

DG 99-127
DG 00-177

NORTHERN UTILITIES, INC.

**Petition for Step Increase for Bare Steel Adjustment
and Settlement Agreement**

**Order Approving Bare Steel Step Adjustment
and Settlement Agreement**

O R D E R N O. 23,576

October 30, 2000

APPEARANCES: Rubin and Rudman L.L.P. by Maribeth Ladd, Esq. for Northern Utilities, Inc. and Larry S. Eckhaus, Esq. for the Staff of the New Hampshire Public Utilities Commission.

I. PROCEDURAL HISTORY

On September 15, 2000, Northern Utilities, Inc. (Northern) filed with the New Hampshire Public Utilities Commission (Commission) a petition for approval of a Settlement Agreement filed with the Commission on August 23, 2000, and a step adjustment for certain defined investments related to its Bare Steel Replacement Program (Program). The Settlement Agreement contained Northern and Commission Staff recommendations regarding the Program requesting that the Settlement Agreement and the step adjustment filing be combined for review and joint consideration. The Commission, by Order No. 20,546 in *Re Northern Utilities, Inc.*, 77 NH PUC 366 (1992), approved a settlement agreement which provided for periodic step adjustments for this purpose.

The Commission, by Order No. 22,386 in *Re Northern Utilities, Inc.*, 81 NH PUC (1996), approved a settlement agreement which eliminated the adjustment related to changes in Domtar net revenues and required the use of Northern's current debt structure and cost when calculating the pre-tax rate of return. The Commission, by Order No. 23,148 in *Re Northern Utilities, Inc.*, 84 NH PUC 134 (1999), approved a settlement agreement which provided for the removal from Northern's rate base of the portion of the Gosling Road Lateral that was sold. In *Re Northern Utilities, Inc.*, 84 NH PUC 573 (1999), by Order No. 23,333 approved an increase in annual revenue of \$120,977 and ordered Northern and Staff to review the bare steel replacement program design and recovery mechanism and to provide recommendations to the Commission.

An Order of Notice was issued September 21, 2000 setting the date of the hearing for October 26, 2000 at the Commission's office in Concord, New Hampshire.

On September 29, 2000, Northern filed the testimonies of David A. Deans and Sharon A. Eon and Schedule F to be added to the original petition. On October 12, 2000, Northern filed updated Exhibit I and Schedule A which are updates to reflect actual data for the month of September 2000 in substitute for estimates for that period included in the petition. On October 24, 2000, Northern filed Exhibits 2 and 3 which provide details of the bare steel replacement

mains described in the pre-filed testimony of Sharon Eon and provide various multi-year data regarding the bare steel replacement main program, respectively.

There were no intervenors in the proceeding. A duly noticed hearing on the merits was held at the Commission on October 26, 2000 at which time Mr. Deans and Ms. Eon testified in support of the Settlement Agreement and the September 15, 2000 petition.

II. SETTLEMENT AGREEMENT

The Settlement Agreement, entered into between Northern and Staff, addresses issues surrounding Northern's Bare Steel Replacement Program. The Settlement Agreement is summarized below:

Northern and Staff recognize the past and continued importance of replacing Northern's bare steel mains and services, which are subject to continuing corrosion. During the period of 1990 through 1999, under the accelerated replacement program and related step adjustment, Northern has replaced approximately 338,000 ft., or nearly one-half, of its bare steel mains. Still, as of September 30, 1999, approximately 388,000 ft. of bare steel mains remain to be replaced. The number of corrosion leaks during that same period declined from 174 in 1990, to 45 in 1999, a decrease of 74%. In 1990, corrosion leaks represented 82% of all leaks; in 1999, that figure had declined to 49%. When the bare steel accelerated replacement program began in 1990, a large percentage of bare steel main segments carried high scores from the Company's Bare Steel Point System Program (which assists in ranking priority of segments replacement), some as high as 30. As of March 20, 2000, forty-four bare steel segments, totaling 28,600 feet, carried scores above 10. At that date, the scores of those segments ranged from 10.03 to 16.06. Several of these segments are proposed for

replacement in 2000. Because bare steel is subject to continuing corrosion, there is no certainty that the scores will remain at this lower level. Bare steel still represents approximately 18% of Northern's system, while it only represents 1.8% of EnergyNorth Natural Gas' system.

Northern has provided Staff with a schedule of its anticipated bare steel mains to be replaced during the twelve months ending September 30, 2000. Staff takes no position, at this time, with regard to the specific projects and pipe segments selected by Northern for replacement, and Northern reserves the right to revise the schedule as may be necessary, with appropriate explanation thereof. Nevertheless, based upon the schedule, the significant improvement in corrosion leaks and the possibility of a general rate case proceeding in 2001, Northern and Staff have agreed to one additional year of the accelerated replacement program and related Step Adjustment, effective November 1, 2000, consistent with the Commission's approval of the step adjustment in Order No. 23,333, as modified below:

1. The Accelerated Bare Steel Replacement Program and related Bare Steel Step Adjustment which is the subject of this Settlement Agreement is for the twelve months ending September 30, 2000 ("Year 2000") bare steel replacements only, i.e. one year only.
2. Depreciation expense will be calculated net, i.e. based upon currently approved depreciation rates as applied to bare steel main and service replacement additions less related retirements.
3. For the purposes of this Bare Steel Step Adjustment only, Northern and Staff agree to use a weighted cost of capital of 8.87%, and a pre-tax weighted cost of capital of 12.50%, based upon the current capital structure. These cost rates are lower than if the return on equity approved by the Commission in Order No. 20,546 continued to be used as in past step adjustments.
4. Municipal/state relocations shall be excluded if the relocation is required because the existing bare steel main is in conflict with the proposed work. Thus, where the municipality or State orders the main to be relocated, the main segment will not be included. However, if the bare steel main segment being relocated has been scheduled by the Company for current replacement, it shall be

- included in the step adjustment.
5. The incremental cost of oversizing and related depreciation will not be included except for the next largest size pipe.
 6. The incremental cost of oversizing bare steel replacements for system improvements and related depreciation will not be included.
 7. The capitalized cost of bare steel mains and services replacement for Year 2000 to be included for the purpose of a bare steel replacement step adjustment shall not exceed one million dollars (\$1,000,000). However, the Company reserves the right to request inclusion of replacements in excess of one million dollars (\$1,000,000) if extraordinary circumstances require such replacements, subject to approval of the Commission.
 8. Northern agrees to provide Staff with an updated schedule of the Bare Steel Point System Program filed on disk and hard copy after completion of Year 2000 replacements, by September 30, 2000.
 9. Northern shall file for its November 1, 2000 step adjustment no later than September 30, 2000, including testimony supporting the filing and the segments replaced, based on 11 months actual and one month estimated data. The filing, updated with 12 month actual data, shall be filed 21 days prior to the date of a hearing on the filing, if possible, but not less than 14 days. The updated filing will include a report, in the same format as Exhibit 14 in Docket DG 99-127, based on the Year 2000 which will include the footage of bare steel mains and total mains replaced during the year, the footage of bare steel mains remaining in the system at the end of the year, the number of corrosion leaks and all leaks during the year, and maps indicating the total bare steel mains replaced and remaining to be replaced at the end of the year
 10. The filings by Northern to implement the bare steel step adjustment to be effective November 1, 2000, shall be subject to audit and review by Staff and approval by the Commission prior to implementation with regard to, but not limited to, segments replaced, costs and all related calculations and assumptions.

11. Subsequent to the step adjustment for the Year 2000, Northern shall continue to monitor the condition of its bare steel system and to inform the Commission's Gas Safety Engineer regarding its bare steel replacement activities. Northern shall annually file with the Commission on December 1 a report based on the preceding twelve month period ending September 30 which will include the footage of bare steel mains and total mains replaced during the period, the footage of bare steel mains remaining in the system at the end of the period, the number of corrosion leaks and all leaks during the period, and maps indicating the total bare steel mains replaced and remaining to be replaced at the end of the period, in the same format as Exhibit 14 in Docket DG 99-127.
12. If Northern does not have a general rate case proceeding in 2001, it reserves the right to petition the Commission for the resumption of bare steel replacement step adjustments if the leak activity of the bare steel system indicates that the resumption of accelerated replacement activity is appropriate. Staff reserves the right to oppose such a petition.

III. POSITIONS OF THE NORTHERN AND STAFF

A. Northern Utilities, Inc.

Northern witness David A. Deans, Regulatory Policy Specialist, explained the calculation of the proposed step adjustment. The proposed step adjustment consists of an increase due to the costs related to the bare steel replacement program for the current twelve months ended September 30, 2000.

The proposed revenue requirement related to replacements is calculated on capital investments of \$893,278 for the period October 1, 1999 through September 30, 2000.

Incremental deferred income taxes related to these plant additions reduce the rate base amount subject to recovery in this step adjustment by \$100,694, leaving a balance of \$792,584. Northern utilized the weighted cost of capital of 8.87% and a pre-tax weighted cost of capital of 12.50% as stipulated in the Settlement Agreement. Applying the tax-effected cost rate (12.50%) to the balance available for recovery (\$792,584) results in a revenue requirement of \$99,073. To that is added the net annualized depreciation expense of \$24,187 and results in a total revenue requirement related to replacements of \$123,260.

This is the eighth bare steel replacement step adjustment and will increase the monthly bill for a typical residential heating customer by less than \$0.30. Mr. Deans testified that Northern's earned return on rate base for the 12 months ended June 30, 2000 was 7.52%, significantly less than Northern believes is needed to support capital investments in its operations and less than the return allowed by the Commission.

Ms. Eon testified regarding the segments of bare steel that were replaced during the twelve month period ending September 30, 2000. Ms. Eon stated that Northern will continue to replace bare steel, even without the incentive of

the step adjustment mechanism, to ensure the safety and reliability of the system. Northern represented that approximately one-half of the original bare steel has been replaced.

Northern's witnesses stated that they were unsure whether Northern would be filing a base rate case in 2001 or, if Northern did not file a base rate case, whether it would request resumption of the step adjustment mechanism.

B. Staff

Staff recommended that the Commission approve the Settlement Agreement and Northern's petition. Staff stated that it had conducted a review of the petition and found it to be consistent with the terms and conditions of the Settlement Agreement. Further, Staff stated that the Commission's Audit Staff had conducted an audit of the expenses related to the bare steel adjustment and found only minor errors which Northern accounted for at the hearing.

Staff stated that the step adjustment was established in a rate case proceeding nine years ago and that over the years, changes have been made to the mechanism. However, Staff believes that the appropriate forum to address investments related to bare steel is in a rate case proceeding.

Staff stated that it will continue to monitor Northern's efforts to replace bare steel. Staff agrees with Northern that bare steel still in Northern's distribution system needs to be replaced. Staff stated that Northern should continue to work with the Commission's Gas Safety Engineer and will file annual bare steel reports which will allow Staff the ability to advise the Commission if corrective actions are necessary to ensure the safety and reliability of the system.

IV. 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. Further, we approve the Settlement Agreement entered into between Northern and Staff regarding the current Bare Steel Step Adjustment.

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 continually reevaluated in the light of these objectives and results. Accordingly, we direct Staff to monitor Northern's activities with regard to bare steel replacement activities and advise the Commission periodically of the status of replacement.

While the investments under this program have been prudent, we find that the factors which contributed to our approval of the step adjustment in Docket DR 91-081 have been minimized and we approve this step adjustment as the last step adjustment, barring a base rate proceeding or a petition from Northern, in accordance with the Settlement Agreement, demonstrating the opposite. Should Northern decide to request resumption of the step adjustment in accordance with the terms of the Settlement Agreement, we require Northern to make such petition on or before July 1, 2001 to allow Staff ample opportunity to investigate the request.

Based upon the foregoing, it is hereby

ORDERED, that the Settlement Agreement entered into between Northern and Staff is APPROVED; and it is

FURTHER ORDERED, that Northern's petition for a bare steel step adjustment to base rate revenues of \$123,260 to recover depreciation and return on investments related to Northern's bare steel replacement program is APPROVED

effective November 1, 2000; and it is

FURTHER ORDERED, that we waive the application of N.H. Admin. Rules, Puc 1203.05(a), which requires generally that rate changes be implemented on a service-rendered basis, and will allow Northern to implement its step adjustment on a bills-rendered basis; 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.

By order of the Public Utilities Commission of New Hampshire this thirtieth day of October, 2000.

Douglas L. Patch
Chairman

Susan S. Geiger
Commissioner

Note: Commissioner Nancy Brockway did not participate in this proceeding.

Attested by:

Thomas B. Getz
Executive Director and Secretary