

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Maritimes & Northeast Pipeline, L.L.C. § Docket No. RP04-____-000
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§

**PREPARED DIRECT TESTIMONY OF
RICHARD J. KRUSE
ON BEHALF OF
MARITIMES & NORTHEAST PIPELINE, L.L.C.**

1 **Q. 1 Pleases state your full name, title, and current place of employment.**

2 A. My name is Richard J. Kruse, and I am Vice President of M&N Management
3 Company, Managing Member of Maritimes & Northeast Pipeline, L.L.C.
4 (“Maritimes”), and I also serve as Vice President, Industry Initiatives, Pricing and
5 Regulatory Affairs for Duke Energy Gas Transmission Corporation (“DEGT”).
6 In accordance with Maritimes’ formation agreements, M&N Management
7 Company is responsible for managing the business operations of Maritimes,
8 subject to the oversight of a Management Committee comprised of a
9 representative and an alternate from each Member of Maritimes. My business
10 address is 5400 Westheimer Court, Houston, Texas 77056.

11 **Q. 2 What is your educational background?**

12 A. I received a Bachelor of Science Degree in Economics from Texas Tech
13 University at Lubbock, Texas, in 1974, and graduated with a law degree from the
14 University of Houston in 1977.

1 **Q. 3 Please describe the course of your professional career and the scope of your**
2 **current professional responsibilities.**

3 A. I started my employment with a predecessor of Texas Eastern Transmission, LP
4 (“Texas Eastern”) in 1977, in the rate department. I subsequently transferred to
5 the legal department, working principally with rates and regulatory affairs groups
6 at the company. In 1988, I was appointed Assistant General Counsel for Texas
7 Eastern, and, in 1990, I became Deputy General Counsel of
8 Regulatory/Operations for Texas Eastern and Algonquin Gas Transmission
9 Company (“Algonquin”). In 1992, I was named Vice President and General
10 Counsel for Texas Eastern and, in 1995, I was named Associate General Counsel
11 of PanEnergy Corp. In 1997, I was named Vice President and General Counsel of
12 Gas Operations for Duke Energy Corporation, and Vice President and General
13 Solicitor in 1998. On January 1, 1999, I was named Senior Vice President and
14 worked on special projects for DEGT. In March 2000, I assumed my current
15 position.

16 In my current position, I am responsible for all of the DEGT proceedings
17 before the Federal Energy Regulatory Commission (“Commission”), which
18 includes rates, certificate matters, and tariff matters generally, including Texas
19 Eastern, Algonquin, East Tennessee Natural Gas Company, and Egan Hub
20 Partners, L.P., and for the pipelines that DEGT affiliates manage, such as
21 Gulfstream Natural Gas System, L.L.C. and Maritimes. In addition, I coordinate,
22 for the DEGT pipelines, with the Interstate Natural Gas Association of America, a
23 gas pipeline trade association, on policy matters affecting the gas pipeline
24 industry generally. I am also on the Board of Directors of the North American

1 Energy Standards Board, an association of numerous energy sector companies
2 that addresses the development of electronic communication and common
3 business practice standards.

4 **Q. 4 On whose behalf are you testifying in this proceeding?**

5 A. I am testifying on behalf of Maritimes.

6 **Q. 5 Have you previously testified before the Commission?**

7 A. Yes. I have filed testimony on a number of occasions, including in Maritimes'
8 previous rate proceeding in Docket No. RP02-134.

9 **Q. 6 What is the purpose of your testimony in this proceeding?**

10 A. The purpose of my testimony is to provide (i) an overview of the filing and the
11 testimony included as part of this Statement P, (ii) an overview of the Maritimes
12 pipeline system and a discussion of Maritimes' business operations and business
13 risks, and (iii) an overview of the proposed rate design treatment for Phase III.

14 **Q. 7 What statements, schedules, or exhibits are you sponsoring in conjunction**
15 **with your direct testimony?**

16 A. I am co-sponsoring the Description of Company Operations (Statement O) with
17 Mr. Christopher T. Ditzel. Specifically, I am sponsoring Statements O and O(2).
18 Mr. Ditzel is sponsoring Statements O(1) and O(3).

19 **Q. 8 Were Statements O and O(2) prepared by you or under your direction or**
20 **supervision?**

21 A. Yes, those statements were prepared under my direction and supervision.

22 **Q. 9 Why has Maritimes filed this Section 4 rate case before the Commission?**

23 A. For several reasons. First, there has been a decline in the projected reserves and
24 related deliverability associated with the Sable Offshore Energy Project ("SOEP")
25 fields, which are located in the offshore Nova Scotia basin. Maritimes and its

1 Canadian pipeline affiliate, Maritimes & Northeast Pipeline Limited Partnership
2 (“Maritimes-Canada”), constructed their respective pipeline systems to provide
3 the transportation facilities necessary to ship production from the SOEP fields to
4 markets in the Canadian Maritime provinces of Nova Scotia and New Brunswick
5 and the Northeastern United States. The SOEP fields are essentially the sole
6 production source connected to the Maritimes system. In addition, markets in the
7 Canadian Maritime provinces, which have consistently taken far less than the
8 195,000 Dth/d of firm contracts in place for primary firm deliveries to Canadian
9 markets, have started to increase their consumption of SOEP production towards
10 levels originally contemplated at the time Maritimes placed its pipeline into
11 service.

12 The decline in deliverability from the SOEP, along with the continued
13 consumption of SOEP production in Canada, has resulted in lower throughput on
14 the United States portion of the Maritimes system. This lower throughput, in turn,
15 has resulted in the need to decrease the billing determinants upon which
16 Maritimes bases its mainline transportation rates. In addition, the decline in
17 reserves and deliverability from the SOEP, along with the lack of development of
18 other offshore Nova Scotia basin fields, has resulted in the need to reinstate the
19 depreciation rate underlying Maritimes’ initial rates established in its original
20 certificate proceeding.

21 Further, Maritimes placed its Phase III facilities into service on November
22 24, 2003. The Phase III facilities represent an extension of Maritimes’ mainline
23 from Methuen, Massachusetts, to an interconnection in Beverly, Massachusetts,

1 with Algonquin. Phase III increases the flexibility and reliability of service for
2 existing shippers on the Maritimes system, as well as providing these shippers
3 with direct access to the heart of the Greater Boston market. In this filing,
4 Maritimes proposes to continue its practice of treating the Phase III facilities as an
5 integral part of the Maritimes system, and thus, Maritimes has not proposed to
6 charge a separate incremental rate for service on Phase III.

7 Finally, Maritimes has filed this rate case in compliance with Article III of
8 the uncontested Stipulation and Agreement in Docket No. RP02-134
9 (“Settlement”), which required Maritimes to file a rate case under Section 4 of the
10 Natural Gas Act (“NGA”) no later than April 1, 2006.

11 **OVERVIEW OF RATE FILING**

12 **Q. 10 By way of overview, please generally explain how Maritimes developed the**
13 **cost-of-service that underlies its proposed rates.**

14 A. Consistent with general Commission practice, Maritimes developed the rates
15 proposed in this filing based on the costs incurred by Maritimes to provide
16 service, including a reasonable return on capital investment.

17 **Q. 11 Please briefly describe the individual components of the cost-of-service.**

18 A. The operation and maintenance expense component allows Maritimes to recover
19 costs related to the operation and maintenance of jurisdictional facilities and costs
20 of administrative and general items, such as employee salaries and benefits,
21 materials and supplies, insurance, and other expenses. The depreciation expense
22 component compensates investors for the loss in value of Maritimes’ assets and
23 provides for return of capital investment. Maritimes is compensated for taxes,
24 including income and other taxes, such as ad valorem taxes, through the tax

1 expense component. Finally, Maritimes is given an opportunity to recover a
2 reasonable amount over and above operation and maintenance expenses,
3 depreciation, and taxes through the overall rate of return applied to rate base. The
4 return allowance is intended to provide investors a reasonable return on their
5 investment in jurisdictional facilities.

6 **Q. 12 Please provide an overview of the results of the cost-of-service process you**
7 **have described.**

8 A. Statement A summarizes Maritimes' overall cost-of-service taken from
9 Maritimes' books and records for the 12 months ended February 29, 2004, as
10 adjusted for known and measurable changes through November 30, 2004. The
11 overall cost-of-service is the sum of the various cost components described in
12 column (A), with further detail provided in the statement or schedule referenced
13 in column (B). Maritimes witness Mr. David S. Abbott is responsible for
14 aggregating these various components of the cost-of-service as they are ultimately
15 reflected in Statement A.

16 Statements A and J of this filing reflect a cost-of-service of \$151,288,531,
17 which, as shown on Schedule J-2, results in an increase in the maximum recourse
18 rate for mainline transportation service under Rate Schedules MN365 and MNIT
19 from \$0.6950 per dekatherm per day ("Dth/d") to \$1.0713 per Dth/d on a 100
20 percent load factor basis, when the proposed billing determinants of 380,575
21 Dth/d and other rate design parameters are factored into the design of the rate.
22 Consistent with its prior practice, Maritimes' proposed rates for service under
23 Rate Schedules MN151, MN90, MNOP and MNPAL are derived from this

1 proposed mainline transportation rate. Schedule J-2 also provides the maximum
2 recourse rates proposed for each of the four incremental laterals.

3 **Q. 13 How were the cost levels for the cost-of-service components derived?**

4 A. Cost levels for the components of the cost-of-service are derived from a “test
5 period” specified by the Commission’s regulations. To develop the test period
6 costs, it is first necessary to establish “base period” costs, which consist of 12
7 consecutive months of recently available actual cost experience. To derive the
8 test period cost-of-service, base period costs are adjusted for changes that are
9 known and measurable with reasonable accuracy at the time of the rate filing, and
10 which will become effective within nine months after the end of the base period.

11 **Q. 14 What base period and test period did Maritimes use for this rate filing?**

12 A. For this rate filing, Maritimes used a base period consisting of the 12 months
13 ending February 29, 2004, as adjusted for known and measurable changes through
14 the test period ending November 30, 2004.

15 **Q. 15 Please provide a summary of Maritimes’ sponsorship of the other material**
16 **segments of the case.**

17 A. The witnesses sponsoring the various segments of the case are as follows:

| | | |
|----|---------------------|---|
| 18 | Richard J. Kruse | Overview of Filing; Business Operations; |
| 19 | | Business Risks; Phase III Rate Design |
| 20 | | |
| 21 | Sabra L. Harrington | Books and Records |
| 22 | | |
| 23 | David S. Abbott | Overall Cost of Service |
| 24 | | |
| 25 | Joe A. Payne | Statement G |
| 26 | | |
| 27 | Leon W. Giese | Deliverability of Available Supply; Reserve |
| 28 | | Life |
| 29 | | |
| 30 | Edward H. Feinstein | Depreciation Rate |
| 31 | | |

| | | |
|----|-------------------------------|--|
| 1 | Gregg E. McBride | Cost Allocation and Rate Design; Tariff |
| 2 | | Revisions |
| 3 | | |
| 4 | Professor J. Peter Williamson | Rate of Return |
| 5 | | |
| 6 | William C. Penney, Jr. | Billing Determinants; Summary of Phase III |
| 7 | | Firm Subscriptions and Usage |
| 8 | | |
| 9 | Christopher T. Ditzel | Operational Benefits of Phase III |
| 10 | | |
| 11 | John J. Reed | Benefits of Phase III; Canadian Market |
| 12 | | Demand |
| 13 | | |
| 14 | Dr. William B. Tye | Economics of Phase III Rate Design |
| 15 | | |

16 **OVERVIEW OF MARITIMES SYSTEM**

17 **Q. 16 What information is included in Statement O?**

18 A. Statements O and O(2) include a description of Maritimes' service area and
19 diversity of operations, and a list of each major expansion and abandonment since
20 Maritimes' last general rate case.

21 **Q. 17 Please explain the Maritimes system.**

22 A. Maritimes is a limited liability company formed under the laws of the State of
23 Delaware that, along with Maritimes-Canada, operates a high pressure natural gas
24 delivery system that transports natural gas in international commerce from the
25 tailgate of a processing plant near Goldboro, Nova Scotia, to the Canadian-United
26 States border, and through the northeastern states of Maine, New Hampshire, and
27 Massachusetts, with a terminus in Dracut, Massachusetts, and another terminus in
28 Beverly, Massachusetts. Maritimes and Portland Natural Gas Transmission
29 System ("PNGTS") share an undivided, joint ownership interest in approximately
30 101.3 miles of pipeline extending from Westbrook, Maine, to Dracut ("Joint
31 Facilities"). Various Maritimes-owned laterals or jointly-owned laterals exist

1 along the entire Maritimes mainline system, including both its individually-owned
2 mainline and the Joint Facilities mainline.

3 Maritimes constructed its mainline to ensure that sufficient capacity
4 existed to meet its long-term firm subscriptions of 360,575 Dth/d and to meet
5 demand from firm shippers in Canada that, from time to time, desire to divert
6 supplies from Canadian markets to markets in the U.S. Northeast to help alleviate
7 supply shortages in the Northeastern U.S. and to take advantage of higher prices
8 for natural gas. Indeed, Maritimes' mainline facilities have delivered quantities at
9 or near its operational peak of 440,000 Dth/d during many critical operating
10 periods in the Northeastern U.S. since Maritimes placed its pipeline into service.

11 **Q. 18 Please explain the Maritimes service area.**

12 A. While Maritimes has interconnections with PNGTS, Tennessee Gas Pipeline
13 Company ("Tennessee"), Algonquin and Granite State Gas Transmission, Inc.,
14 essentially the sole source of natural gas that flows on the Maritimes system is the
15 offshore Nova Scotia basin, of which only the SOEP fields are currently
16 producing. The Maritimes "service area" includes portions of the States of
17 Maine, New Hampshire and Massachusetts. Of course, through use of the
18 existing pipeline grid, Maritimes' service area can extend to other parts of New
19 England and the Northeastern United States.

20 **Q. 19 When did Maritimes place its system into service?**

21 A. Maritimes placed its portion of the Joint Facilities, from Wells, Maine, to
22 Haverhill, Massachusetts, into service on March 10, 1999. Maritimes placed its
23 facilities from the United States-Canada border to Westbrook, Maine, and the
24 remainder of its portion of the Joint Facilities, into service on December 1, 1999.

1 Maritimes commenced construction of its Phase III Project in September 2002,
2 and placed the Phase III facilities into service on November 24, 2003.

3 **Q. 20 What services does Maritimes provide?**

4 A. Maritimes offers several services, all of which are included in its FERC Gas
5 Tariff. Since the Settlement became effective, Maritimes' tariff has been updated
6 to reflect the requirements of Order No. 637. Maritimes currently provides a 365-
7 day firm service under Rate Schedule MN365, and interruptible service under
8 Rate Schedule MNIT. Maritimes also offers peak season service under Rate
9 Schedule MN151 and MN90, and off-peak firm service under Rate Schedule
10 MNOP. Maritimes currently has no contracts for its peak/off-peak services. In
11 addition, Maritimes provides firm lateral line service under Rate Schedule
12 MNLFT. Finally, Maritimes offers parking and lending service under Rate
13 Schedule MNPAL and title transfer tracking service under Rate Schedule
14 MNTTT, although, to date, no shipper has nominated under either rate schedule.

15 **Q. 21 Has Maritimes previously filed a Section 4 rate case?**

16 A. No. I note that Maritimes has a rate cap agreement in effect with certain of its
17 long-term firm shippers that expires on November 30, 2004. This rate cap
18 agreement applies only to Rate Schedule MN365 service, and it caps the rate at
19 \$0.715 per Dth/d on a 100 percent load factor basis for shippers to which it
20 applies. The rate cap agreement does not limit Maritimes' right to file a Section 4
21 rate case.

22 Pursuant to certain Commission orders, Maritimes did file a cost-and-
23 revenue study on December 27, 2001, in Docket No. RP02-134, and
24 supplemented that filing on May 15, 2002.

1 **Q. 22 What is the status of that docket?**

2 A. In that docket, the Commission instituted a proceeding under Section 5 of the
3 NGA, which ultimately was resolved pursuant to Commission order dated
4 March 12, 2003 (“March 12 Order”). In the March 12 Order, the Commission
5 approved the Settlement, which I referred to earlier in my testimony, finding the
6 agreement reached (or unopposed) by all participants in the proceeding was fair,
7 reasonable and in the public interest. Maritimes placed the Settlement rates into
8 effect on April 1, 2003. As part of that Settlement, Maritimes agreed to make a
9 rate case filing on or before April 1, 2006. This filing complies with this
10 requirement.

11 **BUSINESS RISKS**

12 **Q. 23 Please provide an overview of the various risks facing Maritimes in its**
13 **business operations.**

14 A. The most significant risk that Maritimes faces is related to (i) the overall rapid
15 decline of the offshore Nova Scotia reserve base, the essentially the only source of
16 supply accessed by the Maritimes system, and (ii) the continuing decline in
17 throughput due to lower production from the SOEP and the likelihood that the
18 current level of consumption of SOEP reserves in Canadian markets will increase.
19 This risk, in turn, directly affects the appropriate level of billing determinants and
20 the depreciation rate for designing Maritimes’ transportation rates. As I stated
21 earlier in my testimony, and as Mr. Penney explains in his testimony, the
22 Maritimes system is a supply-driven system designed to transport gas from a
23 single offshore-producing region to markets in the maritime provinces of Canada
24 and the Northeastern United States. Unlike many transmission facilities in the

1 United States, the throughput and related billing determinants for the Maritimes
2 system are dependent almost entirely on production from this single supply
3 source, which currently is comprised solely of production from the SOEP fields.
4 Similarly, as Mr. Feinstein explains in his testimony, because Maritimes
5 essentially has access to only a single supply source, the primary factor in
6 determining the appropriate depreciation rate for Maritimes' mainline system is
7 the projected production life of the SOEP fields and any other viable fields in the
8 offshore Nova Scotia basin.

9 **Q. 24 How does the deliverability associated with this supply source affect the**
10 **appropriate level of billing determinants for designing Maritimes'**
11 **transportation rates?**

12 A. As Mr. Penney explains in his testimony, because the throughput on Maritimes is
13 essentially dictated by a single supply source, the projected level of daily
14 throughput on the United States portion of the system in the near-term is the
15 difference between the deliverability of the SOEP and the quantity of SOEP
16 production that is consumed in Canada.

17 To implement this calculation, Mr. Penney relies on the testimony of
18 Maritimes' reserves and deliverability expert, Mr. Leon W. Giese, and Maritimes'
19 Canadian markets expert, Mr. John J. Reed. Mr. Giese's deliverability analysis
20 shows that the deliverability of the SOEP will decline from an actual rate of
21 approximately 471,000 Dth/d in February 2004 (which is net of shrinkage at the
22 Goldboro processing plant and net of fuel use on the SOEP gathering
23 infrastructure) the last month of the base period, to 405,000 Dth/d in November
24 2004, the last month of the test period. Mr. Reed concludes in his testimony that
25 the average daily consumption of SOEP production in Canada during the test

1 period likely will stay the same or increase from the approximately 65,000 Dth/d
2 experienced by Maritimes during the base period. Accordingly, Mr. Penney, in
3 his testimony, projects that the average daily throughput on the mainline of the
4 United States portion of the Maritimes system will be approximately 340,000
5 Dth/d – the difference between 405,000 Dth/d and 65,000 Dth/d. Once fuel on
6 Maritimes and Maritimes-Canada is factored into the analysis, the projected
7 average daily throughput on Maritimes' mainline system is only 334,257 Dth/d.
8 However, because Mr. Reed determines that Canadian consumption may increase
9 during the test period, the projected daily throughput of 334,257 Dth/d may be
10 overstated.

11 **Q. 25 Has the decline in the deliverability of the SOEP affected Maritimes'**
12 **revenues?**

13 A. As Statement G shows, Maritimes is not currently recovering its cost of service,
14 and even with this filing, Maritimes is still at risk.

15 **Q. 26 Please explain.**

16 A. Maritimes has not proposed to use 334,257 Dth/d as billing determinants for rate
17 design purposes, nor has it proposed to use the quantity of long-term firm capacity
18 subscribed on its system of 360,575 Dth/d. Instead, Maritimes proposes to utilize
19 380,575 Dth/d for rate design purposes. This level of billing determinants reflects
20 the 360,575 Dth/d of mainline firm capacity subscribed under long-term
21 agreements, as well as 20,000 Dth/d of interruptible throughput on the mainline.
22 In light of the fact that projected deliveries into the Maritimes system from
23 Maritimes-Canada at the United States-Canada border are expected to be
24 significantly below the quantity of mainline firm capacity currently subscribed,

1 the use of 380,575 Dth/d for rate design purposes leaves Maritimes exposed for
2 considerable under-recovery of its revenue requirement.

3 **Q. 27 Why has Maritimes used this higher level of billing determinants?**

4 A. Maritimes has used this relatively high level of billing determinants in an effort to
5 mitigate the impact of this rate filing on its customers, to encourage settlement
6 discussions with shippers, and to demonstrate its continuing willingness to bear a
7 share of the risks associated with connecting a critically important new gas supply
8 source in order to meet the energy needs of our nation.

9 **Q. 28 How do the reserves and deliverability associated with this supply source**
10 **affect the appropriate depreciation rate for Maritimes' mainline system?**

11 A. The depreciation rate proposed by Maritimes for the mainline transportation
12 facilities is 4.00 percent. This is a change from the 3.50 percent mainline
13 depreciation rate established in Section 1.3 of the Settlement, and represents the
14 reinstatement of the same depreciation rate underlying Maritimes' initial mainline
15 transportation rates that became effective when Maritimes placed its system into
16 service in December 1999. Maritimes is proposing to return to the originally
17 certificated mainline depreciation rate, in light of the decline in reserves and
18 deliverability from the SOEP, along with the lack of development of other
19 offshore Nova Scotia basin fields. Maritimes agreed to the reduction in its
20 mainline depreciation rate in December 2002, when EnCana Energy
21 Corporation's ("EnCana") development of its Deep Panuke field appeared more
22 certain and the SOEP reserve base appeared more prolific. Since that time,
23 EnCana has withdrawn its Deep Panuke development plan applications on file
24 with the National Energy Board of Canada and the Canada-Nova Scotia Offshore

1 Petroleum Board. As Mr. Giese discusses in his testimony, in 2003 and early
2 2004, respectively, the SOEP producers publicly announced reductions in their
3 estimates of recoverable reserves from the SOEP fields.

4 As Mr. Giese demonstrates in his testimony, the projected production
5 profile for offshore Nova Scotia basin reserves declines rapidly from the present
6 time through the year 2027. In light of the substantial decline in reserves
7 projected for offshore Nova Scotia, the proposed 4.00 percent depreciation rate is
8 certainly justified.

9 **Q. 29 How does a decline in the production rate of the offshore Nova Scotia basin**
10 **translate into a higher depreciation rate?**

11 A. Mr. Feinstein, in his testimony, explains that for Maritimes the economic life of
12 its system is primarily dependent upon the productive capability of the offshore
13 Nova Scotia basin. Based on his analysis, Mr. Feinstein concludes that a 4.00
14 percent mainline depreciation rate is within the range of reasonable depreciation
15 rates for Maritimes' mainline system.

16 **Q. 30 Are there other risks facing Maritimes?**

17 A. Yes. As the reserves decline in the offshore Nova Scotia area, competition
18 between markets in the Maritime provinces and the U.S. Northeast for the smaller
19 reserve base will increase. Market prices will dictate the allocation of this
20 depleting resource on any given day. The impact of these factors on Maritimes'
21 system is further detailed in Mr. Penney's testimony and in Mr. Reed's testimony.
22 Mr. Reed concludes in his direct testimony that demand for SOEP gas in the
23 Maritime provinces of Canada will likely remain stable or increase. Since
24 Maritimes is essentially a single supply source pipeline, each dekatherm of natural

1 gas originating in the SOEP fields that is consumed in Canada is one less
2 dekatherm of natural gas that will be transported on Maritimes' system in the
3 United States. Further increases in demand in Canada put Maritimes at greater
4 risk that its throughput in the United States will continue to decline.

5 **Q. 31 Are there other matters that should be considered?**

6 A. Yes. The long-term funds used to finance the Maritimes Project, like most, if not
7 all, greenfield pipeline construction projects, were obtained as part of a large
8 project financing. Because Maritimes' lenders are reliant upon Maritimes'
9 transportation revenues as the sole basis for collateral for, and repayment of, the
10 financing, Maritimes is subject to a number of restrictive covenants that create
11 additional business risks, and Maritimes is prohibited from providing any
12 distributions to its equity investors unless it maintains a minimum debt service
13 coverage ratio. In short, the project finance structure, while an important funding
14 source for large, capital-intensive projects like Maritimes, creates unique business
15 risks for Maritimes and its equity investors.

16 **PHASE III RATE DESIGN**

17 **Q. 32 Turning to Phase III, please provide a brief description of the Phase III**
18 **facilities.**

19 A. The Phase III facilities represent an extension of Maritimes' mainline facilities
20 from Methuen, Massachusetts, to an interconnection in Beverly, Massachusetts,
21 with Algonquin's system. Maritimes placed the Phase III facilities into service on
22 November 24, 2003.

1 **Q. 33 Why did Maritimes construct the Phase III facilities?**

2 A. Maritimes designed the Phase III facilities to enhance the reliability and flexibility
3 of service on its system, which, prior to the in-service date of Phase III, was
4 connected to only one major downstream pipeline, Tennessee. As Maritimes
5 explained in its Phase III certificate application, it developed Phase III to provide
6 its existing shippers with additional service reliability and direct access to the
7 eastern end of Algonquin’s system, which serves the heart of the growing Greater
8 Boston market. In this regard, Phase III is unlike many expansion projects in that
9 there were no new shippers on the facilities. In short, Maritimes constructed
10 Phase III entirely to benefit its existing shippers.

11 **Q. 34 Are there other ways in which Phase III is different from other expansion**
12 **projects?**

13 A. Yes. Phase III is also different from many expansion projects in that it does not
14 expand the mainline capacity of Maritimes, but rather provides existing shippers
15 with access to new markets.

16 **Q. 35 Has the Commission determined that Phase III will create the benefits you**
17 **describe?**

18 A. Yes. The Commission has concluded that Phase III provides substantial benefits
19 to Maritimes’ existing shippers. In its orders approving the Phase III facilities,
20 the Commission concluded that “[t]he direct access to Algonquin’s system will
21 permit Maritimes’ shippers to have another pipeline alternative to reach gas
22 markets and allow its shippers to avoid the additional costs of transporting gas on
23 Tennessee as well as additional scheduling and curtailment risks.”¹ The

¹ *Maritimes & Northeast Pipeline, L.L.C.*, 95 FERC ¶ 61,077, at 61,226, *order granting certificate*, 97 FERC ¶ 61,345 (2001), *order amending certificate*, 99 FERC ¶ 61,277 (2002).

1 Commission also concluded that Phase III would allow existing firm shippers “to
2 maximize use of their capacity on Maritimes” and provide shippers with “another
3 downstream pipeline alternative to access markets, the Boston market being only
4 one example, for their gas.” The Commission then concluded that “[t]hese
5 considerations justify the conclusion that Maritimes’ proposal offers benefits to its
6 existing customers.”²

7 **Q. 36 What rate methodology did Maritimes propose in the Phase III certificate**
8 **proceeding for recovery of Phase III costs?**

9 A. Maritimes proposed to continue charging the mainline system rate.

10 **Q. 37 Does Maritimes propose to change that methodology here?**

11 A. No, however, in the Phase III certificate proceeding, the Commission stated that
12 Maritimes would have the burden in any future rate proceeding to justify the
13 rolled-in treatment of Phase III costs. Thus, Maritimes understands that, to roll in
14 the Phase III costs, it has the burden of proof.

15 **Q. 38 Did Maritimes consider an incremental rate design for Phase III?**

16 A. Yes.

17 **Q. 39 Why did Maritimes rule out an incremental rate design for Phase III?**

18 A. An incremental rate design would be inappropriate in this case for several
19 reasons. This is an extension of the mainline. The service associated with
20 deliveries to Algonquin at the interconnection between Phase III and Algonquin’s
21 system in Beverly is the same service as the one Maritimes provides for deliveries
22 into Tennessee at Dracut. In short, the long-term firm shippers can go back and
23 forth between the Beverly and Dracut interconnections and the shippers are the

² *Maritimes*, 95 FERC at 61,227.

1 same to both points. Further, it would not make sense to charge separately stated
2 incremental rates because this service is the same service as every other long-haul
3 service on the system. In other words, this is not a discrete service on a discrete
4 portion of the system. For example, this is not a single-purpose lateral, serving
5 only one customer.

6 **Q. 40 Does the rate treatment that Maritimes proposes for Phase III result in cost**
7 **shifting between existing firm shippers and Phase III expansion shippers?**

8 A. Cost shifting between these two classes of shippers is not possible. As Mr.
9 Penney explains in his testimony, no other shipper has subscribed firm capacity
10 on Phase III, nor has any new shipper subscribed long-term firm capacity on any
11 other portion of the system. Thus, the existing firm shippers and the Phase III
12 expansion shippers are identical. Moreover, each of these shippers elected to
13 subscribe a quantity of capacity on Phase III that was equal to its existing contract
14 Maximum Daily Transportation Quantity (“MDTQ”), making each shipper’s
15 quantity of capacity subscribed for deliveries into Tennessee at Dracut and into
16 Algonquin at Beverly identical. Consequently, this case does not present the
17 types of cost shifting issues between existing shippers and expansion shippers that
18 are often involved in roll-in cases.

19 **Q. 41 Does the rate treatment Maritimes proposes for Phase III result in cost**
20 **shifting among existing firm shippers.**

21 No. As explained by Mr. Penney in his testimony, each firm shipper has elected
22 to subscribe capacity on Phase III for its entire MDTQ. Thus, this case does not
23 present any issues involving cost shifting among existing firm shippers.

1 **Q. 42 Has Maritimes provided evidence to support its proposal to roll in the costs**
2 **associated with Phase III?**

3 A. Yes. Mr. Penney testifies in his direct testimony that the existing long-term firm
4 shippers on the Maritimes system have subscribed long-term firm capacity on the
5 Phase III facilities. Specifically, Mr. Penney explains that each long-term firm
6 shipper has added the interconnection between Maritimes' Phase III facilities and
7 Algonquin's facilities as a primary firm delivery point under its firm service
8 agreement. Mr. Penney also testifies that, since the in-service date of Phase III,
9 significant quantities of gas have flowed under each such shipper's firm service
10 agreement. As I will discuss further, this is not the traditional roll-in case where
11 separate incremental shippers have subscribed for expansion capacity on newly
12 constructed facilities. This is a case where all of the existing long-term firm
13 shippers have executed agreements for service on the Phase III facilities and gas
14 is actually flowing under those agreements.

15 In addition, Mr. Christopher T. Ditzel, the General Manager, System
16 Planning for Maritimes and the individual responsible for the flow design of the
17 Maritimes system, provides direct testimony and a flow design analysis that
18 demonstrate the manner in which Phase III has increased the operational
19 reliability of service on the Maritimes system.

20 Mr. Reed testifies about the benefits of Phase III to Maritimes' shippers
21 and to the New England pipeline transmission grid. Mr. Reed concludes that
22 Phase III benefits Maritimes' shippers because it (i) provides direct access to
23 higher value markets on Algonquin, (ii) creates a more competitive market at
24 Dracut, resulting in higher net backs for SOEP producers, (iii) creates increased

1 reliability and flexibility for Boston-area deliveries, and (iv) provides an
2 opportunity to segment capacity from Methuen to Beverly through capacity
3 release transactions, with the goal of recovering all or a portion of the releasing
4 shipper's reservation charges. Mr. Reed also states that Phase III provides
5 significant enhancements to the New England pipeline grid from a flexibility and
6 reliability standpoint.

7 Finally, Dr. William B. Tye provides testimony supporting the view that
8 the proposal to roll in Phase III costs is consistent with traditional economically
9 rational rate design principles, and that incrementally pricing Phase III, rather
10 than using a rolled-in rate design, would create economic inefficiencies. In this
11 regard, Dr. Tye concludes that there is no way to incrementally price the Phase III
12 Project under the Commission's traditional rate design principles because
13 Maritimes constructed Phase III to benefit its existing system and shippers, not to
14 benefit new shippers. According to Dr. Tye, the result of incrementally pricing
15 Phase III would be that existing shippers would get the significant benefits of the
16 Phase III facilities without having to pay for those facilities, resulting in a serious
17 "free rider" problem for the Maritimes system and significant market
18 inefficiencies.

19 **Q. 43 Does this conclude your prepared direct testimony?**

20 A. Yes, it does.

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

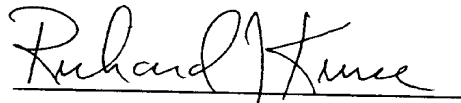
Maritimes & Northeast Pipeline, L.L.C.

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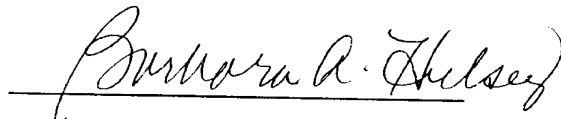
Docket No. RP04-

AFFIDAVIT OF RICHARD J. KRUSE

RICHARD J. KRUSE, being first duly sworn, on oath states that he is the witness whose Prepared Direct Testimony is filed herein; that, if asked the questions which appear in the text of aforesaid Prepared Direct Testimony, affiant would give the answers that are herein set forth; and that affiant adopts the aforesaid Prepared Direct Testimony as his sworn, direct testimony in this proceeding.


RICHARD J. KRUSE

SUBSCRIBED AND SWORN TO before me, a Notary Public in and for the State of Texas, County of Harris, this 22ND day of June, 2004.


Notary Public

My commission expires: 10-2-04