

**STATE OF NEW HAMPSHIRE
PUBLIC UTILITIES COMMISSION**

DG 07-072

**Gas and Electric Indirect Costs—Carrying Charge Rate Regarding
Supply Related Cash Working Capital**

Prehearing Conference Order

ORDER NO. 24,793

September 27, 2007

APPEARANCES: Steven V. Camerino, Esq., of McLane, Graf, Raulerson, and Middleton, on behalf of EnergyNorth Natural Gas, Inc. d/b/a KeySpan Energy Delivery New England; Susan S. Geiger, Esq., of Orr & Reno, and Patricia M. French, Esq., on behalf of Northern Utilities, Inc.; Gerald M. Eaton, Esq. for Public Service Company of New Hampshire; Alexandra E. Blackmore, Esq. for Granite State Electric Company; Gary M. Epler, Esq. for Unutil Energy Systems, Inc.; Kenneth E. Traum, of the Office of the Consumer Advocate, on behalf of residential utility ratepayers; and Edward N. Damon, Esq. for the Staff of the New Hampshire Public Utilities Commission.

I. PROCEDURAL HISTORY

On June 25, 2007, the Commission issued an order of notice opening this docket to consider, among other things, the appropriate carrying charge rate for cash working capital needed to meet the supply obligations of EnergyNorth Natural Gas, Inc. d/b/a KeySpan Energy Delivery New England (EnergyNorth) and Northern Utilities, Inc. (Northern). The Commission indicated that it would also consider the effective date for such rate to the extent it is different from the currently effective rate. The order of notice indicated that if a new method for calculating the carrying charge is appropriate for the gas utilities, it may also apply the principle to electric utilities as well. Therefore, EnergyNorth, Northern, Unutil Energy Systems, Inc. (Unutil), Granite State Electric Company (Granite State) and Public Service Company of New Hampshire (PSNH) were made parties to the docket.

On June 26, 2007, the Office of Consumer Advocate (OCA) entered an appearance on behalf of residential utility consumers pursuant to RSA 363:28, II. On July 25, 2007, the prehearing conference and technical session were held as scheduled.

On July 27, 2007, PSNH filed a motion to be dismissed as a necessary party, to which Northern responded on August 1, 2007. On August 8, 2007, Staff filed a report of the technical session, noting that the parties had not reached agreement on a procedural schedule and recommending that any preliminary motions, such as motions for designation of Staff, motions to dismiss, and requests regarding procedural matters, be filed with the Commission by August 15, 2007. EnergyNorth and Northern filed a joint motion seeking Staff designation, bifurcation of the proceedings and a determination that Staff must file its testimony prior to that of the utilities. Staff filed a motion regarding certain procedural issues and PSNH filed a statement of position on procedural matters. The next day, Unitil filed a letter in support of EnergyNorth's and Northern's joint motion. On August 31, 2007, EnergyNorth and Northern filed an objection to Staff's motion.

II. PRELIMINARY POSITIONS OF THE PARTIES AND STAFF ON THE MERITS

A. EnergyNorth

EnergyNorth stated that Staff's position on the substantive issue in this docket is based on an erroneous assumption that the gas utilities face little or no risk regarding the recovery of their gas supply costs. EnergyNorth maintained that the gas companies face a greater risk of recovery with regard to their supply-related costs because there is no potential to earn a profit on them, but there is a significant risk of disallowance, as evidenced by a number of disallowance proceedings initiated by Staff involving EnergyNorth's gas procurement and gas dispatch decisions. EnergyNorth stated that comparing the gas utilities to the electric utilities is misplaced.

EnergyNorth also argued that cash working capital is part of its total invested capital and is not a separate item to which a separate cost factor can be appropriately applied. Next, EnergyNorth stated that adjusting a single cost factor, the cost of capital, in isolation and without considering other costs in providing service, is a clear case of prohibited single issue ratemaking. Finally, EnergyNorth stated that if the docket goes forward, it should be allowed to defer for future recovery its rate case expenses. According to EnergyNorth, the substantive issue is one that would normally be dealt with in a full rate case and it has been incurring increasing amounts of significant regulatory expense without an opportunity to recover those expenses.

As a procedural matter, EnergyNorth stated that it is premature to include the electric utilities in the docket, referring again to its view that the gas and electric utilities are not in comparable situations. EnergyNorth addressed several more procedural matters, which are more fully described below in Section III.

B. Northern

Northern generally concurred in EnergyNorth's statement of preliminary position. Northern emphasized its view that its cost of capital, and not its short term debt cost, is the appropriate carrying charge rate associated with supply-related working capital and that it is inappropriate to consider in isolation only one component of the revenue requirement established in its last base rate case. According to Northern, such an exercise would constitute single-issue ratemaking, which is disfavored because it can produce a skewed and confiscatory result. Thus, absent a full rate case, it would be inappropriate to make any adjustments to the carrying charge, in its opinion. Northern also argued, as it did in Docket No. DG 07-033, Northern's 2007 summer cost of gas proceeding, that Staff bears the burden of proof in this case.

Northern stated that recovery of direct gas costs is not essentially risk-free, as Staff has asserted, because the Company faces regular prudence reviews and is not guaranteed full recovery of its gas costs. Northern also maintained that since its internally generated long-term and short-term funds are commingled and used simultaneously for both its long-term and short-term financial needs, it is inappropriate to conclude that supply-related working capital is funded solely through short-term borrowings and thus should carry a short-term debt cost. Northern stated that the working capital expense associated with its gas costs represents a long-term, virtually permanent systemic cost and therefore it must be funded with, or contribute to, long-term borrowing costs reflective of its capital structure, and be consistent with the rate mechanisms approved by the Commission in Northern's last base rate case.

Procedurally, Northern asserted that if the Commission decides to proceed with the single issue rate investigation, the Commission should recognize the differences between the gas and electric utilities. Unlike some of the electric utilities, Northern does not receive an explicit finding from the Commission prior to executing its supply contracts that such supply costs are reasonable and recoverable through retail rates. In Northern's view, this difference justifies consideration of the working capital issue in separate dockets for each industry. Finally, Northern urges that if the Commission finds it is appropriate to change the carrying charge rate on its supply-related working capital, the change should be implemented prospectively in conjunction with a full rate case.

C. PSNH

PSNH previewed orally the arguments it said it would make in a motion to be dismissed as a party, which are described in section III below.

D. Granite State

Granite State concurred with EnergyNorth's statement of position and emphasized that its overall cost of capital is the appropriate carrying charge rate for supply-related working capital, notwithstanding the Commission's approval of the use of Granite State's prime rate as the carrying charge on cash working capital associated with the procurement of default service. Although Granite State's position in the prior docket was the result of negotiations with Staff, it said in a full rate case it would urge the use of its overall cost of capital.

E. Unitil

Unitil noted that although the Commission recently ordered the Company to apply the prime rate to its supply-related cash working capital in Docket No. DE 06-123, Unitil continues to believe, consistent with the positions of the other utilities, that its overall cost of capital, grossed up for taxes, is the appropriate rate to use for all working capital. According to Unitil, however, it is not premature to include the electric utility companies in this docket.

For Unitil, the risk of recovery is not the sole basis on which to decide the carrying charge rate for cash working capital. The sources of cash working capital for supply-related needs are the same sources for all capital raised by any utility, i.e., equity, long-term debt and short-term debt. Unitil stated that the cost of working capital, when included in rate base, is the weighted average cost of the various sources of capital, which does not change when recovery is moved from base rates to the default service charge. In this case, the utility does not recover less when recovery is obtained through the default service charge because the risk of recovery is less. In Unitil's view, the issue of risk is addressed when the overall cost of capital is set. Unitil continued that its cost of capital was established pursuant to a settlement that contemplated moving certain costs to the default service charge. According to Unitil, setting the

carrying charge rates contrary to the settlement after recovery was moved to default service rates does not recognize the risk it faces.

F. OCA

The OCA indicated, in response to the objection that this proceeding constitutes improper single-issue ratemaking, that when the issue of including indirect gas costs in a cost of gas proceeding was first raised, it had objected on the grounds of single-issue ratemaking. The OCA also addressed the issue of risk due to disallowances of supply costs for imprudence, which is a very different risk from those traditionally borne by utilities, such as the risks related to weather, conservation or usage levels affected by changes in gas prices. In addition, the OCA stated that the seasonality of gas sales plays a major role in the gas utilities' borrowing needs and it is appropriate to look at the sources of the supply-related working capital. The OCA also posited that it may turn out that short term debt is the source of such capital.

G. Staff

Staff explained that cash working capital is the investor-supplied capital needed to support expense outlays due to timing differences between receipt of revenues from customers and payment of supplier costs. Prior to the unbundling of power supply-related costs by electric utilities and gas supply-related costs by gas companies, cash working capital was included in rate base and earned the utility's overall cost of capital, grossed up for taxes. Staff noted that, since unbundling, the cost to finance the supply-related portion of cash working capital has been recovered by electric utilities through default service rates and by gas companies through cost-of-gas rates. Staff stated that since those rates are adjusted periodically to reflect cost changes, the Commission is obliged to review the justness and reasonableness of the proposed rates, including their cash working capital components. Furthermore, according to Staff, the

Commission does not have to wait until a utility's next base rate case to review the justness and reasonableness of the return earned on its supply-related cash working capital.

Staff stated that the justness and reasonableness of the carrying charge rate is at issue in this proceeding. Staff noted that in a recent default service proceeding involving Unitil, Docket No. DE 06-123, the Commission determined that supply-related cash working capital is a short-term borrowing requirement and that Unitil's overall cost of capital was not an appropriate short-term borrowing cost. Instead, the Commission directed Unitil to use the prime rate to calculate the cost to finance its supply-related cash working capital. And Staff noted that in Docket No. DE 07-012, a Granite State default service proceeding, the Commission approved a default service rate that included a supply-related cash working capital cost calculated using the prime rate.

Since those proceedings, Staff said it has come to understand that each electric and gas utility participates in a money pool operated by its parent and that the primary purpose of a money pool, as Staff understands it, is to fund a participant's short-term borrowing requirements, including its working capital. In Staff's view, the cash working capital component of cost of gas and default service rates should reflect the source of finance for the working capital and therefore the money pool rate, rather than the prime rate or the overall cost of capital, should be the carrying charge rate applied to cash working capital.

Finally, Staff stated that utilities traditionally bear the burden of showing that its proposed rates are just and reasonable. In Staff's view, that burden would include showing that their proposed carrying charge on cash working capital is appropriate.

III. PRELIMINARY PROCEDURAL MATTERS

A. Designation of Staff Advocate

EnergyNorth and Northern jointly moved that utility analyst George McCluskey be designated as a Staff advocate in this docket pursuant to RSA 363:32, I. Pursuant to RSA 363:34 and 35, such designation would have the effect of precluding him from advising the Commissioners with respect to matters at issue in the docket while subjecting Mr. McCluskey to the *ex parte* restrictions that apply routinely in adjudicative proceedings to persons outside the agency. EnergyNorth and Northern stated that Granite State agreed with the relief requested in the motion while Unitil, PSNH and OCA took no position on the motion and Staff objected. Neither these parties, nor Staff, filed written positions on the motion.

EnergyNorth and Northern stated that in their summer 2007 cost-of-gas proceedings, Mr. McCluskey put them on notice of his belief that the carrying charge rate used for gas supply related purposes should be changed to a short-term debt rate instead of the overall cost of capital and he provided testimony to that effect in Northern's cost-of-gas proceeding, Docket No. DG 07-033. They maintained that since Staff indicated that the return on cash working capital would be an issue Staff intended to pursue, the dealings between the Staff and the two gas utilities have been highly contentious.

In particular, they stated that Staff has had disputes with EnergyNorth regarding Staff's obligation to respond to discovery requests concerning the issue, and Mr. McCluskey and the director of the Commission's legal division were designated as Staff advocates in the proceeding that gave rise to Northern's involvement in this docket, Docket No. DG 07-033. In addition, they stated that, as was apparent at the pre-hearing conference, it is likely to be at least as contentious as the prior proceedings in which Mr. McCluskey raised the carrying charge issue.

As examples, EnergyNorth and Northern maintained that the Staff and the utilities have thus far been unable to agree on basic matters such as who bears the burden of proof, what the procedural schedule should be, whether the proceeding should be conducted in one or two phases, and what parties should be included in the docket.

EnergyNorth and Northern invoked two statutory grounds in support of their request: RSA 363:32, I(a)(2), providing for designation of Staff members if requested by a party with full rights of participation in an adjudicative proceeding when “the docket concerns an issue or matter which is particularly contentious or controversial and which is significant in consequence,” and RSA 363:32, I(a)(1), providing for designation when “[i]t appears that staff members have committed or are likely to commit to a highly adversarial position in the proceeding and may not be able to fairly and neutrally advise the commission on all positions advanced in the proceeding.” Regarding the first ground, EnergyNorth and Northern argued that Staff’s proposal would result in a significant change from prior approved ratemaking practice. According to them, in addition to the direct financial impact of the issue raised by Mr. McCluskey, his proposed change would for the first time identify and separate out individual segments of gas utilities’ invested capital and apply different cost factors to them, resulting in a change in the associated revenue requirement.

Regarding the second ground, EnergyNorth and Northern asserted that Mr. McCluskey has already taken an unequivocal position on the issues being contested in this docket and he appears to be sufficiently committed to it that there is at least the appearance that he will be unable to advise the Commission fully of the merits of the utilities’ position in the proceeding.

In Docket Nos. DG 07-033 and DG 07-050, we notified the parties that we would open a separate investigation to resolve for both Northern and EnergyNorth the issue of an appropriate

interest rate to be charged for gas supply cash working capital. Subsequently, Northern filed a motion requesting the designation of Mr. McCluskey, as well as attorney F. Anne Ross, as Staff advocates in DG 07-033. That motion invoked three statutory grounds for the designation -- RSA 363:32, I(a)(2) and 363:32, I(a)(1), which are quoted above, and 363:32, I(a)(3), providing for designation when “[t]he issues in the docket are so contested as to create a reasonable concern on the part of any party about the staff’s role in commission decision making.” We granted the motion but did not specify any particular ground for designation.

Inasmuch as this proceeding effectively continues the consideration of an issue raised in Docket No. DG 07-033, where Mr. McCluskey was designated a staff advocate, we will designate Mr. McCluskey as a Staff advocate for the purposes of this docket as well. To the extent it is necessary to specify the grounds for our designation, we do not find a sufficient basis for concluding either that Mr. McCluskey could not fairly and neutrally advise us or that there is a reasonable concern about his role. The facts of the case, however, do support a finding that the matter is particularly contentious and significant in consequence.

B. Phasing of Docket

EnergyNorth and Northern jointly moved that the proceeding be conducted in two distinct phases. They asserted that administrative efficiency, including the need to avoid overburdening the utilities with unnecessary discovery and testimony, warrant such bifurcation. They propose that the Commission first determine whether the existing practice of applying the overall cost of capital as the return on working capital should be changed to using a short-term debt rate. Then, if the Commission decides to make a change, they propose a second phase in which the Commission would determine the nature of the debt rate (i.e., prime rate, money pool rate or other source of short term debt) that should apply, with consideration of the effective date

of any new method also undertaken in the second phase. EnergyNorth and Northern added that if the Commission does not bifurcate the proceeding, it will be necessary for all five utilities to file testimony and submit to discovery regarding their short term capital costs, even though that issue may ultimately not be relevant to the proceeding.

Unitil filed a letter supporting the motion and PSNH filed a statement of position favoring a two-phased docket if its motion to be dismissed as a party is denied. According to PSNH, discovery in the initial phase of a bifurcated proceeding will be far less involved in that the parties will not need to explore each company's financing strategies and interest rates.

Staff recommended against a phased approach but proposed that the determination of the actual short term debt rate be left to future cost-of-gas or default service proceedings. Staff stated that a two-phase schedule would artificially separate the issues to be decided in each phase and is not an administratively efficient way of resolving them, noting that each phase would have its own procedural schedule, including testimony, discovery, technical sessions and settlement conferences, culminating in an order by the Commission. Staff added that a two-phase proceeding would unnecessarily encourage procedural disputes about the relevance of discovery and evidence to each of the phases. Staff said that there is one substantive issue at stake in the proceeding, namely the justness and reasonableness of the carrying charge rate that utilities use to calculate the cost to finance their supply-related cash working capital. According to Staff, the issue of whether supply-related cash working capital represents a short-term borrowing requirement that is financed at least cost with short term funds implicates several factors, including the actual source of funds used by each utility to meet its cash working capital needs. Staff maintained that because Staff would apparently be prohibited during the first phase from

asking questions on source-of-funds issues, a two-phase procedural schedule would unreasonably restrict Staff's ability to present its case in the best possible light.

EnergyNorth and Northern filed a joint objection to Staff's motion. They stated that they have repeatedly confirmed to Staff that, even in a two-phase proceeding, Staff would be free to inquire during discovery in the first phase as to the source of funds used to finance working capital. They said they understood that the source of funds is part of the basis for the Staff's position that working capital should earn a short term rate of return, and therefore agree that funding sources would be an appropriate area of inquiry during the first phase of the proceeding.

On the other hand, EnergyNorth and Northern contend that an inquiry into the specific cost of those funds, which can vary on a daily basis in addition to varying from utility to utility, would be irrelevant. They maintained that discovery on this point would be burdensome and potentially unnecessary if the Commission determined, as a threshold matter, that it would be inappropriate to depart from the Commission's longstanding practice of applying each company's overall weighted average cost of capital to gas supply working capital. In addition, they maintained that Staff's proposal would involve an unnecessarily broad scope of discovery that would delay resolution of the threshold issue and add expense and administrative burden to the proceeding.

EnergyNorth and Northern also asserted that Staff incorrectly characterized the issue in this proceeding as being the justness and reasonableness of the carrying charge rate and that this led Staff to its erroneous recommendation with respect to Northern in Docket No. DG 07-033. They indicated they would address the problem with Staff's proposal when they file their testimony.

We agree with the parties and Staff that the objective of administrative efficiency should guide our resolution of this procedural issue. It is apparent that there are advantages and drawbacks to the various suggested approaches and it is difficult to assess in advance which approach is best. After careful consideration, we are disposed to proceed in two phases.

Staff has said that it seeks to address, among other things, source-of-funds issues as part of its case in chief and EnergyNorth and Northern are willing to accommodate Staff in this regard. We understand that although the actual numerical cost of the utilities' working capital funding sources would be beyond the scope of the initial phase under EnergyNorth's and Northern's proposal, discovery and testimony of a general nature regarding the cost of the utilities' working capital funding sources may well be relevant to the initial phase. In addition, it is likely that the risks faced by each utility with respect to supply related losses may be relevant to the initial phase. Apart from these general observations, we do not purport to resolve here all possible issues regarding relevance for purposes of discovery and testimony in the first phase. We defer a ruling on the question of the scope of the second phase, including the effective date of any new method, to the conclusion of the initial phase.

C. Order of Pre-filed Testimony

EnergyNorth and Northern jointly moved that Staff be required to file its testimony prior to testimony being filed by the gas utilities on grounds that they do not have the burden of production and that the basis for Mr. McCluskey's position on the merits is not clear. In addition, they stated that this would help ensure that the docket is administered more efficiently. They stated that the Commission could require Staff to submit its testimony first without prejudice to either party's right to dispute the issue of the burden of proof at a later stage of the docket. In addition, they stated that although extensive discovery has already been conducted

regarding the salient issues in several related prior proceedings, they would not object to a reasonable amount of additional discovery if Staff still believes that it does not have sufficient information to present its direct case.

EnergyNorth and Northern reported that Granite State, PSNH, and Unitol concur with the relief requested and that Staff agreed to file its testimony first, a position which OCA supports. Staff filed a motion regarding procedural issues which confirmed its agreement that it would be appropriate for Staff and non-utility parties to file their testimony before the utilities file their testimony, provided that this arrangement does not affect the utilities' ultimate burden of persuasion and provided that Staff and non-utility parties have the final opportunity to file rebuttal testimony following the filing of testimony by the utilities.

Unitol filed a letter supporting the motion for the reasons discussed in *Wilton Telephone Co.*, 86 NHPUC 498, 505-506 (2001), and recommending that any party aligned with Staff's position on the issues in this docket be required to file their testimony and respond to data requests at the same time as Staff. In addition, PSNH filed a statement recommending that Staff be required to file its testimony first. PSNH stated that a party advocating for a change in rate methods that will have the effect of lowering rates to customers should have the burden of making a *prima facie* case. PSNH compared this proceeding to a show cause or complaint proceeding, in which the utilities do not have the burden of going forward with evidence. PSNH also contended that if the OCA favors a short term rate for cash working capital, it should file testimony at the same time as Staff.

We have no reason to disturb the apparent consensus that Staff should file its direct testimony prior to that of the utilities. We agree with the logic and propriety of having any party aligned with Staff's position on the merits in the initial phase submit prefiled testimony. Staff

suggested that Staff and non-utility parties have the final opportunity to file rebuttal testimony following the filing of testimony by the utilities. This suggestion is reasonable and consistent with our typical practice.

D. PSNH Motion to be Dismissed as a Necessary Party

PSNH seeks to be relieved of any obligations as a necessary or mandatory party on the ground that specific statutory provisions governing its provision of default service, in light of its status as the only New Hampshire distribution company that still owns a generation portfolio, would determine the outcome of the issues in this case as applied to PSNH. See RSA 369-B:3, IV(1)(A) (requiring use of PSNH generation portfolio for default service, priced at PSNH's "actual, prudent and reasonable" costs). According to PSNH, it faces different risks than the other electric utilities, which obtain pre-approval of their power procurement efforts and do not face after-the-fact disallowances through application of the PSNH-specific standard in RSA 369-B:3, IV(10)(A). Northern indicated that it did not oppose the PSNH motion but contended that many of PSNH's arguments also support Northern's position.

Hearing evidence and argument from PSNH on the merits may assist our consideration of the issues in the first phase of this docket, therefore we deny its motion pending the outcome of the first phase. In the event we proceed to a second phase, PSNH may renew its motion. At the same time, we do not purport to direct the nature and extent of PSNH's participation but we observe that the determinations in this proceeding may ultimately affect it.

Based upon the foregoing, it is hereby

ORDERED, that EnergyNorth's and Northern's joint motion to designate George McCluskey as Staff advocate for purposes of this docket is granted, as set forth above; and it is

FURTHER ORDERED, that EnergyNorth's and Northern's joint motion to bifurcate is granted, as set forth above; and it is

FURTHER ORDERED, that PSNH's motion to be dismissed as a necessary party is denied; and it is

FURTHER ORDERED, that the parties and Staff shall file proposed procedural schedules consistent with the terms of this order, including but not limited to our ruling on the order of filing testimony, and preferably by agreement, within 14 days.

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

Thomas B. Getz
Chairman

Graham J. Morrison
Commissioner

Clifton C. Below
Commissioner

Attested by:

Debra A. Howland
Executive Director & Secretary