

DG 02-203

NORTHERN UTILITIES, INC.

Inventory Financing Vehicle

**Order Approving the Use of the Money Pool Agreement
to Finance Fuel Inventory**

O R D E R N O. 24,095

December 13, 2002

On November 4, 2002, Northern Utilities, Inc. (Northern), a public utility organized under the laws of the State of New Hampshire and primarily engaged in the business of distributing natural gas in certain cities and towns in New Hampshire and Maine, filed a petition with the New Hampshire Public Utilities Commission (Commission) for approval to use an internal fuel financing vehicle in place of its fuel financing arrangement with BayNor Energy Inc. (BayNor). The Commission has authority to review these arrangements pursuant to RSA 374:2 and 374:3. Northern requests that it be allowed to continue to collect the financing charges associated with its gas inventory through its Cost of Gas Clause.

Northern also requests that the amount of gas fuel inventory financed through the internal fuel financing mechanism not be construed as short-term debt within the meaning of NH Admin. Rule Puc 507.08, which prohibits gas utilities from issuing short-term debt if such debt "exceeds 10% of the

utility's net fixed plant without prior [C]ommission approval pursuant to Puc 201.05."

I. BACKGROUND ON NORTHERN'S FINANCING ARRANGEMENTS

On November 22, 1982, the Commission approved Northern's existing fuel inventory trust financing mechanism with BayNor (BayNor Arrangement). *Northern Utilities, Inc.*, 67 NH PUC 841 (1982). The creation of the inventory trust fund removed fuel inventory from Northern's rate base and allowed recovery through the Cost of Gas mechanism, thereby reducing base rates. The BayNor Arrangement is due to expire December 24, 2002. Northern's request to use an internal fuel financing vehicle would replace this arrangement.

The trust's purchase of storage fuel from Northern is financed by an unaffiliated third party, BayNor, established to finance Northern's, as well as its parent company Bay State Gas Company's, fuel inventory. Presently, when Northern determines it has a need for stored gas to serve its customers, it draws the amount of gas necessary out of storage and BayNor invoices Northern for the amounts withdrawn. Northern has the right on demand to purchase from BayNor whatever quantities of gas it requires to meet the needs of its customers from inventories that Northern has transferred to BayNor. The price paid to BayNor for such purchases is made up of two components: (1) the cost that was paid for the fuel, including transportation or storage costs

paid to third parties, and (2) an increment that represents the costs incurred by BayNor in performing its duties under the contract, including financing costs and associated fees.

This arrangement was desirable for Northern since under the BayNor Arrangement savings resulted from the fact that the cost of BayNor's commercial paper was lower than what Northern would have incurred through its own short-term lines of credit, the manner in which it financed its fuel inventory prior to the BayNor Arrangement. The Union Bank of California provides BayNor a \$37 million irrevocable letter of credit in support of the issuance of BayNor's commercial paper.

On December 8, 1998, the Commission approved an increase in the amount of gas inventory that could be financed through the fuel inventory trust from \$3,000,000 to \$10,000,000.

Northern Utilities, Inc., 83 NH PUC 660 (1998). The proposed increase in the availability of credit from \$3,000,000 to \$10,000,000 was necessitated by changes in Northern's supply portfolio which reflected an increase in storage.

On September 14, 2001, pursuant to the requirements of RSA 366:3, Northern filed a Money Pool Agreement between Northern and certain of its Affiliates (Agreement) with the Commission. The Agreement was subject to approval by both the Securities and Exchange Commission (SEC), as required under the Public Utilities Holding Company Act, and by the Maine Public Utilities Commission

(MPUC), as required by State of Maine utility statutes¹.

On June 4, 2002, Northern filed with the Commission the executed copy of the Agreement. The Agreement permits Northern and certain affiliates to aggregate their short-term cash surpluses in order to: 1) invest such surplus funds to achieve an investment rate that will be generally higher than the typical yield on short-term money market investments, and 2) borrow from the Money Pool at its weighted short-term debt. Under the Agreement, additional funds in excess of surplus funds are provided through external borrowing, primarily the sale of commercial paper, as that is the lowest cost method of obtaining short-term funds. The Money Pool, due to its larger size, can access the commercial paper market and bank financing more efficiently than what Northern can access itself. Northern also benefits because under the Agreement it is able to share financing expenses (rating agency and bank fees) with its affiliates. It is this Money Pool arrangement which Northern proposes to use to replace the expiring BayNor Arrangement.

The Money Pool arrangement will allow Northern to take advantage of lower gas fuel inventory financing costs. According to Northern's filing fees associated with the letter of credit

¹ Approved per SEC order dated December 19, 2001 (Holding Co. Act Release No. 27479) and MPUC Docket No. 2001-646, Order (December 21, 2001) and Supplemental Order (May 13, 2002), respectively.

supporting the BayNor commercial paper are expected to increase significantly (i.e. by 90-100 basis points) if the BayNor Arrangement is renewed. Compared to the total cost of financing fuel inventory through the Money Pool, the BayNor Arrangement is more expensive. According to Northern the Money Pool arrangement would result in a savings of greater than 20 percent on annual financing costs of approximately \$500,000, as compared to using BayNor.

On December 3, 2002, the Maine Public Utilities Commission allowed Northern to terminate the BayNor Arrangement and to use the Money Pool to fund fuel inventories, with reasonable and prudent fuel financing costs to be recovered through the Cost of Gas clause.²

II. COMMISSION ANALYSIS

Under the proposed financing arrangement, Northern anticipates annualized savings on fuel inventory financing in excess of \$100,000 attributable to reduced inventory financing fees and lower interest rates. These savings will be passed through directly to customers in gas commodity charges established through the winter Cost of Gas mechanism. This will benefit customers in New Hampshire.

NH Admin. Rule Puc 507.08, limits use of short-term debt without Commission approval to 10 percent of net fixed

² MPUC Docket No. 2002-680, Order (December 3, 2002).

plant, and is designed to allow a utility to fund typical short-term cash requirements (i.e. receivables, inventory, interim construction funding) up to a reasonable level. If the proposed Money Pool funding for fuel inventory were to constitute an element of Northern's short-term debt, Northern would not have the ability to fully fund the fuel inventory or other short-term borrowing requirements without further Commission approval.

We will approve Northern's request that the amount of gas fuel inventory financed through the internal fuel financing mechanism not be construed as short-term debt as it pertains to NH Admin. Rule Puc 507.08. The Commission has approved a similar arrangement presently used by New Hampshire's other natural gas utility. *EnergyNorth Natural Gas, Inc.*, 85 NHPUC 755 (2000).

The Commission approved the Trust in 1982 and has increased the credit limit in the ensuing years to provide Northern with financial flexibility to meet its other capital requirements, enhance its ability to have adequate supplies of fuel available, and save money for customers. We believe participation in the Money Pool to fund the fuel inventory will provide the same benefits at an even greater savings.

We note that the previously approved BayNor Arrangement and financing arrangement used by EnergyNorth Natural Gas, Inc. contain limits on the amount of fuel inventory to be financed. Northern's present proposal does not contain a limit. Northern's

proposal estimates a peak requirement of \$27 million dollars at a projected commodity cost of \$5.00 per MMBtu. This commodity cost is well below inventory injection gas costs experienced in the past, but is more in line with current costs. Natural gas prices are extremely volatile and depending on the amount of storage and commodity prices, the amount of fuel inventory to be financed may well exceed Northern's \$27 million estimate in the near future.

Northern's filing proposes to continue recovering fuel financing costs through the Cost of Gas mechanism, financing costs will be calculated by applying Northern's short-term debt rate to the average month's inventory balance and the average balance will be calculated using the beginning and ending month value of inventory. In the Cost of Gas filings, we note that Northern will be required to demonstrate that the amount of fuel inventory financed and the terms of the financing were prudent and reasonable. The Commission expects Northern to be prepared to demonstrate during the Cost of Gas proceeding that alternative financing arrangements could not have been entered into at a more favorable rate and that the optimal amount of fuel inventory was financed.

To aid in the Commission's review, we also direct Northern to file as part of the monthly Cost of Gas reports, the amount of fuel inventory in storage each month, the monthly

financing charge and the monthly financing rate (broken out between interest and administrative charges).

While not setting a limit on the amount of fuel inventory to be financed is a departure from the fuel inventory financing arrangements we have previously approved, we are satisfied that the reporting requirements and Commission review as part of the winter Cost of Gas proceedings will provide a reasonable balance between protecting customers and not hindering Northern's ability to obtain financing. Accordingly, we will not set a limit on the amount of fuel inventory to be financed through the Money Pool.

For the foregoing reasons, we find the fuel financing vehicle described in the petition to be in the public good.

Based upon the foregoing, it is hereby

ORDERED, that Northern Utilities, Inc.'s request for authorization to use the Money Pool for fuel inventory financing is APPROVED; and it is

FURTHER ORDERED, gas fuel inventory financing will not be construed as short-term debt as it pertains to NH Admin. Rule Puc 507.08; and it is

FURTHER ORDERED, that Northern shall report fuel inventories and financing costs and rates to the Commission on a monthly basis, to be included in the monthly Cost of Gas report.

By order of the Public Utilities Commission of New
Hampshire this thirteenth day of December, 2002.

Thomas B. Getz
Chairman

Susan S. Geiger
Commissioner

Nancy Brockway
Commissioner

Attested by:

Debra A. Howland
Executive Director & Secretary