STATE OF NEW HAMPSHIRE
PUBLIC UTILITIES COMMISSION

DG 10-139

ENERGYNORTH NATURAL GAS, INC. D/B/A NATIONAL GRID NH

Cast Iron/Bare Steel Replacement Program

Order Approving Revised Distribution Rate

O R D E R N O. 25,127

June 30, 2010

APPEARANCES: Steven V. Camerino, Esq., of McLane, Graf, Raulerson & Middleton, P.A. for EnergyNorth Natural Gas, Inc. d/b/a National Grid NH; and Matthew J. Fossum, Esq., for the Staff of the Public Utilities Commision

I. PROCEDURAL HISTORY

On May 17, 2010, EnergyNorth Natural Gas, Inc. d/b/a National Grid NH (National Grid or Company) filed its fiscal year 2010 (April 1, 2009 – March 31, 2010) Cast Iron/Bare Steel (CIBS) Replacement Program Results. As a result of work completed in fiscal year 2010, National Grid seeks a permanent increase in its base distribution rates of $479,462 effective for usage on and after July 1, 2010.[1] The program results and request for a rate increase are filed pursuant to the merger settlement agreement in Docket No. DG 06-107 and approved by the Commission in *National Grid plc, et al.*, Order No. 24,777 (July 12, 2007).

On May 24, 2010, the Commission issued an order of notice setting a hearing on the matter for June 18, 2010. Commission Staff and representatives of the Company met in

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[1] The narrative portion of the filing states that National Grid seeks an increase in its base delivery rates of $479,462, while the attached schedules compute an increase of $479,762, a difference of $300. The difference is sufficiently small that it does not affect the proposed rate nor does it alter the representative rate impacts calculated by National Grid. Nevertheless, for purposes of this order we base our decision on the amount of the request in the narrative, as that was the amount included in the order of notice issued in this docket on May 24, 2010.

technical sessions on June 3 and June 15, 2010. No other parties intervened in the docket and the hearing was held on June 18, 2010, as scheduled.

II. POSITIONS OF THE PARTIES AND STAFF

A. National Grid

National Grid's initial filing outlined the nature of costs it may recover through the CIBS program and costs that are not to be included for recovery. The filing then stated that, prior to submission of the fiscal year 2010 report, representatives of the Company had met with Staff to review the results of the fiscal year 2010 program against the scope of the program, and that no costs were removed as a result of that meeting. Moreover, the filing noted that, although the costs for projects undertaken between April 1, 2009 and March 31, 2010 were documented, the Company was only seeking recovery for those CIBS projects placed in service between July 1, 2009 and March 31, 2010. National Grid stated that the costs for other projects that might have qualified under the CIBS program, and that were completed between April 1, 2009 and June 30, 2009, were included for recovery in the Company's recent base rate case filing. *See* Docket No. DG 10-017.

Taking into account the shortened timeframe referenced, the Company's filing showed actual spending of $4,848,550 for the fiscal year. As part of the CIBS program, the Company is not permitted to recover revenue relating to the first $500,000 of CIBS spending. *See National Grid plc, et al.*, Order No. 24,777 (July 12, 2007) at 29; *EnergyNorth Natural Gas, Inc. d/b/a National Grid NH*, Order No. 24,996 (July 31, 2009) at 3. Therefore, before calculating the amount to be added to rate base, the Company subtracted a pro-rated portion of that $500,000, or $482,110, to reflect the shortened recovery period. The result was a total incremental expenditure of $4,366,440 for inclusion in rate base and a resulting incremental revenue requirement of $479,462. That incremental revenue requirement was converted, on a per unit basis, to produce a per therm increase based on the Company's annual throughput as calculated in its semi-annual cost of gas filings. Transcript of June 18, 2010 Hearing (Tr.) at 17. Attachment B to the Company's filing indicates that, on an overall bill basis, the increase to a residential heating customer would be $3.98 for a customer using 1,250 therms per year, representing a 0.25 percent increase.

According to the Company's filing, on May 15, 2009 it submitted its proposed plan for fiscal year 2010, which called for the replacement of 4.08 miles of cast iron and bare steel pipes at an estimated cost of $4,029,305.06. During the year it actually replaced 4.0 miles of pipes at a cost of $5,028,169, which included $119,336 in costs incurred in fiscal year 2010 for work completing three projects that were actually part of the fiscal year 2009 program. The Company's filing states that the primary reasons for the difference between the estimated costs and the actual costs are that there was an increase in the overhead rate, and that the estimates were prepared based upon rates in an older contract with an outside contractor, but the actual costs were incurred under a new contract with more current pricing.

At hearing, the Company reiterated the numbers referenced in its filing regarding the amount of work completed and the costs associated with it. Tr. at 7-10. In addition, the Company further explained the differences in costs between the amounts estimated and the actual results. According to the Company, the overhead rate, otherwise known as the "loaded" cost, and primarily consisting of fixed costs such as salaries and benefits, had come in approximately 20 percentage points higher than estimated because the manner of applying the loaded costs varied depending on the number of capital projects. Tr. at 11, 14. Since there were fewer projects than planned, the costs were spread across a smaller base than anticipated. Tr. at 15.

In addition to matters directly affecting the costs and recovery in fiscal year 2010, National Grid testified about potential changes to the program that it had been discussing with Staff, including changes relating to pipe sizing decisions. Tr. at 18. Also, National Grid testified at length about new, so-called road degradation fees that both Manchester and Concord are seeking to impose. Tr. at 18-22. According to the Company, these new fees would be in addition to all other current fees and costs for construction involving impacts to streets. Tr. at 19. National Grid estimated that the fees would add approximately $5.00 per square foot to its construction costs. Tr. at 19. Moreover, it indicated that various municipalities had raised existing fees and requirements for permits and pavement restoration. Tr. at 20-21. The combined impacts of these new and increased costs on the Company were estimated at approximately $790,000 per year. Tr. at 21-22. The total CIBS program is approximately $4,000,000 annually. Tr. at 22.

National Grid stated that it had filed suit against the City of Manchester and that it sought an injunction to prevent the imposition of the fees. Tr. at 19-20. National Grid stated that to date it had not paid any of the fees to the City of Manchester and as a result the City had ceased issuing permits to National Grid for non-emergency work in City streets. Tr. at 20. As to the City of Concord, National Grid stated that it had scheduled a meeting with the City Solicitor to address the fees proposed by Concord. Tr. at 20.

National Grid also informed the Commission that a similar issue had arisen in Massachusetts in the past, with municipalities imposing similar fees. Tr. at 25. In that instance, the Company challenged the municipal road degradation fee in a matter that eventually made it to the Massachusetts Supreme Judicial Court where the Company prevailed. Tr. at 25. The Massachusetts Department of Public Utilities subsequently opened a proceeding to determine uniform construction and pavement restoration standards. Tr. at 25-26; Exhibit 3(c). When asked about whether such common standards would be worth pursuing in New Hampshire, National Grid stated that it believed universally applicable standards would be beneficial to it and would put all utilities “on the same playing field.” Tr. at 34-35.

National Grid also raised an issue relating to the tax treatment of various CIBS investments. Tr. at 65. According to National Grid, in filing its federal income taxes it had taken the position that certain main repair and replacement costs would be treated as operating expenses rather than capital expenditures. Tr. at 65. As a result, the Company’s annual net income, and corresponding tax burden, are reduced, and its accumulated deferred income tax obligation is raised. Tr. at 65. This increase in accumulated deferred income tax reduces the Company’s rate base and, therefore, its revenue requirement. Tr. at 65. The Internal Revenue Service (IRS) has yet to rule on the propriety of this tax treatment and National Grid noted that should the IRS review this tax treatment and render an unfavorable ruling, the result would be a decrease in the Company’s accumulated deferred income tax, and an increase in its rate base and revenue requirement. Tr. at 65-66. National Grid represented that it had raised this issue in its base rate case, but that it also affects CIBS-related investments. Tr. at 66. National Grid also indicated that it had agreed with Staff to address this issue in the context of the rate case, and that whatever resolution was determined in that case would be applied to the CIBS investments. Tr. at 66.

In its closing, National Grid stated that it believed the CIBS-related expenditures related to projects that were used and useful and in service and that the costs were prudently incurred.

Tr. at 69. National Grid, therefore, recommended that the Company's filing be approved. Tr. at 69.

B. Staff

Randall Knepper, Director of the Commission's Safety Division, explained some of features of the CIBS. Tr. at 38-39. Specifically, he noted that the CIBS program in New Hampshire is different than National Grid's standard policies relating to main replacements. Tr. at 38. He noted that the Company's standard policies would not require many of the replacements otherwise required by the New Hampshire CIBS policy. Tr. at 38, 58-60. In addition, he noted that he did not believe the CIBS program was intended to remain in effect until all cast iron and bare steel pipes were removed, but only until the worst and most leak-prone pipes were replaced. Tr. at 39-40. The intent was to remove the most troublesome pipes until the leak rates stabilized or decreased. Tr. at 39-40.

Mr. Knepper stated that some aspects of the program were working as intended and other aspects were not. In particular, he noted that Staff had concerns about the sizing of the Company's pipes. Tr. at 44. He noted that under the current program, the Company is permitted to recover for pipes that are one diameter size larger than those replaced, e.g., when a 2-inch pipe is removed, and a 4-inch pipe is laid in its place, or when a 6-inch pipe is removed and replaced with an 8-inch one. Tr. at 44-45. He stated that the Company had adopted a standard practice of replacing small diameter pipes on its low-pressure system with 6-inch pipes, irrespective of whether the pipes needed to be increased to that size. Tr. at 55-56. He stated that this "upsizing" was often unnecessary and that it resulted in excess installation and material costs, and that he was looking to revise the base conditions of the program. Tr. at 45-46. Under his proposed revision, the standard practice would be to replace pipes with those of the same size (except that

3-inch pipes, which are no longer a standard size, would be routinely replaced with 4-inch pipes), and to allow recovery for "upsizing" only when specifically justified. Tr. at 44. He stated that, although the replacement of a steel pipe with one of polyethylene would result in a reduction in flow areas, that reduction was not sufficient to justify increasing the pipe sizes in most instances because in the majority of areas where the Company's low-pressure system operates there is no expected load growth and thus no need to increase the pipe sizes. Tr. at 44, 58.

Mr. Knepper also expressed a concern with cost controls. He stated that upon reviewing the projects, the Company's estimates and the actual costs often bore little relation to one another and the actual costs were often well over the estimated costs, which would result in fewer projects being completed. Tr. at 42-43. He stated that he was hopeful about resolving these issues since the Company had resolved other problems identified in the past. Tr. at 48-49.

In addition, Mr. Knepper stated that he was concerned that overhead costs were being applied in a manner that caused them to skew the Company's estimates. Tr. at 47-48. Mr. Knepper confirmed that he had met with the Company prior to this most recent filing and had reviewed the results of the program with Company personnel. Tr. at 46. He stated that he was not seeking to strip out any of the Company's costs for the fiscal year 2010 filing, but that his concerns were aimed at addressing and controlling costs going-forward. Tr. at 46-47.

As to the increase in the municipal fees and the possibility that the Commission could look to develop a state-wide standard, Mr. Knepper questioned the feasibility of doing so. Tr. at 61. He stated that the demographic and geographic characteristics of New Hampshire would make the adoption of a uniform policy challenging. Tr. at 61-62.

III. COMMISSION ANALYSIS

Based upon our review of the record presented in this docket, we find that National Grid's proposed adjustments will result in rates that are just and reasonable as required by RSA 378:7. Specifically, we approve the addition of $4,366,440 in expenditures to the Company's rate base and the commensurate incremental increase in its revenue requirement of $479,462.

As to specific issues raised by the participants, we share Staff's concerns about the increasing costs of the CIBS program. Some of these costs come from the Company's standard policy of replacing low-pressure pipes with 6-inch pipes, regardless of the need. Other costs arise from the Company's general increase in the size of the pipes upon replacement and the resulting increases in labor and other costs in installing those pipes. Witnesses from both Staff and the Company indicated that they had been negotiating possible changes to the program to curtail some of these costs.

In addition, we are concerned about the method of applying overhead costs to the projects in this program on, essentially, a rolling basis to the number of projects open at particular points. It would seem, however, that because construction projects are largely seasonal in nature, those near the end of the construction period would absorb more costs than others.

As to the issue of the fees charged, or proposed to be charged, by the cities of Manchester and Concord, we have concerns about those costs. Insofar as the costs are increasing at a substantial rate we are troubled by the potential negative impact on customers. Finally, to the extent that the fee increases threaten the continued viability of this program and other construction necessary to maintain the distribution system, we are concerned and recognize the value of the Company's efforts to control such costs.

As we have identified the above issues as matters of concern, to the degree possible we direct the Company to work with Staff with a goal of controlling the costs of the CIBS program. Specifically, we anticipate that the Company and Staff will work toward developing amendments to the Company's policies and/or the CIBS program to mitigate the increasing costs and to resolve, so far as is possible, issues relating to the externally imposed fees. We anticipate that the Company and Staff will make proposals for amendments in advance of the next CIBS proceeding for our consideration.

Lastly, as to the tax position taken by the Company relative to certain of its main replacements, we render no opinion. The Company and Staff have indicated that they intend to address the matter in the context of the rate case and we will await the proposed resolution of this issue in that case before we opine on the propriety of the practice insofar as the Company's rates may be impacted by this tax position.

Based upon the foregoing, it is hereby

ORDERED, that National Grid be permitted to increase its base distribution rates to provide additional revenues of $479,462 annually, effective July 1, 2010 on a service rendered basis; and it is

FURTHER ORDERED, that National Grid shall work with Staff on potential cost control measures as outlined above for presentation to the Commission prior to the next CIBS proceeding; and it is

FURTHER ORDERED, that National Grid file with the Commission properly annotated tariff pages consistent with this Order within 10 days of the date of this order, as required by N.H. Code Admin. Rules Puc 1603.

By order of the Public Utilities Commission of New Hampshire this thirtieth day of June, 2010.

Thomas B. Getz Chairman	Clifton C. Below Commissioner	Amy Ignatius Commissioner

Attested by:

Debra A. Howland
Executive Director