DG 01-182

NORTHERN UTILITIES, INC.

Petition for Rate Change

Final Order

O R D E R N O. 24,075

October 28, 2002

APPEARANCES: Rubin and Rudman, L.L.P., by Maribeth Ladd, Esq. for Northern Utilities, Inc.; Office of the Consumer Advocate, by Mr. Kenneth Traum on behalf of residential ratepayers; and Marcia A. B. Thunberg Esq. for the Staff of the New Hampshire Public Utilities Commission.

I. PROCEDURAL HISTORY

Northern Utilities, Inc. (Northern or the Company) serves approximately 25,000 customers in the Seacoast region of New Hampshire and Maine. Its last approved general rate increase occurred in 1991. (*Northern Utilities, Inc.*, 77 NH PUC 366 (1992)).

On September 19, 2001, pursuant to N.H. Admin. Rule Puc 1604.05, Northern filed with the New Hampshire Public Utilities Commission (Commission) a Notice of Intent to file rate schedules. On November 15, 2001, Northern filed its proposed tariff revisions, along with supporting documentation, containing new rates designed to produce an increase in annual revenues of $3,834,344, which consisted of a proposed $203,295 increase in indirect gas costs and a $3,631,050 increase in delivery service revenues. This requested increase represents a 7.4% increase over weather normalized test year revenues, with a bill impact representing an average increase of 8.2% for customers. Northern requested an effective date of December 16, 2001.

On September 24, 2001, the Office of the Consumer Advocate (OCA) filed a Notice of Intent to Participate in this docket on behalf of residential utility consumers pursuant to the powers and duties granted under RSA 363:28,II.

On November 15, 2001, pursuant to RSA 378:27, Northern filed a Petition and supporting documentation requesting authority to implement temporary rates in the amount of $3,631,049 during the pendency of the Commission's investigation of Northern's permanent rate request in DG 01-182. Northern requested that it be permitted to implement temporary rates effective November 16, 2001.

On December 7, 2001, the Commission issued an Order Scheduling Prehearing Conference and Temporary Rate Hearing and Suspending Proposed Tariffs, Order No. 23,863 (Suspension Order). The Order scheduled a Prehearing Conference for January 8, 2002 and a temporary rate hearing for February 7, 2002.

On January 3, 2002, the Maine Public Utilities Commission (MEPUC) submitted a Petition for Limited Intervention.

On January 8, 2002, the Commission held a Prehearing Conference in Docket DG 01-182. Immediately following the January 8, 2002 Prehearing Conference, Northern, the OCA, and the Commission Staff ("Staff") participated in a technical session at which a proposed procedural schedule was agreed upon.

On January 15, 2002, Staff submitted the proposed procedural schedule for review and approval by the Commission. The procedural schedule was approved by the Commission on January 25, 2002 by Order No. 23,904.

On January 30, 2002, Northern submitted a proposed settlement agreement between Northern, the OCA, and Staff. On January 31, 2002, Northern submitted to the Commission the executed signature pages to the settlement.

On February 13, 2002, the Commission approved the imposition of temporary rates pursuant to Order No. 23,920.

On February 25, 2002, Staff recommended the Commission close docket DA 01-226 and that the affiliate contract between Northern and NiSource Corporate Service, Inc. be considered in the rate case docket, DG 01-182.

On April 8, 2002, the Commission transferred consideration of the NiSource Corporate Services, Inc. affiliate agreement, originally docketed as DA 01-226, to the instant docket.

The Staff and Parties conducted extensive discovery and submitted testimony according to the dates set forth in the procedural schedule. On September 26, 2002, Staff and the Parties submitted a Settlement Agreement (Agreement) concerning the permanent rate portion of this docket.

II. SETTLEMENT AGREEMENT

The Agreement presented to the Commission by Staff and the parties is summarized as follows:

A. Permanent Rate Levels

The Parties and Staff agreed to permanent rate increase designed to produce an additional $1.05 million in annual distribution revenues above the normalized test year revenues. The increase will be implemented equally among all customer classes, using the method set forth in Northern's filing dated November 15, 2001. This permanent rate increase represents an average increase of 2.25 percent.

1. Revenue Requirement

The parties and Staff agree that the Company's revenue requirement should be $47,746,999, which is 2.25 percent over test year revenues. More specifically, the Parties and Staff agree that the revenue deficiency in this proceeding shall be calculated using the following components:

<u>Stipulated Rate of Return</u>: 7.85 percent.

<u>Stipulated Adjusted Net Operating Income</u>: $3,998,512, (pro forma test year).

<u>Stipulated Rate Base</u>: The overall rate of return shall be applied to the pro forma test year rate base of $58,900,187.

<u>Stipulated Deficiency Before Taxes</u>: $625,153.

<u>Tax Factor</u>: 59.475 percent.

<u>Change in Revenue Requirement</u>: The stipulated annual increase in operating revenues is $1,051,118. This reflects a net distribution revenue requirement increase of $945,739 plus an increase in indirect gas costs of $105,379.

2. Income Taxes

The Parties and Staff agree to recognize the Company’s movement from partial flow through tax accounting to full normalization of books versus temporary tax differences.

3. Depreciation

Northern will complete a new depreciation study within five years from the date of the Commission’s Order approving this Settlement. The Parties and Staff agree that the net impact on Northern’s depreciation expense associated with adjustments is a reduction to Northern’s proposed annual depreciation amortization expense of $149,563.

4. Cost of Capital

Northern's long-term debt has been adjusted to reflect the call premium paid to redeem its 9.70 percent Series Senior notes. Also, the cost of Northern's total long-term debt will decrease from a rate of 6.75 percent to 6.08 percent.

B. Customer Service

Northern will strive to meet specified performance goals for its call center, billing, and meter reading operations:

1) 80 percent of all calls in any given month to the billing, service or credit lines be answered within 30 seconds. The thirty-second call answering period will be measured beginning at the point where an incoming call enters the queue for answering by a call center representative. Calls handled by Northern’s interactive voice response (“IVR”) system shall be considered to be answered in zero seconds.

2) 90 percent of emergency calls received in any given month be answered within 30 seconds. Measurement of Northern’s call answering performance will be determined in the same manner as for measure 1, above.

3) No more than 2 percent of all calls, measured quarterly, to call center, or any other service center with the responsibility for responding to customer calls, shall encounter a busy signal or other busy indication.

4) In any given month, 95 percent of all mutually agreed upon appointments for service shall be met on the day scheduled. Customer initiated postponements shall not be included in this measurement.

   Staff and the OCA agree not to object to a decision to exit the service business by Northern if Northern demonstrates that other qualified entities are available to perform similar services within Northern's service territory.

5) 95 percent of complaints referred by the Commission Staff will be resolved to the satisfaction of the Commission Staff within 2 weeks.

6) The Parties and Staff agree to meet at a minimum annually and discuss actual performance and performance goals.

7) Northern shall report monthly, to the Commission's Consumer Affairs Division, on the performance goals listed in items 1 through 5 above, comparing actual performance to the performance goals. Northern shall also report its monthly average speed of answer for its billing, credit and service lines, its monthly number of calls abandoned and its monthly average time to abandon.

8) Northern agrees to make test calls to its IVR on a daily basis to monitor the functionality of the IVR system. Northern agrees to notify the Commission's Consumer Affairs Division of any IVR malfunctions that affect customers. Northern further agrees to implement a new IVR system by November 1, 2003. Northern will work with the Parties and Staff in developing its new IVR system.

9) The Parties and Staff agree that Northern shall be subject to an automatic penalty of $5,000 per month for failing to meet any one of the performance goals listed in 1 through 5 above in any given month. Multiple failures to meet performance goals within any given month shall not constitute multiple fineable violations and Northern's maximum monthly penalty exposure shall be $5,000. Under no circumstances shall Northern's annual maximum penalties for performance with respect to all service quality categories exceed $60,000. The Parties and Staff recognize that Northern cannot accomplish the agreed upon service quality goals immediately and agree to a 3 month transition period during which Northern would report its performance but no penalties would be assessed. The three month transition period will be measured beginning on the first day of the month following issuance of a Commission Order regarding this Settlement Agreement.

Northern may request that the Commission grant a waiver of any of these penalties. If Northern requests such waivers, Northern will bear the burden of demonstrating that its failure to comply with each particular performance target is the result of circumstances beyond its control.

The Parties and Staff agree that Northern may appeal to the Commission the imposition of fines under the terms of this agreement.

C. Step Adjustment to Revenue Requirement and Rates

1. Automated Meter Reading

Northern will install a fully operational automated meter reading (AMR) system by September 1, 2003

2. Recovery of AMR

The Parties and Staff propose a step adjustment to base rates to recover the AMR installation costs, consistent with the requirements of RSA 378:30-a, net of associated annual savings, which the Parties and Staff agree will amount to $162,500.

D. Rate Design

The rate design approved by the Commission in *Northern Utilities, Inc., Revenue Neutral Rate Redesign*, Order No. 23,674 (April 5, 2001), Docket No. DG 00-046, is preserved in this Settlement Agreement.

E. Rate Schedules and Bill Impacts

The Parties and Staff agree that Northern's revised tariff NHPUC No. 10 – Gas should be approved effective November 1, 2002. The agreed-upon level of permanent rates of $1,051,118 result in the bill decrease of 2.25% when compared to previous permanent rates. The agreed-upon level of permanent rates is lower than the current temporary rates by approximately 2.4 to 2.8 percent.

F. Indirect Gas Costs

The Parties and Staff agree that the appropriate level of indirect gas costs to be recovered through the Cost of Gas Adjustment (COG) should be increased to reflect the agreed upon rate of return on liquid propane and liquefied natural gas peaking facilities, and the percentages applied to direct gas costs for bad debt and working capital changed to 0.45% and 0.19%, respectively, to reflect updated costs.

G. Affiliate Agreements

The Parties and Staff request the Commission approve the Agreement entered into between Northern and NiSource Corporate Services, Inc., as filed on November 19, 2001.

H. Effective Date of Permanent Rates

The Parties and Staff propose a November 1, 2002 implementation date for the permanent rates.

I. Reconciliation

The Agreement provides that the revenues collected pursuant to Northern's authorized temporary rates must be reconciled for the period in effect with the permanent rate level approved by the Commission. The difference between the temporary and permanent rates shall be recovered or refunded, without interest.

III. COMMISSION ANALYSIS

New Hampshire RSA 378:7 authorizes the Commission to fix rates pursuant to an order after hearing. The Commission is obligated to investigate the justness and reasonableness of the proposed rates. *Eastman Sewer Company, Inc.*, 138 N.H. 221, 225 (1994). Traditional rate-of-return principles permit a utility to recover prudently incurred operating expenses along with "the opportunity to make a profit on its investment, in an amount equal to its rate base multiplied by a specified rate of return." *Appeal of Conservation Law Foundation*, 127 N.H. 606, 634 (1986).

As part of our review of utility rate matters, it is not uncommon for Staff and the Parties, after extensive discovery, to present a comprehensive settlement agreement and we note that is the case here. We will address the Agreement as the issues were presented therein.

A. Revenue Requirement

Northern's request for permanent rates sought authority to increase annual distribution revenues by $3,834,344, which consisted of a proposed $203,295 increase in indirect gas costs and a $3,631,050 increase in delivery service revenues. Northern's request was based on a cost of common equity of 13.0 percent and an overall rate of return of 9.49 percent. In contrast, Staff submitted the testimony of Mr. Stephen P. Frink and Ms. Maureen L. Sirois who cited annual overearnings in distribution revenues for Northern of $308,641 based on a cost of common equity of 8.89 percent and an overall rate of return of 7.46 percent. (Exh. 48 at 2 line 3) (Exh. 50 at 2 lines 15-16).

In establishing a proposed revenue increase, the Staff and Parties agreed to specific items such as the rate of return, adjusted net operating income, rate base, before-tax deficiency, and tax factor. The Agreement recommends a revenue increase of $1,051,118 and an overall rate of return of 7.85 percent. The rate of return includes a 9.67 percent cost of equity.

At hearing, Northern's witness, Mr. Stephen H. Bryant, explained the difficulties Northern encountered with choosing the 2000-2001 test year. The test year spanned two fiscal years and during one of those years, Northern underwent substantial rate re-design as a result of *Northern Utilities, Inc., Revenue Neutral Rate Redesign*, Order No. 23,674 (April 5, 2001), Docket No. 00-046. (Hearing Transcript of October 2, 2002 (10/2/02 Tr.) at 10 lines 1-3).

A question arose in the context of the rate case concerning Northern's proposed amortization of the net deficient tax reserves and whether this treatment was consistent with normalization requirements in the Internal Revenue Code, as changed by the Tax Reform Act of 1986. In support of the Settlement Agreement, Northern's Assistant Controller assured the Commission that its treatment is correct and resolves any future liability for this tax treatment favorably to Northern's customers. Specifically, in the event the Internal Revenue Service disputes Northern's treatment, Northern agrees not to seek recovery from its customers as the result of any errors in the overall deferred tax deficiency of $1,066,676 that would cause a higher under-collection as of June 30, 2001. Should an over-recovery occur, Northern agrees to refund the amount of the over-recovery to its customers. Staff supported this position and agreed to an adjustment to deferred taxes for calculating Northern's revenue requirement. Northern's offer not to seek recovery is contained in the Agreement. We find this resolution safeguards Northern's customers and we approve the tax issue settlement terms.

In its filing, Northern proposed an approximately $3.0 million depreciation expense. Staff submitted testimony of Mr. James J. Cunningham, which recommended a depreciation expense amount of approximately $2.6 million, a difference of approximately $400,000. (Exh. 49 at 10 line 2-4). In the Agreement, Northern’s proposed annual depreciation amortization expense was reduced by $149,563. Staff and the Parties agreed to use of the Broad Group/Whole Life depreciation rates with the applicable plant in service balance as of June 30, 2001 plus the annual amortization of the depreciation reserve imbalance over five years to determine the required level of depreciation expense. These depreciation rates for depreciable plant and equipment are set forth in Exhibit 13, Sch. JJC-3, Page 6 of 7. We find these rates reasonable.

In its filing, Northern proposed approximately $3.2 million for affiliate agreement costs for contracts with NiSource Corporate Service Company and Bay State Gas Service Company. Staff testimony of Mr. James J. Cunningham, entered as Exhibit 49, recommended affiliate agreement costs be limited to approximately $2.3 million. This represented a difference of approximately $900,000 between Northern and Staff’s position. In the Agreement, Staff and the Parties settled on an annual affiliate agreement cost that was $426,087 less than Northern’s originally proposed $3.2 million.

We recognize that Staff and the parties scrutinized the costs associated with the affiliate contracts in great detail; we therefore accept their recommendation. We will approve the contract between Northern and NiSource Corporate Service, Inc., as adjusted by the terms of the Settlement Agreement.

B. Customer Service

The Agreement contains a significant section devoted to establishing performance benchmarks for Northern. The benchmarks relate to performance at Northern's call center and its performance with billing.

Northern did not submit pre-filed testimony on this issue; however, Northern's witness, Mr. Stephen H. Bryant, did provide some detail at the hearing. Staff submitted the testimony of Ms. Amanda Noonan which was critical of Northern's estimated billing process and its effect on customers. (Exh. 47). Ms. Noonan's testimony indicated Northern's practice of issuing bills every other month coupled with estimated, and sometimes inaccurate bills, caused some customers to not receive an actual, correct bill for many months. (Exh. 47 at 7, lines 14–19). Ms. Noonan also indicated the Commission had received a high level of customer complaints over the past five years, relative to another New Hampshire gas utility and that call center hold times were inordinately high. (Exh. 47 at 2, lines 22–23 and at 3 lines 16-22).

We find that Staff's concerns over billing and call center deficiencies are reasonably addressed by the terms of the Agreement. The Commission has approved similar performance benchmarks with respect to other gas utilities. *EnergyNorth Natural Gas, Inc.*, 85 NH PUC 360 (2000). At hearing, Mr. Bryant stated Northern had the resources to meet the performance benchmarks. He stated he was confident in Northern's ability to install the interactive voice response system, citing the expertise of Northern's parent company. (10/02/02 Tr. at 30 lines 3-9 and lines 17-22). Given the nature of the concerns raised by Staff and Northern's own admission at hearing that it was not providing customers with service levels it should have been, we believe performance benchmarks are appropriate. We are satisfied the benchmarks contained in the Agreement will address Staff's concerns and we approve them.

An element worthy of note regarding the performance benchmarks is that automatic penalties are triggered if Northern fails to meet the benchmarks in any given month. In reviewing Northern's possible exposure to these penalties, we have assessed whether these performance benchmarks strike an appropriate balance. It is not the Commission's intent to impose unachievable customer service levels on Northern, however, the Commission believes customers should receive adequate service levels from the utilities the Commission regulates. The Commission must also consider the impact on Northern's Springfield, Massachusetts call center, which also services customers in Maine and Massachusetts. Any standards imposed by

New Hampshire will also affect customers of Northern’s Maine and Massachusetts operations who call that center.

Northern already adheres to similar performance standards in Maine and Massachusetts. At hearing, Mr. Bryant testified as to those performance standards. In Maine, Northern’s performance benchmarks are limited and temporary. Massachusetts, however, has more benchmarks and some are similar to those proposed in the Agreement. Mr. Bryant testified the Agreement’s performance benchmarks are generally more comprehensive than both Maine and Massachusetts’ standards. (10/02/02 Tr. at 24 lines 21-24 and at 25 lines 1-5).

Mr. Bryant also testified that Northern was meeting the Agreement’s call answering performance benchmark during the 2000-2001 test year, but that was due to calls getting bumped out of the system. (10/02/02 Tr. at 26-27 lines 22-15). Having said that, Mr. Bryant also went on to explain how he believes the company’s call center problems are behind them and he cited examples of expertise Northern’s parent company has that will be utilized in achieving the customer service performance benchmarks set forth in the Agreement. (10/02/02 Tr. at 29-30). We feel comfortable that these performance benchmarks provide customers with the level of service they ought to be receiving and are achievable by Northern. Adequate due process protections are also available to Northern should Northern believe a particular automatic penalty is unjust under the circumstances.

C. Step Adjustment for AMR

Step adjustments can be implemented following a rate proceeding, taking advantage of that proceeding to substantially reduce the time for regulatory review and approval of anticipated capital additions. *Pennichuck Water Works, Inc.*, Order No. 23,923 (March 1, 2002), slip op. at 11. The Commission employs step adjustments judiciously as a means of ensuring regulated utilities retain their ability to earn a reasonable rate of return even after implementation of large capital projects. Step adjustments avoid placing a utility in an earnings deficiency immediately after a rate case, which is usually based on a historical test year ratemaking methodology.

In this docket, Northern has agreed to install an Automated Meter Reading (AMR) system. As indicated in the Agreement, the Staff and Parties expect the AMR: will reduce the issuance of bills based on estimated meter readings and will therefore send more accurate price signals to customers; improve meter reading accuracy through the reduction of errors from manual readings; reduce the level of estimated bills rendered due to lack of access to meters; reduce ongoing meter reading costs; and, allow Northern to issue bills based upon monthly readings, in lieu of the current bi-monthly meter reading system. (Exh. 1 at 9). It is believed monthly bills for actual amounts and bills containing fewer errors will foster customer satisfaction. The Commission heard testimony from Northern witness, Stephen H. Bryant, (10/2/02 Tr. at 10 lines 2-21) that the AMR will also reduce meter-reading costs to Northern, amounting to an estimated annual savings of $162,500.

We find the step adjustment and method for recovery proposed in the Agreement are narrowly crafted and that the AMR installation will benefit Northern's customers. For these reasons, we approve the step adjustment.

D. Rate Design and Customer Bill Impact

By Order No. 23, 674, (April 5, 2001) in Docket No. 00-046, the Commission approved a significant rate redesign for Northern. The Agreement preserves that rate design. We see no reason to disturb the rate design at this time and will therefore approve it.

At hearing, Mr. Bryant discussed Northern's Report of Proposed Rate Change, entered as Exhibit 3, which demonstrated that the proposed rate increase will raise each customer class's rate by 2.25 percent. Mr. Bryant explained it was Northern's intent to spread the rate impact as evenly as possible among all rate classes, all seasons, and for all months. (10/02/02 Tr. at 42 lines 14-21). The average rate impact for each class is identified as 2.25 percent; however within each class, some customers may see higher and lower percent impacts. (10/02/02 Tr. at 30-40). Exhibits 25, 26, and 27 verify Northern's efforts and show the variation in percent impact per month and class. According to Exhibit 25, Northern's largest customer class is residential heating, which consists of 17,222 customers out of Northern's 23,738 total customer count. Exhibit 26 demonstrates that during different months of the year, residential heating customers may see a rate increase between 2.05 and 2.83 percent as a result of the Agreement. In comparison, Northern's Petition For Authority to Establish Permanent Rate Increase contained a request for a 7.4 percent increase. (Exh. 2).

In light of the foregoing, we find the Agreement results in rates that are just and reasonable for all customer classes.

E. Effective Date

Each year, Northern adjusts its rates on November 1st to reflect expenses associated with the winter period cost of gas. Because customers are accustomed to rate changes at that time, we find it will result in less customer confusion to allow the new permanent rate to go into effect then. For this reason, we approve implementation of the permanent rate effective November 1, 2002, on a service rendered basis.

F. Reconciliation and Rate Case Expenses

The Settlement Agreement states that the difference in revenues recovered at the temporary rate level and what would have been recovered had permanent rate been in effect during the same period are to be recovered or refunded, without interest, through the Local Distribution Adjustment Clause (LDAC) in effect November 1, 2002 through April 30, 2003. Northern is to file an accounting of the rate case expenses, and those approved by the Commission are to be recovered through the November 1, 2002 through October 31, 2002 LDAC.

In Northern's 2002/2003 Winter COG filing, Docket No. DG 02-167, Northern estimated that the over recovery resulting from a reconciliation of temporary and permanent rates to be $980,000 and rate case expenses for recovery to be $480,000, resulting in net credit of $500,000. Although a final reconciliation and accounting of rate case expenses have not been submitted to the Commission, the LDAC is reconciled as part of the Winter COG filing and any later adjustments would addressed in the reconciliation. At the COG hearing, Northern testified that the estimated costs were very close to being finalized and that the estimates should be close to what is ultimately filed.

We direct Northern to file with the Commission an accounting of the amount of the rate case expenses as well as an accounting of the difference between permanent and temporary rates, for Commission review and approval. The approved reconciliation and rate case expenses will be recovered through the LDAC and reconciled as part of Northern's next winter's COG proceeding.

IV. CONCLUSION

We have reviewed the terms of the Settlement Agreement, as well as Staff and the Party's filings, supporting testimony, and exhibits as presented at the October 2, 2002 hearing. Based on our review of the record, we find the terms, as set forth in the Settlement Agreement will produce rates and service that are just, reasonable and in the public good.

Based on the foregoing, it is hereby

ORDERED, that the Settlement Agreement proposed by Staff and the Parties is APPROVED; and it is

FURTHER ORDERED, that the permanent rates for the various customer classes be implemented on a service rendered basis effective November 1, 2002; and it is

FURTHER ORDERED, that Northern shall submit tariff pages including any approved in compliance within 15 days of the date of this order; and it is

FURTHER ORDERED, that Northern submit its rate case expenses for Commission review and approval; and it is

FURTHER ORDERED, that Northern submit its reconciliation report, including a specific proposal for implementing either a surcharge or refund, whichever is necessary, within thirty days from the date of this order.

By order of the Public Utilities Commission of New Hampshire this twenty-eighth day of October, 2002.

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Thomas B. Getz Chairman	Susan S. Geiger Commissioner	Nancy Brockway Commissioner

Attested by:

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Debra A. Howland
Executive Director & Secretary