Q. Please state your name, position and business address.

A. Michael Smith, Manager, Business Services, Northern Utilities, 1075 Forest Ave, Portland, Maine 04104.

Q. Please describe your employment responsibilities.

A. My responsibilities include retaining, expanding and attracting business within Northern Utilities' service territories. I am the point of contact with Northern's designated key business and industrial customers, and I am responsible for insuring quality service and opening business communications to counter competitive pressures. In addition, I manage other field sales representatives in our New Hampshire and Maine service territories.

Q. Please describe your education and employment background.

A. I received a Bachelor of Science in Mechanical Engineering Technology in 1989 from Wentworth Institute of Technology in Boston, Massachusetts. From 1989 to 1996, I was employed at Northrop, Devine and Tarbell in Portland, Maine. While there, I worked as a consulting engineer focusing on energy projects. In 1996, I began my career with Northern Utilities and have held several positions in which I have been responsible for managing Northern's industrial and key account customers in New Hampshire and Maine.

Q. What is the purpose of your testimony in this docket?

A. The purpose of my testimony is to present information to support Northern's proposal for amending and extending the terms and conditions of an existing Special

Contract for firm transportation service with National Gypsum Company ("National Gypsum" or "the Customer"). The proposed contract amendments are intended to: 1) extend the contract term for five (5) additional years beyond the expiration date of November 30, 2011; 2) provide for up to three (3) one-year automatic contract extension periods ; and 3) relieve National Gypsum of certain minimum annual payment obligations if its facility in Portsmouth, New Hampshire is permanently closed and ceases to operate.

Q. Does your testimony include input from other individuals employed by Northern Utilities?

A. Yes. My testimony includes information supplied by Paul Normand of Management Applications Consulting who contributed the marginal cost of service and value of service information used in this filing.

Q. Are you familiar with the provisions of the Special Contract and three (3) Amendments of Agreement that are submitted with this filing as Schedules NU 1-2 (Special Contract), NU 1-3 (Amendment of Agreement), NU 1-4 (Second Amendment of Agreement) and NU 1-5 (Third Amendment of Agreement)?

A. Yes. I worked directly with the Customer to negotiate the Special Contract in 1999, the First Amendment of Agreement and Second Amendment of Agreement in 2009, and the Third Amendment of Agreement that is submitted for the Commission's approval in the instant docket.

Q. Please describe the circumstances that led to the negotiation and execution of the initial Special Contract (Schedule NU 1-2).

A. National Gypsum is a manufacturer of gypsum wallboard. Its corporate offices are located in Charlotte, North Carolina and one of its manufacturing facilities is located at 1 Succi Drive, Portsmouth, New Hampshire. Gas is consumed in the facility's drying and mill operations. National Gypsum had been an interruptible transportation customer of Northern's since 1990. Because of the extremely large volumes of gas it consumed and because Northern's interruptible customers were going to experience at least a thirty-day curtailment period for the winter of 1999-2000, the Customer wanted the security associated with firm transportation service. In addition to that circumstance, newly-installed interstate pipeline facilities provided the Customer with a viable option to bypass Northern's system by interconnecting directly to the pipeline to obtain 365 days per year firm gas service. These circumstances led the Customer to approach Northern for a special pricing arrangement for firm transportation in 1999.

Q. Please summarize the terms and conditions of the original Special Contract relating to the services provided by Northern and the payment for those services by the Customer.

A. A copy of the Special Firm Transportation Agreement dated August 2, 1999 is submitted with this filing as Schedule NU 1-2. Article 1 obligates Northern to transport and deliver to the Customer during any Gas Day up to a Maximum Transportation quantity of 27,000 therms. In each contract year, the Customer is required to use and/or pay Northern for the transportation services for a minimum of 2,500,000 therms of natural gas. After the initial ten year term of the contract, the company will determine the cumulative average usage of gas over the initial term. The Customer is obligated to have used and/or to pay Northern for transportation services for an annual average of 5,000,000 therms per year during the initial term. This requirement is explained in Article 3 of the Special Contract. Initially, the Customer was required to pay a customer charge of $[redacted] per month and a volumetric rate of $[redacted] per therm for the first year. After the second year, Northern was allowed to apply an annual inflation adjustment to that charge and rate as described in Article 3 of the Special Contract. Based on these inflation adjustments, the current rates are now $[redacted] per month for the customer charge and a volumetric rate of $[redacted] per therm. In addition to the above-described service and payment provisions, the Special Contract incorporates by reference and makes a part of the contract all of Northern's General Terms and Conditions and Transportation Terms and Conditions as are in effect from time to time and filed with the New Hampshire Public Utilities Commission. In the event of a conflict, the provisions of the Special Contract govern.

Q. Please describe the initial term of the Special Contract.

A. Commission Order No. 23, 314 approved the Special Contract for a ten year term and required that the provisions of the Special Contract describing the term thereof be amended to require Commission approval for any extension period beyond ten years. The Amendment of Agreement dated October 30, 1999 (submitted herewith as Schedule

NU 1-3) was filed in compliance with Commission Order No. 23, 314. It provides that the initial term of the contract is ten years from the Service Commencement Date which is described in Article 5 of the Special Contract. The Service Commencement date was December 1, 1999; accordingly the initial term of the contract expired on November 30, 2009.

Q. Please describe the provisions of the Second Amendment of Agreement submitted with this filing as Schedule NU 1-4.

A. The Second Amendment of Agreement (Schedule NU 1-4) was approved by the Commission on November 25, 2009 in Order *Nisi* No. 25,047. It extends the provisions of the Special Contract (Schedule NU 1-2) as amended by the Amendment of Agreement (Schedule NU 1-3) for an additional two years beyond the contract's initial term, i.e. until November 30, 2011. The Second Amendment contains language that modifies Article 4 of the Special Contract as amended by the first amendment to extend the term of the contract as indicated above. The Second Amendment also provides that all of the other provisions of the Special Contract remain in full force and effect.

Q. Please describe the provisions of the Third Amendment of Agreement submitted with this filing as Schedule NU 1-5.

A. The Third Amendment of Agreement (Schedule NU 1-5) accomplishes three (3) things: 1) it extends the provisions of the Special Contract as amended by the Amendment of Agreement and Second Amendment of Agreement for five years beyond the current expiration date of November 30, 2011; 2) it provides for up to three (3) one-year automatic contract extension periods; and 3) it eliminates National Gypsum's obligation to make certain minimum annual payments if its facility in Portsmouth, New Hampshire is permanently closed and ceases to operate.

Q. Please explain the circumstances that led to the execution of the Third Amendment of Agreement.

A. Schedule NU 1-1 is a letter from the Customer setting forth the special circumstances that support an extension of the Special Contract and an amendment of some of its terms. In summary, many of the special circumstances that led to the negotiation, execution and approval of the Special Contract as described above continue to exist today. In addition, National Gypsum is facing increasing competitive pressures. High energy costs have led to the closing of one of its plants in New York. The Customer's direct competitor, Georgia Pacific, which is located in Newington, New Hampshire, has bypassed Northern and is taking gas service directly from the interstate pipeline which is located in close proximity. This enables the competitor to avoid costs that National Gypsum is paying to Northern and therefore puts the competitor in a stronger economic position than National Gypsum. Accordingly, the National Gypsum plant in Portsmouth is under pressure to control its energy costs to enable it to remain competitive with Georgia Pacific and to avoid suffering the same fate as its sister plant in New York.

Q. Please describe the steps Northern has taken to evaluate whether the Customer continues to have a viable bypass option.

A. Northern's engineering and construction personnel have estimated and analyzed the costs associated with the Customer's bypass option and have determined that the Customer continues to have an economically viable option to physically bypass Northern's facilities by interconnecting with the interstate pipeline. National Gypsum estimated the cost of the bypass at $[redacted] (Schedule NU-1-1). Northern performed its own estimate of the bypass at $[redacted] million (Schedule NU-1-6), and therefore believes that National Gypsum's bypass option remains economically viable.

Q. Has Northern performed an analysis of the Customer's value of service alternative?

A. Yes. The Company performed a value of service ("VOS") analysis for National Gypsum's bypass. The VOS considers the case where the Customer invests to bypass Northern's facilities and purchase and receive gas directly from the interstate pipeline. Under this scenario, the Customer incurs an initial capital expenditure of $[redacted] million, labeled "Customer Investment" and subsequent expenses for operations and maintenance of the distribution pipeline, labeled "O&M", as well as property taxes. As the base case is defined as the customer continuing with a special contract, under the bypass option the Customer avoids paying the special contract rates. These savings labeled "Net Revenues" on Schedule NU 1-7 are the revenues foregone by Northern. Finally, the Customer incurs some additional income taxes, computed in the remaining columns of

Schedule NU 1-7. Based on a potential annual usage of [redacted] Dt per year, the Customer's bypass would be repaid in five years and would generate a rate of return of [redacted]% over ten years. The second page of Schedule NU 1-7 is based on the minimum annual usage of [redacted] Dt per year, which results in a payback in seven years with a rate of return of [redacted]% over ten years.

Q. Has Northern performed an analysis of its long-run marginal costs of serving the customer? If so, please describe that analysis.

A. Yes. Northern is providing two marginal cost studies with this filing. The first, presented in Schedule NU 1-8, page 1 of 2, is the most recently-approved marginal cost study that was developed for unbundling and submitted in support of the original Special Contract filing in 1999, updated by an escalation factor to inflate the costs to today's dollars. The second marginal cost study, presented in Schedule NU 1-8, page 2 of 2, is the 2011 study for Northern's currently pending rate case, docket DG-11-069, updated with the most recent compliance version of the filing as of October 14, 2011.

The 1999 marginal cost study was originally developed to support unbundling and has since been used as a basis for computing the floor price used in connection with special contracts. Marginal costs may be easily updated. Marginal costs can be estimated from one year to the next by simply escalating the prior period marginal costs. This fact stems from the economist's fixed charge rate used to convert capital investments into annual carrying charges. Unlike a conventional fixed payment mortgage, payments to recover fixed costs rise in nominal dollars. Similarly, marginal operating and maintenance (O&M) expenses can be estimated by simply applying an appropriate escalation factor to the prior measure of marginal O&M expenses. The results of Northern's prior marginal cost study were updated to current price levels by identifying the customer-related and capacity-related unit costs, escalating to current levels and multiplying by National Gypsum's billing units to compute the marginal costs to provide delivery service.

The 2011 marginal cost analysis is the most recent and more relevant marginal cost study. Although this marginal cost study has not yet been approved by the Commission (because Northern's rate case is still pending) I believe that this marginal cost study should be used as the costs are more relevant than the prior study on a going forward basis.

Q. Please explain whether the price to be paid by National Gypsum during the five year extension of the Special Contract and any subsequent extension period(s) proposed in this filing will be above Northern's long-run marginal cost to serve this Customer.

A. In both of the marginal cost analyses referenced above, the price for the five year extension period exceeds the estimated marginal costs to provide service over the proposed extension period. Based on current rates, revenues of $[redacted] would be generated under the Special Contract. These revenues exceed the marginal cost estimate of $[redacted] presented on Schedule NU-1-8, page 1 of 2. This revenue requirement is based on the LRMC study using the original 1999 filing, escalated for inflation. In addition, revenues of $[redacted] also exceed the revenue requirements$[redacted] under the most recent compliance version of the marginal cost study in the 2011 rate case filing. This analysis is presented in Schedule NU-1-8, page 2 of 2. During each year the contract is extended, costs are subject to the same escalation factors, therefore revenues will continue to exceed the marginal costs.

Q. Based on your analysis, do you believe that extending the Special Contract for five years will allow National Gypsum to gain an unfair advantage over its competitor?

A. No. National Gypsum's competitor, Georgia Pacific has already bypassed Northern and does not pay any costs to Northern. Each company is subject to transportation costs on the interstate pipeline.

Q. Based on your analysis, do you have an opinion as to whether extending the Special Contract for five years and modifying it to allow for up to three (3) automatic one-year extension periods and to eliminate National Gypsum's minimum annual payment obligation if its Portsmouth plant closes is just and consistent with the public interest?

A. Yes. I believe that National Gypsum's situation continues to present special circumstances which render departure from Northern's tariffed rates and conditions to be just and consistent with the public interest. Extending the term of the Special Contract for another five (5) years provides benefits and certainty to Northern and its customers because the annual revenues under the Special Contract exceed Northern's long-run marginal costs of serving National Gypsum. Thus, retaining National Gypsum as Northern's customer will continue to keep the average system costs of transporting gas applicable to all of Northern's firm customers lower than it would be if Northern were to lose this Customer to bypass. In addition, the Special Contract helps the Customer to remain competitive and to continue its operations in New Hampshire, which contributes to the state's economy.

Northern is mindful of the fact that the Commission expressed concerns in Order No. 23, 314 relative to the self-executing extension clause contained in the original Special Contract executed in 1999. Those concerns were that because of the length of the term of the contract, the circumstances that justified the Special Contract in 1999 might not exist in the future, and therefore an extension without Commission review would be inappropriate. However, many of the circumstances that justified the initial Special Contract in 1999 have continued in the ensuing years and will likely continue for the foreseeable future. Thus, for administrative efficiency and to provide certainty to Northern, National Gypsum and other customers, Northern believes it is appropriate for the Special Contract to continue for up to three (3) years beyond the five (5) year extension period requested in this filing. This is accomplished by the self-executing extension clause which provides for up to three (3) one-year extensions unless either party notifies the other to the contrary at least six (6) months prior to the upcoming/applicable expiration date.

With respect to the issue of eliminating the minimum annual payment obligation in the event the Customer permanently closes its Portsmouth facility and ceases operations, I believe this contract modification is in the public interest. The Company's 1999 investment to serve this customer has been fully recovered. Thus, the risks associated with plant closure that were addressed by the minimum annual payment obligation during the initial term of the Special Contract are no longer present. In addition, if this Customer were taking service under the Company's tariffs, it would not be liable for a minimum annual payment if it ceased operations and stopped taking service. The risks to other customers posed by National Gypsum's plant closure would therefore be the same under the Special Contract as they would be if the Customer were taking service at tariffed rates.

Q. Please explain the need for the instant filing.

A. As indicated in Commission Order No. 23, 314 and the Amendment to Agreement (Schedule NU 1-3) filed in compliance with that Order, Commission approval is required to effectuate an extension of the Special Contract beyond the initial ten year term.

Q. Does this conclude your testimony?

A. Yes.

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