STATE OF NEW HAMPSHIRE

Inter-Department Communication

DATE: January 6, 2015
AT (OFFICE): NHPUC

FROM: Stephen P. Frink SPF
Assistant Director, Gas & Water Division

SUBJECT: Northern Utilities, Inc. – Supply Related Capacity Cost Allocation between New Hampshire and Maine Divisions
Request for Investigation into the Cost Allocation Methodology

TO: Commissioners
Northern Utilities, Inc.
Office of the Consumer Advocate

Summary

Staff recommends that the Commission open a docket, pursuant to RSA 374:4 and 374:7, to investigate whether the current cost allocation methodology used by Northern Utilities, Inc. (Northern) to assign supply costs to its Maine and New Hampshire Divisions achieves the "just and reasonable" ratemaking standard required under RSA 378:7. Staff further recommends prospectively: if the Commission finds the current methodology, in its design and/or execution, not adequate, the Commission should establish a cost allocation methodology that will satisfy the standard or require Northern to maintain a gas supply portfolio to serve New Hampshire on a stand-alone basis. Staff also recommends that the Commission employ an outside consultant with extensive gas supply planning and cost allocation experience to assist in the investigation.

Background

Northern maintains a single gas supply portfolio for its Maine and New Hampshire operations, and uses a Modified Proportional Responsibility (MPR) allocation methodology to assign supply-related capacity costs to the Maine and New Hampshire Divisions. As described in Northern's 2014-15 Winter Cost of Gas filing, the MPR methodology allocates fixed capacity-related gas costs to the Maine and New Hampshire Divisions in a two-step process: (1) capacity-related cost, by resource type (pipeline, storage and peaking) are allocated to calendar months by application of MPR allocation factors, and (2) the capacity related costs allocated to each month are allocated to the Maine and New Hampshire Divisions based on the relative shares of Design Year demand in that month.[1]

[1] Docket No. DG 14-239, Exhibit 1, Prefiled Testimony of Christopher A. Kahl, pages 4-7.

Northern's use of Proportional Responsibility Allocators to assign supply-related capacity costs between Maine and New Hampshire was first approved in 1995[2] and modified in 2006[3] when the Commission determined that it no longer achieved the "just and reasonable" ratemaking standard due to differences in the cost recovery policies in Maine and New Hampshire.

In Northern's 2014-15 Winter Cost of Gas proceeding, Staff expressed concerns that New Hampshire ratepayers may be paying excess costs due to the Maine capacity assignment requirements. In that proceeding, Northern provided a copy of its filing with the Maine Commission (MPUC Docket No. 2014-00132) in which Northern proposed changes in its Maine retail choice program. In its filing, Northern states that the Maine capacity assignment rules produce a misalignment between costs and benefits which, among other things, results in an inconsistency between cost causation and cost allocation. The filing goes on to say that under the existing rules, the prices charged to suppliers for capacity and related Company-managed supply are not equal to the cost of service, which imposes unnecessary price risk on the Company's sales service customers.[4] Stated more bluntly, Maine third party suppliers benefit at expense of Maine and New Hampshire sales service customers.

Recommendation

Staff recommends that the Commission open an investigative docket, pursuant to RSA 374:4 and 374:7, to investigate if the current cost allocation methodology that Northern uses to assign supply costs to the Maine and New Hampshire Divisions achieves the "just and reasonable" ratemaking standard required under RSA 378:7 for New Hampshire Division customers.

The investigation should analyze the cost/benefit aspects of Northern maintaining a single supply portfolio to serve the two Divisions against the cost of maintaining two discrete supply portfolios to serve each Division on a stand-alone basis.

The supply costs charged to each Division under the MPR allocation methodology should be compared to what supply costs would be for each division if discrete supply portfolios were maintained. That analysis would then be used to determine if the MPR allocation methodology results in a fair and equitable sharing of the cost/benefit of maintaining a single supply portfolio.

If the MPR allocation methodology does not produce a fair and equitable sharing of the cost/benefit, through either errors of design or errors of implementation, or both, alternative cost allocation methodologies should be explored in order to achieve a more equitable sharing. The investigation should also explore whether New Hampshire ratepayers would be better served if Northern were to maintain a supply portfolio to serve New Hampshire on a stand-alone basis.

---

[2] Docket No. DR 95-257 by Order No. 21,882 (October 30, 1995).
[3] Docket No. DG 05-080 by Order No. 24,627 (June 1, 2006).
[4] Docket No. DG 14-239, Exhibit 8 Part 1, p. 7-8 of 286.

Cost allocation methodologies should also be evaluated on the extent to which they protect against cost shifting between Divisions in the event of future policy changes. To the fullest extent possible, New Hampshire customers should not be placed at risk for the policy decisions made outside of our State.

Staff also recommends that the Commission employ an outside consultant, under Staff's general direction pursuant to RSA 363:30, VII, with extensive gas supply purchasing and cost allocation experience to assist in the investigation. Such experience would be invaluable in determining the most cost-effective and reliable supply portfolio model to be applied for the Northern system Divisions, engaging in an accounting review of Northern's accuracy in implementing the existing model, and in determining how best to resolve any inequities that may currently exist.