# STATE OF NEW HAMPSHIRE

# PUBLIC UTITITIES COMMISSION

**DG 14-155**

**In the Matter of:**
**Iberdrola USA Enterprises, Inc. and Liberty Utilities (EnergyNorth Natural Gas) Corp.**
**Joint Petition for Approval of Stock Acquisition**

**Direct Testimony**

**of**

**Stephen P. Frink**
**Assistant Director – Gas & Water Division**

**September 25, 2014**

**New Hampshire Public Utilities Commission**

**Iberdrola USA Enterprises, Inc. &**
**Liberty Utilities (EnergyNorth Natural Gas) Corp.**

**Joint Petition for Approval of Stock Acquisitions**

**DG 14-155**

**Testimony of**
**Stephen P. Frink**

**Q. Please state your name, occupation and business address.**

A. My name is Stephen P. Frink and I am employed by the New Hampshire Public Utilities Commission (Commission) as Assistant Director of the Gas & Water Division. My business address is 21 S. Fruit Street, Suite 10, Concord, New Hampshire 03301.

**Q. Please summarize your educational and professional experience.**

A. I have a Bachelor of Arts degree and a Master of Business Administration from the University of New Hampshire. I attended and completed Depreciation Programs, Inc. at Grand Rapids, Michigan, in 1992, 1993, 1994 and am a member in good standing of the Society of Depreciation Professionals since 1994. Prior to joining the Commission in 1990 I worked as an Auditor for Dallas County and Schenley Industries (3 years) and as a Budget/Financial Analyst for the cities of Dallas and Austin, Texas (4 years). I joined the Commission in 1990 and have held the following positions: Auditor, Analyst, Sr. Analyst and, since 2001, my current position as Assistant Director.

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

A. The purpose of my testimony is to describe Staff's concerns regarding customer bill impacts related to the proposed acquisition of New Hampshire Gas Corporation (NHGC) by Liberty Utilities (EnergyNorth Natural Gas) Corporation (Liberty), and to explain how the proposed acquisition as filed fails to meet the "no net harm" standard.

**Q. Does Staff have concerns regarding utility operations and safety under the proposed transfer of ownership?**

**A.** Yes. The testimony of Randall Knepper, Director of the Safety Division, describes Staff's concerns regarding utility operations and safety under the proposed transfer of ownership.

**Q. What is the "no net harm" standard?**

**A.** Traditionally the Commission has approved transfers of ownership where the utility customers were not expected to see degradation in services, safety, and reliability, or rate increases under the new ownership beyond what could reasonably be expected under the pre-transfer ownership.

**Q. What considerations should be taken into account in assessing this transaction under the "no net harm" standard?**

**A.** The expected cost/benefits and services to both Liberty and NHGC should be considered on a 'stand-alone' basis. In other words, what is the impact on Liberty customers if it acquires NHGC and what is the impact on NHGC customers if acquired by Liberty?

**Q. Please describe the acquisition proposal contained in the Joint Petition.**

**A.** The petition seeks approval for the acquisition of NHGC by Liberty through Liberty's purchase of 100 percent of the common stock of the company from Iberdrola USA Enterprises, Inc. (Iberdrola). Upon consummation of the stock transfer NHGC will be merged into Liberty and will cease to exist as a separate legal entity.

**Q. Does the transfer price include an acquisition premium?**

**A.** Yes. Liberty's purchase price of $3 million is $289,000 or 11.6%, over the NHGC book value as of December 31, 2013.

**Q. Does Liberty intend to seek recovery of the acquisition premium and any transaction or transition costs related to the acquisition?**

A. Liberty does not intend to seek recovery of the acquisition premium, transaction costs, or transition costs, as defined by Liberty, related to the acquisition.

## NHGC History

**Q. Please provide a brief history of NHGC.**

A. The Keene distribution system dates back to 1860 when Keene Gas Light Co. was incorporated for the manufacture, distribution, and sale of gas for the purpose of lighting. In 1901 the company became known as Keene Gas and Electric Co. and was purchased in 1929 by Public Service Co. of New Hampshire, an electric utility. In 1946 the Gas Division was sold to Gas Service, Inc. of Nashua and in 1979 Mr. Sheldon acquired the Keene utility.

At the 1997 Keene Gas Corporation (KGC) summer cost of gas hearing (Docket DR 97-060), Mr. Sheldon, President of KGC, testified that the utility had been subsidized by its affiliated propane company and there was a possibility that the utility could be shut down if the unregulated propane company were sold.

On June 23, 1997 the propane company was sold and the Commission opened an investigation into the operations and management of KGC (Docket DE 97-149). On March 11, 1998 the procedural schedule was suspended upon notice by KGC that sale of the utility was imminent.

On July 7, 1998, KGC and New York State Electric & Gas Corporation (NYSEG) filed a joint petition to transfer KGC's utility franchise and distribution properties to NHGC, both of which were wholly owned subsidiaries of Energy East Enterprises (Docket DG 98-

123). Order No. 23,017 (Sept. 14, 1998) approved the transfer and, pursuant to the approved Asset Purchase Agreement, KGC retained its propane-air manufacturing operations and property and entered into an Operating and Propane-air Sales Agreement (Supply Agreement) with NHGC. The Supply agreement required KGC to continue manufacturing propane air for NHGC until such time as NHGC built its own propane-air plant, liquefied natural gas (LNG) plant or NHGC interconnected with a natural gas pipeline. In that proceeding, the president of KGC testified that there were certain contamination issues associated with the property and NYSEG had no desire to own or operate the property and thereby expose itself to any environmental liabilities. Therefore, KGC would own and operate the property for an indefinite period but expected NHGC to construct an alternate manufacturing facility and KGC would cease business operations when that facility went into service.

When NYSEG purchased Keene Gas in 1998 it had plans to bring natural gas to Keene within 3-5 years. NYSEG did not believe the system could be profitable over the long term without natural gas. At that time there was a pipeline venture in Vermont under consideration that would have enabled NYSEG to bring natural gas to Keene. The pipeline venture fell through and NYSEG/NHGC purchased land to build an LNG plant with an in-service date of November 2002. In 2001 NYSEG determined that it would not be able to recoup the cost of the new plant and instead upgraded the existing plant. In 2003 NHGC filed for a rate increase (Docket DG 02-003), with a proposed increase for less than NHGC would have been entitled to under traditional ratemaking with the increase to be phased in over three years in an effort to minimize customer losses and retain existing customers.

On August 2, 2007, Iberdrola, S.A., an international utility and energy company headquartered in Spain, filed for approval to acquire Energy East Corporation, which would result in NHGC becoming a wholly owned indirect subsidiary of Iberdrola (Docket DG 07-083). Order No. 24,812 (Dec. 28, 2007) approved a Settlement on Iberdrola's acquisition. The approved Settlement required NHGC to provide a feasibility study for siting an LNG plant in Keene as part of its next rate case. In 2009 NHGC filed a rate case (Docket DG 09-038) which included the feasibility study which estimated the cost to build an LNG plant to be approximately $5 million and determined that the resulting rate impact would be prohibitive for a utility with only 1,100 customers. The Settlement provided for a three year phase in of the approved rate increase, intended to limit the bill impacts in an effort to retain existing customers.

In March 2012, Keene Propane Corporation (previously known as KGC) sued NHGC and NYSEG seeking, among other relief, a declaration that the Supply Agreement was no longer valid. In 2014 a settlement was reached whereby KGC received a substantial one-time payment and NHGC and KGC entered into an amended Supply Agreement with a term of 12 years and one year options for an additional 3 years.

**<u>2013 Utility Operations & Earnings</u>**

**Q. Please summarize Liberty's 2013 operations and earnings.**

**A.** Liberty is the largest natural gas utility in New Hampshire serving approximately 90,000 customers along the I93 corridor up to Concord and extends to Laconia; Liberty also serves the city of Berlin. In 2013 Liberty's revenue was $138 million, operating expenses were $128 million, and net operating income was $9 million. As of December 31, 2013, Liberty's rate of return was 5.2% on rate base of $174 million.[1]

In 2013 Liberty reported therm sales of 158 million and usage of 169 million therms (includes interstate pipeline retention, company use and unaccounted for). Usage consumed 167 million therms of natural gas, 1.2 million therms for Liquid Natural Gas (LNG), and 0.5 million therms of Liquid Propane Gas (LPG or propane). In 2013 Liberty's gas supply cost was $82 million.[2]

**Q. Please summarize NHGC's 2013 operations and earnings.**

**A.** NHC is a propane air utility serving approximately 1,200 customers in Keene. In 2013 NHGC's revenue was $ 3.8 million, operating expenses were $4 million, and adjusted net utility operating income was $158,000. As of December 31, 2013, Liberty's rate of return was 7.0% on rate base of $2.25 million.

In 2013 NHGC reported therm sales of 1.35 million and LPG usage of 1.4 million therms (includes company use and unaccounted for). In 2013 NHGC propane cost was $2 million. [3]

**Areas of Concern**

**Q. How does the proposed acquisition differ from the last two changes in ownership of the Keene utility?**

**A.** Unlike the previous two changes this time the acquiring company is another New Hampshire utility and the transfer is expected to impact both NHGC and Liberty's rates. Therefore, the impact on both the Liberty and NHGC must be considered when determining if the

[1] Liberty ROR report for December 31, 2013 (Puc Form F-1).
[2] Liberty 2013 Annual Report (Puc Form F-16).

acquisition results in no net harm.

**Q. Please summarize how the proposed acquisition will impact Liberty's operations?**

A. The acquisition of NHGC should have little impact on Liberty's operations, as Liberty intends to retain the existing NHGC employees that currently perform all NHGC plant and field operations, including leak response, meter reading, and collections. Liberty will be performing back office services for NHGC, such as engineering, accounting, regulatory and other administrative and general functions, but the normal utility operations work will continue to be performed by NHGC personnel. Mr. Knepper's testimony addresses this in greater detail.

**Q. How does the proposed acquisition impact NHGC's operations?**

A. In the short term the acquisition should have little impact on NHGC's operations as existing NHGC employees will be retained and continue to operate the supply plant and perform field operations. Many of the back office operations that Liberty will be providing are currently being performed by NYSEG under an affiliate agreement.

**Q. If Liberty and NHGC operations are not impacted by the acquisition, what are Staff's concerns regarding the acquisition?**

A. NHGC and Liberty have different operating standards and different operating and supply costs. What may be an appropriate operating standard for Liberty may not be appropriate for Keene, and vice versa. The Keene service territory is very limited and therefore can be much more easily monitored locally and issues quickly addressed. Liberty covers a large geographical area and there are benefits to having a more automated system because the distance from operations centers to various points on the distribution system can be

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[3] NHGC 2013 Annual Report (Puc Form F-16) and Liberty response to Staff DR 1-10.

substantial. Being able to access system information on the job can save Liberty crews time and money, whereas in Keene there would be very little, if any, savings associated with having that capability. For the same reason an automated meter reading makes sense for Liberty as it would be prohibitively expensive to manually read 90,000 gas meters. NHGC is able to manually read its 1,200 meters in a relatively short period, while at the same time operating the supply plant and maintaining the distribution system.

**Q. Please give an example of how Keene could be harmed if the Liberty operating standards were implemented in the NHGC service territory.**

A. Emergency response would be one example. If someone in Keene calls in to report a gas leak NHGC personnel respond within 30 minutes, whereas in Liberty's service territory the utility has up to an hour to respond. Mr. Knepper's testimony explains Staff's concerns regarding this and other instances where there could be service degradation if the Liberty operating standards were implemented in the NHGC service territory.

**Q. How might the differences in operating costs impact Liberty and NHGC customers?**

A. Even though NHGC has higher delivery rates, due primarily to its small customer base and limited growth opportunities, NHGC has lower operating costs. The difference in operating costs can be seen in the cost of installing mains and services on the two systems in 2013, as seen below on Table 1:

| Average Cost per Foot | | |
|---|---|---|
| | Liberty | NHGC |
| Mains - new | $83 | N/A |
| Mains - Replacement | $165 | $24 |
| Services - new | $3,303 | $1,730 |
| Services - replacment | $2,559 | $1,650 |

Table 1

When calculating customer contributions in aid of construction (CIAC) the average cost to install mains and services is used. Liberty is expecting significant growth on the NHGC system if the acquisition is approved and CIAC requirements are likely to be much higher for new customers on the Keene system under Liberty.

Although NHGC's operating costs may be lower than Liberty's, Liberty's ratepayers may see a rate increase if NHGC is charged Liberty's delivery rates. As already noted, NHGC delivery rates are higher than Liberty's due to those costs being spread over a much smaller customer base. Charging NHGC customers the Liberty delivery rates means that Keene customers will no longer be paying all of the operating costs associated with serving Keene. That is particularly true under the rate plan presented in Mr. Hall's testimony that would defer the under recovery from NHGC transitioning to Liberty's delivery rates and Liberty would then recover the shortfall, with carrying costs, from customers in a future rate proceeding.

**Q. What would the rate impact be on NHGC customers if Liberty delivery rates were adopted?**

**A.** A typical NHGC residential heating customer paying the delivery rates proposed by Liberty in DG 14-180, including both the proposed permanent and step adjustment, would see a 16 percent decrease in annual bills, as total costs would drop from $1,934 to $1,604. ***See Attachment SPF-1, p. 1 of 3.***

**Q. What would the rate impact be on NHGC customers if Liberty cost of gas rate (COG) and local distribution adjustment charge (LDAC) were adopted?**

**A.** A typical NHGC residential heating customer paying the Liberty COG and LDAC rates would see a 17 percent decrease in annual bills, as total costs would drop from $1,934 to $1,600. ***See Attachment SPF-1, p. 2 of 3.***

**Q. What would the combined rate impact of NHGC paying Liberty rates for all charges?**

**A.** A typical NHGC residential heating customer paying the Liberty proposed tariff rates would see a 36 percent decrease in annual bills, as total costs would drop from $1,934 to $1,243. *See Attachment SPF-1, p. 3 of 3.*

**Q. Could NHGC customer savings be greater than anticipated?**

**A.** Yes. The current NHGC rates do not reflect the cost of the settlement reached with KGC for which NHGC intends to request recovery if the acquisition is not approved. If settlement costs were reflected in the NHGC rates, the NHGC customer savings resulting from the acquisition would be greater than reflected in the bill impact analysis. If the acquisition is approved, those settlement costs will not be passed on to Liberty. While a petition by NHGC for recovery of those costs does not ensure recovery, approval of the acquisition would ensure that those costs will not be recovered from ratepayers.

Liberty believes the NHGC cost of gas rate would be less if the acquisition is approved, due in large part to Liberty's substantial propane storage facilities which will be available to serve NHGC, and NHGC customers will realize savings on both the delivery and supply portions of the bill.

**Q. What would the rate impact be on Liberty customers if NHGC is acquired and charged Liberty's delivery rates?**

**A.** Liberty estimated that if NHGC customers were charged Liberty's delivery rates the overall Liberty rate level would increase by approximately $750,000, or 0.6 percent. Based on the NHGC bill impact analysis in Attachment SPF-1, it can be assumed that the overall Liberty rate level increase when factoring in the supply costs, would be at least 1.2 percent. (OCA DR 1-15)

**Q. Could the negative impact on Liberty's customers be greater than anticipated?**

A. Yes. Liberty has suggested it will invest over $200,000 to install an automated meter reading system in Keene and over $300,000 to integrate NHGC into the Liberty Consumer Information Systems. In total, Liberty expects to make $650,000 of capital investments to serve NHGC, costs that were not factored into the Liberty bill impact analysis. (Tech DR 1-1). As is the case with NHGC/KGC settlement costs, recovery of those costs are subject to Commission approval and Liberty would have to demonstrate that the costs were reasonable and prudent.

Liberty's cost of gas rate could increase if the acquisition were approved because rental payments from Liberty's lease of propane storage or propane supplies that could be dispatched in place of more expensive supplies may no longer be available to serve the Liberty customers.

**Q. Is there a difference in Liberty and NHGC supply costs?**

A. Liberty is a natural gas utility and NHGC is a propane air utility, the supply sources and costs are very different. Liberty does use a small amount of LNG and LPG for peak shaving but natural gas delivered via pipeline made up 99% of 2013 energy usage. NHGC only uses propane which is trucked into Keene and mixed with air at the KGC plant for distribution through the NHGC distribution system. The difference in cost is evident in the average per therm cost of gas for Liberty and NHGC over the past year and forecasted for this winter, as seen below in Table 2.

| Average per Therm COG Rates | | | |
|---|---|---|---|
| | Liberty | NHGC | Difference |
| Winter 2013-14 | 1.1068 | 2.0092 | 0.9024 |
| Summer 2014 | 1.0871 | 1.5299 | 0.4428 |
| Winter 2014-15 | 1.2225 | 1.7069 | 0.4844 |

Table 2

**Q. How will NHGC supply costs be impacted by the acquisition?**

**A.** As previously noted, NHGC supply costs are likely to decrease under Liberty. NHGC will be able to utilize some of Liberty's propane storage capacity that would allow it to make additional purchases during the summer months. This provides NHGC with multiple benefits, including: 1) improved year-round allocations from a regional propane terminal such as Selkirk, resulting in less wait-time penalty charges by its trucking service provider; 2) lower summer-priced propane in storage tanks located within 40 miles of its operations for use during winter-period propane terminal supply restrictions; 3) incremental storage that would contribute to the Company being in compliance with the Commission's seven-day storage requirement; and 4) less exposure to spot market purchases during periods of highest price volatility. Liberty estimates that NHGC would have saved over $300,000 on its 2013-14 propane costs of $2.2 million if Liberty's 300,000 gallons of propane storage had been available to NHGC.

**Q. How will Liberty supply costs be impacted by the acquisition?**

**A.** The propane storage that Liberty would use to serve NHGC is storage capacity that had been leased to an unregulated propane company in prior years. Over the past five years the lease generated annual revenue of $55,000 (Staff DR 2-4). Assigning that storage capacity to NHGC eliminates rental revenues that could be used to offset Liberty's supply costs or the opportunity for Liberty to displace more expensive winter supplies with propane if economic to do so.

**Q. Liberty has suggested that NHGC customers could see substantial savings if the Keene system were converted to natural gas, would you please comment on that?**

A. A number of entities, including the current owners, have considered building an LNG plant to serve Keene but to date none have brought a viable plan forward to do so. Liberty's plans to bring natural gas to Keene as provided in testimony and explored further though the discovery process are highly speculative and lack specifics. The supply savings would have to be substantial to offset the capital costs associated with building an LNG plant, and the existing customer base is insufficient to support such an investment. Staff does appreciate Liberty's willingness to pursue other supply sources for Keene in an effort to produce customer savings and growth.

**Q. Are there other benefits identified in the filing that you would like to comment on?**

A. Yes, Liberty testified that NHGC would benefit from access to natural gas energy efficiency measures and a reduction in regulatory costs.

**Q. Does Staff agree the NHGC customers will benefit from having access to natural gas energy efficiency programs?**

A. No. NHGC customers already have access to energy efficiency measures through their electric utility and will now be paying an additional charge with little or no new benefits. It is also possible that the energy efficiency measures unique to natural gas customers may not be applicable on a propane air system.

**Q. Does Staff agree that the acquisition will reduce regulatory costs for both the utility and commission?**

A. Possibly, but any regulatory costs savings would be negligible. NHGC's 2013 regulatory expense was under $15,000. In cost of gas proceedings the NHGC witness participates by video, *pro se*, and the case expenses approved for recovery in NHGC last rate case (Docket DG 09-038) was only $27,442.

## Acquisition Benefits

**Q. What are some of the benefits you expect if Liberty acquires NHGC.**

A. Four benefits I see are: i) NHGC customers will not have to pay the costs incurred to settle the KGC law suit; ii) supply cost to serve NHGC should be lower and more stable under Liberty, as Liberty has propane storage capacity available to serve NHGC; iii) affiliate charges from the current owner of approximately $200,000 per year will now be provided by Liberty or its affiliate companies; and, iv) Liberty has shown a willingness to pursue various energy projects intended to bring natural gas to Keene, a potentially less costly and cleaner alternative to propane.

## Conclusion and Recommendation

**Q. Will the Liberty customers see a rate increase if the acquisition is approved and NHGC customers paid the Liberty tariff?**

A. Yes, Liberty ratepayers will see higher rates as a result of the proposed ownership transfer because the cost to serve Keene will be recovered from all customers (Liberty and NHGC). Liberty anticipates a $750,000, or 0.6 percent, increase based on the change in delivery rates. The analysis does not include the rate impact of the additional $650,000 of capital improvements related to the NHGC acquisition that Liberty does not consider transition costs and intends to seek recovery of. The analysis also does not include the bill impact of including NHGC's propane costs in the Liberty cost of gas rate to be borne by all customers. The bill impact does not include $85,000 of one-time expenses for items such as mapping and training (Tech DR 1-1). The cost of propane is significantly higher than natural gas and will increase Liberty's cost of gas rate. While NHGC sales will cover some of those costs, NHGC sales made up less than 1% of the 2013 combined Liberty and NHGC sales.

**Q. Will NHGC customers see a rate decrease if the acquisition is approved?**

A. Yes, NHGC customers will be paying significantly lower rates for both delivery and supply if the change in ownership is approved and Liberty's rate plan implemented, a typical residential heating customer will save almost $700 a year, or 36 percent.

**Q. Please summarize your recommendation.**

A. For the reasons stated above and as presented in Mr. Knepper testimony, the proposed change in ownership fails the 'no net harm test' and the Commission should deny the petition. The proposed acquisition and Liberty's rate plan is extremely beneficial to NHGC but detrimental to the Liberty's customers given the amount of costs to be shifted from the NHGC costumers to the Liberty customers. Of particular concern is Liberty's intention to charge the NHGC propane air customers a natural gas supply rate, given the large discrepancy in cost of natural gas and propane.

**Q. Does that conclude your testimony?**

A. Yes.