

**STATE OF NEW HAMPSHIRE
PUBLIC UTILITIES COMMISSION**

DW 13-126

PENNICHUCK EAST UTILITY, INC.

Notice of Intent to File Rate Schedule

Order Approving Permanent Rates and Settlement Agreement

ORDER NO. 25,696

July 25, 2014

APPEARANCES: Devine, Millimet & Branch, P.A., by Thomas B. Getz, Esq., for Pennichuck East Utility, Inc.; Office of the Consumer Advocate on behalf of residential ratepayers, by Rorie E.P. Hollenberg, Esq.; and Marcia A. Brown, Esq. for Staff of the Public Utilities Commission.

In this order, the Commission approves a 9.91% permanent rate increase and a 1.62% step increase for PEU. The Commission also approves clarifications pertaining to Order No. 25,292 and the City of Nashua's acquisition of PWW's parent, Pennichuck Corporation.

I. PROCEDURAL HISTORY

Pennichuck East Utility, Inc. (PEU), provides water service to approximately 7,000 customers in the towns of Atkinson, Barnstead, Bow, Chester, Conway, Derry, Exeter, Hooksett, Lee, Litchfield, Londonderry, Middleton, Pelham, Plaistow, Raymond, Sandown, Tilton, Weare, and Windham. PEU is a subsidiary of Pennichuck Corporation, which is wholly owned by the City of Nashua. In Docket No. DW 11-026 (the Acquisition Docket), the Commission approved the City of Nashua's acquisition of Pennichuck Corporation and required PEU and its affiliates, Pennichuck Water Works, Inc. (PWW), and Pittsfield Aqueduct Company, Inc. (PAC), to simultaneously file full rate cases no later than June 1, 2013. *See generally City of Nashua*, Order No. 25,292 (Nov. 23, 2011).

On April 29, 2013, PEU filed a notice of intent to increase customer rates by \$591,485, or 9.97%, and a request for a step increase of \$133,431, or 2.25%. PWW and PAC also filed rate cases, and the Commission separately docketed those filings. In Order No. 25,602 (Nov. 27, 2013), the Commission approved a 7% temporary rate increase for PEU.

On May 14, 2014, Commission Staff (Staff) filed a Settlement Agreement on permanent rates. PEU, the Office of the Consumer Advocate (OCA), and Staff (together, Settling Parties) agreed to a 9.91% rate increase and a step increase of 1.62%, for a total increase of 11.52%. Exh. 4 at 2. The resulting new revenue requirement, including \$294,576 in annual revenues from the North Country Capital Recovery Surcharge, is \$6,913,261. Exh. 4 at 3. The Settling Parties recommend that permanent rates be effective July 1, 2013, and that the step increase be effective as of the date of the Commission's order approving the Settlement Agreement.

The Commission held a hearing on May 20, 2014, at which the Settling Parties provided testimony and other evidence in support of the Settlement Agreement.

II. SUMMARY OF SETTLEMENT AGREEMENT

A. Revenue Requirement, Permanent Rates, Rate Design, Effective Date

The Settling Parties recommend that the Commission approve an increase of \$683,867 to PEU's annual revenue requirement. This increase is comprised of a \$587,890, or 9.91%, permanent increase and a step increase of \$95,977, or 1.62%. The permanent rate increase is based on test year general water revenues of \$5,934,818. This revenue increase would be added to the North Country Capital Recovery Surcharge (NCCRS)¹ to produce a total revenue requirement of \$6,913,261. The overall rate of return used to calculate the revenue requirement is 3.69%. This rate was derived from: (1) \$6,246,505 of long term debt with a cost rate of

¹ The NCCRS was approved by the Commission in Order No. 25,051 (Dec. 11, 2009) and applies as a surcharge to customer bills in the following water systems: Birch Hill, Sunrise Estates, and Locke Lake Colony.

4.48%, (2) \$3,782,464 of short term debt with a cost rate of 2.32%, and (3) \$106,261 in equity at a cost rate of 5.90%. PEU's capital structure is 99% debt and 1% equity. The Settling Parties agree that the plant in service in rate base is used and useful in the provision of service to PEU's customers. The Settling Parties agree to an effective date of July 1, 2013. The Settling Parties recommend that the Commission adopt PEU's most recent cost of service study, which was completed in 2013. The Settling Parties recommend that the rate increase be applied *pro rata* based on the cost of service study. The study recommends that 86.40% of the revenues be collected from General Metered customers and that 13.60% of the revenues be collected from PEU's fire protection customers. Exh. 4 at 8, 49-51.

B. Clarification of Issues from Acquisition Docket No. DW 11-026

The Settling Parties recommend that in future rate proceedings the value of the "Equity-Related Items," as described in the settlement agreement in Docket No. DW 11-026 at Section III.B.1.c., include the value of common stock at the time of the merger, which for PEU was \$100.

The Settling Parties recommend that in future rate proceedings PEU's return on equity be equal to the average of the most recent 12-months of thirty-year United States Treasury Bond interest rates available at the time of the filing of the rate case, plus 3.0%.

C. Treatment of Non-Revenue Producing Assets

The Settling Parties agree that in future rate cases, non-revenue producing assets should be recognized in rate base at year-end value when:

1. The underlying project that establishes the acquired or installed asset(s) is in response to a regulatory mandate, such as a state agency's regulations or enforcement action or a municipality's construction projects.

2. The underlying purpose of the project is not to increase PEU's revenues through either increasing its customer base or service capacity. Any increase in annual revenues resulting from the project should be both incidental and negligible. For PEU, the Settling Parties define incidental and negligible annual revenues as those which result in an increase in annual revenues of less than 1% of a project's expended cost during the test year. When incidental revenues do result from a non-revenue producing asset(s), such as the increased revenue under a municipal fire protection tariff after a main has been upsized, those increased revenues should be reflected in test year revenues to the benefit of customers.

3. The expended cost during the test year on the project are significant, i.e., the resulting asset(s) placed into service has a book value greater than 1.5 times the reportable amount for filing a Form E-22 set forth in Puc 609.12 (d). For PEU, the expended cost must exceed \$45,000 (\$30,000 x 1.5).

4. The asset(s) are used and useful by the end of the test year.

If the asset(s) in question meet the above criteria, the Settling Parties recommend that the value of the assets in rate base be recognized at year-end value rather than the 13-month average value. The Settling Parties recommend that this treatment extend to the Plant in Service, Accumulated Depreciation, Contributions in Aid of Construction (CIAC), and to any Accumulated Amortization of the CIAC.

D. Eminent Domain Costs

The Commission previously authorized the City of Nashua to recover from PEU and its affiliates, PWW and PAC, up to \$5 million in costs incurred from January 2002 through August 2009 in the eminent domain proceeding. *See, City of Nashua*, Order No. 25,292 (Nov. 23, 2011). On October 1, 2013, the Commission's Audit Staff recommended that the Commission allow the

City of Nashua to recover \$4,458,232. Exh. 4 at 7. Audit Staff recommended disallowance of \$490,090. *Id.*

E. Municipal Acquisition Regulatory Asset (MARA)

This regulatory asset was authorized in Order No. 25,292. The Commission ordered that the MARA be subject to an audit at PWW, PEU, and PAC's next full rate cases. On November 19, 2013, the Commission's Audit Staff issued its report and found no exceptions concerning the MARA accounts of PWW, PEU, and PAC.

F. North Country Capital Recovery Surcharge

The Settling Parties recommend the Commission approve the following decreases to the following surcharges: (1) Birch Hill, \$46.94 to \$46.05, (2) Sunrise Lake Estates, \$11.01 to \$10.74, and (3) Locke Lake Colony, \$17.00 to \$16.36. Exh. 4 at 9.

G. Rate Case Expenses

PEU agrees to file for recovery of its reasonable rate case expenses, in accordance with Puc 1905.02, no later than 30 days from the date of the final order in this docket.

III. COMMISSION ANALYSIS

Pursuant to RSA 541-A:31, V(a), informal disposition may be made of any contested case at any time prior to the entry of a final decision or order, by stipulation, agreed settlement, consent order, or default. Notwithstanding a settlement among the parties, the Commission must independently determine whether the settlement results comport with applicable standards. N.H. Code Admin. Rules Puc 203.20(b) requires the Commission to determine whether the settlement results are just and reasonable and serve the public interest. RSA 378:7 authorizes the Commission to fix rates after a hearing upon determining that the rates, fares, and charges are just and reasonable. In determining whether rates are just and reasonable, the Commission "must

balance consumers' interest in paying no higher rates than are required with the investors' interest in obtaining a reasonable return on their investment." *Eastman Sewer Company, Inc.*, 138 N.H. 221, 225 (1994). Applying those standards, the Commission approves the Settlement Agreement.

A. Revenue Requirement, Rates, and Effective Date

The Settling Parties propose an overall, permanent increase of \$587,890 in PEU's revenue requirement, based on a test year ending December 31, 2012. Exhibit 4 at 2. The Settling Parties also propose a step increase of \$95,977, all of which would increase PEU's revenue requirement by a total of \$683,867 to \$6,913,266. *Id.* This is a combined increase of 11.52% to PEU's revenues. *Id.* The Commission finds this revenue requirement to be reasonable and approves it.

Along with approving PEU's revenue requirement, the Commission approves an overall rate of return of 3.69% for PEU. In PEU's last rate case, the Commission approved an overall rate of return of 7.60%. Thus, the proposed rate of return is lower. *Pennichuck East Utility, Inc.*, Order No. 24,840 (April 4, 2008). The rate of return is based in part on PEU's borrowing costs. As stated above, PEU's cost of long term debt is 4.48%, and its cost of short term debt is 2.32%. These rates are low. PEU's cost of equity is 5.90%, but, given that PEU's capital structure is 99% debt and 1% equity, the cost of equity minimally impacts PEU's rate of return. With respect to the capital structure, the Commission finds that PEU's capital structure is reasonable in light of the unique ratemaking mechanisms in place for PEU and its affiliates. Those mechanisms are further described below. The capital structure and rate mechanisms were approved in the Acquisition Docket and take into account the municipal stock ownership of PAC's parent, Pennichuck Corporation.

In the Acquisition Docket, the City of Nashua anticipated that savings would benefit PEU and its affiliates after the City of Nashua acquired PEU's parent. The requirement that PEU and its affiliates file rate cases was an effort to pass those savings on to customers. The rate case was also to ensure that rates were adjusted promptly to reflect the actual borrowing costs of the City Acquisition Bonds in the new ratemaking structure approved in the Acquisition Docket. As illustrated above, components of PEU's revenue requirement are lower than in the past. The cost of debt and cost of equity are lower than in PEU's prior rate cases. The anticipated savings have been incorporated within the proposed revenue requirement. The proposed rate increase in this proceeding is thus lower than it would otherwise have been under the prior ownership.

The revenue requirement for the permanent rate increase is based on a rate base of \$9,992,096. The Settling Parties testified that the plant in service in PEU's rate base is used and useful in the provision of service to PAC's customers. Hearing Transcript of May 20, 2014 (5/20/14 Tr.) at 21. The Commission finds, pursuant to RSA 378:28, that the plant is used and useful.

The Settling Parties propose an effective date of July 1, 2013, for the new permanent rates. The Commission found this effective date reasonable and consistent with *Appeal of Pennichuck Water Works*, 120 NH 562, 567 (1980), when it determined temporary rates. In *Appeal of Pennichuck Water Works*, the Court held that the earliest date on which rates may take effect when billing is on a service-rendered basis is the date on which the utility files its underlying request for its permanent rates. *Id.*; *see also*, Order No. 25,602 (Nov. 27, 2013). Accordingly, we approve the July 1, 2013, effective date for permanent rates.

The Settling Parties propose that the revenue requirement be applied to PEU's customer classes consistent with the recommendations of its latest cost of service study. Exh. 4 at 8. The

Commission finds this recommendation reasonable and approves it. PEU has two major customer classes: general metered and fire protection. Within the fire protection class, PEU has the following subclasses: private fire protection, public fire protection, and municipal hydrants. Exh. 4 at 50. PEU has approximately 6,809 general metered customers and 722 fire protection customers. *Id.* The cost of service study recommended that 86.4% of the revenue requirement be collected from the 6,809 general metered customers and that 13.6% of the revenue requirement be collected from the fire protection customers. By way of comparison, as a result of PEU's previous cost of service study, PEU currently collects 85.27% of its revenue requirement from its general metered customers and 14.73% from its fire protection customers. Exh. 4 at 8. PEU's witness testified that since PEU's 2007 cost of service study, private fire protection services more than doubled. Exh. 1, Direct Prefiled Testimony of Christopher P.N. Woodcock, at 10. This prompted Mr. Woodcock to recommend modifying the allocation to account for this growth in fire protection service. In addition, Mr. Woodcock testified that the 2007 study allocated fire protection costs based on the area of service. *Id.* Mr. Woodcock, instead, allocated costs according to the flow capacity of the different size pipes in order to account for friction losses. *Id.* The objective of a cost of service study is to allocate all costs required to serve customers among each customer class in a fair and equitable manner. The Commission finds these modifications achieve a fair and equitable allocation of the revenue requirement and that the resulting rates are just and reasonable pursuant to RSA 378:7.

As stated earlier, the Commission approved a 7% temporary rate increase for PEU. Pursuant to RSA 378:29, if the permanent rates approved by the Commission are higher than temporary rates, then the utility is entitled to recover the difference. Here, PEU's permanent rates are higher than its temporary rates. The Settling Parties recommend that PEU recover the

difference between temporary and permanent rates through a surcharge collected from customers over twelve months. Exh. 4 at 3. PEU agreed to make a reconciliation filing within 30 days of the date of the final order on permanent rates. *Id.* The Commission will await PEU's proposal before making a determination on the amount and duration of any recovery surcharge.

The Settling Parties ask the Commission to approve a step increase in rates for PEU, effective as of the date of this order. The Commission approves this request. The Commission employs step adjustments to rates as a means of ensuring that a regulated utility retains its ability to earn a reasonable rate of return after implementing large capital projects, and to avoid placing a utility in an earnings deficiency immediately after a rate case in which a revenue requirement was based on a historical test year. Traditional rate-of-return principles permit a utility to have "the opportunity to make a profit on its investment, in an amount equal to its rate base multiplied by a specified rate of return." *Appeal of Conservation Law Foundation*, 127 N.H. 606, 634 (1986). Here, PEU's rate case was based on a 2012 test year. The assets subject to the step increase were plant additions and improvements completed in 2013. Exh. 6. The Commission's Audit Staff conducted an audit of the costs and verified that the assets were in service to customers. Exh. 6. Accordingly, the Commission finds that the plant included in the proposed revenue requirement is prudent, used, and useful. Applying the proposed 3.19% rate of return to the \$1,087,491 of 2013 plant, and accounting for taxes and depreciation, would result in a revenue increase of \$95,977. Exh. 4 at 27. The Commission finds this reasonable and approves this step increase to PEU's revenue requirement. The approval is effective as of the date of this order, on a service rendered basis. This step increase shall not be considered part of permanent rates for purposes of reconciliation pursuant to RSA 378:29. Last, the Commission finds that the step increase will result in just and reasonable rates to customers.

B. Clarifications to Settlement Agreement in Docket No. DW 11-026

The Settling Parties recommend two clarifications to the settlement agreement approved in the Acquisition Docket. First, the Settling Parties recommend that in future rate proceedings the value of the “Equity-Related Items” include the value of common stock at the time the City of Nashua closed on its acquisition of Pennichuck Corporation, which for PEU, was \$100. Exh. 4 at 5. The Settling Parties also recommend that this amount be removed from the computation of the revenue deficiency. *Id.* at 4; 5/20/14 Tr. at 43–44. Second, the Settling Parties recommend that in future rate proceedings PEU’s return on equity be equal to the average of the most recent 12-months of thirty-year United States Treasury Bond interest rates available at the time of the filing of the rate case, plus 3.0%. The Commission accepts these clarifications and approves them. These provisions were associated with the establishment of a unique ratemaking structure. The Commission reserved this rate case and PEU’s affiliates’ rate cases to test these mechanisms and make modifications, if necessary. The Commission finds it reasonable to set the value of PEU’s Equity-Related Items to include the value of its common stock at the time the City of Nashua closed on the acquisition.

C. Treatment of Non-Revenue Producing Assets

The Settling Parties recommend that non-revenue producing assets be recognized in rate base at year-end value when they meet the following criteria: (1) the project is in response to a regulatory mandate, (2) the project is not intended to increase revenues, (3) the costs of the project are significant, and (4) the assets of the project are used and useful by the end of the test year. Exh. 4 at 5-7. The Settling Parties also recommend that the year-end valuation extend to: Plant in Service, Accumulated Depreciation, CIAC, and any Accumulated Amortization of the CIAC. *Id.* at 7. The Commission finds these criteria to be reasonable and approves them. The

criteria are not new. The Commission has approved a year-end valuation of assets in rate base in other rate cases when they meet similar criteria. *See Lakes Region Water Company, Inc.*, Order No. 25,391 (July 13, 2012). Accordingly, the Commission approves this term of the Settlement Agreement.

D. Eminent Domain Costs

The Commission authorized the City of Nashua to recover from PEU and its affiliates, PWW and PAC, up to \$5 million in costs associated with the City's eminent domain proceeding in Docket No. DW 04-048. *See, City of Nashua*, Order No. 25,292 (Nov. 23, 2011). The Settling Parties recommend that the Commission authorize the City of Nashua to recover \$4,458,232. Exh. 4 at 7. This amount is not included in the establishment of customer rates, but can be recovered through earnings and profits of PEU and its affiliates. Only costs incurred by the City of Nashua from January 2002 through August 2009 qualify for recovery. *Id.* The Commission must therefore determine whether: the costs submitted by the City of Nashua relate to Docket No. DW 04-048, are within the time frame specified, and are reasonable.

The Commission's Audit Staff reviewed the City of Nashua's documentation and recommended that the Commission allow the City of Nashua to recover \$4,458,232 in eminent domain costs. 5/20/14 Tr. at 10. The Audit Staff recommended that the Commission disallow \$490,090. *Id.* at 9. The disallowed amounts pertain to: attorney fees and report expenses relating to Docket No. DW 02-126, mathematical errors, and expenses that exceeded contract caps. Exh. 4 at 32-40. The Settling Parties, including PAC, recommend that the Commission accept this recovery amount. The Commission finds that the \$4,458,232 is reasonable, that the costs relate to Docket No. DW 04-048, and that the costs were incurred within the requisite time frame. The Commission approves recovery of \$4,458,232 from PWW, PEU, and PAC.

E. MARA

The MARA is another unique accounting mechanism authorized by the Commission in the Acquisition Docket. *See City of Nashua*, Order No. 25,292 (Nov. 23, 2011). As PEU testified, the MARA entry on PEU's books is PEU's pro rata share of the acquisition premium resulting from the City of Nashua's acquisition of Pennichuck Corporation. 5/20/14 Tr. at 49. The Commission's Audit Staff reviewed the components of the MARA and found no exceptions. Exh. 4 at 41-48. The Commission accepts Audit Staff's report and finds that the City of Nashua and PEU have complied with the terms of Order No. 25,292.

F. North Country Capital Recovery Surcharge

The Settling Parties recommend that the Commission approve decreases to the NCCRS. The Commission finds this recommendation consistent with *Pennichuck East Utility, Inc.*, Order No. 25,051 (Dec. 11, 2009), and approves the decreases. In Order No. 25,051, the Commission established the NCCRS and ordered that the NCCRS "be recalculated in each general rate case for PEU to reflect changes in the number of customers" in each water system. *Id.* at 5 and 21. The Settling Parties have recalculated the NCCRS. Due to the increase in the number of customers served in these water systems, the recalculation results in the following decreases: (1) Birch Hill, \$46.94 to \$46.05, (2) Sunrise Lake Estates, \$11.01 to \$10.74, and (3) Locke Lake Colony, \$17.00 to \$16.36. Exh. 4 at 9. The Commission finds these rates just and reasonable and approves them.

G. Rate Case Expenses

Pursuant to the Settlement Agreement, PEU agrees to file documentation of its rate case expenses no later than thirty days from the date of the final order in this proceeding. The Commission's administrative rules authorize utilities to file for rate case expenses. *See N.H.*

Code Admin. Rules Chapter Puc 1900. A utility seeking recovery of rate case expenses shall file its request for recovery along with all supporting documentation no later than thirty days after the Commission's final order. N.H. Code Admin. Rules Puc 1905.02. Accordingly, the Commission will allow PEU thirty days from the date of this order to file its rate case documentation and will defer ruling on the recovery of rate case expenses until after PEU makes its filing.

H. Conclusion

The Commission approves the Settlement Agreement and incorporates its terms and conditions into this order. The Commission finds that the revenue requirement proposed by the Settling Parties is reasonable and that the resulting rates are just and reasonable. The Commission finds that the terms of the Settlement Agreement represent an appropriate balancing of ratepayer interests and the interests of PEU's investor under current economic circumstances, are just and reasonable, and serve the public interest.

To facilitate the efficient administration of the Settlement Agreement, the Commission authorizes PEU, Staff, and the OCA to modify the Settlement Agreement so long as any modification is mutually agreed upon and non-substantive, such as a clerical or ministerial amendment that involves timing or scheduling. The Settling Parties shall file any such modification with the Commission and provide a copy to all parties on the service list. The Commission will approve the requested modification, if appropriate, via a secretarial letter but will not require notice or hearing.

Based upon the foregoing, it is hereby

ORDERED, that the terms of the Settlement Agreement are hereby adopted and **APPROVED** as discussed herein; and it is

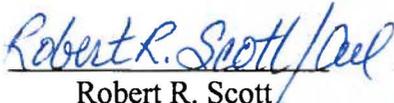
FURTHER ORDERED, that PEU is authorized to collect from customers permanent rates, as discussed herein, effective for service rendered on or after July 1, 2013; and it is

FURTHER ORDERED, that PEU shall file with the Commission its calculation and reconciliation of temporary and permanent rates no later than thirty calendar days from the date of this order, and it is

FURTHER ORDERED, that PEU shall file with the Commission a final accounting of its rate case expenses no later than thirty days after the date of this order; and it is

FURTHER ORDERED, that PEU file with the Commission tariff pages in compliance with this order within fourteen days of the date of this order.

By order of the Public Utilities Commission of New Hampshire this twenty-fifth day of July, 2014.


Robert R. Scott
Commissioner


Martin P. Honigberg
Commissioner

Attested by:


Kimberly Nolin Smith
Assistant Secretary