

STATE OF NEW HAMPSHIRE

Inter-Department Communication

DATE: November 24, 2009

AT (OFFICE): NHPUC

FROM: Robert J. Wyatt *RJW*
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SUBJECT: DG 09-201
Northern Utilities, Inc.
Petition for Approval of a Two-Year Term Extension to the Special Contract
with National Gypsum

TO: Commissioners
Docket File
Service List



BACKGROUND

On October 19, 2009, the petitioner, Northern Utilities, Inc. (Northern or Company), filed with the New Hampshire Public Utilities Commission (Commission) a petition for approval of an extension to its special contract with National Gypsum. The special contract covers firm transportation 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, and an important employer in the Portsmouth area.

Northern had been providing delivery service to National Gypsum on an interruptible basis since 1990, and has been serving National Gypsum and under a special contract for firm (year-round) delivery service for the past ten years. *See Northern Utilities, Inc.*, Order No. 23,341 (Oct. 5, 1999). As a condition of its final 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 special contract is set to expire at the end of November 2009. On October 9, 2009 National Gypsum sent Northern a letter requesting a two-year extension of the special contract. According to that letter, the extension of the special contract term will allow National Gypsum to more thoroughly explore its options going forward.

In the context of this request for an extended term, National Gypsum informed Northern that if it is unable to negotiate an acceptable new special contract with Northern for delivery service it will pursue other possible alternatives, such as: 1) bypassing Northern's system and connecting directly to an interstate natural gas pipeline located 6,700 feet from the facility; or 2) switching to a potentially lower cost bio-mass energy source alternative, such as wood pellets, for its energy requirements. National Gypsum

also noted that its parent company has closed 5 plants around the country due to their high cost structure and inability to compete in their respective regions. In the New Hampshire region and in Northern's territory, National Gypsum competes directly with another wallboard manufacturing facility located in Newington and owned by Georgia Pacific. The Georgia Pacific facility has bypassed Northern's system and is connected directly to the interstate natural gas pipeline. The Georgia Pacific facility, therefore, does not pay Northern's delivery service costs, while National Gypsum incurs those costs, albeit at the discounted special contract rate.

Included with Northern's petition is testimony of Michael Smith, Senior Business Development Executive for Northern; a copy of the letter from National Gypsum requesting the term extension; a copy of the original agreement, with approved and proposed amendments; a letter illustrating the bypass cost estimate; a value of service estimate; 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 the revenues from the special contract have exceeded its marginal costs and will continue to do so during the two-year extension.

STAFF INVESTIGATION

Staff sent out data requests related to the petition, and following a conference call with Northern on November 19, 2009, sent out additional questions. In its investigation of this petition, Staff referred back to DR 91-172, a generic discounted rate docket, and NHPUC Order No. 20,633, 77 NH PUC 650, 654-55 (1992), which identified the types of issues that will be seriously considered with regard to special contracts and discounted rates. Staff also referred to the initial National Gypsum special contract approval in Docket No. DG 99-123. Using the issues identified in NHPUC Order No. 20,663, Staff used the following checklist of issues related to the special contract request:

1. *Finite Term, dependent on circumstances.* As noted earlier, the first amendment to the special contract limited its initial term to ten years. The proposed second amendment to the agreement, as presented with the petition and subject to Commission approval, would extend the term for an additional two years, with an effective date of December 1, 2009.
2. *The contract rate is greater than the long-run marginal cost.* In Mr. Smith's testimony (pg. 7), he explains how the most recent marginal cost study was updated by escalating the prior period marginal costs. According to Northern's analysis, the special contract rates for the two-year extension period exceed the marginal costs to provide service over that period.
3. *The request has been thoroughly scrutinized by the utility.* 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 two years and allows National Gypsum to more thoroughly explore its long-term energy options for this facility. One of the Company's support schedules provides a value of service analysis of the Customer's estimated capital investment to potentially bypass Northern and install its own pipeline to connect to an interstate natural gas pipeline located approximately 6,700 feet from National Gypsum's facility. Another support schedule included an updated marginal cost analysis to serve this facility. Thus, the Company has scrutinized the request, and under its analysis, 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.

4. *The special contract process does not provide the utility an unfair advantage over a competitor.* The Company asserts that it is not obtaining an unfair advantage over a competitor. First, National Gypsum has several existing and potential energy options for this facility, such as the previously mentioned bio-mass, and it has clearly indicated that it has explored, and that it will continue to explore, its energy options. Thus, National Gypsum has alternatives with which Northern may not be able to compete. Second, this facility is already unbundled whereby National Gypsum purchases its gas supply from a third party supplier and contracts only for the firm gas delivery service from Northern. Northern notes that there are no competitors for its delivery service within its service territory, and states that if it had offered natural gas at below market rates, it could possibly have obtained an advantage. Because Northern is not offering a discount on the natural gas costs, and because it has no competitors for the delivery service, it is not gaining an unfair advantage.
5. *The discounted rate will not increase the rates paid by the State of New Hampshire or other customers.* As previously stated, Northern's analysis shows that the special contract delivery rates exceed long run marginal costs. The special contract delivery rates produce revenue in excess of the cost to serve the National Gypsum load and the additional revenue will reduce the amount of revenue requirement to be recovered from other customers in future rate proceedings. Thus, the special contract will not increase others' rates. Also, because the terms of the special contract have been in place for the past ten 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 assist the Company in achieving its approved rate of return.
6. *Prior to requesting a discounted rate, the customer took actions to decrease its consumption and to use its natural gas more efficiently.* The Company reports that this National Gypsum facility is in direct competition with a Georgia Pacific wallboard plant located in nearby Newington. The operations and maintenance costs associated with the Portsmouth plant are also weighed against those of

National Gypsum's other manufacturing facilities, five of which have been closed in recent years because of cost inefficiencies. Over the past five years National Gypsum has replaced all motors over 20 HP to high efficiency motors, upgraded plant lighting, rebuilt its main gas-fired kiln and switched to a high efficiency compressed air system. Thus, this facility is continually reviewing its energy consumption patterns and making necessary operational modifications or upgrades to become more efficient.

7. *The Company is prepared to address requests for discounted rates from other customers that may have similar circumstances.* The Company currently has two special contract customers and will continue to deal with these requests on a customer-specific basis.

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 two 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 subject to the same inflation escalation factors, ensuring revenues will exceed the marginal costs. Staff collected the CPI-U factors from the Bureau of Labor Statistics web page and performed its own inflation escalation rate calculations as a check on the Company's numbers. Staff determined that the rates were correct, and that they continue to exceed Northern's marginal costs.
- There will be no additional costs to Northern or its customers resulting from the two-year extension to the term of this agreement. The special contract rate inflation escalator provides a level of assurance that the rate will continue to be above the marginal cost to serve this customer during the next two years. The contract also provides that in no event shall fluctuations in the CPI-U, such as what is being experienced this year, reduce the special contract rates below the then current rates.
- Northern's firm ratepayers will benefit from the revenue associated with the two year extension of this 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. The LDAC surcharge, applied to all firm customers' rates, is

adjusted effective November 1 of each year and is at a lower cost per therm as a result of this additional firm load from this customer account.

- Northern and its firm customers benefit from the incentives in this 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 term extension of this second amendment to the agreement is scheduled to begin on December 1, 2009 and will remain in effect until November 30, 2011.
- 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 two year extension of the special contract with the National Gypsum.

- Staff requests that consideration for the approval of this special contract two year extension to the term be based on the research and analysis provided and for the reasons stated above.
- Staff notes Northern and its other firm customers benefit from both the large load and the revenue associated with this customer.