DG 07-033

NORTHERN UTILITIES, INC.

2007 Summer Season Cost of Gas

Order Approving Cost of Gas Rates

O R D E R N O. 24,743

April 27, 2007

APPEARANCES: Susan S. Geiger, Esq., of Orr & Reno, and Patricia M. French, Esq., on behalf of Northern Utilities, Inc.; Rorie E.P. Hollenberg, Esq., of the Office of Consumer Advocate, on behalf of residential utility ratepayers; and F. Anne Ross, Esq., for the Staff of the New Hampshire Public Utilities Commission.

I. PROCEDURAL HISTORY

On March 15, 2007, Northern Utilities, Inc. (Northern) filed with the New Hampshire Public Utilities Commission (Commission) proposed rate adjustments pursuant to the Cost of Gas (COG) clause in its tariff for the period May 1, 2007 through October 31, 2007 (2007 Summer Season COG), applicable to Northern's natural gas operations in the seacoast area of New Hampshire. The filing was accompanied by supporting schedules and the direct testimony of Joseph A. Ferro, manager of regulatory policy, and Ronald D. Gibbons, lead regulatory analyst.

On March 14, 2007, Commission Staff and the Office of the Consumer Advocate (OCA) filed a report titled "Report on Northern's Calculation of Carrying Charges Related to the Development of the Cost of Gas Rate" in Docket No. DG 06-129, as directed in Order No. 24,684 (October 27, 2006) approving Northern's 2006-2007 Winter COG. The report contains findings and recommendations related to carrying costs in the COG and is also relevant to the immediate docket.

On March 20, 2007, the Commission issued an order of notice scheduling a hearing for April 23, 2007. On March 26, 2007, the OCA entered an appearance on behalf of residential utility ratepayers pursuant to RSA 363:28. There were no other intervenors in this docket.

On April 16, 2007, Staff filed the direct testimony and supporting attachments of George R. McCluskey, utility analyst. The supporting attachments included the report filed on March 14, 2007. Mr. McCluskey's testimony addressed two issues: (1) Northern's methodology for determining the over/under collection of gas costs for the prior winter and summer period, and (2) the appropriate carrying charge rate to calculate the cost of Northern's supply-related working capital.

On April 18, 2007, Northern filed a motion to defer certain issues and to enlarge time for filing rebuttal testimony. On April 19, 2007, Staff filed an objection to the motion to defer, without objecting to the request to extend the time for filing rebuttal testimony. On April 19, 2007, the OCA filed a letter concurring with Staff's objection to Northern's motion. On April 19, 2007, the Commission issued a secretarial letter denying Northern's motion to defer but granting Northern's request to extend the time for filing rebuttal testimony.

On April 20, 2007, Northern filed rebuttal testimony and a revised COG. The hearing on Northern's COG filing took place as scheduled on April 23, 2007.

On April 26, 2007, Northern filed revised COG rates, removing a minor change made in the rate calculation methodology that was not specifically identified and addressed at the hearing. The Staff and OCA supported the revised filing.

II. POSITIONS OF THE PARTIES AND STAFF

A. Northern

Northern witnesses Ferro and Gibbons addressed a number of matters, including (1) calculation of the proposed COG rates, (2) reasons for the proposed rate decrease and customer bill impacts, (3) calculation of COG rates using a simplified market-based allocation, and (4) the COG issues raised in Staff's pre-filed direct testimony.

1. Calculation of the Firm Sales COG Rates

Pursuant to the COG clause, Northern may, subject to the Commission's jurisdiction, adjust on a semiannual basis its firm gas sales rates in order to recover the costs of gas supplies, capacity and certain related expenses, net of applicable credits, as specified in Northern's tariff. The average COG rate, which is the COG rate paid by residential customers, reflects anticipated direct and indirect gas costs as well as various adjustments, including the over- or under-collection of allowable prior period costs. Northern's filing proposes a residential COG rate of $0.9040 per therm. Anticipated indirect gas costs, consisting of working capital, bad debt, and overhead charges, total $82,106. Anticipated direct gas costs total $10,529,106 and are decreased by adjustments totaling $639,658 consisting of a prior period over-collection of $615,732 and interest of $23,926. The net gas costs to be recovered in connection with the 2007 Summer Season total $9,971,554 and are divided by projected summer season sales of 11,029,620 therms to arrive at Northern's proposed residential COG rate.

Northern calculated commercial and industrial (C&I) "low winter" and "high winter" COG rates using a new method, including the use of revised high winter use and low winter use ratios, which are more fully described below. The resulting C&I low winter use COG rate is $0.8556 per therm and the resulting C&I high winter use COG rate is $0.9523 per therm.

2. Reasons for the Decrease in the Residential COG Rate and Bill Impacts

The decrease in the proposed Residential COG rate, as compared to last summer's rate, can be primarily attributed to a decrease in demand charges and a prior period over-collection.

Northern's proposed 2007 summer season residential COG rate of $0.9040 per therm represents a decrease of $0.0831 per therm from the average weighted 2006 summer season residential COG rate of $0.9871 per therm. The combined impact of the proposed firm sales COG rate and a prior change in the local delivery adjustment clause rate is a decrease in the typical residential heating customer's summer gas costs of $27, which represents a 5.4 percent decrease from last summer's rates.

3. Simplified Market-Based Allocation

Northern filed this COG calculation based on a new methodology of allocating costs referred to as a simplified market-based allocation. Company witness Ferro testified that this method allows for much better commodity price signals for Northern's C&I customers as compared to the current market-based allocation method. The simplified method creates three categories of supply resources and associated costs: (1) pipeline natural gas, (2) underground storage natural gas, and (3) delivered and on-site peaking supply. The simplified market-based allocation method uses a normal year forecast to allocate average pipeline capacity and commodity costs to the base use portion of the load curve with all remaining supply costs being allocated to the remaining load. The simplified method then allocates all remaining capacity not used in the normal year forecast on a design day basis. This method more accurately assigns capacity to customer class groupings based on the load profiles, or shapes, of the groupings. The customer class groupings are similar to what are currently in place under the market-based allocation method. Residential customers will continue to be allocated gas costs based on the system average cost of gas while C&I high winter classes, also referred to as low load factor C&I customers, will see more of the peaking costs used to serve those customers reflected in their COG rate. Conversely, C&I low winter customer classes, the high load factor customers, will see less of the winter peaking contract costs being allocated to their COG rate.

In summary, Mr. Ferro explained that the simplified method results in no shifting of costs between the Maine and New Hampshire divisions, minor shifting of commodity costs from summer to winter period, and approximately $580,000 in demand costs shifted from summer to winter period. The simplified market-based allocation method is consistent with the capacity assignment method provided in Northern's New Hampshire tariff related to delivery service terms and conditions. And, finally, Northern's implementation of the simplified method in its Massachusetts, Maine and New Hampshire jurisdictions will allow for increased administrative efficiencies for the Company.

4. COG Issues Raised by Staff

In response to Staff's testimony recommending that Northern revise its COG reconciliation mechanism by using accrued revenues rather than billed revenues, Northern reminded the Commission that the current COG mechanism has been in place for more than 30 years. Northern cautioned against changing the COG reconciliation mechanism without further analysis and without considering whether the change would be applicable to other gas companies operating in New Hampshire, especially KeySpan. Northern noted that the Commission plans to consider the same revision to KeySpan's reconciliation mechanism in a separate docket and asked that the Commission include Northern in that KeySpan docket.

Northern testified that the existing lead-lag study, which forms the basis of its cash working capital allowance, does not fully compensate for timing differences between the payment of gas supply costs and receipt of gas revenues due to volatility in gas prices and monthly gas consumption. Northern asserted that the current reconciliation methodology compensates it for the costs of timing differences not collected through the cash working capital allowance. However, Northern took the position that its reconciliation calculation reflects 30 or 31 days of actual purchased volumes and associated gas costs as well as 30 or 31 days of actual billed volumes and associated gas cost collections. Nonetheless, Northern acknowledged that in its reconciliation calculation in the first month of the summer and winter periods only 15 days of billed revenues were included in the reconciliation calculation.

With its rebuttal testimony Northern included a four page exhibit, JAF-1, which according to Northern demonstrated that Staff's accrued revenues approach under-recovers interest costs by $14,339 and that using billing month as-billed revenue over recovers the cash flow interest by $31,600 resulting in a total difference of $45,939. After Staff pointed out some problems with this analysis, Northern requested that it be allowed to submit a revised exhibit JAF-1 following the hearing. Northern stated that its analysis was inconclusive and asserted that there was not an adequate basis for modifying the COG reconciliation calculation.

Finally on this issue, Northern argued that Commission rulings regarding the same issue for New Hampshire electric companies should not apply to natural gas companies because electric companies do not experience the same volatility in consumption and price that natural gas companies experience.

Northern disagreed with Staff's recommendation that Northern use its short-term borrowing rate to calculate the cost of financing supply-related working capital. Northern stated that cash working capital has always earned interest at the cost-of-capital rate. Northern contended that such treatment is appropriate given the risk that Northern bears of the Commission finding that its gas procurement practices are imprudent. Further, Northern testified that cash working capital is financed with long term borrowings and equity and not withdrawals from the NiSource Money Pool.

B. OCA

The OCA supported Staff's argument that Northern is compensated twice for timing differences between the payment of supply costs and the collection of revenues, once through the working capital allowance and a second time through the COG reconciliation mechanism. The OCA also took the position that Northern is over-recovering its carrying costs by using the overall cost of capital to calculate the supply-related working capital when this cost is actually financed with short term borrowings at a rate that is several percentage points lower.

C. Staff

Staff supported the Northern proposed summer 2007 COG rates, with the reservation that new rates be filed to comply with a Commission finding that Northern is over charging for carrying costs. Staff noted that the Commission's Audit Staff had reviewed the 2006 summer season reconciliation and found no substantive exceptions and that the sales forecast is consistent with prior forecasts and reflects market expectations.

Staff recommended approval of the proposed changes related to the simplified market-based allocation method, having concluded that using this method to assign various pipeline, supply, storage and peaking resources and associated costs to C&I customer classes based on load shapes seems to match resources more closely with actual load patterns. Residential customers will continue to be allocated gas costs based on the system average cost of gas. The

Company has testified that the simplified allocation methodology does not result in any resource cost shifting between Northern's Maine and New Hampshire divisions.

Staff witness McCluskey testified that Northern is over-compensated for timing differences between when Northern pays its gas supply costs and when it receives gas revenues, once through the working capital allowance and second time through the COG monthly reconciliation mechanism. According to Staff, the over-collection occurs because both the supply-related working capital allowance and the COG reconciliation calculation reflect a 15.2-day meter reading lag. Since the working capital allowance is designed to compensate for timing differences between when costs are paid and revenues collected, Staff argued that the over-collection should be eliminated by re-designing the COG reconciliation methodology. Specifically, this re-design could be achieved by proper matching of gas costs and revenues. That is, both gas costs and revenues would be recorded on an accrued basis rather than the current practice of recording gas costs on an accrued basis and revenues on a billed basis, which creates a second timing difference.

Mr. McCluskey also testified that while it is appropriate for Northern to recover the cost to finance its supply-related working capital, the interest rate used by Northern to calculate that cost is almost twice its actual financing cost. According to Staff, Northern finances its working capital through borrowings from the money pool at a rate that is almost half of Northern's overall cost of capital adjusted for taxes, the rate used by Northern to calculate its supply-related working capital. Staff also argued that the money pool rate, or short-term borrowing rate, is the appropriate rate because gas supply costs are fully reconcilable and, therefore, Northern is subject virtually to no risk of under-recovery.

Staff requested that the Commission adopt Staff's proposed changes and that Northern reflect the results of those changes in its compliance filing.

III. COMMISSION ANALYSIS

Based on our review of the record in this docket, we approve the proposed COG rates as just, reasonable and lawful pursuant to RSA 378:7, subject to possible revision, inasmuch the issues of interest recovery and the rate of interest earned on the cash working capital allowance need further development. Regarding the appropriate carrying charge rate to calculate the cost of Northern's supply-related working capital, we heard testimony from Staff that under the terms of the NiSource Money Pool Northern may fund its supply-related working capital with short-term borrowings. On the other hand, we heard from Mr. Ferro that the supply-related working capital is actually funded through long term borrowings and equity capital. Given that Mr. Ferro's responsibilities at the Company do not encompass financial matters, we ask that Northern's Director of Finance provide information on the source and cost of funding for Northern's supply-related working capital. The response is due by close of business May 11, 2007. To the extent the source of funding is not the Money Pool, the respondent must explain why not and provide the actual cost.

In addition, we provide the opportunity for Staff and the parties to submit briefs on or before May 25, 2007, summarizing their positions on the two issues raised in Mr. McCluskey's testimony, namely: (1) the over-collection of the cost of timing differences between the payment of gas supply costs and the receipt of gas revenues; and (2) the appropriate carrying charge rate to calculate the cost of supply-related working capital. Following our review of the briefs and the testimony presented at hearing, we will issue our decision on how the two issues should be resolved. We also note that the COG reconciliations for the winter 2005-2006 and summer 2006 periods are dependent on the outcome of our deliberations on the first of these two issues.

Based upon the foregoing, it is hereby

ORDERED, that Northern's proposed 2007 Summer Season COG rates for the period of May 1, 2007 through October 31, 2007 are APPROVED, subject to revision, effective for service rendered on or after May 1, 2007 as follows:

	Cost of Gas	**Minimum COG**	**Maximum COG**
Residential	$0.9040	$0.7232	$1.0848
C&I, Low Winter Use	$0.8556	$0.6845	$1.0267
C&I, High Winter Use	$0.9523	$0.7618	$1.1428

; and it is

FURTHER ORDERED, that Northern may, without further Commission action, adjust the approved COG rates upward or downward monthly based on Northern's calculation of the projected over- or under-collection for the period, but the cumulative adjustments shall not vary more than twenty percent (20%) from the approved unit costs of gas; and it is

FURTHER ORDERED, that Northern shall provide the Commission with its monthly calculation of the projected over- or under-calculation, along with the resulting revised COG rates for the subsequent month, not less than five (5) business days prior to the first day of the subsequent month. Northern shall include revised tariff pages 38 & 39 - Calculation of Cost of Gas Adjustment and revised rate schedules under separate cover letter if Northern elects to adjust the COG rates; and it is

FURTHER ORDERED, that the over- or under-collection shall accrue interest at the Monthly Prime Lending Rate as reported by the Federal Reserve Statistical Release of Selected Interest Rates; and it is

FURTHER ORDERED, that Northern shall 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 shall file a response to our question on funding sources for cash working capital by May 11, 2007; and it is

FURTHER ORDERED, that the parties may file by May 25, 2007, briefs on the reserved interest recovery issues described in this Order.

By order of the Public Utilities Commission of New Hampshire this twenty-seventh day of April, 2007.

Thomas B. Getz Chairman	Graham J. Morrison Commissioner

Attested by:

ChristiAne G. Mason
Assistant Executive Director & Secretary