STATE OF NEW HAMPSHIRE
Inter-Department Communication

DATE: November 30, 2011
AT (OFFICE): NHPUC

FROM: Robert J. Wyatt RJW
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SUBJECT: DG 11-231
Northern Utilities, Inc.
Petition for Approval of 3rd Amendment to the Special Contract with National Gypsum

TO: Commissioners
Docket File
Service List

BACKGROUND

On October 18, 2011, the petitioner, Northern Utilities, Inc. (Northern or Company), filed with the New Hampshire Public Utilities Commission (Commission) a petition for approval of a third amendment to its special contract with National Gypsum. The third amendment seeks to accomplish three things: 1) extend the current agreement for an additional five years; 2) provide for up to three one-year automatic extensions; and 3) eliminate Nation Gypsum's obligation to make certain minimum payments if its facility in Portsmouth, NH is permanently closed and ceases to operate. The special contract covers firm transportation (delivery) service for National Gypsum's wallboard manufacturing facility at 1 Succi Drive in Portsmouth, New Hampshire. National Gypsum is a significant firm load in Northern's New Hampshire division, and an important employer in the Portsmouth area.

Northern had been providing delivery service to National Gypsum on an interruptible basis during the 1990-1999 period, and has been serving National Gypsum under a special contract for firm (year-round) delivery service since late 1999. *See Northern Utilities, Inc.*, Order No. 23,314 (Oct. 5, 1999). As a condition of its final approval, the initial special contract was amended to limit the term to ten years, and to require the parties to get approval from the New Hampshire Public Utilities Commission for any extension of the term beyond the initial term of ten years. The first expiration of the special contract took place in 2009, and the special contract was extended for two years, by means of a second amendment. *See Northern Utilities, Inc.*, Order No. 25,047 (Nov. 25, 2009). The special contract, as extended, is set to expire on December 1, 2011. On October 18, 2011, Northern filed a petition requesting approval for a third amendment to the contract that would extend the term of the special contract for five more years in order to allow National Gypsum to have its long-term energy needs met in an economic and stable fashion.

In the context of this request for an extended term, National Gypsum informed Northern that if it is unable to negotiate an acceptable new special contract with Northern for delivery service it will pursue other possible alternatives, such as bypassing Northern's system and connecting directly to an interstate natural gas pipeline located 6,700 feet from the facility. National Gypsum competes directly with another wallboard manufacturing facility located in Newington, New Hampshire, owned by Georgia Pacific. The Georgia Pacific facility has bypassed Northern's system and is connected directly to the interstate natural gas pipeline. The Georgia Pacific facility, therefore, does not pay Northern's delivery service costs, while National Gypsum incurs those costs, albeit at the discounted special contract rate.

Included with Northern's petition is testimony of Michael Smith, Manager, Business Services, Northern Utilities; a copy of the letter from National Gypsum requesting the term extension, dated September 20, 2011; a copy of the original agreement, with approved and proposed amendments; a letter illustrating the bypass cost estimate; a value of service estimate; and a marginal cost analysis update. Mr. Smith notes that the special circumstances and competitive pressures justifying the initial special contract continue to exist today. Northern asserts that the special contract was designed to meet the specific needs of the National Gypsum facility while at the same time providing benefits for Northern and its other customers. Northern asserts the revenues from the special contract have exceeded its marginal costs and will continue to do so during the five-year extension.

STAFF INVESTIGATION

Staff sent out data requests related to the petition and reviewed the file from the previous amendment to this special contract in DG 09-201. Staff also referred to the initial National Gypsum special contract approval in Docket No. DG 99-123.

As noted earlier, the first amendment to the special contract limited its initial term to ten years and the second amendment to the agreement extended the term for an additional two years. The third amendment, as filed in this petition, extends the term for an additional five-years, after which three self-executing one-year extensions will occur unless either party notifies the other that it intends to opt out. The third amendment also eliminates the current provision whereby National Gypsum is required to make annual payments if the facility is closed.

In its petition, the Company provided testimony and schedules supporting the reasons why this special contract is necessary. The discounted rate in this case enables Northern to retain National Gypsum as a firm customer for at least the next five years and allows National Gypsum continue operating its New Hampshire facility in a competitive environment. The Company's Schedule 7 provides a value of service analysis of the

Customer's estimated capital investment to potentially bypass Northern and install its own pipeline to connect to an interstate natural gas pipeline located approximately 6,700 feet from National Gypsum's facility.

In Mr. Smith's testimony (pg. 8), he explains how Northern provided updated marginal costs using the results from two separate marginal cost studies. First, in supporting Schedule 8, page 1, Northern uses the most recent "approved" marginal cost study, developed in the unbundling docket in DG 00-046 and updated by escalating the prior period marginal costs to current dollars. Additionally, in Schedule 8, page 2, Northern uses the most recently revised marginal cost study from its current base rate filing in DG 11-069, which was then updated to current dollars by escalating the 2010 test year result to 2011. On page 9 of Mr. Smith's testimony, he notes the results from the 2011 marginal cost analysis are the most recent and relevant marginal cost study. Although the base rate case is still pending, he believes the results from this study should be used as the costs are more relevant to use on a going-forward basis than those of the prior study.

The Northern study shows that the projected special contract delivery rates exceed long run marginal cost results based on either of the marginal cost studies. The special contract delivery rates produce revenue in excess of the cost to serve the National Gypsum load, therefore retaining National Gypsum as a customer will generate additional revenue and reduce the amount of revenue requirement to be recovered from other customers in future rate proceedings. Because the terms of the special contract have been in place for the past twelve years, and annual revenue generated by National Gypsum under the contract was used in determining the revenue requirement on which current rates are based, extending the contract should assist the Company in achieving its approved rate of return. Continuing the special contract will allow Northern to maintain its firm customer base to the benefit of all of its ratepayers without the expenditure of any additional capital investment.

The Company reports that this National Gypsum facility continues to be in direct competition with a Georgia Pacific wallboard plant located in nearby Newington. The operations and maintenance costs associated with the Portsmouth plant are also weighed against those of National Gypsum's other manufacturing facilities, five of which have been closed in recent years because of cost inefficiencies. In DG 09-201, National Gypsum reported that over a period of five years it had replaced all motors over 20 HP to high efficiency motors, upgraded plant lighting, rebuilt its main gas-fired kiln and switched to a high efficiency compressed air system. Thus, this facility is continually reviewing its energy consumption patterns and making necessary operational modifications or upgrades to become more efficient and competitive.

STAFF ANALYSIS

The following summarizes Staff's analysis and is the basis for Staff's recommendation in the case.

- Northern has updated its most recent marginal cost study and demonstrates that the *long run marginal cost* to serve this customer for the next five years is less than the special contract rates. Based on current rates, revenues generated from this account exceed the marginal cost estimate presented in its schedules. During each year of the contract extension, costs are also subject to inflation escalation factors, ensuring revenues will exceed the marginal costs. Staff collected the CPI-U and GDP-IPD factors from the Bureau of Labor Statistics and the Bureau of Economic Analysis web pages and performed its own inflation escalation rate and marginal cost calculations as a check on the Company's numbers. Staff determined that the rates were adjusted correctly and confirmed that the special contract rates continue to exceed Northern's marginal costs, whether starting with escalated marginal cost study results from the marginal cost study used in 2000, or using escalated marginal costs from the updated marginal cost study in Company's current base rate filing in DG 11-069. The downloaded GDP data Staff incorporated into its analysis reflected a slight variance beginning in year 2003 compared to the data used by the Company in its analysis. Staff believes its analyses uses the correct GDPLEV data for the annual marginal cost escalation factors and the results supported the Company's conclusions that the annual rate adjustments have remained higher than Northern's marginal costs.

- There will be no additional costs to Northern or its customers resulting from the extension of the term of this agreement. The special contract rate inflation escalator provides a level of assurance that the rate will continue to exceed the marginal cost to serve this customer over the term of the contract. The contract also provides that in no event shall fluctuations in the CPI-U reduce the special contract rates below the then current rates. In order to ensure that is the case before allowing the self-executing extensions to commence, Northern should file an updated analysis with the Commission seven (7) months prior to the first annual self-executing agreement. If circumstances have changed over the course of the five year extension such that the continuation of the terms of the agreement would be detrimental to the public interest, Northern would have the opportunity to terminate or revise the terms of the contract at that time.

- Northern's firm ratepayers have benefitted from the revenue associated with the special contract. The special contract delivery rates produce revenue in excess of the cost to serve the National Gypsum load and the additional revenue has reduced, and will continue to reduce, the amount of the revenue requirement to be recovered from other customers in base rate proceedings.

- Northern and it firm customers will continue to benefit from the 'must take' provisions of the special contract that encourage National Gypsum to run its Portsmouth facility at a high rate of production, which, in turn, results in the use of natural gas at higher volumes. The 'must take' provision will apply unless National Gypsum ceases operations and permanently closes its New Hampshire facility, in which case it will not be liable for the Minimum Annual Payment Obligation.

- The term extension of this third amendment to the agreement is scheduled to begin on December 1, 2011 and will remain in effect until at least November 30, 2016, with three successive one-year extensions if neither party exercises its right to terminate the extension through written notice six months prior to the new self-executing contract year.

- All other provisions of the original agreement, as amended and previously approved by the Commission, will remain the same.

- The extension of the special contract between Northern and National Gypsum is also in the general public interest, in that it will enhance National Gypsum's ability to secure economic energy supply for a major New Hampshire industrial facility with 65 full-time employees and 120 indirect support personnel.

STAFF RECOMMENDATION

That the Commission approve the Northern petition requesting a five-year extension, followed by three one-year self-executing extensions of the special contract with the National Gypsum absent either of the parties exercising its annual opt-out provision for the reasons stated above.

That Northern be required to provide the Commission with written notice of actual or impending termination of the special contract, resulting from closure of the facility or written notice prior to the three annual self-executing extensions.

That Northern be required to file an update of the special contract rate and marginal cost analysis with the Commission seven (7) months prior to the commencement of the first of the three annual self-executing extensions.