STATE OF NEW HAMPSHIRE
PUBLIC UTILITIES COMMISSION

DG 07-033

NORTHERN UTILITIES, INC.

2007 Summer Season Cost of Gas

Order Adopting Revised Rates

O R D E R N O. 24,786

September 13, 2007

I. PROCEDURAL HISTORY AND BACKGROUND

On April 27, 2007, the Commission issued Order No. 24,743 adjusting the rates of Northern Utilities, Inc. (Northern) for the summer season (May 1, 2007 through October 31, 2007) pursuant to the cost of gas (COG) clause in the Company's tariff. However, the Commission reserved the right to revise those rates after it received briefs addressing two issues: (1) Northern's possible over-collection of costs associated with timing differences between payments by Northern of wholesale gas costs and the Company's receipt of associated revenues from its retail customers, and (2) the appropriate interest rate to apply for ratemaking purposes to the supply-related working capital borrowed by Northern from the "money pool" it shares with other subsidiaries of its parent firm, NiSource, Inc. This order addresses the first of those two issues, the second having been deferred to another proceeding.

Pursuant to the schedule set forth in Order No. 24,743, the Commission received a brief on May 25, 2007 from Northern as well as a brief submitted jointly by Commission Staff (Staff) and the Office of Consumer Advocate (OCA). On May 30, 2007, Northern filed a motion seeking to designate Staff advocates pursuant to RSA 363:32, which the Commission granted by secretarial letter on May 31, 2007.[1] Northern filed a letter on June 6, 2007, taking factual exception to certain assertions in the Staff/OCA brief. Staff responded by letter of June 7, 2007, disagreeing with the positions taken by Northern and asking the Commission either to disregard Northern's June 6 filing or to consider both it and the Staff response.

The COG clause for Northern permits the adjustment of rates to reflect certain prudently incurred wholesale costs that would otherwise be reflected in rates after a full rate case. In this instance, the wholesale costs covered by the COG clause are for gas supply, as well as capacity charges and certain related expenses, net of applicable credits. The COG adjustment to Northern's retail rates is calculated prospectively every six months; the adjustment approved in Order No. 24,743 was effective on May 1, 2007, and another adjustment will be approved by the Commission for effect on November 1, 2007. The two six-month periods are commonly referred to as the "summer" and "winter" periods.

The COG adjustments are reconciled to Northern's actual costs. In other words, when Northern seeks a new six-month adjustment to reflect anticipated gas supply and capacity costs, it also reports on the actual gas supply and capacity costs the Company incurred during the preceding period, taking into account any over- or under-recovery of these expenses. This reconciling mechanism made it possible for the Commission to approve a new COG adjustment in Order No. 24,743 while reserving the right to make a subsequent adjustment to reflect the two issues left unresolved in that order.

Another gas utility, EnergyNorth Natural Gas Inc. d/b/a KeySpan Energy New England (KeySpan) filed a petition to intervene on May 10, 2007. The following day, KeySpan moved to consolidate this docket on a limited basis with DG 07-050, concerning COG rates for KeySpan.

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[1] The May 23, 2007 secretarial letter also granted a motion to intervene that had been submitted on May 10, 2007 by the state's other gas utility, EnergyNorth Natural Gas, Inc. d/b/a KeySpan Energy Delivery New England (KeySpan). KeySpan did not make any submissions with respect to the issues addressed in this order.

KeySpan withdrew this motion by letter filed on May 22, 2007. By secretarial letter issued on May 25, 2007, the Commission determined that (1) it would open a separate investigation to consider, as to both Northern and KeySpan, the appropriate interest rate to apply to supply-related working capital for COG adjustment purposes, deferring that issue to Docket No. DG 07-072, and (2) the Commission would limit this docket to consideration of the possible over-collection by Northern of costs arising out of timing differences between the receipt of supply-related revenues and the payment of gas supply costs.

II. POSITIONS OF THE PARTIES AND STAFF

A. Northern Utilities

Northern indicated that it opposes any change to the way in which it recovers gas supply costs associated with the lag, if any, between receipt of retail revenue from customers and payments by Northern to suppliers and pipelines. According to Northern, these costs are covered by the Company's working capital and are properly reimbursed to Northern at its weighted average cost of capital. Moreover, according to Northern, Staff bears the burden of establishing that the current practice is unjust and unreasonable. Northern characterizes as "noteworthy" the fact that Staff has not proposed specific COG rates that it believes are more just and reasonable than those proposed by Northern. Northern Brief at 6.

Of particular significance to Northern is the longevity of the current practice. According to Northern, that practice has been in place for more than 30 years and the factual findings that supported the relevant approvals are entitled to a presumption of correctness. Northern also contends that the rates derived from the current method fall within the "zone of reasonableness" that marks the constitutional standard. *Id*.

Northern contends that Staff is simply wrong in the assertion, as presented at hearing, that the Company is being compensated twice for a 15-day billed revenue lag through Northern's working capital calculation and the Company's collection of interest on under-recoveries. According to Northern, its working capital calculation is derived from the "lead-lag" study approved by the Commission in a base rate case submitted in 2001. The study, Northern notes, measures the average annual behavior of the Company and its customers, with respect to payment, in order to determine Northern's average annual need for working capital.

According to Northern, the lead-lag study does not take into account the timing differences experienced every month between Northern reading its customers' meters for billing purposes and the Company's suppliers reading *their* meters and billing Northern for wholesale gas actually purchased. Northern contends that these billing differences are a direct result of "volumetric differences" between billing-cycle-month meter readings for consumers and calendar-month meter readings reflected in the invoices it receives from suppliers and pipelines. *Id*. at 8. According to Northern, such differences in volumes and associated collections are particularly great during the transitional month between summer and winter gas seasons. Northern contends that (1) its lead-lag study did not attempt to reflect timing changes, volumetric changes in gas use, or other unpredictable marketplace changes, (2) the Company's working capital factor does not compensate it for variations in monthly volume and price that occur between billing-cycle and calendar-month metering and billing of gas use as compared to the average, and (3) that it is the calculation of interest on deferred gas cost collections that compensates Northern for such swings. In other words, according to Northern, the working capital allowance captures costs associated with the difference in payment behavior between the Company as a wholesale purchaser and its customers as retail purchasers, whereas the interest recovered on monthly deferred gas cost balances compensates the Company for differences between the actual gas costs charged to Northern at wholesale as compared to the actual gas metered and billed to customers.

Northern further contends that the Commission should reject a Staff recommendation to replace “as billed” revenues with Northern’s accrued revenues for purposes of calculating interest on over- or under-recoveries. According to Northern, adopting this recommendation would be inappropriate because the Company is entitled to recover interest on actual costs – i.e., the amount recorded by the Company at the end of each month for all sums it has either billed to customers or been charged by vendors. Northern notes that, at the end of each month, it has on average only read the meters and billed customers for half of that month’s gas costs – and thus, according to Northern, the current method of recovery applies actual gas cost collections to actual calendar months. Northern characterizes as inappropriate a shift to using accrued revenues to calculate over- or under-recoveries because this would result in the inclusion of “fictitious revenues” in the calculation. *Id*. at 12.

Northern rejects a Staff contention that New Hampshire’s electric utilities have accepted accrual accounting for purposes of calculating over- or under-recoveries in reconciling default service and transmission rates. According to Northern, the comparison to electric service is inappropriate and, in any event, there is no indication in any of the relevant Commission orders that the electric utilities have acquiesced to a change from “as billed” to accrued revenues. Northern further contends that, to the extent Staff contends electric utilities agreed to such treatment in settlement agreements, the agreements are not of record here and therefore Northern has no way to verify such assertions.

According to Northern, accepting Staff's recommendation would essentially require Northern to match 1.5 months of collections with one month of costs during the first month of the season in which such a change is implemented. Further, according to Northern, "in the real world" it is "as-billed" information from the Company's books that is (1) used to measure customer behavior, driving the need for working capital, and (2) analyzed annually to determine the average daily lag of the associated payments. By contrast, according to Northern, accrued revenues are not used for these purposes because this would create a mismatch of revenues the Company has not received with a full month of actual costs.

B. Commission Staff and Office of Consumer Advocate

Staff and OCA contend that Northern's COG reconciliation mechanism builds in recovery for timing differences that are already captured in the Company's lead-lag study and the resulting working capital allowance. According to Staff and OCA, the lead-lag study recommended calculation of the working capital allowance based on an average net lag, between payment of costs and receipt of revenues, of 6.33 days per month. Staff and OCA contend that the lead-lag study took into account, among other things, the fact that Northern reads its meters an average of 15.2 days after the applicable gas has been consumed. Therefore, according to Staff and OCA, if the lead-lag study was conducted properly then the cash working capital component of the COG mechanism should fully compensate Northern for any timing differences associated with wholesale costs and retail receipts.

According to Staff and OCA, the record demonstrates that timing differences do contribute to the over- or under-collection balances used by Northern to conduct its COG reconciliation – and, thus, that Northern is over-collecting carrying costs. Specifically, Staff and

OCA contend that billed revenues lag accrued costs by an average of 15 days per month, which is the same time interval already reflected in the Company's lead-lag study.

Staff and OCA draw the Commission's attention to the table that appears in the record as page 21 to Exhibit 5. According to Staff and OCA, the table reflects Northern's month-by-month cost-of-gas reconciliation for the 2005-06 winter period, from November 2005 through April 2006.[2] The column for each month contains a figure reflecting Northern's cost of the gas consumed that month by its customers. According to Staff and OCA, this reflects an "accrual accounting concept" that Northern did not use elsewhere on the table, specifically in developing each month's figure for the Company's revenue applicable to that month. Staff/OCA Brief at 4. The revenue figures reflect billed revenues, according to Staff and OCA. Therefore, Staff and OCA assert, revenue associated with gas consumed in a particular month but not billed until the following month is assigned to that second month for purposes of developing the reconciliation figures for each month. Staff and OCA point to an exception to this practice, applicable to gas consumed in October. According to Staff and OCA, revenue associated with gas consumed in October but not billed until November is not assigned to November because Northern treats October as a summer month for COG reconciliation purposes and, thus, consumption in October is not applicable to the winter period. The result, explain Staff and OCA, is that only 15 days of consumption are assigned to November for purposes of calculating billed revenues and therefore the reconciliation balance. Staff and OCA further explain that there is an offsetting adjustment in May, which contains an extra 15 days of revenue so as to assure that each six-month

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[2] This appears to be in error. The Staff and OCA brief references "Attachment 1 of Exhibit GRM-2 to Exhibit 5." Exhibit 5 is Staff's written rebuttal testimony, filed on April 16, 2007. Exhibit GRM-2 to the written rebuttal testimony is a copy of a Staff report of March 15, 2007 entitled "Report on Northern's Calculation of Carrying Charges Related to the Development of the Cost of Gas Rate." *See* Order No. 24,684 (October 27, 2006) slip op. at 8 (directing Staff to develop such report). Attachment 1 to the March 2007 Staff report, in turn, consists of a table reflecting Northern's gas reconciliation from May of 2005 through April 2006. The discussion in the Staff/OCA brief addresses itself to the 13-month period reflected in the table.

reconciliation period (i.e., summer and winter) includes six months of both costs and revenues. According to Staff and OCA, "[t]he important point to draw from this analysis is that the stream of billed revenue in the attachment effectively begins on the 16th day of November and ends on the 15th day of May. Stated differently, the billed revenue stream lags accrued gas costs by on average 15 days." *Id.* at 5.

Staff draws the Commission's attention to certain testimony offered at hearing on April 23, 2007 by Joseph Ferro, Northern's manager of regulatory policy. Mr. Ferro referred to the Company's "actual" as opposed to "accrued" gas costs, specifically defining "actual" as "the Company recording its costs and revenues at the end of the month for everything it has either billed out or been charged." Tr. 4/23/07 at 91-92. According to Staff, this is contradicted by a data response provided by Northern in Docket No. DG 06-129 (Northern's 2006-07 winter cost of gas proceeding), which, according to Staff, states that "costs of firm gas allowable through the Cost of Gas Clause are incurred in the month [gas is] utilized, and recorded as an expense at the end of that month." Staff Brief at 7. Staff further contends that Mr. Ferro himself conceded, during cross examination, that Northern employs accrual accounting for gas costs.

According to Staff, the reality of the situation is that Northern bills and collects a full month of revenue each month, but the reconciliation that determines the amount of carrying costs paid by customers: (1) does not include a full month of revenues in the first month of each season, and (2) includes a full month of costs. This, according to Staff, is consistent with the March 2007 Staff Report but not the schedule attached to Mr. Ferro's prefiled rebuttal testimony (Exhibit 4).

Next Staff asks the Commission to consider Exhibit 6, a schedule prepared by Northern and labeled "Working Capital Revenue Lag." According to Staff, Exhibit 6 shows that Northern calculates the average revenue lag from billing to collection by using monthly accounts receivable balances. Staff further points out that Exhibit 6 shows that the accounts receivable balances during the winter months are considerably higher than the balances during the summer months, reflecting the fact that gas volumes change with the transition from the summer to the winter gas period. According to Staff, Exhibit 6 “flatly contradicts Mr. Ferro’s assertion that the lead/lag study does not compensate Northern for the impact of volumetric changes on cash working capital, as suggested by Mr. Ferro at page 109 of the April 23, 2007 hearing transcript. Staff Brief at 8. Moreover, according to Staff, even assuming that changes in volume increase the difference between monthly costs and revenues and that such difference is attributable to increases in revenue lag, Northern has not explained why this longer revenue lags is not simply offset by the shorter revenue lag during the transition from the winter to summer periods.

Staff also asks the Commission to consider the fact that, assuming an equal number of customers in each billing cycle and assuming that billing cycles are spread uniformly throughout each month, Northern’s meter readings lag consumption, on average, by 15.2 days. According to Staff, the fact that this lag is reflected in Northern’s lead/lag study contradicts Mr. Ferro’s assertion that the allowance for cash working capital does not compensate Northern for the differences in monthly costs and monthly revenues attributable to billing cycles.

Staff dismisses as “not credible” Northern’s position that the Commission should not alter a reconciliation mechanism that has been in place for more than 30 years. *Id*. at 11. Staff’s position is that the mechanism was flawed when implemented and should therefore not be perpetuated. Finally, Staff does not agree with Northern’s contention that the Staff bears the burden of demonstrating why the currently used reconciliation method should be changed. According to Staff, the plenary ratemaking authority granted by RSA 378:7 means the

Commission "is entitled to base its rate determination upon a preponderance of the evidence regardless of which party produced that evidence." *Id*. at 12.

III. COMMISSION ANALYSIS

A. Burden of Proof

We begin with the threshold issues raised by Northern. N.H. Code Admin. Rules Puc 203.05 establishes that, unless otherwise specified by law, "the party seeking relief through a petition, application, motion or complaint shall bear the burden of proving the truth of any factual proposition by a preponderance of the evidence." We are unable to agree with Northern that this rule, and the legal principles that undergird the rule, mean that Staff has the burden of proving the necessity of deviating from the COG reconciliation submitted by the Company pursuant to longstanding precedent.

RSA 378:8 provides that whenever a utility seeks a rate increase, "the burden of proving the necessity of the increase shall be upon such applicant." As Mr. Ferro noted in his testimony for Northern, fuel adjustment mechanisms have the effect of obviating successive rate cases as sometimes volatile fuel costs fluctuate. *See* Tr. 4/23/07 at 84 (describing this as "the practical thing to do"). This concession to practical reality does not relieve, and was not intended to relieve, utilities of the burden of proof they have under a full RSA 378:8 rate case. In other words, when a gas utility makes a COG filing, the utility is "the party seeking relief" for purposes of Puc 203.05 and thus bears the burden of proof as to whether the rates it seeks are reasonable, regardless of whether the Commission *sua sponte* or with the assistance of Staff flags particular issues for scrutiny. In this case, however, both Staff and Northern have marshaled a full record in support of their respective positions. Thus the question, in reality, is not who has the burden of proof but, more to the point, between the two who has made the convincing case.

B. Alleged Factual Mischaracterizations

Next we turn to the concerns expressed in Northern's letter filed on June 6, 2007, and Staff's response of the following day. Northern contends the Staff/OCA brief contains certain statements that "directly contravene the record evidence." Northern Letter of June 6, 2007 at 1.

According to Northern, Staff repeatedly claims that in its COG reconciliation the utility only accounts for a half-month of revenue in the first month of the winter and summer periods while reflecting a full month of costs. Northern's position is that its witness testified that, for the first month of each six-month period, the Company records a half-month of revenue in its "off-season" account that has zero associated costs. *Id*. Staff's response is that this allegation is misleading, and that the point it sought to make in the brief was that

> tacking the other half of the November billed revenue onto the end of the prior summer period reconciliation [i.e., covering the period ending on October 31], and matching it with zero November costs, produces a one-month over-collection at the end of the summer period. As a result, customers are paid the carrying costs on this one-month over-collection. In contrast, the under-collection resulting from matching a full month of gas costs in the first month of the winter period reconciliation (i.e., November) with half a month of revenue must be carried by the Company throughout the winter period, requiring customers to pay six months of carrying costs.

Staff Letter of June 7, 2007 at 2. We accept this clarification of Staff's position on the issue and thus disagree with the suggestion that there has been any material misstatement of the evidence. The substantive issues implicated by this disagreement are addressed *supra*.

Northern also contends in its letter that the Staff/OCA Brief contains an incorrect statement to the effect that the annual averages used by Northern in its lead-lag study reflect monthly differences between supply costs incurred and retail revenue received. According to Northern, the evidence shows that the lead-lag study "reflects a simple average of the annual data." Northern Letter of June 6, 2007 at 1. Staff disagrees with Northern's characterization of the evidence, citing the rebuttal testimony of Northern witness Joseph Ferro that the Company "used monthly accounts receivable balances from the books and records to determine its average accounts receivable balance" for purposes of the collection lag reflected in the lead-lag study. Northern Letter at 2, quoting Exh. 10. We need not resolve this disagreement because the decision we explain below does not turn on how Northern calculates its average accounts receivable balance.

C. Recovery of Working Capital Costs

Having carefully reviewed both the evidentiary record and the well-developed, thorough arguments of the parties, it is our determination that Northern is not entitled to recover carrying costs associated with seasonal fluctuations in gas volumes, beyond those costs recovered for working capital needs supported by Northern's most recent lead-lag study. In other words, we agree with Staff that a double recovery of certain working capital costs occurs when interest is calculated on deferred gas cost collections using accrued costs and billed revenues.

A working capital allowance, on which Northern earns a return through retail rates, gives the Company the ability to pay the wholesale bills before the applicable customer funds are received. Staff witness George McCluskey testified about two kinds of lag that are relevant to this proceeding. The first is a 6.33-day lag, as calculated by Northern's most recent lead-lag study, that covers the difference between the Company's payment of gas costs to suppliers and the Company's receipt of the applicable retail revenue from customers. The second kind of lag, identified by Mr. McCluskey to be slightly more than 15 days, arises out of the reconciliation process Northern uses to calculate its semi-annual cost-of-gas adjustment. According to Mr. McCluskey, this lag arises out of Northern's comparison of accrued gas costs with billed revenues for purposes of calculating its monthly cost reconciliation. Staff's position is that

Northern is already recovering, through interest on working capital, any costs associated with this 15-day lag between costs and revenues. Therefore, according to Staff, there is double recovery when Northern is also allowed to recover a carrying charge on the 15-day lag.

We credit Mr. McCluskey's testimony that the 15-day lag arises out of an apples-to-oranges comparison of accrued costs and billed revenues. As noted by Staff, the phenomenon is essentially the result of Northern receiving less than a full month of revenue in the first month of both the winter and the summer COG periods.[3] Staff persuasively points out that it is more appropriate to compare accrued costs (i.e., costs associated with actual gas consumption during the month) and accrued revenue (i.e., money Northern is entitled to collect from customers for gas consumed in that month) for purposes of conducting the monthly COG reconciliation. In other words, accounting treatment for rate reconciliation purposes notwithstanding, the Company's need for actual working capital associated with gas costs, and the attendant need for a return on that working capital, is adequately captured by the 6.33 days identified in the lead-lag study.[4] Northern apparently believes otherwise, its witness having testified that the Company would be indifferent to Staff's proposal if demand for gas were flat and there were no "volume mismatch." Tr. 4/23/07 at 88. This may suggest the need to conduct a new lead-lag study, but it

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[3] This is a reality notwithstanding the fact that Northern uses a special "off-season" account to record a half-month of revenues received during each six-month period that is not associated with that period, as noted in Northern's letter of June 6, 2007 and discussed *supra*.

[4] OCA made the same point in its cross-examination of Mr. McCluskey, by causing him to agree that the 6.33 days of revenue lag identified in the lead-lag-study is actually the net of individual monthly leads and lags, each of which is comprised of the 15 days identified by Northern as the additional, volume-related lag for which it seeks recovery here. Therefore, Northern is fully compensated by obtaining a return on the working capital required for 6.33 days of revenue lag.

does not support the recognition of an expense based on comparing accrued costs to billed revenue.[5]

Northern complains that Staff's approach of using accrued costs and accrued revenues for the purpose of monthly COG reconciliations amounts to the inclusion of "fictitious" revenue in the calculation because such revenues have not yet been received and are calculated in an effort to "calendarize" sales. *Id*. at 12. The result, according to Northern, is to calculate the Company's cost of gas based in part on an incorrect assumption that the utility has the use of this billed revenue. We disagree. To the extent Northern lacks use of these funds, must advance them and is thus entitled to a return on them, this is already taken into account through the working capital allowance calculated by using the lead-lag study.

Northern's assertion that Staff's recommendation to use accrual accounting for both costs and revenues would require Northern to match 1.5 months of collections with one month of costs during the first month of the season in which such a change is implemented would only be the case if Northern failed to adopt full accrual accounting at the time of implementation. Revenues billed in the first month related to prior month sales would not be included in the first month's revenues under accrual accounting. October sales billed in November will not be recorded as November revenue; rather, November revenues will reflect sales in November that are billed in both November and December, just as April revenues (the final month of the winter period) will include April sales billed in both April and May. Implemented correctly, a change to accrual accounting will record one month of revenue in the first month. The summer COG reconciliation will be similarly adjusted to record October sales billed in November as October sales and adjust the summer period ending balance accordingly.

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[5] In arguing to the contrary, Mr. Ferro testified that the 15-day lag is, in reality, a "volume lag" and "not a lag in days." Tr. 4/23/07 at 94. This is merely a theoretical distinction, since the relevant unit of measure is actually dollars, which can readily be converted to days of revenue in connection with a lead-lag study or otherwise.

IV. CONCLUSION

For the reasons set forth above, it is our determination that the cost-of-gas adjustment mechanism employed by Northern requires a correction, effective with the 2005-2006 winter COG reconciliation, to use accrued revenues rather than billed revenues in the reconciliation calculations. The appropriate vehicle for making necessary adjustment is the new cost-of-gas filing Northern is making this month to be applicable during the 2007-2008 winter period.

Based upon the foregoing, it is hereby

ORDERED, that Northern make a compliance filing in its 2007-2008 winter cost-of-gas proceeding to reflect the correction in the Company's cost-of-gas adjustment mechanism described herein.

By order of the Public Utilities Commission of New Hampshire this thirteenth day of September, 2007.

Thomas B. Getz Chairman	Graham J. Morrison Commissioner	Clifton C. Below Commissioner

Attested by:

Debra A. Howland
Executive Director & Secretary