STATE OF NEW HAMPSHIRE

PUBLIC UTILITIES COMMISSION

March 9, 2010 - 10:17 a.m.
Concord, New Hampshire

RE: DG 09-141
UNITIL SERVICE CORP.:
Petition by Northern Utilities, Inc. for approval of proposed financial hedging program redesign.

PRESENT: Chairman Thomas B. Getz, Presiding
Commissioner Clifton C. Below
Commissioner Amy L. Ignatius

Sandy Deno, Clerk

APPEARANCES: Reptg. Northern Utilities, Inc.:
Susan Geiger, Esq. (Orr & Reno)

Reptg. Residential Ratepayers:
Kenneth E. Traum, Asst. Consumer Advocate
Office of Consumer Advocate

Reptg. PUC Staff:
Matthew J. Fossum, Esq.

Court Reporter: Steven E. Patnaude, LCR No. 52

I N D E X

E X H I B I T S

EXHIBIT NO.	D E S C R I P T I O N	PAGE NO.
1	Unitil's Petition for Approval of Proposed Financial Hedging Program Redesign (08-07-09)	6
2	Revised Petition for Approval of Proposed Financial Hedging Program Redesign (02-17-10)	8
3	Direct Testimony of Stephen P. Frink in Support of Revised Hedging Policy (02-23-10)	39

P R O C E E D I N G

CHAIRMAN GETZ: Good morning, everyone. We'll open the hearing in docket DG 09-141. On August 7, 2009, Northern Utilities filed a petition for approval of a proposed Financial Hedging Program designed in conjunction with a similar proposal in Maine. The Commission issued an Order of Notice on November 10. A prehearing conference was held on December 7, and a secretarial letter was issued on December 11 approving interventions and approving a procedural schedule culminating in the hearing this morning.

Can we take appearances please.

MS. GEIGER: Yes. Good morning, Mr. Chairman, Commissioner Below, Commissioner Ignatius. I'm Susan Geiger, from the law firm of Orr & Reno, representing Northern Utilities, Inc. And, with me this morning from the Company is Rob Furino.

CHAIRMAN GETZ: Good morning.

MR. TRAUM: Good morning, Mr. Chairman, Commissioners. Representing the Office of Consumer Advocate, Kenneth Traum.

CHAIRMAN GETZ: Good morning.

MR. FOSSUM: And, good morning. Matthew Fossum, on behalf of the Commission Staff. And, with me this morning are Stephen Frink and Bob Wyatt from the Staff of the Commission.

CHAIRMAN GETZ: Good morning. I'm not putting it out there because I'm planning on using it.

(Referring to the Chairman's gavel.)

(Laughter.)

CHAIRMAN GETZ: Just rearranging. Are you ready to proceed, Ms. Geiger?

MS. GEIGER: Yes. Thank you very much, Mr. Chairman. Northern would like to call to the stand Mr. Rob Furino.

(Whereupon Robert S. Furino was duly sworn and cautioned by the Court Reporter.)

ROBERT S. FURINO, SWORN

DIRECT EXAMINATION

BY MS. GEIGER:

Q. Could you please state your name for the record.

A. Yes. Hi. Robert S Furino.

Q. And, by whom are you employed and in what capacity?

A. Unitil Service Corp., as the Director of Energy Contracts for the Unitil companies.

Q. I'm sorry, Mr. Furino. What are your responsibilities at Unitil?

A. My responsibilities relate to procurement of energy supplies for the Unitil companies.

Q. And, Mr. Furino, I'd like to show you a set of documents that begins with a cover letter dated August 7, 2009, and is appended thereto several other documents. The cover letter is from Attorney Gary Epler to Debra Howland. Are you familiar with these documents?

A. Yes, I am.

Q. Could you please explain for the Commission what these documents are?

A. Yes. This is a filing made by Northern on August 7th, 2009, seeking the New Hampshire Commission's approval for certain changes to Northern's Hedging Program.

MS. GEIGER: And, Mr. Chairman, I'd like to have this set of documents marked as the first exhibit in this docket.

CHAIRMAN GETZ: That is so marked.

(The document, as described, was herewith marked as Exhibit 1 for identification.)

MS. GEIGER: Does the Bench need copies?

CHAIRMAN GETZ: We're all set.

MS. GEIGER: How about, Mr. Patnaude, do

you need a copy?

MR. PATNAUDE: Yes, please.

MS. GEIGER: Thank you.

BY MS. GEIGER:

Q. And, Mr. Furino, did Northern make a similar filing to the one that's just been marked for identification as Exhibit 1 with the Maine Public Utilities Commission?

A. Yes, we did. Virtually identical.

Q. And, with respect to the filing in New Hampshire and Maine that has just been marked, have you, on behalf of Northern Utilities, engaged in technical sessions with both staffs of the Maine and the New Hampshire Public Utilities Commission regarding this matter?

A. Yes, I have.

Q. And, have you answered data requests propounded by staffs of both Commissions concerning this filing?

A. Yes, I have.

Q. And, what, if anything, has Northern done in response to those technical sessions and data response answers that have been provided to the staffs of both Commissions?

A. Right. As a result of conversations with and questions from both the Maine and New Hampshire Commission staffs, Northern has made another subsequent filing on

February 17th, 2010 with both the Maine and New Hampshire Commissions, which revises the August 2009 filing concerning the proposed changes to the -- excuse me, to Northern's Hedging Program.
Q. Mr. Furino, I'd like to show you another set of documents that begins with a cover letter from me to Debra Howland dated February 17th, 2010. Could you please identify those documents?
A. Yes. This is the revised petition for proposed changes to the Financial Hedging Program filed on February 17th, 2010.
MS. GEIGER: Mr. Chairman, I'd like to have this set of documents marked as "Exhibit 2" for identification.
CHAIRMAN GETZ: So marked.
(The document, as described, was herewith marked as Exhibit 2 for identification.)
MS. GEIGER: Thank you. Does anyone else need a copy of this filing? Okay. Thank you.
BY MS. GEIGER:
Q. Now, Mr. Furino, did Northern prefile testimony in this docket?
A. No, we did not. I understand that Puc Rule 203.06(a)

does not require prefiled testimony to be filed along with petitions. In addition, the Commission did not order Northern to provide prefiled testimony.

Q. And, Mr. Furino, do you have any revisions or corrections to make to the filing that's just been marked for identification as "Exhibit 2"?

A. No, I don't.

Q. And, notwithstanding the fact that neither you nor anyone else from Northern Utilities prefiled testimony in this docket, do you today, under oath, accept as true all of the information that is contained in what's been marked as "Exhibit 2"?

A. Yes, I do.

Q. Okay. Could you please briefly summarize for the Commissioners the changes that Northern proposes to make to its Hedging Program?

A. Yes. Thank you. And, thank the Commission for the opportunity to describe Northern's Hedging Program and its proposed changes. First, as background, Northern revisited the structure of its Hedging Program largely in response to requests from the Maine Commission, for Northern to assess the performance of the Program and to recommend changes as appropriate. Shortly after assuming the ownership of Northern, Unitil began enhancing its monthly hedging reports to show time-based transactions versus price-based transactions and to summarize the portfolio of contracts that were associated with each season that was being hedged. Northern also enhanced its cost of gas filings to provide clear and transparent purchasing plans for each future season that would be hedged.

In April 2009, Northern filed an annual Hedging Report with the Maine Commission, and provided a courtesy copy to the New Hampshire Staff, that identified certain program attributes that might serve to improve the Hedging Program. This led to Northern filing its August 2009 proposal, which has been marked as "Exhibit 1", which precipitated this docket, and ultimately to the revised proposal, Exhibit 2, which reflects significant contributions from the staffs of both Maine and New Hampshire.

The proposed redesign builds upon the structure of the current program. In the filing of Exhibit 2, there is a matrix on Pages 3 and 4 that provide a summary of the program attributes Northern seeks to modify. As mentioned earlier, the proposal submitted to both Maine and New Hampshire Commissions are identical, as Northern intends to maintain a common program in both divisions.

I'd like to provide a brief overview of the current program. By means of purchasing NYMEX natural gas futures contracts in a systematic manner, Northern presently hedges between 40 percent and 70 percent of its projected pipeline supply requirements for the months of October through May each year. Seasonal hedging programs -- plans, excuse me, are presented with each cost of gas filing, documenting the financial hedging to be performed for the season that begins one year after the period covered in that cost of gas filing. Thus, hedging begins 12 months in advance of service.

Under the current program, there are two types of financial hedges; time-based and price-based. Time-based hedges are implemented each month for the 12-month period in a dollar cost averaging manner under a schedule designed to meet 40 percent of pipeline supplies. Additional futures contracts, the price-based hedges, may be purchased in response to price drops. Price-based hedges are structured to target three separate pricing points. These are set at 65th, 35th, and 20th percentile of historical price range. The pricing points are provided with the cost of gas filings. For each pricing point below which prices drop, Northern purchases additional futures contracts for an additional 10 percent of pipeline supplies. Thus, in cases where all three price targets are triggered, the total price-based hedges cover 30 percent of pipeline supply requirements. And, taken together with the time-based perform -- time-based hedges result in total pipeline supplies of 70 percent being hedged. In the past two years, I believe Northern has triggered all price-based -- all price-based triggers and therefore has hedged 70 percent of its pipeline supplies.

For the proposed changes, turning to the proposal itself, Northern proposes to redesign the Hedging Program using simple techniques and clearly defined rules meant to provide transparency and structure. Northern proposes four primary changes to the program.

First, Northern would adopt a portfolio approach to hedging, whereby Northern would apply both its physically hedged supplies, which include its storage gas, and may include fixed price contracts, and financial program to target beginning each peak season with 70 percent of its requirements available at a fixed price. And, that's 70 percent of its total requirements, not just its pipeline requirements.

The second piece is to introduce a price ceiling. The price ceiling is calculated pursuant to a formula, as described in the filing, above which purchases of futures contracts would be postponed.

The third piece is to eliminate the price-based component of the program.

And, the fourth would be to introduce a process under which futures contracts that appreciate in value above 40 percent would be sold. We refer to that in the filing as the "Appreciation Rule".

The proposed redesign also addresses the structure and timing of program implementation. And, the manner in which price parameters are determined, because the price ceiling may result in postponed or even forgone purchases, Northern proposes to provide its Winter Season Hedge Plan six months earlier than it has in the past, and to begin hedging winter volumes 18 months before service, rather than 12, in order to provide time for forgone purchases to be made up in the event that prices would fall.

Timing for summer hedges would remain the same. In fact, the proposed volumes for the summer period would remain the same, at 40 percent of requirements for the months of May and October. Plus, the hedging plans would be provided by the Company only once per year, along with -- which would be provided with the spring cost of gas filings, and it would cover the 12-month period or the summer period 12 months later, and the following winter period, which would be 18 months later.

Northern has incorporated this proposed redesign of the Financial Hedging Program into its 2010 off-peak cost of gas filing submitted to the Maine Public Utilities Commission on February 17th, 2010, and intends to do the same on March 15th, 2010 for the New Hampshire Division.

Northern believes that the proposed Hedging Program described will provide significant benefits to ratepayers going forward, in terms of reduced exposure to market volatility and the ability to capture financial benefits of Northern's hedging contracts.

The proposed program addresses certain shortcomings in the existing Hedging Program, most notably by introducing price ceilings for hedges, which would avoid purchases during periods of price spikes, while preserving the opportunity to purchase those -- make those transactions at lower prices in the future.

The proposal also provides a mechanism to liquidate hedges that have significantly appreciated in value. A few years ago, Northern experienced the situation where it made financial futures purchases at, we'll say at one price, call it $8, saw those contracts appreciate in value to approximately $13 or $14, held those contracts, and then saw those contracts actually expire at about $5 to 4$. So, Northern had the opportunity to realize gains from those contracts, but, because its program was blind and didn't allow for that, that opportunity was lost. And, in the end, they expired, worth much less than when they were purchased, creating a loss to the cost of gas.

In short, Northern believes the proposed program will offer greater predictability for ratepayers and for the Commissions. Northern will continue to monitor the program and will propose additional changes to the program as appropriate.

In closing, from opening remarks anyway, I would like to thank the New Hampshire Staff for the time and effort that they've put in to working with Northern to refine the proposal.

MS. GEIGER: Thank you, Mr. Furino. I have no further questions for this witness. Thank you.

CHAIRMAN GETZ: Thank you. Mr. Traum.

MR. TRAUM: No questions.

CHAIRMAN GETZ: Thank you. And, Mr. Fossum.

MR. FOSSUM: Thank you.

CROSS-EXAMINATION

BY MR. FOSSUM:

Q. Sort of I guess to give, by way of background, moving from the older or existing policy to the proposed policy, looking at this current winter of '09-10, what percentage of the Company's supplies were fixed prior to November 1st, if you know?

A. Right. I don't have an exact schedule before me, but I would say approximately 88 percent.

Q. And, of that 88 percent, what was the Company's storage gas?

A. Approximately 55 percent. Again, I don't have the schedule before me.

Q. And, to the best of your knowledge, what percentage was due to fixed price contracts?

A. Yes. Approximately 10 percent. Northern has a fixed price contract in play for this current winter, and it

will be in play for next winter as well.
Q. And, so, it expires following next winter?
A. It expires actually the -- Halloween, if you will, October 31st, before the next following winter. So, it does run through the summer.
Q. So, it would be October 31st of 2011?
A. Correct.
Q. And, upon expiration, does Northern expect to have a new fixed price contract to renew that current contract? What are the Company's expectations regarding its fixed price contract?
A. The particular contract is not -- the structure of that contract is not typically available these days. That's a little bit of a legacy contract at this point. It's been around for maybe ten years. Northern has not determined exactly how we'll replace that contract. And, we'll take up the matter as part of its Integrated Resource Plan analysis.
Q. Now, turning back to this current winter, and taking the numbers that you've given so far, there would be -- the percentage of current winter supplies that are fixed through financial hedges would be about, my math, about 23 percent, is that accurate?
A. That's about right. Twenty-two (22) percent was going

to be my guess, my answer.
Q. And, just for clarity sake, what type of financial hedges does the Company use?
A. The Company is purchasing NYMEX natural gas futures contracts for specific futures months associated with the period set forth in the plans that we have for the cost of gas. So, 12 months in advance for the summer and 18 months in advance for the winter period, as proposed.
Q. And, that's, at least currently, the only financial instruments?
A. That's right. That's correct.
Q. Now, under the revised policy, what amount of the supplies would be fixed through strictly financial hedges?
A. Well, this gets to the first point that we raised, which was actually a proposal brought to us really by New Hampshire, which is to set or to target 70 percent of supplies available under a fixed price in the beginning of a season. So, Northern has storage that can meet, you know, approximately 55 percent of its requirements, and has the fixed price contract in play for next winter. But, beginning the winter after, that won't be available, unless it's replaced. So, the

answer is that we would target 70 percent, and would include our physical supplies, storage and any fixed price contracts, and make up the difference with financial contracts. In the filing, I think Table 2 gives a depiction of what we're proposing in this year's cost of gas filing. This would be found on Page 5, bottom of Page 5. And, if we just focus on the winter period, this would be for the Winter 2011-12, we're showing our sendout requirement, we're showing storage from Washington 10 and from Tennessee totally 53 percent of the sendout requirement. And, then, the balance to get you to 70 would be entirely made up of financial hedges. Seventeen (17) percent of that sendout requirement is approximately 0.96 Bcf, or 96 futures contracts' worth.

Q. Thank you. Now, in Exhibit 1, Northern's initial filing, there was the indication that there would be a cap on margin requirements, do you recall that?

A. Yes. That was part of our initial proposal.

Q. And, that cap was about $4 million?

A. Yes, set at $4 million.

Q. And, is there a cap under the revised policy, as presented in Exhibit 2?

A. No. The Company has taken that off the table. There

is no proposed cap of margin requirements.
Q. And, why is that?
A. The Company realized that margin requirements occur and grow when prices are falling. And, the Company felt that it was the best thing to do for customers to continue purchasing when prices are falling, rather than to suspend program activity. Moreover, the Company feels that some of the measures that we seek to implement, the price ceiling and the Appreciation Rule, will serve to mitigate some of the margin requirements themselves.
Q. Now, also in the original filing, there was a provision that would have the Company hedging its storage supplies, do you recall that?
A. That's correct.
Q. And, that provision does not exist in the revised policy, as shown in Exhibit 2, is that correct?
A. That's correct.
Q. And, why was that provision removed?
A. That provision was removed, again, this was actually on New Hampshire Staff's recommendation, and it did make sense to the Company. What the Company was trying to do with that proposal was to essentially hedge and firm up what would otherwise have been a firm and known

price at the start of the gas season. So, November 1st, following an injection season, the Company would have known what its weighted average cost of gas in storage was. Under the initial proposal, the Company sought to -- proposed to hedge that gas in advance of the injection season, the injection period. But, at the end of the day, really, it does not create any more stability in rates. And, you know, we felt that it did make sense to, you know, to not seek that in the revised proposal.
Q. Now, as part of its revised -- as part of, I guess, its current proposal, which is the revised proposal that is, Northern has proposed to, if I understand, to eliminate the price trigger hedges to sell appreciated contracts and to set a price ceiling over which any further purchases would be suspended. Now, could you briefly just explain sort of the benefits to be gained from those three things working in concert here?
A. Yes. Sure. Thank you. First of all, the price-based contracts, we did some analysis in responding to questions from the Maine Commission. And, what we found was that the price-based contracts were purchased as prices were falling, this was a good thing, but what happened -- what appears to have happened is that

prices continued to fall. And, although price-based purchases are made as prices fall, within months the time-based prices, again, these are just periodic, regular, every month you're making a purchase, the average price of those time-based contracts would often be lower than the price-based contracts. So, in fact, on Page six of Exhibit 2, the end of the second paragraph we state some numbers, where it says "Transaction Types", that following paragraph. Where we state that, according to our research, "time-based transactions lost approximately 63 cents a decatherm", but "price-based transactions lost $2.21 per decatherm." And, again, that's because they were purchased at a price, and prices were continuing to drop. So, that's the "why discontinue the price-based aspect of the program?"

The other part of that is that, you don't, from a planning perspective, you don't know how much supply you're going to be entering the season with under a fixed price. It could be 75 percent, it could be 88 percent. It would vary with the level of price-based purchases that were made.

The price ceilings, the concept of the price ceiling, I touched on it a little bit earlier, it's to try to avoid purchasing when, for lack of a better term, its not a good time to purchase. In terms of historical prices and recent historical prices, it's when prices are above one standard deviation from the mean, as we've calculated it. And, we believe that, by moving back our purchasing, at least for a winter period, by six months, we would have the ability to withstand or to avoid purchasing during fairly short-lived price spikes, say, four- to six-month periods and then yet still make up those purchases at better times.

Q. Thank you. And, you had noted that Northern's requested approval of an identical program from the State of Maine. What status is that request in, to the best of your knowledge, with the Maine Commission?

A. Yes. Well, as I mentioned, Northern filed the new program as part of its cost of gas filing in February with Maine. That was well received. Maine is preparing an Examiner's Report, Maine Staff are preparing an Examiner's Report for the Commission, which I believe is due to them next week.

Q. Now, it's my understanding that Northern was hoping to have an order from both the New Hampshire and Maine Commissions for effect by April 1st, is that correct?

A. That's correct.

Q. And, why April 1st?

A. Well, April 1st, because we would implement the program or fully implement the program in late April, as we begin purchases for the subsequent summer and winter periods. And, we wanted to provide an opportunity for, you know, as much of a 30-day window to roll off following an order.

Q. And, will implementing the program in April allow the Company to meet its targets, its 70 percent target for the coming winter?

A. Yes, it will.

MR. FOSSUM: Thank you. I have nothing further. Whoa. Excuses me, I apologize.

(Atty. Fossum conferring with Mr. Frink.)

MR. FOSSUM: I apologize.

BY MR. FOSSUM:

Q. You had indicated the Company would be able to make its 70 percent target for the coming winter. Will the Company actually be in excess of 70 percent for the coming winter?

A. I was speaking to the beginning of the purchasing process, the hedging process for the subsequent winter, '11-12, which we are proposing with the current cost of gas filing.

Q. Right.

A. For the current -- for the coming winter, 2010-11, the Company has determined that it already has resources in excess of 70 percent, and has suspended additional purchases under the Financial Hedging Program. We have 75 percent available under fixed contracts. And, actually, the question I think came up about Maine, shortly after Northern made the proposal, Maine advisors went to the Commission and requested approval to suspend the price-based portion of the current program. And, so, for the -- and which they did. So, for the past -- for the past six months during this period, Northern has been making price-based purchases for New Hampshire only.

As we look at what we have for fixed price supplies coming into the coming winter, we have 70 percent available by a combination of storage, fixed price contract, and time-based contracts. In addition, there's another 5 percent that are New Hampshire only price-based contracts. We'll describe this more fully in the cost of gas filing itself.

MR. FOSSUM: Now I have nothing further.

Thank you.

CHAIRMAN GETZ: Thank you. Commissioner Below.

BY CMSR. BELOW:

Q. Just to clarify the units, volume units in Table 2, is that decatherms in that?

A. Yes, they are decatherms.

Q. In the first column, and then the -- what's the unit in the "Futures Contracts" column?

A. In the "Futures Contracts" column, those are number of contracts, and they represent 10,000 decatherms each.

Q. Okay. And, that's a standard unit in futures contracts, a 10,000 decatherm contract?

A. Yes, it is.

Q. Okay. So, likewise, on Table 4, those are numbers of contracts of 10,000 decatherms each in Table 4?

A. Yes, that's correct. And, Table 4 is the plan that we would provide, we will provide in the cost of gas filings.

Q. And, when you delay purchase under a price ceiling, and you have a situation where at some point, say, a month later, prices start trending down, are you saying the purchases, all of the delayed purchases would then occur at the point in time, the day the prices fall

below that ceiling?
A. That's right. We would make all those -- we would purchase all those make-up transactions at one time.
Q. And, there's no provision that, if you see it's trending down and it keeps going down, you wouldn't spread that over the trend down?
A. No. It's -- yes, it's enticing to think about. We couldn't find a way to model that, without certainly risking losing that price itself. So, the idea is it's capturing a price that is, you know, at or below the price ceiling, when you've avoided a price that was above the price ceiling.
CMSR. BELOW: Okay. That's all.
CHAIRMAN GETZ: Commissioner Ignatius.
CMSR. IGNATIUS: Thank you. Good morning, Mr. Furino.
WITNESS FURINO: Good morning.
BY CMSR. IGNATIUS:
Q. The filing in Maine was made it sounds like during February. Is there a requirement that both states approve as is, in order for the program to go forward, or is each state free to make its own independent decision and not affect the other state?
A. The Company has not factored in any requirements that

both states do everything the same, and could accommodate changes, as we did this past -- this past winter period really.

Q. Thank you. The Appreciation Rule of going to, if you hit a 40 percent appreciation, you make the decision to liquidate the contract. Where does 40 percent come from as the appropriate level?

A. Well, that was something that we introduced in the August filing, and we provided quite a bit of data behind that. We looked historically at the likelihood of appreciation at various levels, and did frequency distributions to determine, you know, over the history, say, call it an eight year history of the program, among the things we were trying to do is we didn't want to set the threshold so high that it would never happen or very seldom happen, and we also didn't want to set it so low that it would happen very often and we might lose the opportunity for additional gain. I want to say that, subject to check, that the actual average value, average percentage, based on a history of those contracts that did appreciate by 40 percent or more, was around 15 percent. But, again, we provided a pretty comprehensive write-up on that.

Q. And, when you describe purchases that would lead you to

70 percent hedged over time, you always have the question of "percent of what", if you're working with a forecasted load. If load drops, for a variety of reasons, do you continue to have an obligation to make those purchases or do you adjust your target number on the basis of a more updated forecast?
A. Yes. Great question. Our intention at this point is that we would continue to implement the program. I think the most likely reason for the forecast to drop or sales to drop would be migration or perhaps conservation, you know, things, you know, if conservation continues. But migration is a big one. If customers were to come back to the service, the supply service offered by Northern, we'd have those supplies. But, certainly, if some supplier came into town and, you know, offered the greatest deal that could be had, and all our customers -- half of our customers left, we'd definitely be making changes.
CMSR. IGNATIUS: Thank you. Nothing else.
CHAIRMAN GETZ: A couple of questions.
BY CHAIRMAN GETZ:
Q. I wanted to follow up on Commissioner Ignatius's question about the Appreciation Rule. So, let me just

make sure I understand how this works. So, effectively, when you purchase a contract and market price goes above -- 40 percent above the market price or the contract price, then you're going to liquidate the contract, meaning sell it to someone else?
A. Correct.
Q. And, then, you're going to have to repurchase or refill that amount?
A. Under the proposal, actually, we would not do that. We would just take the proceeds, if you will, credit them to the cost of gas. And, then, that would just -- it would stand as it would -- as that. You'd have 69. whatever percent hedged at that point.
Q. Okay. So, then, though over time, you're going to try to get back to the hedging volume?
A. Under the proposal, no. Really, it's possible that prices could increase dramatically, and we could sell all the contracts. And, if that were to happen, we'd have what at that time would be a credit to the cost of gas filing itself. You know, I think it's important to realize that Northern has substantial storage, and it's 55 percent or so of storage, that provides, you know, a lot of stability, in terms of rates.
Q. Okay. Thank you. And, then, the other thing was, I

guess following up on Commissioner Below's question about the price ceilings, I guess he was looking at the issue if the price keeps going down. And, I guess, how long could the ceiling be enforced such that you wouldn't be making purchases or is there some concern or vulnerability to that, in a steadily increasing market, that you keep bumping against the ceiling price, and then what happens?

A. Right. One of the -- well, if the prices -- if you started the season, prices were high relative to the history, and they just continued to be high, you would have a period that would be a sustained period of high prices. And, you know, the price ceiling is designed and able to protect against more short-lived price spikes, you know, say maybe four to six months, maybe longer, given that the purchasing period is 18 months, and we would still look to purchase even into the supply delivery period. You know, if we had a contract or a set of contracts we were going to purchase, but had not due to the price ceiling, we would, you know, even if it was during that cost of gas, and prices fell, we would purchase them.

But, again, you know, you would maintain -- you can't -- essentially, Northern is a price-taker

in this market, and it's trying to structure a program against which you can achieve reasonable results for customers. And, if prices have exploded and stay extremely high relative to the recent historical context, then very few transactions would be made. And, ultimately, customers would pay the cost of gas that would be realized let's call it on a first-of-month index, in the absence of it being a purchase, you know, under the price ceiling. But the structure gives us every opportunity, and, even in that case, gives the customer the opportunity to get a lower price, should prices drop as these futures come to delivery.
Q. Okay. And, then, the last thing is about the time-based and price-based transactions that you talked about on Page 6 of Exhibit 2. So, and discontinuing the price-based transaction, that's basically because they didn't deliver the value that they, in theory, they might have, and the more value was delivered under the time-based approach, is that essentially the --
A. That's the biggest part of it. And, the other part of it is it provides more structure and allows us to be a little more, you know, to know we're targeting 70 percent, as opposed to having this whole other set

out there that may or may not happen.
Q. But is it that the theory of, you know, of price-based transactions doesn't hold or it was just -- was it the function of the predefined levels you used against a market that fell a lot further than people anticipated?
A. It would -- I would say it's really, in practice, just the experience that was observed over the eight year period in the history.
Q. So, it's over the entire period, not just kind of heavily weighted for the last couple of years?
A. Yes. There were periods throughout the history that, of course, you know, excuse me, of course, prices, you know, during the last two years have been extremely volatile, very high, very low. You know, so, there was, you know, that period did, you know, push the average substantially, but it was also observed in prior periods as well.
CHAIRMAN GETZ: Okay. All right. Thank you. That's all I have. Redirect?
MS. GEIGER: Yes. Thank you, Mr. Chairman. Just briefly.
REDIRECT EXAMINATION
BY MS. GEIGER:
Q. Mr. Furino, just so that the record is clear, I don't

believe, in the summary, your summary description of the Company's proposed Hedging Program, you indicated the manner in which the Company would be making reports to the Commission about its hedging practices and activities. Could you please briefly explain to the Commissioners how the Company's proposed modifications to its Hedging Program will differ from its current reporting responsibilities under the current program?

A. Yes. Excuse me. And, currently, the Company provides, with its monthly cost of gas update, a monthly report on the Hedging Program. We are looking to enhance that, so that we can show where the Company is at a given point in time, in terms of following, you know, the new program. How we are in terms of being on track towards the 70 percent target. And, so, each month we should be able to see that. And, we would identify the contracts that were sold due to -- liquidated due to appreciation. As well as identifying anything that -- any contracts that were not purchased and are queued up for purchase due to the price ceiling. So, we'll be trying to enhance the program. We'll solicit feedback from the Staff as well, to make sure that it's an effective tool for the Commission.

MS. GEIGER: Thank you. Nothing

further.

CHAIRMAN GETZ: Thank you. Then, hearing nothing else, the witness is excused. Thank you. Mr. Fossum.

MR. FOSSUM: Yes. I call Stephen Frink to the stand please.

(Whereupon Stephen P. Frink was duly sworn and cautioned by the Court Reporter.)

STEPHEN P. FRINK, SWORN

DIRECT EXAMINATION

BY MR. FOSSUM:

Q. Good morning. Could you first state your name and business address for the record please.
A. Stephen Frink. And, my business address is 21 South Fruit Street, in Concord.
Q. And, you're employed by the Commission and -- are you employed by the Commission?
A. Yes, I am.
Q. And, what is your position and your responsibilities with the Commission?
A. I'm the Assistant Finance Director -- the Assistant Director of the Gas and Water Division. And, I mainly oversee the regulation of the natural gas utilities.

Q. Thank you. Initially, I'd like to ask whether you have any thoughts on, before it escapes everybody's memory, some of the comments that Mr. Furino has made in response to the Commissioners' questions?
A. Yes, I do. On the suspended hedging piece, I -- part of the proposal is that there's enhanced hedging. And, we'll know at any point in time where hedges stand, as far as a percentage of the total portfolio that's been hedged. And, this isn't a static program. And, if prices reach the point where they appreciate 40 percent, that's going to be in the news and everybody is going to be aware of that. The Company is going to be looking at that, the Commission is going to be looking at it. There's the opportunity to respond, if we believe it's a structural, long-lasting event that will keep prices at a high level, then there's the opportunity to adjust the hedging. And -- or, if it's a situation where we had in 2005, where a hurricane comes in and prices shoot up for a brief period, then maybe we don't do anything and just leave the current program in place.

So, this -- another point is, 55 percent of Northern's portfolio is storage gas. And, so, you're always going to have 55 percent of the supplies going into a winter period at a fixed price. So, spending, right now it would be about 10 percent of your winter supply, once that fixed contract expires, it's more likely to be 20 percent, but it's still a limited amount of price protection that you'd be losing. And, again, we will have -- the Commission will have the opportunity to adjust the hedging, if it feels appropriate.

I would also say, I want to address the gains and losses -- well, the gains. The fact that the program calls for realizing gains when it appreciates 40 percent, well, to steal a line out of the Maine analysis of hedging, Northern's hedging, "nobody's ever lost money taking a profit." That those gains, if they realize a 40 percent gain, is a credit that will go into the corresponding period for which that was supplied, and those gains will earn interest at prime, and that will offset the cost. If costs continue to go up, you still have that hedge, that profit you realized. If prices drop, well, it's just that much more of a benefit to ratepayers.

And, then, the -- I'd like to speak just briefly about the price-based hedges that were in the past. In theory, that was a pretty good program, in that the thought was, if prices are dropping, and you hedge more supplies, customers are going to be happy that "okay, we've got more hedged, the prices are going to be lower than they were, because these are much lower than the historical prices." So, customers wouldn't complain too much, if -- or, customers would be satisfied to see their prices going down compared to the historical rates.

But what happened with the recession in 2008 is our prices dropped to such an extent that customers weren't happy seeing a 10 percent decrease in last year's prices, they're reading the news and they're seeing what's happening with energy prices, and wondering why they're not getting 40 percent reductions in their rates.

So, really, that triggered the whole review of the existing program, and came -- and the Company and Staff came to the conclusion that maybe customers would be more satisfied having less of their rate locked in place, to where it's more reflective of what's happening in the energy market. So, if customers are reading about natural gas prices that are going up 100 percent, seeing a 50 percent increase in their rates, they're going to be more understanding.

And, on the other side, if it's dropping 40 percent and they see 20 percent, well, they're going to be a little more understanding of that than they are at a 10 percent drop. So, really, that was the impetus behind this review and these revisions.

Q. Thank you. Now, apart from what you just said, had you filed prefiled testimony in this matter?

A. Yes, I did.

Q. And, is that the testimony that you filed back on February 23rd in this case?

A. Yes, it is.

MR. FOSSUM: I'd like this marked as "Exhibit 3" for identification.

CHAIRMAN GETZ: So marked.

(The document, as described, was herewith marked as Exhibit 3 for identification.)

BY MR. FOSSUM:

Q. Now, do you have any corrections or additions or changes to that testimony?

A. No, I don't.

Q. And, if I were to ask you the questions contained in that testimony, would your answers be the same today as they were at the time it was filed?

A. They would.
Q. Could you briefly summarize your testimony please.
A. Yes. One thing I start with is the objective of the hedging policy, and that's to protect customers from unanticipated price spikes. And, a significant number of utility customers elect the Fixed Price Option where it's available; demonstrating that customers value some level of price protection, and therefore hedging is in the public interest. While it's impossible to determine what level of hedging exactly matches the average risk aversion of Northern's customers, based on the limited studies available the 70 percent target appears reasonable, because it's within the range of hedging performed by other utilities throughout the country and consistent with the amount of fixed price supplies hedged in Northern's winter portfolio. Whereas the amount of fixed supplies in Northern's winter portfolio is currently will in excess under the current Hedging Program.
Assessing the impact of Northern's current hedging policy on rate volatility reveals that there's been a limited impact, which isn't surprising considering, even with all the price triggers in effect this winter, only 23 percent of your supplies are

hedged through financial hedges, compared to approximately 60 percent that's hedged through storage gas and fixed contracts. And, while the impact on rate volatility has been limited, so has the hedging costs. Looking at the hedging costs for the current winter period, they amount to approximately one-third of one percent of total gas costs, and that includes utility personnel costs, which are not likely to change, even if hedging were to be eliminated. So, while hedging may provide only limited rate stability, it comes at a very small cost.

Northern's revised hedging policy will lower hedging costs. And, if there is a severe spike in natural gas prices, the proposed program would lock in profits and suspend hedging. If such an event were to occur, this happened with the hurricanes Katrina and Rita in 2005, the Company and the Commission would have the opportunity to assess the situation at that time and determine if additional hedging would be appropriate.

For the most part, my testimony ignores the fluctuations in natural gas commodity prices, assuming that they average out over time, consistent with the experience under the current program in which there has been a net loss of approximately one percent of the total gas costs for that period. At this time, natural gas prices are relatively low, compared to the highs and lows over the past seven years, indicating that there is a greater probability of hedging gains than losses at current prices. While there may be continued losses, any such losses will be limited, compared to recent losses.

I recommend approval of the Northern revised hedging proposal as, in conjunction with physical hedges of fixed price contracts, it will provide additional rate protection at minimum cost.

Q. Thank you. I wanted to clarify with you one thing. You had mentioned that a significant number of customers elected the Fixed Price Option where it's available. Does that include a Fixed Price Option with Northern?

A. No. The Fixed Price Option is available with New Hampshire Gas Company, in Keene, and with National Grid New Hampshire. And, at one point, Northern did have a Fixed Price Option, it was a pilot program for one year. And, they asked to terminate it after the first year, and hedge for everybody, to stabilize prices for everybody, and the Commission granted that request.

But, for the New Hampshire -- the National Grid New Hampshire and the New Hampshire Gas hedging, in my testimony, there is an attachment that shows the results of those programs and participation in those programs. And, participation is at its lowest for EnergyNorth, right now at 15 percent, it has been as high as 30 percent, and, for New Hampshire Gas, I believe it's somewhere in the range of 20, to almost 46 percent that participated in the program. A lot of that just depends on what's in the news at the time those rates are available.

Q. And, just to be clear, that you take from that that customers do value some degree of reduction in their volatility?

A. Those customers have to pay a premium to lock in those rates. So, they're willing to pay an additional cost for price certainty. So, yes.

MR. FOSSUM: Thank you. I have nothing further at this time.

CHAIRMAN GETZ: Thank you. Mr. Traum.

MR. TRAUM: Thank you. Just a couple of questions, Mr. Frink.

CROSS-EXAMINATION

BY MR. TRAUM:

Q. On Page 12 and 13 of your testimony, Exhibit 3, you lay out that one of the reasons for moving to this new Hedging Program is the potential impact on non-migrating customers of migration, that the new Hedging Program might reduce those costs?
A. That's correct.
Q. And, at the bottom of Page 12 therein, you mention that "customers switching from firm sales to transportation must remain on transportation service for a minimum of twelve months." Now, that's the standard policy, and you're not proposing to change anything here?
A. No. That's correct. We're not changing the transportation tariff, transportation service tariffs.

MR. TRAUM: Thank you. That's all I have.

CHAIRMAN GETZ: Thank you. Ms. Geiger?

MS. GEIGER: I have no questions for Mr. Frink. Thank you.

CHAIRMAN GETZ: Commissioner Below? Commissioner Ignatius?

CMSR. IGNATIUS: I don't.

CHAIRMAN GETZ: Nothing from the Bench. And, so, the witness is excused. Thank you, Mr. Frink. Is there any objection to striking the identifications and admitting the exhibits into evidence?

(No verbal response)

CHAIRMAN GETZ: Hearing no objection, they will be admitted into evidence. Is there anything before we hear closing statements?

(No verbal response)

CHAIRMAN GETZ: Hearing nothing, we'll start with Mr. Traum.

MR. TRAUM: The OCA is not taking a position on this filing.

CHAIRMAN GETZ: Thank you. Mr. Fossum.

MR. FOSSUM: Thank you. Having reviewed the initial proposal, as well as the Company's revisions to it, and those amendments brought about through the discovery process, both here and in Maine, Staff would recommend that the Commission approve the revised hedging policy as proposed by Northern.

While it is the case that hedging doesn't have a huge impact on price volatility, it's also true that, for Northern, the costs for hedging are relatively small. Thus, it would seem the reduction in volatility is worth the small cost. This would seem especially true at present where the risk of price increases appears to outweigh the risk of price -- of significant price decreases, and having an appropriate hedging policy in place would help to protect against such risks. Therefore, Staff supports the revised policy, in that, with little cost, the Company would have a new policy that would help shield its customers and itself from a sometimes volatile natural gas market. Thank you.

CHAIRMAN GETZ: Thank you. Ms. Geiger.

MS. GEIGER: Thank you, Mr. Chairman. Northern greatly appreciates all the time and effort that the New Hampshire and Maine staffs have put into reviewing both the initial filing, technical sessions, data requests, informal communications, and all the efforts that have led up to the filing of the revised Hedging Program proposal, which has been marked in this docket as "Exhibit 2". Northern believes it's an improvement over its existing hedging proposal and we therefore ask the Commission to approve it.

Again, we'd like to thank the Staff, the Office of Consumer Advocate and the Staff and Consumer Advocate in Maine for all of their work on what we think is an improved proposal for the Commission's consideration.

In addition, as Mr. Furino indicated at the end of his testimony, the enhanced reporting requirements, I believe, or the reporting obligations under the existing program will give the Commissioners and Staff added knowledge and information every month about where the Company stands with its hedging activities. And, therefore, if there are any problems that Staff sees or any issues that the Company wants to bring to the Staff's and the Commission's attention, we can do that on a monthly basis, rather than waiting every six months during the reports on the COG. Thank you.

CHAIRMAN GETZ: Thank you. Then, we'll close this hearing and take the matter under advisement.

MS. GEIGER: Thank you.

(Whereupon the hearing ended at 11:19 a.m.)