STATE OF NEW HAMPSHIRE

Inter-Department Communication

DATE: February 2, 2012
AT (OFFICE): NHPUC

FROM: Robert J. Wyatt RJW
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SUBJECT: DG 12-031
Northern Utilities, Inc.
Petition for Approval of 5th Amendment to the Special Contract with Foss Manufacturing Company

TO: Commissioners
Docket File
Service List

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BACKGROUND

On January 26, 2012, the petitioner, Northern Utilities, Inc. (Northern or Company), filed with the New Hampshire Public Utilities Commission (Commission) a petition for approval of a fifth amendment to its special contract with Foss Manufacturing Company (Foss). The Fifth Amendment seeks to extend the current agreement for an additional five years. The special contract covers firm transportation (delivery) service for Foss's specialty fibers and engineered fabrics manufacturing facility at 380 Lafayette Road in Hampton, New Hampshire. Foss is the second largest firm located in Northern's New Hampshire division, and an important employer in the seacoast area.

Northern initially provided sales service to Foss on an interruptible basis beginning in 1988 and has been serving Foss under a special contract for firm (year-round) delivery service since late 1999. *See Northern Utilities, Inc.*, Order No. 23,381 (Jan. 6, 2000). As a condition of its final approval, the initial special contract was amended to limit the term to five years, removing the contract language that would have allowed for continuance of the agreement beyond the five-year term for successive one-year periods. In its place, the amended contract required the parties to get approval from the New Hampshire Public Utilities Commission for any extension of the term beyond the initial term of five years. The first expiration of the special contract took place in 2005, and the special contract was extended for five years, by means of a Second Amendment which was subject to Commission approval. Commission Staff concluded that the rates contained in the original contract should be increased. Northern and Foss negotiated a Third Amendment to address Staff's concerns related to the transportation rates to be charged by Northern to Foss under the extended special contract. The Commission then approved both the Second and Third Amendments of the agreement. *See Northern Utilities, Inc.*, Order No. 24,478 (July 1, 2005). On February 16, 2010 Northern and Foss negotiated a Fourth Amendment to extend the Agreement for an additional two years. Again, this Fourth Amendment was subject to Commission approval. The Commission approved the Fourth Amendment to the Special Contract in Order No. 25,085, issued on March 25, 2010. The special contract, as extended, is set to expire on February 29, 2012. On January 26, 2012, Northern filed a petition requesting approval for a Fifth Amendment to the Special Contract that would extend the term of the special contract for five more years in order to allow Foss to have its long-term energy needs met in an economic and stable fashion.

In the context of this request for an extended term, Foss informed Northern that if it is unable to negotiate an acceptable new special contract with Northern for delivery service it need to seriously consider other option in order to remain competitive with companies from Mexico and China, as well as others located in southern states in the U.S. Foss competes with other manufacturing facilities that in many cases experience lower energy, raw materials and labor costs, located throughout the global economy.

Included with Northern's petition is testimony of Michael Smith, Manager, Business Services, Northern Utilities; a copy of the letter, dated January 17, 2012 from Foss explaining why it is necessary to request the term extension; a copy of the original agreement, with approved and proposed amendments; and a marginal cost analysis update. Mr. Smith notes 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 the revenues from the special contract have exceeded its marginal costs and will continue to do so during the five-year extension.

STAFF INVESTIGATION

Staff reviewed the file from the previous amendment to this special contract in DG 10-034. Staff also referred to the initial Foss special contract approval in Docket No. DG 99-171.

As noted earlier, the first amendment to the special contract limited its initial term to five years and the second amendment to the agreement extended the term for an additional five years while at the same time the third amendment, relating to Staff's preference for means to include rate increases were approved. The fourth amendment to the agreement extended the term for an additional two years, through February 29, 2012 was approved. The fifth amendment, as filed in this petition, extends the term for an additional five-years, through February 28, 2017 and is subject to Commission approval.

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 five years and allows Foss to continue operating its New Hampshire facility in a globally competitive environment.

Beginning on page 10 of Mr. Smith's testimony he explains how Northern provided updated marginal costs using the results from two separate marginal cost studies. First, in supporting Schedule 9, page 1, Northern uses the most recent "approved" marginal cost study, developed in the unbundling docket in DG 00-046 and updated by escalating the prior period marginal costs to current dollars. Additionally, in Schedule 9, page 2, Northern uses the most recently revised marginal cost study from its current base rate filing in DG 11-069, which was then updated to current dollars by escalating the 2010 test year result to 2011. On page 11 of Mr. Smith's testimony, he notes the results from the 2011 marginal cost analysis are the most recent and relevant marginal cost study. Although the base rate case is still pending, he believes the results from this study should be used as the costs are more relevant to use on a going-forward basis than those of the prior study.

The Northern study shows that the projected special contract delivery rates exceed long run marginal cost results based on either of the marginal cost studies. The special contract delivery rates produce revenue in excess of the cost to serve the Foss load, therefore retaining Foss as a customer will generate additional revenue and reduce the amount of revenue requirement to be recovered from other customers in future rate proceedings. Because the terms of the special contract have been in place for the past twelve 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. 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 investment.

The Company reports that this Foss facility continues to be in direct competition with companies located both domestically and globally. In the letter attached in Schedule NU-1-7, Foss explains that over the past one and one half years it has made substantial investments to replace less efficient manufacturing equipment with much more efficient machinery in order to keep its New Hampshire facility competitive.

STAFF ANALYSIS

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

- Northern has updated its most recent marginal cost study and demonstrates that the *long run marginal cost* to serve this customer for the next five years is less than the special contract rates. Based on current rates, 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 the marginal costs. Staff collected the CPI-U and GDP-IPD factors from the Bureau of Labor Statistics and the Bureau of Economic Analysis web pages and performed its own inflation escalation rate and marginal cost calculations as a check on the Company's numbers. Staff determined that the rates were adjusted correctly and confirmed that the special contract rates continue to exceed Northern's marginal costs, whether starting with escalated marginal cost study results from the marginal cost study used in 2000, or using escalated marginal costs from the updated marginal cost study in Company's current base rate filing in DG 11-069. The downloaded GDP data Staff incorporated into its analysis reflected a slight variance beginning in year 2003 compared to the data used by the Company in its analysis. Staff believes its analyses uses the correct GDPLEV data for the annual marginal cost escalation factors and the results supported the Company's conclusions that the annual rate adjustments have remained higher than Northern's marginal costs.

- There will be no additional costs to Northern or its customers resulting from the extension of the term of this agreement. The special contract rate inflation escalator provides a level of assurance that the rate will continue to exceed the marginal cost to serve this customer over the term of the contract. The contract also provides that in no event shall fluctuations in the CPI-U reduce the special contract rates below the then current rates. In order to ensure that is the case before allowing the self-executing extensions to commence, Northern should file an updated analysis with the Commission seven (7) months prior to the first annual self-executing agreement. If circumstances have changed over the course of the five year extension such that the continuation of the terms of the agreement would be detrimental to the public interest, Northern would have the opportunity to terminate or revise the terms of the contract at that time.

- Northern's firm ratepayers have benefitted from the revenue associated with the 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 it firm customers will continue to benefit from the 'Minimum Annual Payment Obligation' of the special contract that guarantee a certain level of revenues and encourages Foss to run its Hampton facility at a high rate of production. A higher rate of production benefits the local economy and generates additional revenues for Northern through the Foss contract.

- The term extension of this fifth amendment to the agreement is scheduled to begin on March 1, 2012 and will remain in effect until at February 28, 2017.

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

- The extension of the special contract between Northern and Foss is also in the general public interest, in that it will enhance Foss's ability to secure economic energy supply for a major New Hampshire industrial facility with nearly 400 full-time employees.

STAFF RECOMMENDATIONS

- That the Commission approve the Northern petition requesting a five-year extension of the special contract with Foss.

- That Northern inform the Commission (via letters filed in this docket) of inflation-related special contract rate adjustments (made pursuant to the existing terms of the special contract with Foss) when such adjustments are made. Support for the adjustments should include updated schedules in a format similar to what is currently being used by the Company. The template used to update GDP factors for calculating marginal cost components and CPI-U factors to adjust the rate components will be provided to the Company by Staff. Staff reserves the right to modify its recommendation if any actual rate adjustment is significantly different than the warranted adjustment.