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STATE OF NEW HAMPSHIRE

Inter-Department Communication

DATE: October 23, 2019
AT (OFFICE): NHPUC

FROM: Al-Azad Iqbal
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SUBJECT: DG 19-152
Northern Utilities, Inc.
Petition for Approval of 4th Amendment
to the Special Contract with National Gypsum

TO: Commissioners
Docket File
Service List

SUMMARY OF STAFF RECOMMENDATION

The Fourth Amendment to the Special Contract between Northern and National Gypsum should be approved. Northern's ratepayers have benefitted, and will continue to benefit, from the revenue associated with the special contract. The contracted rates produce revenue in excess of the cost to serve the National Gypsum load. National Gypsum has a viable option to bypass Northern and take natural gas service directly from an interstate pipeline; approval of the fourth amendment provides for an additional five years of service and the opportunity for Northern to continue to serve National Gypsum indefinitely.

BACKGROUND

On September 13, 2019, the petitioner, Northern Utilities, Inc. (Northern or Company), filed with the New Hampshire Public Utilities Commission (Commission) a petition for approval of a fourth amendment to its special contract with National Gypsum Company (National Gypsum). The fourth amendment seeks to accomplish two things: 1) extend the current agreement for an additional five years; and 2) provide for up to three one-year automatic extensions. The special contract covers firm transportation (delivery) service for National Gypsum's wallboard manufacturing facility at 1 Succi Drive in Portsmouth, New Hampshire. National Gypsum is a significant firm load in Northern's New Hampshire division.

Northern had been providing delivery service to National Gypsum on an interruptible basis during the 1990-1999 period, and has been serving National Gypsum under a special contract for firm (year-round) delivery service since late 1999. *See Northern Utilities, Inc.*, Order No. 23,314 (Oct. 5, 1999). As a condition of its approval, the initial special contract was amended to limit the term to ten years, and to require the parties to get approval from the New Hampshire Public Utilities Commission for any extension of the term beyond the initial term of ten years. The first expiration of the special contract took place in 2009, and the special contract was extended for two years, by means of a second amendment. *See Northern Utilities, Inc.*, Order No. 25,047 (Nov. 25, 2009). The third amendment extended the agreement for five years with three one-year automatic extension. It also eliminated National Gypsum's obligation to make certain minimum annual payments if its facility in Portsmouth, New Hampshire is permanently closed and ceases to operate. The Commission approved the Third Amendment of Agreement in Order No. 25,306 issued December 22, 2011 in Docket DG 11-231. The special contract, as extended, is set to expire on November 30, 2019. The current petition is to extend the term of the special contract for five more years in order to allow National Gypsum to have its long-term energy needs met in an economic and stable fashion, plus up to three additional years through one-year extensions.

National Gypsum informed Northern that if it is unable to negotiate an extension of its special contract with Northern for delivery service, it will pursue other possible alternatives, such as bypassing Northern's system and constructing a direct connection to an interstate natural gas pipeline located approximately 1.25 miles from the facility. National Gypsum competes directly with another wallboard manufacturing facility located in Newington, New Hampshire, owned by Georgia Pacific. The Georgia Pacific facility has bypassed Northern's system and is connected directly to the interstate natural gas pipeline.

Included with Northern's petition are: testimony of Michael Smith, Manager, Business Services, Northern Utilities; a copy of the letter from National Gypsum requesting the term extension, dated April 30, 2019; 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 National Gypsum facility while at the same time providing benefits for Northern and its other customers. Northern asserts that 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 files from the previous amendments to this special contract in DG 11-231 and DG 09-201. Staff also referred to the initial National Gypsum special contract and the first amendment approved in Docket No. DG 99-123.

As noted earlier, the first amendment to the special contract limited the initial contract term to ten years; the second amendment to the agreement extended the term for an additional two years; the third amendment extended the term for an additional five years with three one-year extensions. The fourth amendment, as filed in this proceeding, also extends the term for an additional five years, after which three self-executing one-year extensions will occur unless either party notifies the other that it intends to opt out.

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 National Gypsum as a firm customer for at least the next five years and allows National Gypsum to continue operating its New Hampshire facility in a competitive environment.

Mr. Smith explains in his testimony that Northern provided updated marginal cost analyses using the results from the most recent marginal cost study from its current base rate filing in DG 17-070, which was then updated to current dollars by escalating the test year result to December 1, 2019. The Northern study shows that the projected special contract delivery rates exceed long-run marginal cost results based on the marginal cost studies. The special contract delivery rates produce revenue in excess of the cost to serve the National Gypsum load. As a result, retaining National Gypsum as a customer will generate additional revenue and reduce the amount of revenue requirement to be recovered from other Northern customers in future rate proceedings. Because the terms and conditions of the special contract have been in place for the past twelve years, and annual revenue generated by National Gypsum under the contract was used in determining the revenue requirement on which current rates are based, extending the contract should permit the Company to achieve 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.

According to Northern, National Gypsum has made significant investments in several projects to reduce energy usage and costs at its Portsmouth facility. Thus, it appears that the facility is continually reviewing its energy consumption patterns and making necessary operational modifications or upgrades to become more efficient and 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 demonstrated 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 that revenues will exceed the 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. If circumstances change 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 National Gypsum 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 will continue to benefit from the 'must take' provisions of the special contract that encourage National Gypsum to run its Portsmouth facility at a high rate of production, which, in turn, results in the use of natural gas at higher volumes. The 'must take' provision will apply unless National Gypsum ceases operations and permanently closes its New Hampshire facility, in which case it will not be liable for the Minimum Annual Payment Obligation.

- The term extension of this fourth amendment to the agreement is scheduled to begin on December 1, 2019, and will remain in effect until at least November 30, 2024, with three successive self-executing one-year extensions if neither party exercises its right to terminate the extension through written notice six months prior to the new contract year.

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

STAFF RECOMMENDATION

Staff recommends:

That the Commission approve the Northern petition requesting a five-year extension, followed by three one-year self-executing extensions of the special contract with National Gypsum, absent either of the parties exercising its annual opt-out provision for the reasons stated above;

That Northern be required to provide the Commission with written notice of actual or impending termination of the special contract, resulting from closure of the facility or written notice prior to the three annual self-executing extensions; and

That Northern be required to file updates of the special contract rate and marginal cost analyses with the Commission seven (7) months prior to the commencement of the first of the three annual self-executing extensions.

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