STATE OF MAINE
PUBLIC UTILITIES COMMISSION

Docket No. 2004-266

August 18, 2004

NORTHERN UTILITIES, INC.,
Request for Approval of Affiliated Interest Transaction with Granite State Gas Transmission and Bay State Gas Company (Field Services Agreement)

ORDER

WELCH, Chairman; DIAMOND and REISHUS, Commissioners

I. SUMMARY

In this Order, we approve Northern Utilities, Inc.'s (Northern or NU),[1] Field Services Agreement with its affiliates Bay State Gas Company and Granite State Gas Transmission (Agreement) as discussed in further detail below. We also allow Northern to provide services to Granite at fully distributed costs.

II. PROCEDURAL HISTORY

On April 21, 2004, Northern filed for approval *nunc pro tunc* of a Field Services Agreement it proposed to execute with its affiliates, Bay State Gas Company (Bay State) and Granite State Gas Transmission (Granite).[2] The proposed Agreement documents, in writing, an arrangement among the affiliates that was implemented in October 2003. Northern states that the arrangement was necessitated by the sudden removal of a Granite supervisor and other key operations employees for cause. Northern maintains that it delayed seeking MPUC approval for this arrangement to allow it to first review and determine whether the requirements in Federal Energy Regulatory Commission (FERC) Order 2004 regarding affiliate dealings, issued on November 5, 2003, would affect the agreement or require a particular modification of the arrangement. Later, despite lingering questions about FERC compliance, because a number of months had elapsed, Northern decided it should not delay further and filed the Agreement with MPUC.

On May 6, 2004, the Hearing Examiner issued a Notice of Proceeding and Procedural Order setting a May 17, 2004 intervention date and an initial case

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[1] Northern is a wholly owned subsidiary of Bay State Gas Company. Bay State Gas Company and Granite State Gas Transmission, Inc. are wholly owned subsidiaries of NiSource, Inc.

[2] We understand Northern's request to include approval back to the initial implementation of this arrangement.

conference and hearing on May 18, 2004. On May 11, 2004, the Office of the Public Advocate (OPA) filed for intervention, which was granted at the May 18 case conference. In addition, prior to the May 18, 2004 conference, both the Advisory Staff and the OPA issued written data requests. On June 9, 2004, a second technical conference was held to further explore the agreements and Northern's answers to the Oral Data Requests asked at the initial conference.

An Examiner's Report was issued on August 6, 2004. Northern filed a revised, redlined version of the Agreement incorporating changes to which it had agreed at the technical conferences. On August 11, 2004, the OPA filed exceptions to the Report, recommending that we decide as follows: 1) that we will not consider approving any Field Services Agreement until the Federal Energy Regulatory Commission (FERC) approves a waiver requested by NiSource to its new affiliate conduct rule; 2) that we "allow Northern another opportunity to demonstrate that the arrangement is not adverse to Northern's ratepayers;" and 3) that we require Northern to charge its services at market price rather than at fully distributed cost as it has proposed.

On August 16, 2004, Northern requested leave to respond to OPA's exceptions and filed its response, in which it proposed three additional conditions in an effort to address the OPA's concerns.

III. FIELD SERVICES AGREEMENT

A. Reason for Agreement

Northern states in its filing that certain events caused Granite to remove field services management personnel on short notice in late September 2003. In order to fill the void, Northern personnel were asked to assist Granite in field service functions. At that time, evidently both Northern's Operations Management and Granite's (NiSource's) FERC attorneys failed to recognize the need for state regulatory approval for this arrangement. Consequently, the Northern operations personnel who assisted Granite believed that they were free to work with Granite so long as the costs of the service were allocated to Granite.

The Agreement sets out in writing the assistance that Granite seeks from Northern and Bay State and the cost allocation methodology proposed to be used. Northern states in its filing that the Agreement is not adverse to the public interest because it will allow all the affiliated parties to realize benefits through the efficient use of common field services personnel and equipment; through the contribution by Granite to the fixed costs of Bay State's and Northern's maintenance of field services personnel and equipment; through the reduction of "stand down time" for Bay State and Northern field services personnel and equipment; and through an increase in understanding and expertise related to the physical distribution and pipeline connections and the interrelationship of equipment.

B. Summary of Agreement

The Agreement provides that Bay State and/or Northern will furnish certain field services to Granite at Granite's request. These services will be provided at the fully distributed cost of the party rendering the service.[3] The Agreement states that the services will be provided by existing field service personnel and maintenance organizations and that Northern will not be required to increase personnel levels or incur any expenses to render the expected services to Granite.

Schedule A of the Agreement states that Granite will receive field services from its affiliates for Operations & Maintenance (O&M), Metering Services, and Miscellaneous Services. Examples given of O&M services include the supervision of the construction of elements of the pipeline system, the maintenance and operation of the gas transmission system, transportation operation services, including transportation nominations and scheduling, and safety and any other field operational functions which either Bay State or Northern is capable of supplying. Miscellaneous services include any other field services not specified and any administrative services related to field services as may be properly rendered to Granite within the meaning and intent of the Public Utility Holding Company Act of 1935.

The Agreement provides that labor will be directly charged where possible and where it is not possible will be based upon an allocation of labor costs. Northern based the allocation on estimates of the time spent by the three Northern employees and one Bay State employee who will be providing services to Granite.[4] It will review these allocation factors at least annually.

The Agreement provides that to the extent materials, equipment or supplies are used by Bay State or Northern in rendering field services to Granite, a direct charge shall be made to Granite according to a fully allocated cost methodology to ensure Granite remunerates the Companies for the full allocated value of the costs incurred by them to provide such services. The Agreement states that other expense incurred by the Companies in connection with services rendered to Granite, such as travel expenses, shall be charged directly to Granite.

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[3] The Agreement does provide for direct charging for time spent but unless the service is provided as overtime or emergency service, Northern does not require its employees to track their time in this manner. Therefore, in essence, the majority of charges under this agreement will be at fully distributed costs.

[4] Northern clarified that Northern is providing the supervisory field services whereas Bay State handles nominations and scheduling.

C. Effect of FERC Order 2004 on Agreement

On November 25, 2003, FERC issued its Order 2004 in FERC Docket No. RM01-10-000, Standards of Conduct for Transmission Providers. This Order limits the services that can be provided among affiliates of FERC regulated entities. On April 16, 2004, FERC issued Order 2004-A, Order on Rehearing and Clarification of Order 2004 in FERC Docket No. RM01-10-000. Order 2004-A appears to clarify that field services but not gas supply functions may be provided to an interstate pipeline by an affiliate.[5]

IV. ANALYSIS AND DECISION

Pursuant to 35-A M.R.S.A. § 707(3), a public utility may not make a contract or arrangement with an affiliate for services until the Commission finds that the contract or arrangement is not adverse to the public interest and gives it written approval. The Commission may approve an affiliate contract or arrangement subject to conditions and requirements necessary to safeguard the public interest. 35-A M.R.S.A. §707(3)(B). Section 707(3)(B) also states that if a contract or arrangement is not consented to or approved by the Commission as required by statute, the Commission may disallow, for rate-making purposes, any part of payments it finds not to be in the public interest and, after notice and hearing, declare the arrangement prospectively void as it applies to utility operations within the State.

In reviewing the proposed Agreement, we must ensure that it is not adverse to Northern's ratepayers either financially or operationally. We also need to determine if the Agreement complies with our rules and regulations and, if not, to decide whether to grant the necessary waivers. For reasons further detailed below, we conclude that the Agreement, as modified in the course of this proceeding, is not adverse to Northern's ratepayers operationally or financially. We find that it is not necessary to grant a waiver of Chapter 820, Section 4(A) which allows Northern to charge Granite at Northern's fully distributed cost if a market price is not available and we accept Northern's contention that market price is not available. Finally, we adopt Northern's three additional conditions, outlined in its August 16th filing.

The Agreement came about as a result of management action taken by Granite in its daily operations and resolves Granite's resulting need for supervisory staff for its field operations. Under the modification Northern has submitted, Northern and Bay State are not required to provide such services if it would be harmful to their operations, nor are the Companies required to hire or enlist additional personnel to provide services

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[5] On June 17, 2004, Granite filed a request for a waiver of the FERC Order to allow it to receive certain services from its affiliates, including those provided by Bay State under this Agreement. If Granite does not receive the waiver from FERC, it is our understanding that Bay State would not be allowed to provide these services to Granite. To date, FERC has not acted on Granite's request. However, the portion of this Agreement with which we are concerned – Northern's provision of field services to Granite – does not appear to be at issue.

to Granite. Therefore, operationally, it appears that Northern's customers are protected by the terms of the Agreement.[6] We further specify in this Order that Northern's first priority shall be to its service obligations to its own customers. Northern represents that it has sufficient personnel to provide these services. There is no record evidence that this Agreement will work to the detriment of Northern or its customers.

In reviewing the financial aspects of the contract, Staff and OPA expressed concern that the majority of the costs will be allocated using fully distributed costs, rather than a market price, and that the amount of time charged to Granite will be based upon an allocation instead of detailed time records. Regarding the accuracy of time charged to Granite, we note that using a cost allocation based on a fixed estimate of time each week could result in inaccurate charges to Granite. For instance, if the time spent in one month is greater than the time in the allocation formula, Northern will not receive reimbursement commensurate with the amount of service it provided. However, given that the costs to be incurred under this Agreement are not significant (on average $6,650 per month) and that Northern will review and adjust the allocation percentages at least annually, we will approve the Agreement without requiring further modification.

Another concern arises when Northern's employees provide service to Granite during regular business hours but, as a result, must provide service to Northern customers after hours, resulting in overtime costs to be incurred by Northern.[7] Northern believes that this situation would be unlikely given the supervisory nature of the services it is providing.[8] We agree that the likelihood of this happening may be small; however, we will require Northern to remain vigilant for such circumstances. We will stop short of requiring Northern to report on instances where this happens but note that we would be inclined to disallow increased costs to Northern's ratepayers as a result of this Agreement. Direct billing any Northern employee's time worked for Granite would resolve this concern. However, the Company contends that its payroll system does not easily allow for direct billing for supervisory employees during normal work hours, so we will not require it at this time.

Regarding the pricing of Northern's services to Granite, Chapter 820 requires that transactions between affiliates be charged at a market based rate or tarriffed rate. If neither exists, it allows for costs to be charged at fully distributed cost. In this instance, Northern requests that we allow it to charge fully distributed cost. Northern maintains that there is not a market for these services because they are specialized, typically

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[6] We note that Northern produced no support for the statement in the Agreement that this arrangement will reduce the unproductive, or "stand down time," of Northern's field services employees.

[7] Northern tracks all overtime worked on a specific project basis and as a result, would directly charge Granite for time spent after hours at the overtime rate.

[8] Northern's supervisors' responsibilities include overseeing Granite's field service employees' schedules and attendance at work.

in-house, services and require knowledge of the operational aspects of both Northern's and Granite's facilities. OPA contends that the eliminated position at Granite provides a market price proxy. The OPA does not, however, include any real analysis of what the market price would be, and thus, does not refute Northern's contention that there is no real market for those services on a part-time contractual basis.

When an accurate market price for services is not readily available, fully distributed cost is the appropriate method of charging for services under Section 4(A) of the Chapter 820. Based on the record in this case, we will approve the Agreement's use of fully distributed costs, but we will stop short of accepting that methodology for ratemaking purposes. In any upcoming rate case, Northern may be required to demonstrate why it used fully distributed costs instead of a market-based rate.

As further safeguards and to address OPA's concerns, we adopt Northern's proposed conditions. First, it shall report on an annual calendar year basis, beginning February 15, 2005, the amount of costs borne by, and revenues received by, Northern for these services in the prior years. Second, our approval of this Agreement will expire two years from the date of this Order. Third, Northern shall inform Staff and OPA when FERC rules on Granite's waiver request, indicating any actions Northern or Granite may take as a result thereof.

Northern has requested that we approve this Agreement *nunc pro tunc*, explaining the circumstances of its delay in seeking approval. We accept that Northern's delay was caused in the first instance by Northern's operations managers' misplaced reliance on Granite's attorneys [9] to advise them of all necessary regulatory requirements, resulting in their failure to be aware of Maine's jurisdiction, followed by Northern's effort to determine whether the arrangement was allowed under a recently issued federal ruling before filing for state approval. We recognize that such a review would assist in determining whether the arrangement, even if approved by the state, would survive federal muster.

Considering the totality of the circumstances, we conclude that Northern's delay in seeking approval was caused by an unfortunate combination of managerial oversight and jurisdictional confusion, rather than willful refusal or neglect on Northern's part. Northern states that it has attempted to ensure that such an oversight will not happen again by informing operations management and field services personnel of the need for prior state approval before taking such action in the future. Moreover, it does not appear that the arrangement is adverse to Northern's ratepayers.

Accordingly, we approve the Agreement and take no punitive action for the fact that Northern began providing services to Granite in October 2003 without first obtaining our approval.

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[9] Granite is a natural gas transmission pipeline company and is subject to the regulations of the FERC and therefore, its attorneys would have greater familiarity with FERC's regulatory requirements.

V. CONCLUSION

We approve Northern's revised Field Services Agreement (attached and incorporated into this Order) with its affiliates, Bay State Gas Company and Granite State Gas Transmission, with Northern's three additional conditions, as discussed above. We also allow Northern to provide services to Granite at fully distributed costs.

Dated at Augusta, Maine, this 18th day of August, 2004.

BY ORDER OF THE COMMISSION

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Raymond J. Robichaud
Acting Administrative Director

COMMISSIONERS VOTING FOR: Diamond
Reishus

COMMISSIONER ABSENT: Welch

NOTICE OF RIGHTS TO REVIEW OR APPEAL

5 M.R.S.A. § 9061 requires the Public Utilities Commission to give each party to an adjudicatory proceeding written notice of the party's rights to review or appeal of its decision made at the conclusion of the adjudicatory proceeding. The methods of review or appeal of PUC decisions at the conclusion of an adjudicatory proceeding are as follows:

1. Reconsideration of the Commission's Order may be requested under Section 1004 of the Commission's Rules of Practice and Procedure (65-407 C.M.R.110) within 20 days of the date of the Order by filing a petition with the Commission stating the grounds upon which reconsideration is sought.

2. Appeal of a final decision of the Commission may be taken to the Law Court by filing, within **21 days** of the date of the Order, a Notice of Appeal with the Administrative Director of the Commission, pursuant to 35-A M.R.S.A. § 1320(1)-(4) and the Maine Rules of Appellate Procedure.

3. Additional court review of constitutional issues or issues involving the justness or reasonableness of rates may be had by the filing of an appeal with the Law Court, pursuant to 35-A M.R.S.A. § 1320(5).

Note: The attachment of this Notice to a document does not indicate the Commission's view that the particular document may be subject to review or appeal. Similarly, the failure of the Commission to attach a copy of this Notice to a document does not indicate the Commission's view that the document is not subject to review or appeal.