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THE STATE OF NEW HAMPSHIRE

BEFORE THE

PUBLIC UTILITIES COMMISSION

NORTHERN UTILITIES, INC.

Docket No. DG 12-_________

PREFILED TESTIMONY OF MICHAEL SMITH
ON BEHALF OF NORTHERN UTILITIES

I. Introduction

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

A. Michael Smith, Manager, Business Services, Northern Utilities, 1075 Forest Ave, Portland, Maine 04104.

Q. Please describe your employment responsibilities.

A. My responsibilities include retaining, expanding and attracting business within Northern Utilities' service territories. I am the point of contact with Northern's designated key business and industrial customers, and I am responsible for insuring quality service and opening business communications to counter competitive pressures. In addition, I manage other field sales representatives in our New Hampshire and Maine service territories.

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Q. Please describe your education and employment background.

A. I received a Bachelor of Science in Mechanical Engineering Technology in 1989 from Wentworth Institute of Technology in Boston, Massachusetts. From 1989 to 1996, I was employed at Northrop, Devine and Tarbell in Portland, Maine. While there I worked as a consulting engineer focusing on energy projects. In 1996, I began my career with Northern Utilities and have held several positions in which I have been responsible for managing Northern's industrial and key account customers in New Hampshire and Maine.

II. Purpose of Testimony and Description of Schedules

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

A. The purpose of my testimony is to present information to support Northern's proposal for extending the terms and conditions of an existing Special Contract for firm transportation service with Foss Manufacturing Company, Inc. ("Foss" or "the Customer") for five (5) additional years beyond the Contract's stated expiration date of February 29, 2012.

Q. Does your testimony include input from other individuals employed by Northern Utilities?

A. Yes. My testimony includes information supplied by Paul Normand of Management Applications Consulting who contributed the marginal cost of service information used in this filing.

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Q. Please identify the documents that are submitted with this prefiled testimony.

A. The following Schedules are submitted with this prefiled testimony:

Schedule NU-1-1: Special Firm Transportation Agreement;

Schedule NU-1-2: Amendment of Agreement;

Schedule NU-1-3: Letter Agreement (March 8, 2005);

Schedule NU-1-4: Second Amendment of Agreement;

Schedule NU-1-5: Third Amendment of Agreement;

Schedule NU-1-6: Fourth Amendment of Agreement;

Schedule NU-1-7: Letter from Paul Koroski to Michael Smith (January 17, 2012);

Schedule NU-1-8: Fifth Amendment of Agreement;

Schedule NU-1-9: Marginal Cost Analysis

Q. Are you familiar with the provisions of the Special Contract and the five amendments to the Special Contract that are submitted with this filing as Schedules NU-1-1, NU-1-2, NU-1-4, NU-1-5, NU-1-6 and NU-1-8, respectively?

A. Yes. I worked directly with the Customer to negotiate the initial Special Contract in 1999 and the Amendments of Agreement.

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III. Special Contract and First Amendment

Q. Please describe the circumstances that led to the negotiation and execution of the initial Special Contract (Schedule NU-1-1).

A. Foss is Northern's second largest customer. It has a manufacturing facility located in Hampton, New Hampshire which employs close to 400 people and produces specialty fibers and engineered fabrics. Foss has been a customer of Northern Utilities since 1988. In May of 1999, Foss switched to transportation service and began purchasing gas through a third party supplier. At that time, Foss had multiple alternative fuel capabilities. Prior to the execution of the Special Contract, this fuel switching capability had resulted in substantial reductions in Foss's natural gas usage. Although Foss had significantly increased its gas consumption during the times when summer rates applied, it was not expected to do so during the times when winter season rates applied, given the Customer's fuel switching capabilities. Northern negotiated the Special Contract in October, 1999 to obtain more of the Customer's load year round on firm service at a competitive price while minimizing the risks for Northern and its other customers.

Q. Please summarize the terms and conditions under which Northern is currently providing service to Foss.

A. The Special Firm Transportation Agreement dated October 28, 1999 (Schedule NU-1-1) together with the Third Amendment of Agreement (Schedule NU-1-5) establish the contractual service and payment obligations. Northern is currently obligated to

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transport and deliver to the Customer during any Gas Day up to a Maximum Transportation quantity of 15,500 therms. However, such transportation and delivery is limited to no more than 860 therms per hour. In each contract year, the Customer is required to use and/or pay Northern for the transportation services for a minimum of 2,400,000 therms of natural gas. The Customer is currently required to pay a monthly customer charge of [redacted], a monthly minimum fixed charge for the first 200,000 therms or less of [redacted], and a minimum annual payment of [redacted]. Monthly volumes above 200,000 therms are billed at the following rates:

- Quantities between 200,000 and 300,000 therms: [redacted] per therm
- Quantities between 300,000 and 400,000 therms: [redacted] per therm
- All quantities over 400,000 therms: [redacted] per therm

In addition to the above-described service and payment provisions, the Customer is subject to all of the other charges and fees set out in Northern's General Terms and Conditions and Transportation Terms and Conditions as are in effect from time to time (unless otherwise specified in Article 3 of the Special Contract).

Q. Please describe the initial term of the Special Contract and any extension thereof.

A. Commission Order No. 23,381 dated January 6, 2000 in Docket DG 99-171 approved the initial Special Contract for a five (5) year term and required that the provisions of the Special Contract describing the term thereof be revised to require Commission approval for any extension period beyond five (5) years. The Amendment

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of Agreement dated January 11, 2000 (submitted herewith as Schedule NU-1-2) was executed in compliance with Commission Order No. 23, 381. It provides that the initial term of the contract is five (5) years from the Service Commencement Date which is described in Article 5 of the Special Contract.

IV. Second and Third Amendments

Q. Please explain the circumstances that led to the execution and submission to the Commission of the Second Amendment of Agreement.

A. The original Special Contract expired on February 28, 2005. Foss and Northern executed the Second Amendment of Agreement (Schedule NU-1-4) effective March 1, 2005 to extend the Special Contract term for another five (5) years until February 29, 2010. By letter agreement dated March 8, 2005 (Schedule NU-1-3), Foss and Northern agreed that if the Commission did not approve the Second Amendment of Agreement in form and substance acceptable to Northern and Foss, the rate for transportation service rendered from March 1, 2005 would be Northern's applicable rate schedule and that Northern would recalculate the charges for services rendered since March 1, 2005 and Foss would be responsible for those charges. The Second Amendment to Agreement stated that Commission approval was required to effectuate an extension of the Special Contract beyond the stated expiration date of February 29, 2010. On April 1, 2005, Northern filed a Petition and supporting documents with the Commission seeking approval of the Second Amendment of Agreement.

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Q. Please provide some additional background on the Second and Third Amendments, the Staff recommendation to the Commission and the Commission's approval of those amendments.

A. In the April 1, 2005 Petition requesting approval of the Second Amendment Northern explained that the Customer's desire for cost certainty and Northern's commitment to continue to provide firm transportation service were the primary reasons for Northern's willingness to negotiate a contract extension for five (5) more years at the 2000 rates expressed in the initial Special Contract. The filing also indicated that there were no system improvements needed to continue serving the Customer under the amended Special Contract and that revenues generated under the amended Special Contract would clearly exceed the annual marginal cost revenue requirement. The filing further stated that the Amended Special Contract would provide Northern with a continued guaranteed revenue stream that might escalate with inflation through the application of an annual inflation escalator provision, and that this guaranteed revenue stream would benefit both Northern and its ratepayers.

Staff's investigation of the April 1, 2005 filing led it to conclude that an increase in the Special Contract rate would be appropriate because the value of service to Foss had increased slightly from when the initial Special Contract rates were established and because the actual usage over the five years of the Special Contract greatly exceeded the must-take provisions of the Special Contract. At Staff's request, Northern approached Foss regarding an increase in the minimum payment requirements. Foss agreed to the

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proposed increase and, along with Northern, executed the Third Amendment of Agreement (Schedule NU-1-5) reflecting the increased rate. On July 1, 2005, the Commission issued Order No. 24,478 approving the Second Amendment of Agreement (extending the contract term to February 29, 2010 and subjecting the contract rates to an annual inflation adjustment) and the Third Amendment of Agreement (which increased Foss's minimum payment obligations).

V. Fourth Amendment

Q. Please explain the circumstances that led to the execution and approval of the Fourth Amendment of Agreement (Schedule NU-1-6).

A. Northern informed Foss that the Special Contract as amended was scheduled to expire at the end of February 2010 and that, at that time, Foss would take service from Northern under tariff rates. Foss responded with a letter dated February 2, 2010 requesting that a filing be made with the Commission to extend the Special Contract as amended. In support of its request, Foss stated that if it reverted to tariff rates, the company's operations and job security at Foss's Hampton facility would be adversely affected. Foss noted that it employed 319 employees whose wages have an economic impact to the State of New Hampshire. Foss also advised Northern that the State of New Hampshire, through the Business Finance Authority and Coastal Economic Development Corporation, had assisted Foss with [redacted] in loans to acquire a state of the art production line to improve operational efficiencies to maintain jobs and to keep Foss

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competitive with its competition located in other areas where utility costs are lower. Foss further stated that it was trying to preserve jobs that benefit New Hampshire but that if tariff rates go into effect, Foss would have to seriously consider eliminating skilled associate positions. In reaction to Foss's circumstances, Northern and Foss executed the Fourth Amendment to Agreement to extend the existing terms under which firm transportation service was being provided to Foss for two (2) additional years, i.e. until February 29, 2012.

Northern and Foss sought approval for the Fourth Amendment of Agreement from the Commission because the Second Amendment of Agreement expressly stated that any further extension of the Special Contract beyond February 29, 2010 required Commission approval in a form and substance acceptable to Northern and Foss. The Commission approved the Fourth Amendment of Agreement in Order No. 25,085 issued on March 25, 2010.

VI. Fifth Amendment

Q. Please explain the circumstances that led to the execution of the Fifth Amendment of Agreement (Schedule NU-1-8) and this submission to the Commission for approval.

A. Northern informed Foss that the Special Contract as amended was scheduled to expire at the end of February 2012 and that, at that time, Foss would take service from Northern under tariff rates. Foss responded with a letter dated January 17, 2012

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requesting that a filing be made with the Commission to extend the Special Contract as amended. (Schedule NU 1-7). In support of its request, Foss stated that if it were required to pay tariff rates for gas transportation service, the savings it has achieved from a variety of improvement efforts made to remain competitive with companies from Mexico and China, as well as southern states, which it detailed in the letter (investments in technological improvements, replacement of the unit fork truck force, negotiated reduced property tax assessment) would be lost and it would have to seriously consider other options. In reaction to Foss's circumstances, Northern and Foss executed the Fifth Amendment to Agreement to extend the existing terms under which firm transportation service was being provided to Foss for five (5) additional years, i.e. until February 28, 2017.

This filing is being made because the Fourth Amendment of Agreement expressly stated that any further extension of the Special Contract beyond February 29, 2012 required Commission approval in a form and substance acceptable to Northern and Foss.

Q. Has Northern performed an analysis of its long-run marginal costs of serving the customer? If so, please describe that analysis.

A. Yes. Northern is providing two marginal cost studies with this filing. The first marginal cost study is presented in Schedule NU-1-9, page 1 of 2. This marginal cost study is based on the marginal cost study that was developed to support unbundling and was submitted in support of the original 1999 special contract filing, updated by an

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escalation factor to inflate the costs to today's dollars. This study has been used as a basis for computing the floor price used in connection with special contrasts.

Marginal costs may be easily updated. They can be estimated from one year to the next by simply escalating the prior period marginal costs. This fact stems from the economist's fixed charge rate used to convert capital investments into annual carrying charges. Unlike a conventional fixed payment mortgage, payments to recover fixed costs rise in nominal dollars. Similarly, marginal operating and maintenance (O&M) expenses can be estimated by simply applying an appropriate escalation factor to the prior measure of marginal O&M expenses. The results of Northern's 1999 marginal cost study were updated to current price levels by identifying the customer-related and capacity –related unit costs, escalating to current levels and multiplying by Foss's billing units to compute the marginal costs to provide delivery service.

The second marginal cost study, presented in Schedule NU-1-9, page 2 of 2, is the 2011 study for Northern's currently pending rate case, docket DG-11-069, updated with the most recent compliance version of the filing as of January 24, 2012. The 2011 marginal cost analysis is the most recent and more relevant marginal cost study. Although this marginal cost study has not yet been approved by the Commission (because Northern's rate case is still pending), I believe that this marginal cost study should be used because as the costs are more relevant than the prior study on a going forward basis.

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Q. Please explain whether the price to be paid by Foss during the five (5) year extension of the Special Contract proposed in this filing is above Northern's long-run marginal cost to serve this Customer.

A. In both of the marginal cost analyses referenced above, the price for the five (5) year extension period exceeds the estimated marginal costs to provide service over the proposed extension period. Based on current rates, revenues of [redacted] are generated, exceeding the marginal costs estimate of [redacted] presented in Schedule NU-1-9 page 1 of 2. In addition, revenues of [redacted] also exceed the revenue requirements of [redacted], presented in Schedule NU-1-9, page 2 of 2. During each year of the contract extension, costs are subject to the same escalation factors, therefore revenues will continue to exceed the marginal costs.

Q. Based on your analysis, do you believe that extending the Special Contract for five (5) additional years will allow Foss to gain an unfair advantage over its competitors?

A. No. In my opinion special circumstances exist which support the extension of the Special Contract for five (5) more years. As explained in Schedule NU-1-7, Foss has made significant financial investments to improve its facilities and upgrade its equipment and has negotiated a lower property tax assessment. The Customer faces competitive pressures from competitors located in Mexico and China, as well as southern states North Carolina, South Carolina and Georgia, where labor and utility costs are lower than Foss's and where there are state subsidies and a lower tax burden. Foss has also experienced an

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increase in raw materials costs. All employees took a [redacted] wage reduction from April to November of 2011; a [redacted] reduction remains in effect for salaried workers. In May of 2011 the work force was reduced by [redacted] employees. During 2012 Foss faces renegotiation of their Union contract and renewal of health insurance programs. Thus Foss is under pressure to maintain its energy costs such that it remains competitive. Foss has indicated that if it were required to take transportation service under Northern's tariff rates, the savings it has achieved from a variety of improvement efforts made to remain competitive with companies from Mexico and China, as well as southern states would be lost and it would have to seriously consider other options.

Q. Does Northern know whether Foss has taken steps to reduce its energy consumption?

A. Foss's letter of January 17, 2012 (Schedule NU-1-7) states that since acquiring the company out of bankruptcy in 2006 the owners have invested heavily in equipment and process improvements, many of which have been undertaken to reduce energy consumption. As has been referenced in earlier filings, Foss has replaced light fixtures and added motion sensors, projects that it has funded on its own because it produces its own electricity and thus is not eligible for any electric utility rebates for fixture appliances. Foss also used an outside engineering firm to identify energy saving projects throughout the factory that have significantly reduced costs. In December 2009, the Business Finance Authority secured funding in the amount of [redacted] to address three

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(3) of these projects which consist of motor upgrades which have saved significant amounts annually.

Q. Has Northern evaluated whether the Customer continues to have viable fuel switching options?

A. Yes. Foss has the capability of utilizing No. 2 oil and natural gas at its facilities which include process ovens, boilers for heat and process, a 5.3 megawatt cogeneration turbine and a 3.5 megawatt reciprocating engine for cogeneration. Foss has on-site fuel storage capability for 50,000 gallons of No. 2 oil. Foss decides which fuels to burn based primarily on price. Although Foss clearly has the ability to displace its natural gas consumption with an alternate fuel, at the present time, that option does not appear to be economically viable because the current price of the alternate fuel is higher than natural gas.

Q. Based on your analysis, do you have an opinion as to whether extending the Special Contract for five additional years is just and consistent with the public interest?

A. Yes. I believe that Foss's situation continues to present special circumstances which render departure from Northern's tariff rates and conditions to be just and consistent with the public interest. Foss states that it is doing its part to be a successful manufacturer and to preserve jobs that benefit New Hampshire in a challenging business climate that continues to see reduced employment as companies look to move their

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operations elsewhere. Foss states that if they are to pay Northern's tariff rates, its cost savings from recent facility investments would be reduced and Foss would be forced to seriously consider eliminating skilled associate positions. Retaining Foss's load under the Special Contract for five more years provides benefits to Northern and its customers because the annual revenues under the Special Contract exceed Northern's long-run marginal costs of serving this Customer. Thus, retaining Foss as Northern's customer will continue to keep the average system costs of transporting gas applicable to all of Northern's firm customers lower than it would be if Northern were to lose this Customer. In addition, the Special Contract helps Foss to remain competitive and to continue its operations in New Hampshire without layoffs, which contributes to the state's economy.

Q. Does this conclude your testimony?

A. Yes.