STATE OF NEW HAMPSHIRE

PUBLIC UTILITIES COMMISSION

DG 09-038

In the Matter of:
New Hampshire Gas Corporation
Petition for Permanent Rate Increase

Direct Testimony

of

Stephen P. Frink
Assistant Director – Gas & Water Division

September 30, 2009

New Hampshire Public Utilities Commission

New Hampshire Gas Corporation

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Testimony of
Stephen P. Frink

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-5***.

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

A. The primary purpose of my testimony is to provide Staff's recommendations for a revenue requirement for New Hampshire Gas Corporation (NHGC or the Company), a change in the minimum annual capital expenditures required as a condition of the Iberdrola/NHGC merger settlement, and a phase in of the rate increase and recovery of the resulting deferred revenues. Staff's recommendations are reflected in the settlement agreement reached between Staff, the OCA and NHGC.

Q. Please summarize Staff's recommendations on these issues.

A. Staff recommends: an increase in the revenue requirement of $288,732; that the minimum average annual capital expenditures be reduced from $275,000 to $200,000; and, that the rate increase be phased in over three years and the Company have the opportunity to recover deferred revenue in years four and five.

Q. Are temporary rates currently in effect in this docket?

A. Yes. On April 30, 2009 the Commission issued Order No. 24,964 authorizing a temporary revenue requirement increase of $69,995. The temporary rate surcharge became effective May 1, 2009, the day following the expiration of the deferred revenue surcharge, essentially replacing one surcharge for another at almost the identical rate.

Q. What is the increase to the revenue requirement proposed by NHGC?

A. On March 31, 2009, NHGC filed testimony and schedules requesting an additional $423,806 in annual revenues, representing a 12.5% increase.

Q. What is Staff's recommendation with respect to a revenue requirement?

A. As shown on Attachment SPF-1, Staff recommends an increase in the revenue requirement of $288,732 based on pro-formed test year income of $26,741, as detailed on SPF-2. The increase is 8.5% over total test year revenue and 29.1% over test year delivery revenues. This revenue requirement is calculated on total rate base of $2,236,222, as detailed on SPF-3, and provides for an overall rate of return of 8.875%, as shown on SPF-4.

Q. Briefly describe NHGC's filing.

A. The test year utilized by NHGC is the twelve months ending December 31, 2008 with the only pro forma adjustments being to weather normalize revenue, remove charitable donations from expenses, and remove non-utility revenues and expenses. No test year revenues or expenses were annualized and there were no adjustments for known and measurable changes beyond the test year.

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

A. Staff issued two rounds of discovery, held two technical sessions and performed a comprehensive audit. In performing its audit, the Commission Audit Staff issued numerous audit requests and issued a final report on July 9, 2009.

Revenue Requirement

Q. Please explain how Staff's schedules were developed.

A. Staff's schedules begin with NHGC's revised schedules and make adjustments to the Company's pro-formed schedules.

Q. Why does Staff begin with NHGC's revised pro-formed test year schedules?

A. Staff agrees with the pro forma adjustments made by NHGC, and the Company's testimony and schedules accurately describe and account for those adjustments. Therefore, Staff's testimony and schedules only address adjustments beyond those in the Company's filing. The Company and Staff agree on these adjustments and they are reflected in the settlement agreement.

Q. What areas were adjusted and what was the basis for those adjustments?

A. The overall rate of return has been adjusted to conform to returns the Commission has granted in recent rate cases. Rate base was adjusted to remove plant held for future use and deferred taxes. Expenses were reduced to reflect depreciation rates more in line with those in effect for other New Hampshire utilities.

Rate Base Adjustments

Q. What are Staff's rate base adjustments?

A. Staff has eliminated $418,384 for land held for future use and $100,511 for deferred taxes.

Q. What is Staff's rate base recommendation?

A. Staff's rate base recommendation is $2,236,222, the sum of the above adjustments ($518,895) deducted from test year rate base of $2,755,117. ***See Attachment SPF-3.***

Q. Why should land held for future use be excluded from rate base?

A. Under RSA 378:28, a utility cannot include in its rate base any return on any plant until the Commission determines that the plant is prudent, used and useful. In making its determination regarding the inclusion of plant held for future use in rate base, the Commission uses a case-by-case, parcel-by-parcel approach and requires the utility to demonstrate a definite plan for actual use within a reasonable time. *See Public Service Co. of N.H.*, 65 NH PUC 251, 271 (1980); *Unitil Energy Systems, Inc.*, Order No. 24,677 (Oct. 6, 2006), 91 NH PUC 416.

In response to data requests, the Company stated that it purchased the land at issue as the site of a potential gas production and storage facility. According to the Company, the land is properly included in rate base because it will be available for a new plant should the current one become obsolete or unavailable. A study provided by the Company, however, indicates that building a plant as suggested by the Company would cost approximately $5,000,000, and would add a burden of about $920,000 per year on the existing customers. On a customer base as small as that of NHGC, such a plant would be prohibitively expensive without state or federal grant funding. Because the Company proposes no other use for the land, it cannot show that it has a definite plan for actual use of this property within a reasonable time.

Moreover, the Commission has held that retaining land for potential future use as a means of contingency planning, without some demonstration of how retaining that property for future use benefits the ratepayers, is an insufficient basis for including the property in rate base. *See Public Service Co. of N.H.*, 69 NH PUC 67, 73-75 (1984). Since the Company has not made any demonstration of how retaining the land would benefit ratepayers, the land should not be included in rate base.

Q. Has the Company explored acquiring state or federal grant money for building the plant envisioned by the Company?

A. As of the August 17, 2009 technical session, no. At the technical session Staff did suggest NHGC contact its New Hampshire state and federal representatives to inquire about potential funding.

Q. Why did Staff reduce rate base for deferred taxes?

A. NHGC's books reflect a deferred tax credit which results from NHGC having collected payments from customers for state and federal income taxes in advance of actually paying those taxes. In essence, ratepayers have paid in advance and the deferred tax credit should be deducted from rate base when calculating the revenue requirement. In its filing the Company intended to exclude deferred revenue but the deferred revenue calculation was inadvertently missed in the revenue requirement calculation. Staff's adjustment corrects that oversight.

<u>Revenue Adjustments</u>

Q. What are Staff's revenue adjustments?

A. Staff has increased revenue by $14,020 to correct for an error NHGC made in calculating its 2008 year-end unbilled revenue. ***See Attachment SPF-2.***

Q. Please explain the error in unbilled revenue.

A. The Final Audit report filed on July 9, 2009 found that the Company's 2008 year-end unbilled revenue estimate contained an error due to certain information not being correctly carried into the supporting spreadsheet. The Company agreed with the audit find and Staff's adjustment corrects for the miscalculation.

Expense Adjustments

Q. **What are Staff's expense adjustments?**

A. Staff has decreased expenses by $8,875 to reflect lower depreciation rates. ***See Attachment SPF-2.***

Q. **Why should depreciation rates be lowered?**

A. The depreciation rates NHGC has been charging on certain accounts are well above those of New Hampshire's other regulated utilities. Staff reduced certain NHGC depreciation rates to bring them more in line with those of New Hampshire's two natural gas utilities, both of which have rates based on depreciation rate studies, Staff review and Commission approval. Rather than require NHGC to perform a depreciation study, given the high cost of such an undertaking and NHGC's small customer base, Staff used the depreciation rates of New Hampshire's other gas utilities to test for reasonableness. For large accounts and in instances were large discrepancies in depreciation rates exist, NHGC rates were adjusted accordingly.

Q. **What accounts were adjusted?**

A. Five accounts were adjusted, as follows:

	Current Rate	New Rate
Mains	5.00%	3.00%
Meters	5.00%	4.00%
Transportation Vehicles	20.00%	10.00%
Tools & Shop Equipment	20.00%	10.00%

Q. **Were there any other concerns Staff has with NHGC's depreciation expense?**

A. Yes, the audit report found three plant accounts with negative depreciation, meaning the depreciation charges exceeded the cost of the plant. Staff recommends that when a plant account has been fully depreciated NHGC stop taking depreciation on that account.

Rate Plan and Deferred Revenue

Q. Please describe the rate plan.

A. The rate plan calls for the approved revenue increase to be phased in over three years as follows:

	Revenue Increase	Cumulative Increase	Deferred Revenue	Effective Date
Year 1	173,239	173,239	115,493	November 1, 2009
Year 2	57,747	230,986	57,746	November 1, 2010
Year 3	57,746	288,732		November 1, 2011

Q. Why is the rate increase being phased in?

A. Both the Company and Staff are concerned with the rate impact if the full amount of the increase were implemented on November 1, 2009. Of particular concern is NHGC's ability to remain competitive in the Keene energy market. Although a market analysis performed by NHGC at Staff's request indicates there would not be a significant loss of customers due to a rate increase, unregulated propane dealers serving the area may take advantage of the increase and target NHGC's commercial and industrial customers that have the ability to site propane tanks. Given NHGC's small customer base and limited growth opportunity, the loss of such customers would put a financial strain on the Company and could lead to further rate increases. The proposed rate plan reduces the risk of customer migration while still providing the necessary funds for NHGC to continue providing safe and reliable service.

Q. Please describe how deferred revenues will be calculated.

A. Deferred revenues will be calculated in the same manner temporary and permanent rates are reconciled. The difference between the lower rates in year one and two will be reconciled with the year three rates, year three rates reflecting the full amount of the approved revenue increase. Total deferred revenue under the rate plan is expected to be $173,239 ($115,493 in year one and $57,746 in year two).

Q. How will deferred revenue be treated on NHGC's books.

A. NHGC has the option to recognize deferred revenue as income either during the period earned or recovered, as long as such treatment does not violate generally accepted accounting principles. NHGC's accounting treatment will have no impact on rates.

Q. Will NHGC be allowed to recover deferred revenue?

A. Yes, NHGC will have the opportunity to fully recover the deferred revenue over a two year period following the three year rate plan if it does not file for an increase in delivery rates during those five years. If NHGC does file for an increase in delivery rates during that period, the deferred revenue surcharge will cease when, and if, temporary rates become effective. With the implementation of temporary rates, NHGC would forgo any future recovery of the deferred revenue and adjust its books accordingly.

Q. Will deferring revenue for recovery in subsequent years result in intergenerational subsidies?

A. Any intergenerational subsidies are likely to be very limited and the overall rate impact on customers under the rate plan and deferred revenue recovery provisions will be less than if NHGC were to implement the full increase November 1, 2009. The rate plan gradually increases delivery rates which will help retain existing customers; the number of commercial and industrial customers, NHGC's largest, has been consistent over the years and is expected to remain so; deferred revenue recovery does not include carrying costs, so ratepayers benefit from the time value of money; and, allowing NHGC recovery of the deferred revenue if it does not file for a delivery rate increase provides improved cash flow for the company over the two years following the rate plan without the added cost of a rate filing, for which prudently incurred costs are recovered from ratepayers. Therefore, while there may be a small amount of intergenerational subsidy, the value to ratepayers in deferring a portion of the revenue recovery outweighs any impact from the subsidy.

Rate Case Expense and Temporary/Permanent Rate Reconciliation

Q. How are rate case expenses and the difference between temporary and permanent rates to be recovered?

A. Rate case expenses and the difference between temporary and permanent rates are to be recovered through a surcharge effective November 1, 2009 through October 31, 2010.

Q. How will the temporary/permanent rate reconciliation surcharge be calculated?

A. The difference between the temporary rates in effect for May 1, 2009 through October 31, 2009, will be reconciled with the new rates effective November 1, 2009 (year 1 of the rate plan). The difference between what has been collected under temporary rates (designed to recover additional annual revenue of $69,995) and permanent rates effective November 1, 2009 (designed to recover additional annual revenue of $173,239) will be divided by the projected therm sales for the twelve month period.

Q. What is the temporary/permanent rate reconciliation surcharge expected to be?

A. The surcharge is expected to be $0.0172 per therm, based on a preliminary estimate of $22,752 in revenue that would have been collected under permanent rates compared to what was billed under temporary rates and projected annual sales of 1,324,945 therms.

Q. What rate case expenses are eligible for recovery?

A. The cost of prudently incurred services provided by unaffiliated companies, primarily outside legal counsel, is eligible for recovery. Services performed by affiliate companies, primarily the Berkshire Gas Company (Berkshire), will not be eligible for recovery. Also, the cost of services related to the Commission audit of NHGC is not eligible for recovery, whether performed by an affiliate or non-affiliate company.

Q. Why are costs related to the audit not eligible for recovery?

A. Responding to audit requests is a continuing obligation of utilities under RSA 374:18, whereby a utility is required to produce books and records for examination by the Commission. Any costs in retaining and producing these records are, therefore, regular costs of the utility, which are recognized in calculating permanent rates under RSA 378:28. Allowing expenses associated with responding to audit requests, such as by production of records, as a surcharge for rate case expenses would, in effect, amount to double recovery of these expenses. *See Aquarion Water Company of New Hampshire*, Order No. 24,665 (Sept. 12, 2006). Accordingly, costs relating to the audit are not eligible for recovery as rate case expenses.

Q. Why are affiliate company rate case costs ineligible for recovery?

A. Berkshire provides services to NHGC under the terms of an affiliate agreement. Under the agreement if a Berkshire employee performs work for NHGC the time is tracked and the cost charged to NHGC. During the test year Berkshire employees billed NHGC for 590 hours, the cost of which is reflected in test year expenses used in determining the revenue requirement. In a data response comparing 2008 to 2009, the Berkshire employees' hours charged to NHGC in 2009 increased an average of 5.4 hours per month (54.6 compared to 49.2), even though the 2009 hours include the time Berkshire employees spent on the rate case. It appears the marginal cost due to work on the rate case is not significant.

Also, the vast majority of Berkshire's personnel costs for those employees who also perform work for NHGC are recovered through Berkshire's delivery rates in Massachusetts. A reasonable estimate of how those costs are apportioned between New Hampshire and Massachusetts would be 10 percent and 90 percent, respectively, designed to recover 100 percent of Berkshire labor costs. If 100 percent of Berkshire labor costs are being recovered through Massachusetts and New Hampshire delivery rates, any additional recovery of Berkshire personnel costs through the rate case expense surcharge would result in a double recovery of those costs by Berkshire.

Q. What is the rate case expense surcharge expected to be?

A. The surcharge is expected to be $0.0186 per therm, based on a preliminary estimate of $24,580 in eligible costs and projected annual sales of 1,324,945 therms.

Q. What is the estimated combined rate case and reconciliation surcharge?

A. The combined surcharge is expected to be approximately $0.0358 per therm.

<u>Rate Impact</u>

Q. What is the rate impact due to the $288,732 increase in the revenue requirement when compared to 2008 test year revenue?

A. The rate impact when compared to test year revenue will be an increase of approximately 8.5% when test year revenue of $3,321,641 is adjusted to include $59,745 of deferred revenue surcharges recovered in the test year but recognized as income prior to 2008, for a total of $3,381,386 collected from customers during the test year.

Q. What is the rate impact, including estimated surcharges, when compared to test year revenue?

A. The increases over test year revenue year to year and cumulatively are as follows:

	Delivery Rate Increase	Surcharge	Revenue Increase	Cumulative Revenue Increase	Increase over Test Year	Year to Year Increase
Year 1	173,239	47,332	220,571	220,571	6.52%	6.52%
Year 2	57,747	0	10,415	230,986	6.83%	0.29%
Year 3	57,746	0	57,746	288,732	8.54%	1.60%
Year 4	0	86,619	86,619	375,350	11.10%	2.36%
Year 5	0	86,619	0	375,350	11.10%	0.00%

Q. Has NHGC filed its 2009-2010 winter cost of gas (COG)?

A. Yes, the Company filed its winter COG on September 16, 2009, Docket No. DG 09-168.

Q. How does the 2009-2010 winter COG compare to the 2008-2009 winter COG?

A. For the upcoming winter the Company is seeking to recover $1,426,124 through the COG (November 1, 2009 and April 30, 2010). Last winter the Company recovered $1,792,531 through the COG. As a result of lower commodity costs the recoverable COG revenues are expected to be $366,407 lower this winter.

Q. When factoring in the decrease in gas costs in NHGC's COG filing, what is the overall rate impact?

A. The changes in annual revenue are as follows:

	Delivery Rate Increase	Surcharge	Winter COG Revenue	Revenue Change	Cumulative Revenue Change	Change in Test Year Revenue	Change Yr to Yr
Year 1	173,239	47,332	(366,407)	(145,836)	(145,836)	-4.31%	-4.31%
Year 2	57,747	0		57,747	(88,089)	-2.61%	1.78%
Year 3	57,746	0		57,746	(30,343)	-0.90%	1.75%
Year 4	0	86,619		86,619	56,276	1.66%	2.58%
Year 5	0	86,619		0	56,276	1.66%	0.00%

Q. Since the commodity rate decrease exceeds the delivery rate increase, why should the increase be phased in?

A. NHGC's chief competition comes from unregulated propane dealers serving the Keene area, dealers experiencing a similar decrease in their commodity costs. Therefore, even though NHGC customers would see a decrease if the revenue increase were not phased in, NHGC's rates would be less competitive if that were done. This would increase the risk of customer migration from regulated to unregulated propane service.

Annual Capital Expenditure Requirement

Q. What is the average annual capital expenditure requirement?

A. Order No. 24,812 dated December 28, 2007, approving the settlement under which Iberdrola acquired NHGC requires NHGC to maintain average annual capital expenditures for the next five years, i.e., through December 31, 2012, at no less than $275,000, adjusted for inflation, but subject to reevaluation in NHGC's next base rate case.

Q. Do the Company's planned capital expenditures meet the requirement?

A. The Company's normal business capital requirements are expected to be in the range of $125,000 to $175,000 annually and NHGC is spending an additional $75,000 to $100,000 annually replacing its infrastructure as pat of the City of Keene/EPA sewer replacement project expected to continue through 2014. To meet the $275,000 minimum the Company would have to increase capital spending beyond normal requirements.

Q. Should the current requirement be modified?

A. Yes, the minimum requirement should be reduced to $200,000 to avoid NHGC having to make expenditures that it would not make absent the $275,000 requirement, expenditures that will ultimately be borne by ratepayers. This modification can be accomplished without adversely affecting safety and reliability.

Summary

Q. Does the settlement agreement between Staff, the OCA and NHGC reflect Staff's recommendations?

A. Yes, the settlement agreement contains provisions that address and satisfy each of the issues raised in Staff's testimony.

Q. Is the lack of pro forma adjustments a concern?

A. No, NHGC sought to keep rate case expenses down by limiting adjustments. Generally, the majority of adjustments are to expenses to reflect increases due to inflation, as well as increases in wages, pension and health benefits, and property taxes. By limiting adjustments NHGC not only kept rate case expense down but provided a conservative estimate as to its revenue deficiency. The adjustments made by Staff and the Company ensure that the rate determination satisfies all statutes and rules and results in just and reasonable rates.

Q. Does that conclude your testimony?

A. Yes.