STATE OF NEW HAMPSHIRE

PUBLIC UTILITIES COMMISSION

DG 13-086

In the Matter of:
Northern Utilities, Inc.
Petition for Permanent Rate Increase

Direct Testimony

of

Stephen P. Frink
Assistant Director – Gas & Water Division

March 11, 2014

Q. Please state your name, occupation and business address.

A. My name is Stephen P. Frink and I am employed by the New Hampshire Public Utilities Commission (Commission) as Assistant Director of the Gas & Water Division. My business address is 21 S. Fruit Street, Suite 10, Concord, New Hampshire 03301.

Q. Please summarize your educational and professional experience.

A. See ***Attachment SPF-1***.

Q. What is the purpose of your testimony in this proceeding?

A. My testimony summarizes the initial filing, describes Staff's review, summarizes the Settlement Agreement (Settlement), explains the revenue requirement adjustments in the Settlement not covered in the Company's initial filing and explains why approval of the Settlement is in the public interest.

Q. Briefly describe Northern's filing.

A. On April 15, 2013, Northern filed testimony and schedules requesting an additional $5,171,302 in annual revenues effective July 1, 2013. Northern's revenue requirement is calculated on a test year ending December 31, 2012, rate base as of December 31, 2012 and a return on equity of 10.0%.

In addition, the Company proposed a Rate Plan whereby there would be annual increases in delivery rates over the next four years, referred to as Targeted Infrastructure Rate Adjustments (TIRA), designed to recover targeted infrastructure investments made in the prior year. The proposed Rate Plan includes a Stay Out provision whereby Northern would not file a general rate case to increase delivery rates before 2017.

Northern's proposed annual revenue requirement increases (TIRA increases based on capital budget estimates at the time of the filing) are as follows:[1]

Northern Proposed Increases in Annual Revenue Requirement					
	2013	2014	2015	2016	2017
Annual	5,171,302	910,282	1,041,697	1,005,291	982,861
Cumulative	5,171,302	6,081,584	7,123,281	8,128,572	9,111,433
Test Year Revenue	54,863,406	54,863,406	54,863,406	54,863,406	54,863,406
% over Test Year	9.43%	1.66%	1.90%	1.83%	1.79%
Cumulative %	9.43%	11.08%	12.98%	14.82%	16.61%
% Year-to-Year	9.43%	1.52%	1.71%	1.62%	1.56%

Table 1

In addition to the TIRA and stay-out provision, the proposed Rate Plan includes a cap on annual TIRA-related rate increases, an Earnings Sharing Mechanism, an Off Ramp Provision, and an Exogenous Event Mechanism.

It should be noted that due to higher than projected capital spending in 2013, the actual annual increase in 2014 under Northern's proposed rate plan would be considerably higher than the proposal projections reflected in Table 1 above.

Q. Please describe Staff's review of the filing.

A. Staff issued three rounds of discovery, held three technical sessions and performed a comprehensive audit. In performing its audit, the Commission Audit Staff issued numerous audit requests, issued a draft report, discussed the report and its finding with the Company and issued a final report on October 25, 2013. The Company agreed to make a number of changes based on the audit report and discovery and incorporated

1 TIRA increases per Northern Schedule JDS-3, p. 1 (Bates p. 276) of Northern

those changes in an updated revenue requirement calculation provided in response ODR 3-30. ***See Attachment SPF-2 (ODR 3-30).***

In addition, Staff closely monitored Northern's April 1, 2013 rate filing at the Maine Public Utilities Commission (MPUC Docket No. 2013-00133) which reflected the same time period, request format and shared costs allocated between Northern's Maine and New Hampshire divisions. ***See Attachment SPF-3 (Staff DR 1-2).***

Q. Briefly describe the Settlement.

A. The Settlement provides for an additional $4,573,098 in annual revenues effective July 1, 2013, two step adjustments to allow for recovery on capital spending to install mains during 2013 and 2014, with a cap on the 2014 investment, a Stay Out provision until 2017, an earnings sharing mechanism tied to over earnings, an Exogenous Event Mechanism, a change in the Service Quality Metrics and a tariff revision to the line extension policy whereby on-main service requests of less than 100 feet do not require a customer contribution in aid of construction. The annual revenue requirement increases (step increases based on capital budget estimates at the time of the Settlement) are as follows:[2]

filing.

2 Step adjustment revenue requirements per Exhibit 4 of the Settlement (2014 actual and 2015 estimated).

Settlement Increases in Revenue Requirement			
	2013	2014	2015
Annual	4,573,098	1,354,863	1,439,738
Cumulative	4,573,098	5,927,961	7,367,699
Test Year Revenue	54,863,406	54,863,406	54,863,406
% over Test Year	8.34%	2.47%	2.62%
Cumulative %	8.34%	10.80%	13.43%
% Year-to-Year	8.34%	2.28%	2.37%

Table 2

Q. Please explain the revenue requirement adjustments not addressed in Northern's initial filing.

A. As previously stated, the Company agreed to make a number of changes based on the audit report and discovery and incorporated those changes in an updated revenue requirement calculation in data response ODR 3-30, which describes the adjustments made to the initial filing. ***See Attachment SPF-2***. Settlement revenue requirement adjustments (Settlement Exhibit 1) not explained in either the initial filing or the revised filing are as follows:

- Cost of Capital Adjustment – Return on Equity of 9.50%
- Revenue Adjustment – Update Special Contract Rates
- Revenue Adjustment - Annualize Year-end Customer Count
- Expense Adjustment – Return on Headquarters Lease of 9.50%

Q. Please describe Cost of Capital Adjustment related to the return on equity.

A. Northern's initial and revised revenue requirement calculations reflect a 10% return on equity, the Settlement provides for a 9.50% return on equity. See Settlement Exhibit 1, p.

56 of 56.

Q. Please describe the revenue adjustment related to special contracts.

A. Northern has two customers that take service under special contract which contain price escalation clauses tied to the annual rate of inflation. Test year revenue was increased $18,923 to reflect updated special contract rates. The adjustment was determined by subtracting the test year revenue for those customers from what the revenue would have been had the updated rate been in effect for the entire test year. See Settlement Exhibit 1, p. 7 of 56.

Q. Please describe the revenue adjustment related to the year-end customer count.

A. During the test year Northern had a net gain of 358 in its meter count. Test year revenue was increased by $178,799 to reflect annual revenue based on the year end customer count (assumes each meter represents a customer). The incremental revenue increase was determined using average weather normalized sales per meter and average revenue per meter and multiplying by the change in meters for each customer class. See Settlement Exhibit 1, p. 8 of 56.

Q. Please describe the expense adjustment related to the return on the headquarters lease.

A. Northern's headquarters lease expense includes a 12% rate of return on equity to an affiliate company. The test year lease expense was reduced by $22,366 to reflect a 9.50% return on equity. See Settlement Exhibit 1, p. 9 of 56.

Q. Did the signatories to the Settlement agree with each of the adjustments contained

in the Settlement revenue requirement calculation?

A. No, but for the purpose of the settlement the parties agreed to the adjustments that produced the overall revenue requirement as calculated in the Settlement.

Q. Section 2.2 of the Settlement explicitly states that a 9.50% return on equity was utilized in determining the revenue requirement, is that a fair and reasonable return?

A. The 9.50% return on equity is fair and reasonable based on current equity markets and is consistent with the returns on equity currently allowed for other NH regulated utilities and compares favorably with the 9.55% return on equity contained in the Granite State Electric Settlement Agreement being deliberated by the Commission in Docket No. DE 13-063.

Q. Section 2.3 of the Settlement addresses cost of service and rate design, please summarize the changes.

A. Northern's cost studies purportedly show that both demand-related and customer-related costs have increased since Northern's last rate filing (Docket No. DG 11-069), although the increase in customer-related costs is far more dramatic. Consequently, Northern's proposed rate design increased customer charges while decreasing the volumetric charges to such an extent that the residential customer charge almost doubled ($13.73 to $25). While the parties have not agreed on a specific cost of service study methodology, we have agreed on a rate design. The Settlement implements a smaller customer charge increase than Northern proposed ($13.73 to $19). The Settlement also increases volumetric charges, in contrast to Northern's proposal to decrease volumetric charges.

Q. Is the Settlement rate design fair and reasonable?

A. Yes. While the parties did not agree on a specific cost study methodology, all agree that there should be greater cost recovery from the fixed component of charges in this case. The Settlement rate design does that but also recognizes the important principles of gradualism and fairness by limiting the rate impact on lower use customers.

Q. Section 2.3 of the Settlement provides for two step adjustments; please compare the proposed TIRA mechanism with the Settlement step adjustments.

A. The TIRA mechanism proposed by the Northern would allow for annual increases in the delivery rate to provide for recovery of certain non-revenue producing capital investments made in the prior year. At the time of the filing, the estimated increase in the annual revenue requirement was expected to be approximately $1 million per year for 2014 through 2017.

The Settlement provides for two step adjustments to provide for recovery of Northern capital investment in main installations during 2013 and 2014. The 2014 step adjustment increases the annual revenue requirement by $1,354,863 and the 2015 step adjustment is expected to increase the annual revenue requirement by $1.4 million.

Q. Why are the Settlement step adjustments preferable to the TIRA mechanism?

A. Both the TIRA and step adjustments are a critical component of the rate plan that will allow Northern a reasonable opportunity to achieve its allowed rate of return without filing a rate case before 2017, but the step adjustments alleviate some of the concerns inherent in rate plans that allow future increases based on projected spending and incents Northern to extend its distribution system. In addition, the 2015 step adjustment provides for a hard cap whereas the TIRA mechanism has a soft cap that defers increases above the cap, with interest, for future recovery.

The proposed TIRA would limit recovery to certain non-revenue producing investments, whereas the Settlement allows for recovery on main installations whether revenue producing or not. There is always a concern in determining what constitutes a non-revenue producing capital investment, as many such projects serve to reinforce the distribution system which allows for additional growth and, even if truly non-revenue producing, such investments can reduce maintenance costs, particularly where leak-prone sections of the distribution system are being replaced.

Another concern is the uncertainty of the rate increases in future years. Under the Settlement, the only uncertainty is tied to 2014 capital spending on mains, compared to projected capital spending for years 2014 through 2016 under the TIRA. Calendar year 2103 serves as an example of just how variable capital spending can be, as Northern's actual capital spending was approximately $16 million compared to the $12 million of proposed 2013 capital spending Northern filed with the Commission Safety Division on April 4, 2013. Another way the Settlement step adjustments reduce rate uncertainty is by imposing a hard cap on the 2015 step increase, whereby the 2014 capital investments in mains eligible for recovery through the 2015 step increase is limited to $12 million (the projected 2014 capital budget for mains is $9.4 million). Most significantly, after the

2015 step adjustment, delivery rates will remain unchanged until Northern's next rate case, whereas under the proposed TIRA mechanism, delivery rates would continue to see annual increases; the Company's TIRA proposal also provided for an 'Off Ramp' that would allow for an earlier rate filing under certain conditions.

Also, the 2015 step adjustment allows Northern to recover on 2014 capital spending on mains that extend its distribution service into areas where natural gas is currently unavailable, even though such investment should increase revenue. Because of that, the step adjustment improves the economic feasibility for further expansion and customer growth, which in the long run benefits all customers through increased revenue to meet Northern's fixed costs.

Q. Does the Settlement provide any other incentives for Northern to add new customers?

A. Yes. Northern expects customer growth in New Hampshire to average 4.5% over the next four years, well in excess of the annual growth experienced by Northern since being acquired by Unitil in December of 2008. The expected growth is being driven by customer requests for natural gas service and Northern has been marshaling the resources to try and meet the increased demand. The 2015 step adjustment provides for a variable Return on Equity that penalizes the Company for failing to meet expected growth and rewards the Company for exceeding expected growth. If customer growth in 2014 is between 4-5 percent the return on equity used in calculating the 2015 step adjustment revenue requirement will be 9.50%, the return on equity will be 9.25% if growth is below

4 percent and 9.75% if growth exceeds 5 percent.

In addition, per the terms of the Settlement, Northern's Line Extension Policy (Tariff p. 16) has been amended so that residential customers within 100 feet of an existing main will be not be required to pay a contribution in aid of construction under normal conditions. Although Northern is currently not collecting a contribution in aid of construction under those circumstances, it could if the economics of installing a service line were to change. The amendment ensures such customers will not have to pay a contribution going forward and incentives the Company to keep the cost of service extensions to a minimum.

Q. Please describe the changes to Northern's service quality benchmarks.

A. The Settlement eliminates the service quality benchmark which requires no more than 2% of calls to the call center, or any other service center with the responsibility for responding to customer calls, to encounter a busy signal or other busy indication. In Docket DG 01-182, a number of service quality benchmarks were established to address service quality issues identified by Staff. At the same time, there was agreement to review and adjust all benchmarks annually as necessary. As part of this rate proceeding, Staff reviewed the existing service quality benchmarks with Unitil. The service quality benchmark associated with call completion percentage was established to address staffing and technological constraints of the Northern Utilities call centers in 2001. Much has transpired since then including the physical relocation of the call centers following the Unitil acquisition of Northern Utilities in 2008, thereby resolving the issue. Accordingly, Staff supports the elimination of this benchmark.

Under the current service quality benchmarks, Unitil is required to respond to and resolve 95% of complaints referred by the Commission Staff to the satisfaction of the Commission Staff within 2 weeks. At the time this metric was established, the Commission received a much higher volume of calls from the Northern customers than it does today. In 2000, 2001 and 2002, calls to the Consumers Affairs Division from Northern customers totaled 169, 156 and 150, respectively. In 2011, 2012 and 2013, the numbers were 70, 57 and 66, respectively, a 60% decrease from when the original benchmark was established. It is unrealistic to expect that every complaint will be resolved in 2 weeks and given the limited number calls received that is what it takes to meet the current benchmark. In recognition of that fact, the Settlement establishes a more reasonable benchmark of 90% of complaints to be resolved within 30 days.

Q. Would you please comment on the Over Earning Sharing and Exogenous Event mechanisms?

A. Neither of those provisions are likely to come into play but do provide limited protection to ratepayers and the Company.

Northern's capital budget over the next few years is substantial and while some of that investment may increase revenue, it will be a challenge for Northern to increase revenue and hold costs down to the extent that it would exceed its allowed return on equity of 9.5%. The Over Earning Sharing mechanism essentially sets a cap of 10.5% on Northern's return on equity, as customers and the Company share equally if Northern realizes a return of between 10 and 11 percent and all earnings above 11% is returned to ratepayers.

The Exogenous Event Mechanism provides for the recovery or refund of unforeseen cost increases or decreases in excess of $200,000 if due to certain circumstances beyond Northern's control and protects both Northern and its ratepayer in those instances.

Q. Does that conclude your testimony?

A. Yes.