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STATE OF MAINE
BEFORE THE
PUBLIC UTILITIES COMMISSION

Docket No. 2005-87

NORTHERN UTILITIES, INC.

REBUTTAL TESTIMONY OF
JOSEPH A. FERRO

EXHIBIT NORTHERN-3

September 9, 2005

I. INTRODUCTION

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

A. My name is Joseph A. Ferro. I am Manager, Regulatory Policy for Northern Utilities, Inc. ("Northern" or the "Company"). I hold the same title for Bay State Gas Company ("Bay State"), Northern's Massachusetts affiliate. My business address is 300 Friberg Parkway, Westborough, Massachusetts 01581.

Q. Are you the same Joseph A. Ferro who previously submitted prepared direct testimony on behalf of Northern in this proceeding?

A. Yes, I am.

Q. What is the purpose of your rebuttal testimony?

A. The purpose of my rebuttal testimony is to respond to the following Intervenors that filed testimony in this proceeding: George R. McCluskey on behalf of the New Hampshire Public Utilities Commission ("NHPUC"), Rebecca Bachelder on behalf of Select Energy ("Select"), and George E. Briden on behalf of the Competitive Gas Suppliers ("CGS"). These witnesses challenge various elements of the Company's proposals initially filed with the Commission on February 22, 2005. My rebuttal testimony responds to matters that pertain to regulatory policy, capacity assignment and Northern's other tariff proposals. In addition, Francisco C. DaFonte, Director of Energy Supply Services also presents rebuttal testimony on behalf of Northern addressing supplier-of-last-resort ("SOLR"), capacity planning and reliability issues.

Q. Please summarize your rebuttal testimony.

A. My testimony is summarized in the following four areas:

(1) **The marketers seek to perpetuate the inequities that support the existing transportation services:** Transportation customers and their marketers accrue substantial benefits because transportation services were adopted in Maine without addressing critical issues including capacity assignment. As a result, customers have elected transportation service on the basis of economics that include artificial savings associated with cost-shifting to other customers. The marketers' recommendations would diminish the effect of the Company's proposals to redress these inequities or outright delay of any change to the *status quo*.

(2) **Mandatory capacity as proposed by Northern is a workable resolution of the cost allocation and capacity planning issues at hand:** Mandatory capacity assignment ensures that marketers serving transportation customers are responsible for the capacity-related costs of offering transportation service. Northern's resource portfolio includes the costs of capacity resources under long-term contracts acquired to serve all customers, including those that have subsequently elected to switch from firm bundled sales to transportation service. The resource portfolio also includes the costs of ensuring reliability for all customers, including transportation customers. Mandatory capacity assignment ensures that all customers pay their fair share of these capacity costs.

(3) **There is no reserve or excess capacity under mandatory capacity assignment:** Under a mandatory capacity assignment program, the LDC does not acquire any resources to backstop the market. Instead, Northern has the right to recall assigned resources in the event that customers return to sales service or their marketer fails to deliver supplies to Northern's citygates. So long as the marketer serves the customers, it has full access to sufficient levels of Northern's capacity to meet its customers' requirements. A reserve or duplicative level of

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capacity is only required to backstop transportation customers that have not been assigned Northern's capacity.

(4) **Other tariff modifications proposed by the Company are needed to achieve benefits sought by the marketplace:** The non-daily metered service option proposed by Northern is recognized as an important tool to provide the benefits of transportation to more customers. Other tariff changes are necessary to achieve a fully-functioning transportation program.

Q. Are there any other witnesses that filed testimony on behalf of Intervenors in this proceeding?

A. Yes. Jerome D. Mierzwa filed testimony on behalf of the Maine Office of the Public Advocate ("OPA"). The OPA represents the interests of the consumers that purchase Northern's services including sales and transportation services. Mr. Mierzwa supports Northern's proposals to institute mandatory capacity assignment and a non-daily metered transportation program, as well as its proposal to retain the role of SOLR to support the competitive marketplace. Thus, the entity representing the interests of Northern's customers in this proceeding advocates an approach that is the same as that recommended by Northern.

Q. Does the testimony offered by the Intervenor witnesses offer any basis for modifying Northern's proposals in this proceeding?

A. No.

II. MANDATORY CAPACITY ASSIGNMENT

Q. Please summarize the Company's capacity assignment proposal.

A. Northern's Maine transportation program has operated for a number of years without implementation of any capacity assignment methodology. In this docket and consistent with proposals made since 1999, the Company proposes to implement mandatory capacity assignment for all future customers that elect transportation service and for existing transportation customers on the next renewal date of their service agreement with Northern. Northern's capacity assignment proposal appropriately balances the need to allow competitive markets to develop with the need to prevent inequitable cost-shifting between sales and transportation customers. The capacity assignment framework proposed by Northern is consistent with that adopted for Northern's New Hampshire customers as well as for other New England states.

Q. What objections to the Northern's capacity assignment proposals do the Intervenors raise in their testimonies?

A. Witnesses Balchelder, Briden and McCluskey challenge Northern's proposal on various grounds including those of economics, policy and procedure. Ms. Bachelder claims that mandatory assignment is inconsistent with transportation customer contracts with marketers and that it constitutes 100% backup capacity. Messrs. Briden and McCluskey also raise the specter that the proposal represents

100% backup capacity, while Mr. Briden further claims that the proposal is detrimental to competition. I will address each of these concerns in turn.

Q. Are the existing contracts between marketers and their customers an impediment to the implementation of capacity assignment?

A. Northern's proposal appropriately balances the need to implement capacity assignment protocols with the potential that an existing transportation customer's contract with its supplier is based on the assumption that no capacity will be assigned by Northern. Northern proposes to delay the assignment of capacity until the expiration of a customer's service agreement with Northern. To the extent that customers and their suppliers choose to enter into an agreement that goes beyond the term of the customer's underlying transportation agreement with Northern, they have done so at their own risk that the contractual terms of Northern's transportation program would change. This is particularly true in Maine where the issue of capacity assignment has been pending in various dockets before the Commission for more than six years. The fact that these customers and their marketers have already benefited from the inequity between sales and transportation services for a number of years is not a valid basis to perpetuate the inequity beyond the term of customer agreements with Northern. A compelling reason does not exist to withhold the assignment of capacity to existing transportation customers once the underlying agreement with Northern that enables transportation service to that customer expires.

Q. Does mandatory capacity assignment equate to a 100% capacity reserve?

A. The suggestion that mandatory capacity assignment equates to a capacity reserve is simply untrue. Reserve capacity is capacity that is held above the needs of existing customers and that is not used unless the capacity is called upon. Under a mandatory capacity assignment approach, capacity is assigned to suppliers to serve customer needs. As such, there is zero reserve capacity. The market structure can accommodate competitive services without any capacity reserve under a mandatory capacity assignment approach because the utility can recall capacity from marketers that do not serve their customers at any point in the future, regardless of how tight capacity markets might be. Under mandatory capacity assignment, reliable capacity is signed over to marketers to serve their customers. At the same time, this capacity serves the dual purpose of backstopping the market. There is no capacity redundancy under this approach contrary to the claims by the Intervenors. Only the capacity that is needed to serve transportation customers that subsequently need supplies from Northern is recalled.

Q. Will mandatory assignment quash the competitive market in Northern's service territory as alleged by Mr. Briden?

A. One need only examine the transportation programs in the nearby states of New Hampshire, Massachusetts and Rhode Island to realize that transportation programs continue to provide benefits to customers after the adoption of rules regarding mandatory capacity assignment. While some may argue that these programs serve fewer customers than they would without the assignment of capacity, there are numerous factors that affect the implementation and success of transportation programs and it is impossible to determine to what extent capacity assignment helps or hinders the development of the market. Further, the size of the program is not the only measure of success. Programs with mandatory capacity assignment do not depend on artificial benefits achieved through cost-shifting to achieve success. Thus, with mandatory assignment, savings provided by competitive suppliers truly achieve lowest commodity cost service, just as the utility's gas supply service represents its best cost service. Comparisons of the level of transportation in various states must take into consideration whether or not transportation service depends on the shifting of costs to sales customers in order to achieve a higher level of migration.

It should also be pointed out that two of these states, New Hampshire and Massachusetts, have implemented a slice-of-system assignment approach, which the marketers claim leads to unmanageable capacity contracts. Generally, the marketers serving customers in Maine are the same as those serving customers in New Hampshire and Massachusetts that require mandatory slice-of-system assignment of capacity. In both cases, it appears that the minimum pool size before the assignment of capacity and the availability of capacity mitigation service allow the slice-of-system method to be implemented in a workable manner.

Q. Do any of the Intervenors offer alternative capacity assignment proposals?

A. Yes. Ms. Bachelder recommends a program that exempts all existing customers from capacity assignment and provides for marketers to commit to take assignment for an unspecified percentage of the capacity needed to serve customers that migrate to transportation in the future. Mr. McCluskey indicates that Northern's mandatory capacity assignment program could be modified through the use of planning assumptions that appropriately take into account the probability of supplier failure or through the use of a transition cost surcharge model. Mr. Briden offers no capacity assignment proposal other than to recommend that the Commission establish future procedures to investigate capacity assignment and other issues.

Q. Isn't it true that other states have exempted existing transportation customers from revised capacity assignment rules requiring mandatory capacity assignment as claimed by Ms. Balchelder?

A. Yes, other states including Massachusetts and New Hampshire grandfathered existing transportation customers from capacity assignment rules that include the mandatory assignment of capacity. However, the states that Ms. Bachelder cites as examples in support of her recommendation to grandfather Maine customers from mandatory capacity assignment point out the inequities created in Maine through a long delay in addressing these critical capacity issues. With the exception of New Hampshire, which established a cutoff date for the assignment of capacity of March 14, 2000, the date of the New Hampshire Commission's Order of Notice in DE 98-124, Gas Restructuring to address unbundling and natural gas competition, the other decisions were rendered during the 1990s. The adoption of mandatory capacity assignment in these states was resolved at a point in time that could accommodate the level of grandfathering that resulted. The same is not true in Maine where such a substantial proportion of load has migrated while the Commission has considered capacity assignment issues. If a grandfathering date is established, it should be June 4, 1999, which is the date the Commission opened the inquiry into Natural Gas Competition and Unbundling issues, Docket No. 99-342. The parties were well aware that the Commission was considering capacity assignment issues at that time and that Northern was advocating the mandatory assignment of capacity to suppliers serving all transportation customers. The Commission even asked commenters to address the need to limit migration to transportation prior to the establishment of capacity assignment rules so that marketers would not be able to avoid mandatory capacity assignment responsibility.

Q. Please comment on Ms. Bachelder's recommendation that suppliers could commit to taking a percentage of capacity for customers that migrate in the future.

A. Ms. Bachelder did not offer a concrete proposal through her testimony as to how much capacity she recommends that suppliers take assignment of, making it difficult for the parties and the Commission to consider the merits. In response to Northern's discovery request to Select, Northern 1-18, she indicates that an allocation of 25-35 percent would be reasonable. As a result, a much larger percentage, i.e. 65-75 percent, would be subject to voluntary assignment. When considering the impact of grandfathering 100% of the substantial volumes that have already migrated to transportation service, Ms. Bachelder's proposal represents likely less than 10% assignment of capacity to transportation customers, with the remaining amount voluntarily assigned. Voluntary assignment continues the undesirable cost-shifting that I discussed in my direct testimony and should not be adopted.

Mr. McCluskey's recommendation that Northern's program be modified to take into account planning assumptions or to include transition cost surcharges also represents some form of voluntary assignment. Mr. McCluskey acknowledges that mandatory capacity assignment addresses the cost-shifting concerns that he indicates are the basis for the NHPUC's interest in this Maine proceeding. I would also point out that Northern's proposed mandatory capacity assignment is consistent with the approach adopted by the NHPUC for New Hampshire customers.

Q. What are the regulatory policy implications of delaying resolution of capacity assignment issues until further proceedings are conducted by the Commission as recommended by Mr. Briden?

A. Mr. Briden's recommendations are most troubling. The capacity assignment issues have been before the Commission and subject to discussion since 1999. The issues are more than ripe for resolution now and should be addressed by the Commission. Substantial effort has been made to support and explain Northern's proposals, including the time and expense invested in responding to numerous discovery requests propounded by CGS. To claim at this stage of the proceeding that Northern's proposals are wholly unsupported is disingenuous. In response to Advisors request 5-1, Mr. Briden indicates that he has no way of knowing how long the new proceeding he recommends would take in order to reach conclusion.

It is reasonable to conclude that Mr. Briden's proposal is a disingenuous attempt at continuing the status quo to the detriment of Northern's firm sales customers. Mr. Briden's recommendation to begin anew is counterproductive and wasteful. The Commission should dismiss this recommendation.

III. NON-DAILY METERED SERVICE

Q. Please summarize Northern's proposal to offer non-daily metered service.

A. Consistent with its recommendations in the Commission's 1999 inquiry into natural gas competition issues, Northern proposed to offer a non-daily metered service option. This optional service would eliminate costly metering requirements and require the LDC to assume responsibility for establishing required marketer deliveries and balancing differences between these deliveries and actual customer usage on a day-to-day basis. These differences are attributable to weather and other causes.

Q. How have the Intervenors commented on the Company's proposal to offer non-daily metered service?

A. Ms. Bachelder supports the offering of non-daily metered service as one of the more important aspects of a workable transportation program, although she recommends that the daily supplier balancing charge be eliminated. Mr. Mierzwa indicates that he has no concerns presently with the proposal and Mr. McCluskey does not address it.

Q. Please discuss Ms. Bachelder's recommendation to eliminate the daily balancing charge.

A. The daily balancing charge is needed to compensate Northern's sales customers for the use of the capacity resources that are called upon to manage the daily imbalances of non-daily metered customers. It should be noted that the supplier balancing charge is designed to recover the daily imbalances caused only by the variance in the anticipated or short-term forecast weather, in terms of effective degree days, and the actual weather, and does not impose on suppliers any imbalance caused by any inaccuracy of the Company's algorithm or a customer's unanticipated change in, or erratic, daily consumption behavior. The revenues derived from the charge are fully credited to Northern's sales customers who pay for the necessary resources through the cost of gas adjustment mechanism. Elimination of the charge would be unfair to sales customers and result in a further subsidization by firm sales customers of transportation customers.

Q. Does Mr. Briden support Northern's non-daily metered service proposal?

A. No. Mr. Briden recommends that all of the Company's enhancements to its transportation tariff terms and conditions be summarily rejected by the Commission. For the reasons explained previously, such a recommendation is counter-productive and denies customers the benefits of service improvements desired in the marketplace.

Q. Does this conclude your rebuttal testimony?

A. Yes, it does.