DG07-050

THE STATE OF NEW HAMPSHIRE

CHAIRMAN
Thomas B. Getz

COMMISSIONERS
Graham J. Morrison
Clifton C. Below

EXECUTIVE DIRECTOR
AND SECRETARY
Debra A. Howland

PUBLIC UTILITIES COMMISSION
21 S. Fruit Street, Suite 10
Concord, N.H. 03301-2429

Tel. (603) 271-2431

FAX (603) 271-3878

TDD Access: Relay NH
1-800-735-2964

Website:
www.puc.nh.gov

RECEIVED
MAR 29 2007
N.H. PUBLIC
UTILITIES
COMMISSION

March 29, 2007

Debra A. Howland
Executive Director and Secretary
New Hampshire Public Utilities Commission
21 South Fruit Street, Suite 10
Concord, New Hampshire 03301-2429

Re: DG 06-121 Winter 2006-07 Cost of Gas
EnergyNorth Natural Gas, Inc. d/b/a KeySpan Energy Delivery New England

Dear Ms. Howland:

In Order No. 24,688 in this docket the Commission deferred several issues regarding KeySpan's indirect gas costs for decision following further investigation. Staff submits the enclosed report and attachments to the Commission for filing and requests that the Commission open a new docket to consider Staff's recommendations.

Sincerely yours,

F. Anne Ross, Esq.
Staff Attorney

Cc: Counsel for EnergyNorth Natural Gas, Inc.
Service List

STATE OF NEW HAMPSHIRE
Inter-Department Communication

DATE: March 29, 2007
AT (OFFICE): NHPUC

FROM: Stephen P. Frink SPF
Assistant Director, Gas & Water Division

SUBJECT: Report and Recommendation for Investigation of the rate adjustments to EnergyNorth Natural Gas, Inc. Cost of Gas rate for reconciliation, working capital and bad debt

TO: Commissioners
Debra Howland
Counsel for EnergyNorth Natural Gas, Inc.

Background

Each fall, EnergyNorth Natural Gas Inc. (ENGI or Company) files with the Commission an estimated Cost of Gas (COG) rate for the upcoming six month winter period which begins in November of the current year and ends in April of the following year. In addition to the projected direct gas costs for that winter period, the winter COG rate covers several other costs that relate to gas supply service. These include: (i) prior winter period under/over collection; (ii) demand-related costs incurred during the summer period but deferred for recovery during the upcoming winter period; (iii) carrying charges on deferred costs; (iv) carrying charges on the difference between monthly gas costs and revenues during the upcoming winter period; (v) carrying charges on supply-related working capital; (vi) bad debt costs; (vii) depreciation and return on peak shaving plant; (viii) labor costs related to gas dispatch operations; and (ix) interruptible profits. The first part of the report focuses on the methods used by ENGI to calculate the amounts covered by items (i) and (v), while item (vi) bad debt is addressed later in the report.

ENGI Reconciliation Calculation

In its COG filing for the 2006-07 winter period, ENGI proposed to: (i) return $2,149,312 in over-collected gas costs for the prior 2005-06 winter period ; (ii) collect $323,198 in carrying charges on both deferred and direct gas costs related to the current period; and (iii) collect $1,039,575 in carrying charges on supply related working capital.[1] Because the over-collection of $2,149,312 was net of carrying charges of $391,790, these amounts indicate that the Company proposed to collect carrying charges totaling $1,754,563. This amount compares to total gas costs of $107,505,132 for the 2006-07 winter period.[2] At the October 18, 2006 hearing, Staff and the OCA expressed two related concerns regarding ENGI's prior period reconciliation calculation.

[1] This amount relates to the six month 2006-07 winter period.
[2] Including deferred summer demand-related costs.

The first was the method used to account for revenues in the reconciliation calculation, which produces a significant under-collection of gas costs in the first month of the reconciliation period and associated carrying charges through the period. The second was that the recovery of these carrying costs through the winter COG rate could constitute double recovery of the Company's carrying costs, once through an adjustment to the COG rate to recover the prior period under/over-collection plus carrying charges and a second time through an adjustment to the COG rate to recover the carrying costs on the supply related working capital. In order to address this concern, Staff and the OCA recommended that they work with the Company to determine whether their concerns are valid and, if so, how they might be resolved. In Order No. 24,688, the Commission directed the parties and Staff to file a report on the results of their discussions prior to ENGI filing its Summer 2007 COG rate. Because the parties and Staff have been unable to reach agreement on whether the Company is over-collecting its carrying costs, this report presents the views of Staff and the OCA only.

ENGI Bad Debt Expense

ENGI's 2006-07 Winter COG filing (Docket No. 06-121), filed September 1, 2006, proposed a change in the bad debt percentage from 0.97% to 3.54%, based on ENGI's net uncollectible account expressed as a percentage of revenue for calendar year 2005. On October 13, 2006, ENGI filed a revised COG with a proposed bad debt percentage of 2.98%, based on an adjusted 2005 net uncollectible account. In the COG proceeding, Staff recommended that ENGI implement its three-year average bad debt percentage of 2.57%, pending further review. In Order No. 24,688 (October 27, 2006), approving ENGI's 2006-07 winter COG using a 2.57% bad debt percentage, the Commission noted that the expedited process of the COG did not provide adequate opportunity to examine the proposed changes to indirect gas costs and stated: "... we reserve any decision concerning ENGI's efforts to collect unpaid amounts, or an appropriate bad debt percentage, until the Staff, OCA and ENGI have explored the issue further."

Staff Findings

ENGI Reconciliation

As noted above, ENGI's reconciliation calculation produced an over-collection of $2,149,312 net of carrying charges totaling $391,790. That is, the over-collection would have been $2,541,020 had the Company not incurred carrying charges on the monthly imbalances. See Attachment 1. Although the period covered by this calculation appears to be seven months - November 2005 through May 2006 - the November beginning balance of $4,152,233 is actually the sum of: (i) the balance at the end of the prior winter period (i.e., April 2005); (ii) the costs of carrying this balance over the summer period; (iii) specific summer gas costs deferred until the winter[3]; and (iv) the costs of carrying the deferred gas costs over the summer period. This calculation is shown in Attachment 2. Thus, ENGI's reconciliation calculation actually spans 13 months and

[3] Summer gas costs deferred to the winter period include storage related demand, commodity and capacity charges, LNG and LPG inventory replenishment and winter peaking contract demand costs.

includes, among other things, summer gas costs recovered during the winter period. There is one final feature of ENGI's reconciliation calculation that must be highlighted; namely, the inclusion of a thirteenth month - May 2006 – that includes only revenues and no gas costs. The reason for including a thirteenth month is explained below.

Staff concludes that: (i) ENGI's failure to properly match revenues with costs in the reconciliation calculation resulted in the appearance of significant carrying costs on monthly imbalances attributed to timing differences between the receipt of revenues and the payment of gas supply costs; and (ii) these imbalances can be eliminated in large part through the consistent application of accrual accounting methods to gas supply service. This is not to suggest that timing differences do not exist. On the contrary, we accept in the next section that timing differences exist but argue that ENGI is fully compensated for the associated carrying costs through its working capital rate adjustment.

Attachment 1 shows that despite starting the prior winter period with an under-collection of $4,152,233, the under-collection increased to $13,348,771 (inclusive of carrying charges) in a single month. This substantial increase is explained, in part, by the Company's use of different accounting concepts for costs and revenues in the reconciliation calculation. On the cost side, the Company recorded $13,097,244, or the total cost of gas used in the month. This is consistent with accrual accounting.[4] On the revenue side, the Company recorded $4,380,801, or the revenue associated with gas that was consumed and billed in November. This is not consistent with accrual accounting because the revenue relates only to a portion of the gas used in the month. Revenue associated with gas consumed in November but billed in December was assigned to December, a practice known as billed revenue accounting.

A similar mismatch of costs and revenues occurs in each of the months December 2005 through April 2006, although the magnitude of the mismatch is not as great. In each month, costs correspond to the total gas used in the month whereas revenues comprise revenue associated with gas consumed and billed in the current month plus revenue associated with gas consumed in the current month but billed in the next. Finally, in May 2006, the revenue is associated with gas consumed in the previous month but billed in the current month.

Despite the use of different accounting treatments, it could conceivably be argued that billed revenue is a reasonable proxy for accrued revenue and, therefore, unlikely to lead to large monthly imbalances and associated large carrying charges. There are two reasons why this argument is questionable. The first relates to the Company's implementation of billed revenue accounting. Under the above described billed revenue accounting, revenue associated with gas consumed in October but billed in November would be assigned to November. The Company, however, assigns that revenue to October because October is regarded as a summer month and therefore outside of the winter period. As a result, November billed revenue will always be less than November gas costs producing a cost under-collection. In fact, if the number of daily meter reads is assumed to be constant and daily gas usage does not change throughout the month, it can be shown that November billed revenue would equal half November's gas costs. Maintaining

[4] The general idea of accrual accounting is that economic events are recognized by matching revenues to expenses at the time in which the transaction occurs.

the assumption of constant daily usage through May 2006, it can be shown that billed revenue would exactly match gas costs in each month of the period December 2005 through April 2006 and that billed revenue in May 2006 would equal half April's gas costs. In short, the assumption of constant daily gas usage results in billed revenue lagging gas costs by half a month.

The second fact relates to the assumption of constant daily gas consumption. Because the weather in November becomes increasingly colder as the month progresses, daily gas usage does not remain constant but actually increases. This means that the revenue associated with consumption in the second half of the month is greater than the revenue associated with consumption in the first half. It also means that the revenue assigned to December because of billed revenue accounting will be greater than half the November total. Thus, November billed revenue should be less than half November gas costs. A review of Attachment 1 confirms this conclusion (see revenues of $4,380,801 and gas costs of $13,097,244). This qualitative analysis suggests that lag between costs and revenues may increase as the months get progressively colder and decrease as the months get progressively warmer.

Working Capital Rate Adjustment

ENGI is authorized to adjust its COG rate to collect the carrying costs on its gas supply-related working capital. Working capital is the cash needed to support the delay in the receipt of revenues relative to the payment of costs. The extent of this delay, and hence the amount of working capital needed, is to be determined based on a lead/lag study. Because such studies analyze all of the factors that cause the date customer payments are received to lag the date gas costs are paid, including the effect on customer receipts of the Company's billing cycle, the resulting net lag or lead should fully compensate the Company for all costs due to timing differences. In this regard, it is worth noting that ENGI sought to recover over $650,000 in its 2005-06 winter COG filing as compensation for the costs of working capital. The significance of this request can be measured by comparing it to Northern's request of only $92,000 for the same time period. After adjustment for Northern's lower gas costs, ENGI's request is almost three times that of Northern. Finally, it is important to note that in its 2006-07 winter COG filing, ENGI proposed to almost double its working capital rate compared with the previous year. This change, if approved, would further widen the gap between ENGI and Northern related to the calculation and recovery of working capital costs.

What is unclear is whether the carrying costs associated with these varying lags are fully recovered through the working capital adjustment to the COG rate. If not, we recommend that ENGI conduct a more detailed lead/lag study and use the results of that study to justify any proposed modifications.

Based on the above analysis, Staff and the OCA believe that the combination of ENGI's working capital and reconciliation rate adjustments over-collects the costs of timing differences. In order to correct this problem, Staff and the OCA recommend that ENGI's reconciliation calculation be modified such that monthly revenues reflect accrued revenues derived from the amount utilized by customers each calendar month. In addition, given the significant disparity between ENGI and Northern regarding the amount of working capital costs recovered through winter COG rates, Staff and the OCA recommend that the Commission conduct an investigation of the methodology used by ENGI to calculate its supply-related working capital costs including, but not limited to, the reasonableness of the recently revised lead/lag study and the appropriateness of using the overall cost of capital as a proxy for the carrying charge rate.

ENGI Bad Debt Expense

As a result of further investigation, Staff has concluded that the increase in bad debt percentage was due largely to reduced efforts in pursuing EnergyNorth delinquent accounts following the acquisition of EnergyNorth by KeySpan in November 2000. In late 2005 KeySpan increased its collection efforts and experienced a significant decrease in its 2006 bad debt percentage (2.24%) compared to 2005 (2.98%). It is Staff's belief that the 2006 percentage is more representative of what KeySpan can expect going forward and, given more time and additional improvements in the collections area, the bad debt percentage will continue to drop. As explained below, and based upon information available at this time, Staff is recommending that the level of uncollectible accounts included in KeySpan's indirect gas costs be set at 2%.

In 2004, in the course of investigating a number of high bill complaints, Staff became aware that for some period of time KeySpan had not been properly managing accounts where the meter appeared not to be registering usage. While the time frames varied, some of the non-registering meters dated back to 2000. When Staff questioned the large number of adjusted bills as a result of non-registering meters, Staff was told that, since the merger, no one at KeySpan had been reviewing these accounts. To correct this, KeySpan had implemented a non-registering meter initiative to "clean-up" these accounts. During the same time, Staff began to notice that customers calling the Commission for assistance in the negotiation of payment arrangements frequently had higher than normal balances. This trend continued through 2005 and into 2006. While gas prices were increasing during this period, Staff has concluded that an inadequate focus on accounts receivables during this time contributed to the higher past due balances Staff was seeing. It was not unusual to learn that a customer had not made a payment in a year or more before being disconnected for failure to pay the utility bill. In some extreme cases, customers had not made payments in 3 or 4 years and still had not been disconnected. This failure to appropriately manage its accounts receivables is reflected in the increase in the company's level of uncollectible accounts.

In August 2005, KeySpan hired a new credit and collection manager. As indicated above, since that time Staff has seen a renewed focus on and increased attention to accounts receivables and collection efforts. Setting the level of uncollectible accounts included in KeySpan's indirect gas costs at 2%, .24% lower than the 2006 actual, better reflects KeySpan' actual experience and provides an incentive to the company to continue to focus on managing its accounts receivables.

Recommendation

Despite discussions between Staff, OCA and ENGI over the past 6 months, the parties have not reached agreement on the issues covered by this report and, therefore, Staff recommends that the Commission immediately open a docket to establish an appropriate reconciliation methodology for ENGI gas costs, as well as appropriate levels for certain indirect gas costs discussed above.

Staff recommends that, consistent with Commission Order No. 24,688, the results of this docket would adjust these costs and methods beginning with ENGI's cost of gas calculations for the Winter 2005-2006 docket where these issues were first raised.

Attachment 1

EnergyNorth Natural Gas, Inc.
Prior Period Reconciliation Calculation
November 2005 - May 2006

Accrued Costs/Billed Revenues

		Nov-05	Dec-05	Jan-06	Feb-06	Mar-06	Apr-06	May-06	Total
	Days in Month	30	31	31	28	31	30	31	
1	Beginning Balance	$ 4,152,234	$ 13,348,772	$ 16,424,871	$ 13,986,312	$ 14,079,221	$ 8,156,207	$ 2,265,462	
2	Gas Costs	$ 13,097,244	$ 20,823,227	$ 20,770,445	$ 18,425,287	$ 13,228,153	$ 6,378,982		$ 92,723,338
3	Fuel Financing Costs	$ 72,941	$ 96,429	$ 69,284	$ 76,037	$ 67,041	$ 67,985		$ 449,717
4	Production, Storage & Misc. Overhead	$ 492,772	$ 492,772	$ 492,772	$ 492,772	$ 492,772	$ 492,772		$ 2,956,632
5	FPO Admin Costs	$ -	$ -	$ 37,736	$ -	$ -	$ -	$ -	$ 37,736
6	Billed Revenues.	$ (4,380,801)	$ (18,353,237)	$ (23,854,071)	$ (18,921,391)	$ (19,743,660)	$ (12,451,381)	$ (4,414,771)	$ (102,119,312)
7	Broker Revenues	$ (62,628)	$ (38,708)	$ (28,532)	$ (33,376)	$ (11,988)	$ (6,382)		$ (181,614)
8	Non-Firm Margin and Credits	$ (69,615)	$ (26,341)	$ (16,325)	$ (21,572)	$ (21,233)	$ (404,744)		$ (559,830)
9	Ending Balance	$ 13,302,147	$ 16,342,914	$ 13,896,180	$ 14,004,069	$ 8,090,306	$ 2,233,439	$ (2,149,309)	
10	Average Balance	$ 8,727,191	$ 14,845,843	$ 15,160,525	$ 13,995,191	$ 11,084,763	$ 5,194,823		
11	Prime Rate	6.50%	6.50%	7.00%	7.00%	7.00%	7.50%		
12	Interest Applied	$ 46,625	$ 81,957	$ 90,132	$ 75,152	$ 65,901	$ 32,023		$ 391,791
13	Ending Balance with Interest	$ 13,348,772	$ 16,424,871	$ 13,986,312	$ 14,079,221	$ 8,156,207	$ 2,265,462	$\boxed{\$(2,149,309)}$	
	PRIOR PERIOD RECONCILIATION W/O INTEREST								
14	Beginning Balance w/o Interest	$ 4,152,234	$ 13,302,147	$ 16,296,289	$ 13,767,598	$ 13,785,355	$ 7,796,440	$ 1,873,672	
15	Costs (lines 1-4)	$ 13,662,957	$ 21,412,428	$ 21,370,237	$ 18,994,096	$ 13,787,966	$ 6,939,739	$ -	
16	Revenues (lines 6-8)	$ (4,513,044)	$ (18,418,286)	$ (23,898,928)	$ (18,976,339)	$ (19,776,881)	$ (12,862,507)	$ (4,414,771)	
17	Ending Balance w/o Interest	$ 13,302,147	$ 16,296,289	$ 13,767,598	$ 13,785,355	$ 7,796,440	$ 1,873,672	$\boxed{\$(2,541,099)}$	

Attachment 2

EnergyNorth Natural Gas, Inc.
Prior Period Reconciliation Calculation
November 2005 - May 2006

Accrued Costs/Billed Revenues

Days in Month	31	30	31	31	30	31	
	May-05	Jun-05	Jul-05	Aug-05	Sep-05	Oct-05	Total
Beginning Balance	$ 5,877,928	$ 1,761,482	$ 2,116,627	$2,621,050	$ 3,094,401	$ 3,624,918	
Gas Costs	$ 513,669	$ 489,485	$ 488,358	$ 488,812	$ 483,624	$ 490,377	$ 2,954,325
Fuel Financing Costs	$ 20,043	$ 22,891	$ 29,392	$ 34,556	$ 96,736	$ 46,760	$ 250,378
Prior Period Adjustment	$ (10,347)	$ -	$ -	$ -	$ -	$ -	$ (10,347)
Account 175.21 Adjustment	$ 230,847	$ -	$ -	$ -	$ -	$ -	$ 230,847
Billed Revenues	$ (4,489,119)	$ -	$ -	$ -	$ -	$ -	
Broker Revenues	$ (8,424)	$ (136,439)	$ (2,440)	$ (28,150)	$ (40,241)	$ (10,396)	$ (226,090)
Non-Firm Margin and Credits	$ (390,916)	$ (29,538)	$ (22,928)	$ (36,392)	$ (26,130)	$ (20,833)	$ (526,737)
Ending Balance w/o Interest	$ 1,743,681	$ 2,107,881	$ 2,609,009	$3,079,876	$ 3,608,390	$ 4,130,826	
Average Balance	$ 3,810,805	$ 1,934,682	$ 2,362,818	$2,850,463	$ 3,351,396	$ 3,877,872	
Prime Rate	5.50%	5.50%	6.00%	6.00%	6.00%	6.50%	
Interest Applied	$ 17,801	$ 8,746	$ 12,041	$ 14,526	$ 16,527	$ 21,408	$ 91,049
Ending Balance with Interest	$ 1,761,482	$ 2,116,627	$ 2,621,050	$3,094,401	$ 3,624,918	$ 4,152,234	