.* at 29. The base amount of capital expenditures under the CIBS program is $500,000, with National Grid being permitted to earn a return and recover increases in related expenses for CIBS capital spending in excess of the base amount. *See id.* Recovery of this excess is through an adjustment to permanent base distribution delivery rates, effective on July 1 of each year. *See id.* To make the adjustment, the Company is to submit to the Commission, on May 15 of each year, a reconciliation report detailing the actual amount expended in implementing the CIBS plan for the prior fiscal year. *See id.* at 29. The form of the calculation is set forth in the merger settlement agreement approved by the Commission in Docket No. DG 06-107. The current filing represents the results of, and reconciliation for, the initial year of the CIBS program.

On June 23, 2008, Staff filed with the Commission a June 19, 2008 letter from National Grid expressing certain understandings between Staff and the Company relating to the implementation of the CIBS program. *See* DG 09-095 Settlement Agreement, Exhibit B, Letter of June 19, 2008. The letter provided that "bare steel segments that have been removed will be catalogued, photographed, and tested for remaining wall thickness and reported back to Staff." Id. at 3. Following the Company's submission of the fiscal year 2009 reconciliation report, Staff identified eight instances where the Company had failed to conduct the cataloguing and testing called for in the letter of understanding.

III. SUMMARY OF THE SETTLEMENT AGREEMENT

In addressing this CIBS filing, Staff and the Company reached a settlement agreement which purports to resolve the outstanding issues relating to the CIBS reconciliation and adjustment for the Company's fiscal year 2009. By the terms of the agreement, the Company would be allowed an increase of $262,185 to its permanent base distribution delivery rates, effective August 1, 2009. Exhibit C to the settlement agreement states that the new rate would result in an annual increase of approximately $2.12, or 0.12%, for a typical residential heating customer.

In addition, the settlement agreement states that the Company will return to the eight sites where it had not previously conducted testing to obtain the required pipe segments and that it will submit the results of tests on those pipes to Staff. To the extent the Company would be unable to obtain the necessary samples, there would be a $10,000 reduction to the rate base, and a corresponding reduction to the allowed increase to its distribution rates, for each sample it could not obtain. This reduction to rate base would continue until the Company's next base rate case. Moreover, the Company agreed that it would not seek to recover the costs of returning to the eight sites to obtain the required pipe segments.

On July 10, 2009, the Company provided to Staff the reports of testing done on pipe segments extracted from the eight sites at which it had previously failed to obtain samples. *See* Hearing Exhibit 3. At the July 13, 2009 hearing, the Company confirmed that it was able to obtain the required samples at each of the sites and that the results of testing had been provided to Staff, though some of the tests were not yet complete. Transcript of July 13, 2009 Hearing (Tr.) at 17-18.

IV. POSITIONS OF THE PARTIES

A. National Grid

Michelle Roche, Program Manager in the Company's construction group, and William Richer, Director of Gas Revenue Requirements, testified for National Grid at the July 13, 2009 hearing. Ms. Roche confirmed that the CIBS program was an important one for the Company, and that the settlement agreement in this matter is fair and equitable. Tr. at 8, 12. Regarding the Company's revenue requirement as it appears in the settlement agreement, Mr. Richer noted numerous differences between the initial filing and the amount agreed to in the settlement agreement, including changes in depreciation rates and municipal taxes. Tr. at 10-11. These differences led to the Company's request for $262,185, instead of the $314,318 it had originally requested. One difference was the inclusion of so-called "bonus" depreciation. Bonus depreciation is the result of the Economic Stimulus Act of 2008 and allows National Grid to depreciate 50% of the additions that occur in the current year. Tr. at 11. Despite this change in the law, however, Mr. Richer stated that he was not aware of the Company having altered its pipe replacement plans to take advantage of "bonus" depreciation. Tr. at 13. Mr. Richer confirmed that the increase in the revenue requirement would be recovered consistent with the rate design currently in effect for distribution rates. Tr. at 13.

Ms. Roche noted that in fiscal year 2009 the Company did not complete five projects for which it had planned and budgeted. Tr. at 14. This was due to a delay in beginning some projects, which resulted, in some instances, in the projects being halted by municipalities refusing to issue the required permits. Tr. at 14. She stated that one of those projects has now been completed, and that the Company has begun work on the others. Tr. at 14-15. In addition, she stated that National Grid has taken steps to ensure that it will be able to complete all projects scheduled for the coming year. Tr. at 15. Furthermore, Ms. Roche noted that as part of its "non-discretionary" spending, National Grid replaced approximately 13,000 feet of cast iron and bare steel pipe that was not part of the CIBS program, at a cost of about $2,300,000. Tr. at 15-16.

In closing, National Grid stressed the importance of the CIBS replacement program and expressed its appreciation of Staff's active participation in program planning and evaluation. Tr.

at 32. National Grid stated that it agreed with Staff that there had been some difficulties during the first year of the CIBS program, such as its inability to complete particular projects, but that it believed it had dealt with many of the problems and that it would be able to perform better in future years. Tr. at 32. National Grid recommended that the settlement agreement be approved. Tr. at 32.

B. Staff

Randall Knepper, Director of the Safety Division, testified for Staff. He stated that the CIBS program was important because Staff had observed a rise in leaks of cast iron and bare steel pipes and had concerns that the Company, as the state's largest provider of natural gas, was not repairing or replacing the pipes at a rate commensurate with that of some other operators in the state. Tr. at 21. Staff accepted National Grid's proposal of an accelerated program of pipe replacement as a means of reducing the safety hazards associated with main failures and corrosion leaks. Tr. at 22. He emphasized that while the Company had similar plans for Massachusetts and New York, which contained larger amounts of worn pipes, the Company's plan for New Hampshire was unique in that there was a collaborative effort in identifying, evaluating and prioritizing the selected segments for inclusion in the program. Tr. at 22-24. According to Mr. Knepper, the New Hampshire CIBS program requires pipe and soil testing with associated reporting so that replacement rates may, if necessary, be altered based upon actual field results rather than on conceptual modeling methods. Tr. at 25.

Mr. Knepper pointed out that during the prior year Staff had a very active role in determining which pipes would be replaced and in monitoring the work done. Tr. at 21, 24. He noted that Staff's role in helping to determine which pipes would be replaced was greater than anticipated because Staff had little confidence in the conceptual models and methods used by the

Company to select pipes for replacement. Tr. at 25. He stated that this was because the Company's models were not based on the circumstances present in New Hampshire. Tr. at 25. He also stated that the Company has now been able to develop a program that is unique to New Hampshire and that has met some of Staff's expectations. Tr. at 24. Moreover, he expected Staff's role in the process would diminish as the program progressed. Tr. at 30.

He further stated that he was disappointed with the Company's inability to complete five of the anticipated projects in fiscal year 2009, and he attributed that failure to delays within National Grid's control. Tr. at 26. He did agree that the Company has improved some of its processes to remove the internal delays. Tr. at 26. Despite not completing some projects, however, he also noted that he was pleased with the overall resulting customer impact of the CIBS program so far, noting that the impact on customers is only about $2-3 per customer per year. Tr. at 25. He also stated that he was satisfied with the Company's level of "discretionary" spending, in that it had completed twenty-six projects for between $2,000,000 and $3,000,000 in fiscal year 2009. Tr. at 27.

In sum, Staff expressed concern with the difficulties during the initial year of CIBS program implementation, but was also aware that National Grid had taken steps to cure some of the initial problems. Tr. at 31. Staff urged the Commission to approve the increase in distribution rates consistent with the CIBS settlement agreement. Tr. at 31.

V. COMMISSION ANALYSIS

New Hampshire Code of Administrative Rules Puc 203.20(b) provides that the Commission shall approve disposition of any contested case by settlement "if it determines that the result is just and reasonable and serves the public interest." *See also* RSA 541-A:31, V(a). In general, the Commission encourages parties to attempt to reach a settlement of issues through negotiation and compromise "as it is an opportunity for creative problem solving, allows the parties to reach a result more in line with their expectations, and is often a more expedient alternative to litigation." *Unitil Energy Systems, Inc.*, Order No. 24,677, 91 NH PUC 416, 425-426 (2006) (quotation omitted). However, even where all parties enter into a settlement agreement, the Commission cannot approve it "without independently determining that the result comports with applicable standards." *Id.*

We start by noting our agreement with Staff and National Grid that the CIBS program is important for ensuring safe and reliable service of natural gas in New Hampshire. Through this program, the Company is able to remove from service those pipes most likely to endanger public safety by leaking or failing, while permitting the Company the ability to recover the reasonable costs of replacing pipe without being subject to the degree of regulatory lag often associated with the replacement of such assets. As National Grid has acknowledged the importance of this program, we expect that it will be diligent in complying with its obligations thereunder going forward, and that it will be able to complete those projects for which it has planned and budgeted for fiscal year 2010. Considering the number of projects completed, we agree with Staff that the Company was reasonably effective in completing its work under the CIBS program during the initial program year.

The settlement agreement filed in this docket anticipates that the Company will increase its base distribution rates by $262,185 annually, effective August 1, 2009. This represents an increase of 0.12%, or $2.12 per residential customer per year. We find that the amount of the increase is reasonable, particularly given the benefits to safety and reliability provided by implementation of the CIBS program. We note that the settlement agreement accounts for changes to depreciation and taxes, as well as other, minor changes, to provide a rate increase that covers the costs to the Company and includes a return on National Grid's program-related investment. We are hopeful that National Grid will be able to make beneficial use of the federal legislation providing for "bonus" depreciation in completing its future projects under the CIBS program. We note also that while National Grid will be increasing its distribution rates, it is not proposing to alter its rate design. Thus, the Company is not attempting to use the CIBS process for more sweeping changes to its rates.

Also, in the settlement agreement, the Company agreed to a potential decrease to its rate base for those projects on which it had failed to perform the required testing and subsequent reporting during the fiscal year. The Company did perform, though belatedly, testing after its May 2009 filing, and has submitted partially completed reports for those test results that were available. Thus, no adjustments under this provision are necessary. Still outstanding at the time of hearing were the results of the microbial corrosion testing for the eight sites as demonstrated in Exhibit 3. By doing at least some testing before the hearing, the Company accepted the consequences of not complying with the commitments it made in its letter dated June 19, 2008. In the future, we expect that the Company will not require such on-going supervision and that such incentives will not be needed to guarantee compliance with the program.

Based on the above, we find the settlement agreement to be reasonable and in the public interest. Accordingly, we approve the increase in distribution rates as contemplated by the settlement agreement.

Based upon the foregoing, it is hereby

ORDERED, the settlement agreement filed with the Commission on July 8, 2009 is hereby approved; and it is

FURTHER ORDERED, that National Grid be permitted to increase its base distribution rates to provide additional revenues of $262,185 annually, effective August 1, 2009 on a service rendered basis, consistent with the settlement agreement; and it is

FURTHER ORDERED, that National Grid file with the Commission properly annotated tariff pages consistent with the settlement agreement and this Order within 10 days of the date of this order, as required by N.H. Code Admin. Rules Puc 1603.

By order of the Public Utilities Commission of New Hampshire this thirty-first day of July, 2009.

Thomas B. Getz
Chairman

Clifton C. Below (KNS)
Commissioner

Attested by:

Debra A. Howland
Executive Director

THOMAS O'NEILL
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07/31/09 Order No. 24,996 issued and forwarded to all parties. Copies given to PUC Staff.

Docket #: 09-095 Printed: July 31, 2009

FILING INSTRUCTIONS: PURSUANT TO N.H. ADMIN RULE PUC 203.02(a),

WITH THE EXCEPTION OF DISCOVERY, FILE 7 COPIES (INCLUDING COVER LETTER) TO:

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