DG 99-127

NORTHERN UTILITIES, INC.

Petition for Step Increase for Bare Steel Replacement

Order Approving Bare Steel Step Adjustment

O R D E R   N O. 23,333

October 29, 1999

APPEARANCES: LeBoeuf, Lamb, Greene & MacRae, L.L.P., by Paul B. Dexter, Esq., on behalf of Northern Utilities, Inc. and Larry S. Eckhaus, Esq., for the Staff of the New Hampshire Public Utilities Commission.

I. PROCEDURAL HISTORY

On September 13, 1999, Northern Utilities, Inc. (Northern) filed with the New Hampshire Public Utilities Commission (Commission) a petition for approval of a step adjustment for certain defined investments and depreciation relative to a program for replacement of bare steel pipe and reduced by the sale of a portion of the Gosling Road Lateral (GRL). On September 20, 1999, Northern filed a cover letter and testimony of David A. Deans, Regulatory Policy Specialist, in support of the petition.

By Order No. 20,546, Re Northern Utilities, Inc. 77 NHPUC 366 (1992), the Commission approved a settlement agreement which provided for periodic step adjustments for certain defined investments and depreciation in a program for replacement of bare steel. By Order No. 22,386, Re Northern Utilities, Inc. 81 NHPUC 818 (1996), the Commission approved modifications to the original settlement agreement which eliminated the adjustment related to changes in Domtar net revenues and required that the pre-tax rate of return be calculated using Northern’s current debt and cost structure. By Order No. 23,148 (February 19, 1999), the Commission approved a settlement agreement which provided for the removal from Northern’s rate base of the portion of the GRL that was sold, the removal to take place through Northern’s next bare steel step adjustment.

An Order of Notice was issued September 15, 1999 setting the date of the hearing for October 15, 1999 at the Commission’s office in Concord, New Hampshire. There were no intervenors and a duly noticed hearing on the merits was held as scheduled.

II. POSITIONS OF THE PARTIES AND STAFF

A. Northern

Northern witness David A. Deans, Regulatory Policy Specialist, explained the calculation of the proposed step adjustment. The proposed step adjustment consists of two components: an increase due to the costs related to the bare steel replacement program for the current twelve months ended September 30, 1999 and a reduction related to Northern’s sale of the GRL.

The proposed revenue requirement related to replacements is calculated on capital investments of $1,175,274 for the period October 1, 1998 through September 30, 1999.

Incremental deferred income taxes related to these plant additions reduce the rate base amount subject to recovery in this step adjustment by $102,689, leaving a balance of $1,072,585. Using Northern's current capital structure and cost of debt results in a weighted cost of capital of 9.40% and a tax effected cost rate of 13.46%. Applying the tax-effected cost rate (13.46%) to the balance available for recovery ($1,072,5852) results in a revenue requirement of $144,370. To that is added the annualized depreciation expense of $32,943 and results in a total revenue requirement related to replacements of $177,313.

Northern's total proposed step adjustment revenue requirement related to the sale of the GRL is calculated on a reduction in rate base of $328,299 (the net plant book value at the time of sale) adjusted for incremental deferred income taxes related to the GRL sale. This reduces the rate base amount by $30,526 and results in a balance of $297,773. Applying the tax-effected cost rate (13.46%) to the balance available for recovery ($297,773) results in a reduction in the revenue requirement of $40,080. The annualized depreciation expense of $12,926 is also deducted, resulting in a total reduction in the revenue requirement related to the sale of the GRL of $53,006.

The proposed revenue requirement, based on the above calculations, is $124,307. This is the seventh bare steel replacement step adjustment and will increase the monthly bill for a typical residential heating customer by less than $0.50.

The cumulative impact of the approved and proposed step adjustments over the eight years of the program has increased customer bills by five percent (5%).

Mr. Deans testified that Northern’s earned return on rate base for the 12 months ending June 30, 1999 was 4.11%, significantly less than that needed to support capital investments in its operations and significantly less than that allowed by the Commission. Mr. Deans argued that the proposed step adjustment was necessary to allow Northern an opportunity to earn a reasonable return in order to be able to continue to finance the necessary investments in new and replacement plant to service its new and existing customers. Mr. Deans stated that it was his opinion that the step adjustments have enabled Northern to avoid filing a general rate case since 1991 and saved ratepayers the extraordinary costs associated with such a filing.

Northern witness Raymond Johnson, Engineering Manager, testified that since the inception of the bare steel replacement program, the number of corrosion leaks have declined steadily from a high in 1990 of 174 to a low of 45 for 1999. Mr. Johnson further testified that the program has been in operation ten years and, if continued at current levels, would require approximately 15 to 16 years to replace all bare steel mains and services.

Mr. Deans testified that included in this filing, and in prior bare steel replacement step adjustments, are main replacements that have occurred as part of municipal or state required main relocation projects. In addition, the incremental cost of installing upgraded (i.e., mains of a larger diameter) mains has also been included in the step adjustments. Mr. Johnson stated that such replacements are equally effective in reducing leaks as are replacements done outside of municipal and state-mandated utilities relocation projects. He also pointed out that all of the relocation projects, except one, were high on the bare steel main replacement priority list and would have been replaced regardless of the relocation requirement. The cost of the replacement not on the replacement priority list was $12,215 and the incremental cost for over-sizing a replacement pipe was $8,304.

B. Staff

Staff stated that the bare steel replacement program, as approved by the Commission, established two phases. The first phase, which has already been completed, was the immediate repair phase and was instituted due to safety concerns. The second phase, which Northern is currently in, replaces bare steel that does not pose an immediate risk to safety. Consequently, Staff believes that this may be the time that step adjustments related to these bare steel replacements should end, in accordance with Article III, Paragraph 6, of the stipulation.

Staff pointed out that the testimony and information obtained in this proceeding indicate that the number of leaks has significantly declined over time and that the ratepayers have paid a significant amount of money for these replacements. Staff calculated that customers have paid revenues in excess of $7 million for replacements that cost $8.7 million and will annually pay an additional $1.4 million.

Staff suggested that bare steel replacement costs might be better addressed in base rates, as a case is developed, rather than through step adjustments. Staff conceded that the cost of a general rate case would be significantly higher than that related to a step adjustment, but given that Northern has not been in for a general rate case in a number of years, felt that there are probably a number of costs that should be adjusted and issues addressed, such as the appropriate return on equity.

Staff took exception to including the cost of the replacements resulting from municipal and state required relocations. It is Staff's position that this particular program should be utilized to make Northern do that which it would not ordinarily be required to do. The Commission noted in its Order establishing the step adjustment, "the Commission normally does not allow plant added after the end of the test, unless it is an extraordinary event." This program was designed to encourage Northern to make investments to replace bare steel. Some of these replacements where there are municipal and state relocations would have been required without the bare steel program. The fact that these replacements have been allowed in the prior proceedings is not a basis for continuing to do so.

In addition, Staff took exception with including the cost of incremental over-sizing for recovery through the step adjustment. Incremental sizing may serve to improve or provide an opportunity for additional sales, and may not be construed as totally non-revenue producing, and, therefore, that amount should be excluded.

Staff requested the Commission to direct Northern and Staff to consider whether the bare steel replacement step adjustment should continue going forward in the same form or some other form, if at all, prior to the next bare steel step proceeding.

III. COMMISSION ANALYSIS

After reviewing the record, we find that the investments required to replace Northern’s bare steel mains have been prudently incurred and are used and useful in the provision of utility service. In addition, the program has improved safety and limited leakage, which the Commission has supported since its initiation in DR 91-081.

That said, the replacement program was implemented in order to minimize active corrosion and gas leaks and has accomplished those objectives. As the magnitude of the problem has decreased, the risk to public safety has been substantially reduced and the program design and cost should be reevaluated in this light. As requested by Staff, we direct Northern and Staff to meet prior to the next bare steel step proceeding and evaluate the program design, both the level and recovery mechanism.

While the investments under this program have been prudent, we agree with Staff that certain of those costs should not be recovered through this step adjustment. Specifically, if a main replacement results from a municipal or state-mandated utilities relocation project, and the particular main is not subject to corrosion or leakage as indicated by the priority replacement list, then the cost of that project should not be recoverable through this program. On the other hand, if a bare steel main is scheduled for replacement and is done as part of a municipal or state-mandated utilities relocation project, those particular projects have addressed the problems the bare steel replacement program was designed to address and should be included as part of the program. Accordingly, we will disallow the $12,215 cost associated with the main replacement done as part of a municipal program but not scheduled for relocation per the bare steel replacement priority list.

We would also agree with Staff that the incremental cost of over-sizing replacement mains should not be included in the bare steel step adjustment, as the intent of the original order was that replacement costs were to be non-revenue producing and that such upgrades may have a revenue impact. Accordingly, we will disallow the $8,304 incremental cost for the over-sized main included in the filing.

Based upon the foregoing, it is hereby

ORDERED, that Northern's petition for a bare steel step adjustment to base rate revenues of $124,307 is adjusted to $120,977 per year, to recover depreciation and return on investments related to Northern's bare steel replacement program net of the sale of the Gosling Road Lateral is APPROVED for bills rendered on or after November 1, 1999; and it is

FURTHER ORDERED, that Northern file properly annotated tariff pages in compliance with this Order no later than 15 days from the issuance date of this Order, as required by N.H. Admin.

Rules, Puc 1603; and it is

FURTHER ORDERED, that Northern and Staff are directed to review the bare steel replacement program design and recovery mechanism and to provide their recommendations to the Commission by March 31, 1999.

By order of the Public Utilities Commission of New Hampshire this twenty-ninth day of October, 1999.

Douglas L. Patch Chairman	Susan S. Geiger Commissioner	Nancy Brockway Commissioner

Attested by:

Thomas B. Getz
Executive Director and Secretary