STATE OF NEW HAMPSHIRE

Inter-Department Communication

DATE: March 16, 2010
AT (OFFICE): NHPUC

FROM: Robert J. Wyatt RJW
Utility Analyst IV, Gas & Water Division

SUBJECT: DG 10-034
Northern Utilities, Inc.
Petition for Approval of Fourth Amendment of Agreement with Foss Manufacturing Company, LLC

TO: Commissioners
Docket File
Service List

RECEIVED
MAR 18 2010
NH PUBLIC UTILITIES COMMISSION

BACKGROUND

On February 16, 2010, the petitioner, Northern Utilities, Inc. (Northern or Company), filed with the New Hampshire Public Utilities Commission (Commission) a petition for approval of an amendment to its special contract with Foss Manufacturing Company, LLC (Foss). The special contract covers firm transportation service for Foss's manufacturing facility at 11 Merrill Industrial Drive in Hampton, New Hampshire. Foss is a significant firm load in Northern's New Hampshire division, and an important employer in the seacoast area.

Foss has been a customer of Northern's since 1988 and Northern began providing intermittent delivery service to Foss, a dual fuel customer, in May 1999. Northern negotiated a special contract with Foss in October 1999 in an attempt to retain the load on a more permanent basis for firm (year-round) delivery service. *See Northern Utilities, Inc.*, Order No. 23,381 (Jan. 6, 2000). To comply with the terms of its final approval, the initial special contract was amended to limit the term to five years. Also, the parties were required to get approval from the Commission for any amendment to extend the term beyond the initial term. On March 1, 2005, a second amendment to the special contract extended the term for another 5 years. *See Northern Utilities, Inc.*, Order No. 24,478 (July 1, 2005). Also on March 1, 2005, Northern submitted a third amendment which added an annual rates and charges adjustment mechanism tied to inflation for the purpose of increasing the transportation rates to be charged by Northern to Foss, thus providing a level of confidence that the special contract rates will remain above marginal costs. *See id.* The third amendment to the agreement recently expired on February 28, 2010. On February 2, 2010, Foss sent a letter to Northern to request an extension to the term of the special contract. The petition for approval of a fourth amendment to this agreement, as filed with the Commission by Northern on February 16, 2010, requests a two-year extension of the special contract.

The current petition states that there were special circumstances that led to the negotiation, execution and approval of the original special contract. Specifically, the petition notes that Foss has the capability to use alternate fuels when it is cost effective to do so. Also, Northern recognized Foss as its second largest customer in New Hampshire, with revenues that contributed toward its fixed costs and wanted to retain the load on a year-round basis by offering a competitive rate that would make the fuel switching option unattractive. Foss was seeking a level of certainty in its gas transportation costs and Northern wanted to maintain a certain revenue stream from the customer.

Foss noted in a letter to Northern that it employs 319 people at its New Hampshire facility, which has had a positive impact on both state and local economies. Foss emphasized that it is continually pressured by its main competitors in Georgia, North Carolina and South Carolina, a region that traditionally experiences lower labor and energy costs than New Hampshire.

Included with Northern's petition is the testimony of Michael Smith, Manager, Business Services for Northern; a copy of the letter from Foss requesting the term extension; a copy of the original agreement, with approved and proposed amendments; a letter agreement which obligates Foss to pay Northern's applicable tariff rates for service rendered beginning March 1, 2010 in the event that the Commission does not approve the fourth amendment of the agreement; and an updated marginal cost analysis. Mr. Smith explains that the special circumstances and competitive pressures justifying the initial special contract continue to exist today. Northern asserts that the special contract was designed to meet the specific needs of the Foss facility while at the same time providing benefits for Northern and its other customers. Northern asserts that the revenues from the special contract have exceeded its marginal costs and will continue to do so during the two-year extension.

STAFF INVESTIGATION

Staff sent out data requests related to the petition and received and reviewed the Company's responses on March 8, 2010. Follow-up conversations between Staff and the Company clarified certain issues raised in both the petition and the data responses. The Company updated and filed a revised schedule 1-9 that clearly shows how Northern escalates its marginal costs using readily available GDP data. The revised schedule also reflects how the company adjusts the special contract rates from year to year, and in compliance with the terms of the agreement with Foss. These templates can be seen in Northern's revised schedule 1-9, filed in this docket on March 15, 2010.

In its investigation of this petition, Staff referred back to DR 91-172, a generic discounted rate docket, and NHPUC Order No. 20,633, 77 NH PUC 650, 654-55 (1992), which identified the types of issues that will be seriously considered with regard to special contracts and discounted rates. Staff also referred to the initial Foss special contract petition and its first amendment, approved in Docket No. DG 99-171 and second and third amendments approved in Docket No. DG 05-065. The third amendment modified the rates and charges in the agreement and the fourth amendment extends the term in the agreement. Using the issues identified in NH PUC Order No. 20,663, Staff used the following checklist of issues related to the special contract request:

1. *Finite Term, dependent on circumstances.* As noted earlier, the initial agreement limited its term to five years. The second amendment extended the term for another five years. This proposed fourth amendment to the agreement, as presented with the petition and subject to Commission approval, would extend the term for an additional two years, with an effective start date of March 1, 2010.

2. *The contract rate is greater than the long-run marginal cost.* In Mr. Smith's testimony (beginning on pg. 8), he explains how the most recent marginal cost study was updated by escalating the prior period marginal costs. According to Northern's analysis, the special contract rates for the two-year extension period exceed the marginal costs to provide service over that period. In section 7 of the petition, Northern notes that the third amendment to this agreement added a provision for the purpose of increasing the transportation rates that allows for the rates to be adjusted for inflation in order to keep the special contract rates above Northern's marginal costs. During the discovery process, Northern provided Staff a confidential data response revealing 2009 calendar year usage and revenue that demonstrated revenues exceeded marginal costs.

3. *The request has been thoroughly scrutinized by the utility.* In its petition, the Company provided testimony and schedules supporting the reasons why this special contract is necessary. The discounted rate in this case enables Northern to retain Foss as a firm customer for at least the next two years. The Company has been involved in ongoing discussions with Foss leading up to this petition being filed and has provided an updated marginal cost analysis to serve this facility. Thus, the Company has scrutinized the request, and, under its analysis, continuing the special contract will allow Northern to maintain its firm customer base to the benefit of all of its ratepayers without the expenditure of any additional capital.

4. *The special contract process does not provide the utility an unfair advantage over a competitor.* Mr. Smith, in his testimony (pages 2 and 10), asserts that Northern is not obtaining an unfair advantage over a competitor. First, Foss has existing alternative energy capabilities for this facility and prior to the execution of the special contract, its fuel switching capability resulted in substantial reductions in natural gas usage. Thus, Foss has fuel alternatives with which Northern may not always be able to compete. Second, this facility is already unbundled whereby Foss purchases its gas supply from third party suppliers and contracts only for firm gas delivery service from Northern. Northern noted in another recent special contract case (Docket No. DG 09-201, National Gypsum), as in this case, that there are no competitors for its delivery service within its service territory, and states that if it had offered natural gas at below market rates, it could possibly

have obtained an advantage. Because Northern is not offering a discount on the natural gas costs, and because it has no competitors for the delivery service, it is not gaining an unfair advantage.

5. *The discounted rate will not increase the rates paid by the State of New Hampshire or other customers.* As previously stated, Northern's analysis shows that the special contract delivery rates exceed long run marginal costs. The special contract delivery rates produce revenue in excess of the cost to serve the Foss load and the revenue resulting from the special contract will reduce the amount of revenue requirement to be recovered from other customers in future rate proceedings. Thus, the special contract will not increase others' rates. Also, because the terms of the special contract have been in place for the past ten years, and annual revenue generated by Foss under the contract was used in determining the revenue requirement on which current rates are based, extending the contract should assist the Company in achieving its approved rate of return.

6. *Prior to requesting a discounted rate, the customer took actions to decrease its consumption and to use its natural gas more efficiently.* Mr. Smith reports in his testimony (pg. 10, lines 5-13) that Foss's facility has undergone many energy efficiency upgrades. Over the past three years Foss has replaced light fixtures and added motion sensors. This project is about half complete and is expected to cost $272,000 for the full conversion upgrade. Because it generates its own electricity Foss stated that it was not eligible for any of the electric utility rebates currently being offered. Foss has also used the help of an outside engineering firm for advice on energy saving measures at the facility. The outside engineering firm has identified over 30 projects throughout the plant related to energy efficiency. Foss, with help from the State of New Hampshire, the Governor's office and the Business Finance Authority secured funding in December 2009 to address 3 energy saving projects with large returns on investment. These projects relate to electric motor upgrades to high efficiency motors. Foss expects to obtain annual savings of over $300,000 from these projects. Thus, this facility is continually reviewing its energy consumption patterns and making necessary operational modifications or upgrades to become more efficient.

7. *The Company is prepared to address requests for discounted rates from other customers that may have similar circumstances.* The Company currently has two special contract customers and will continue to deal with these requests on a customer-specific basis.

STAFF ANALYSIS

The following summarizes Staff's analysis and is the basis for Staff's recommendation in the case.

- Northern updated its most recent marginal cost study and demonstrated that the *long run marginal cost* to serve this customer for the next two years is less than the special contract rates. Staff's separate analysis of the escalation of Northern's most recent marginal costs resulted in a similar, but not identical, outcome as that of the Company. After further discussion with the Company Northern filed a revised schedule 1-9, specific to this docket, which Staff supports. Staff notes the escalation factor in revised schedule 1-9 uses a ratio of factors scaled to GDP in billions of chained 2005 dollars, coinciding with the start year of Northern's last marginal cost study in 2001 and ending with current year 2010. The resulting escalation factor for 2010 was 1.1665, compared to 1.1729 in the initial petition. Using the revised escalation factor the total marginal revenue requirement experienced minimal change, decreasing by less than 0.5%.

- Based on current rates, which are adjusted upward with inflation as necessary, revenues generated from this account exceed the marginal cost estimate presented in its schedules. During each year of the contract extension costs are also subject to inflation escalation factors, ensuring revenues will exceed marginal costs. Staff collected the CPI-U factors from the Bureau of Labor Statistics web page and performed its own inflation escalation rate calculations as a check on the Company's numbers. Staff determined that the rates were adjusted according to the terms of the agreement and that they continue to exceed Northern's marginal costs. Staff notes that in a few instances, specific prior special contract block rates were off slightly from Staff's calculations, mostly due to rounding issues, and in one instance in 2006 Northern did not adjust its tail-block rate for Foss. The contract allows Northern some discretion in adjusting the special contract rates in language spelled out in Article 3B of the agreement and in these examples the discrepancies were insignificant. Staff supports the Company's continued use of this special contract rate adjustment mechanism to provide a level of assurance that revenue from this agreement remains above marginal costs.

- There will be no additional costs to Northern or its customers resulting from the two-year extension to the term of this agreement. The special contract rate inflation adjustment provision provides a level of confidence that the transportation rate will continue to be above the marginal cost to serve this customer during the next two years.

- Northern's firm ratepayers will benefit from the revenue associated with the two year extension of this special contract. The special contract delivery rates produce revenue in excess of the cost to serve the Foss load and the additional revenue has reduced, and will continue to reduce, the amount of the revenue requirement to be recovered from other customers in base rate proceedings.

- Northern and its firm customers benefit from the incentives in this special contract that encourages Foss to utilize natural gas when operating its Hampton, NH facility rather than its alternative energy source, number 2 fuel oil. Along with generating additional revenues through increased throughput, environmental benefits are realized by displacing fuel oil usage with cleaner burning natural gas.

- The term extension of this fourth amendment to the agreement was scheduled to begin on March 1, 2010, subject to Commission approval and will remain in effect until February 29, 2012.

- All other provisions of the original agreement, as amended and previously approved by the Commission, will remain the same.

STAFF RECOMMENDATIONS

That the Commission approves the Northern petition requesting a two year extension of the special contract with the Foss Manufacturing Company, Inc. for the reasons stated above.

That Northern file in this docket a letter informing the Commission of special contract rate adjustments when such adjustments are made. Support for these adjustments should include updated schedule 1-9, pages 1 and 2, in the format as revised. If rates are not adjusted to the full amounts warranted an explanation should also be included supporting the modified adjustment. Staff reserves the right to modify its recommendation if the modified adjustment is significantly different than the warranted adjustment.

SUSAN GEIGER
ORR & RENO PC
ONE EAGLE SQUARE
PO BOX 3550
CONCORD NH 03302-3550

Docket #: 10-034 Printed: March 18, 2010

FILING INSTRUCTIONS: PURSUANT TO N.H. ADMIN RULE PUC 203.02(a),

WITH THE EXCEPTION OF DISCOVERY, FILE 7 COPIES (INCLUDING COVER LETTER) TO:

DEBRA A HOWLAND
EXEC DIRECTOR & SECRETARY
NHPUC
21 SOUTH FRUIT STREET, SUITE 10
CONCORD NH 03301-2429

PURSUANT TO N.H. ADMIN RULE 203.09 (d), FILE DISCOVERY

DIRECTLY WITH THE FOLLOWING STAFF

RATHER THAN WITH THE EXECUTIVE DIRECTOR

LIBRARIAN
NHPUC
21 SOUTH FRUIT ST, SUITE 10
CONCORD NH 03301-2429

BULK MATERIALS:

Upon request, Staff may waive receipt of some of its multiple copies of bulk materials filed as data responses. Staff cannot waive other parties' right to receive bulk materials.

MATTHEW FOSSUM
NHPUC
21 SOUTH FRUIT ST, SUITE 10
CONCORD NH 03301-2429

STEPHEN FRINK
NHPUC
21 SOUTH FRUIT ST, SUITE 10
CONCORD NH 03301-2429

ROBERT WYATT
NHPUC
21 SOUTH FRUIT ST, SUITE 10
CONCORD NH 03301-2429

AMANDA NOONAN
CONSUMER AFFAIRS DIRECTOR
NHPUC
21 SOUTH FRUIT ST, SUITE 10
CONCORD NH 03301-2429