STATE OF NEW HAMPSHIRE

BEFORE THE

PUBLIC UTILITIES COMMISSION

Re: Pennichuck Water Works, Inc.

DW 08-073

JOINT PREFILED DIRECT TESTIMONY

REGARDING TEMPORARY RATES

OF

WILLIAM D. PATTERSON AND BONALYN J. HARTLEY

June 2008

1 **Q. Please state your names and positions with Pennichuck Water**
2 **Works, Inc. (the "Company").**
3 A. We are William D. Patterson, Sr. Vice President and CFO and Bonalyn J.
4 Hartley, Vice President-Administration of the Company.
5 **Q. Mr. Patterson, please state your professional and educational**
6 **background.**
7 A. I hold a Bachelor of Science in Engineering Degree, summa cum laude, in
8 Civil Engineering from Princeton University. I also hold a Master of
9 Business Degree n Finance and Accounting from the University of
10 Chicago Graduate School of Business. I have spent the first eighteen
11 years of my professional career as an investment banker specializing in
12 the utility industries. From 1990 to 1996, I was a Managing Director in the
13 Investment Banking Division of Smith Barney, Inc. I have extensive
14 experience in equity and debt financing for utilities in both the public and
15 private markets as well as advising utilities on a variety of strategic issues
16 including, capital structure, dividend policy, acquisitions, divestitures, and
17 restructurings. From January 2000 to June 2001, I was employed as Chief
18 Financial Officers of Enermetrix, an early stage energy software
19 development company. Thereafter, I returned to independent consulting
20 practice until my employment with Pennichuck Water Works in January
21 2005 as Vice President and Chief Financial Officer.
22 **Q. Ms. Hartley, please state your professional and education**
23 **background.**

1 A. Prior to my current position, I had served in various capacities including
2 Vice President-Controller, Manager of Systems and Administration and
3 Office Manager. I have been with the Company since 1979. In 1989, I
4 attended the Annual Utility Rate Seminar sponsored by the National
5 Association of Regulatory Commissioners and the University of Utah. I
6 am a graduate of Rivier College with a B. S. in Business Management. In
7 addition, I am a Director of the New England Chapter of the National
8 Association of Water Companies and Chairman and Trustee of the
9 Southern New Hampshire Medical Center of Nashua, NH. I have had the
10 opportunity to testify in numerous cases before this Commission.
11 **Q. What is the purpose of your testimony?**
12 A. Our joint testimony has been prepared to support the Company's request
13 for a temporary rate increase of 11.27% in this docket. We are providing
14 joint testimony since the discussion of temporary rates summarizes certain
15 issues and data that are also covered in our respective direct testimony for
16 permanent rates. Our testimony regarding temporary rates will
17 demonstrate that the Company's overall return on its rate base investment
18 is dramatically less than the Company's last found return by the
19 Commission in DW 06-073, thereby warranting approval of temporary
20 rates. In particular, our testimony will demonstrate that the Company
21 needs the temporary rate increase being requested in order to earn a
22 reasonable return on the cost of the Company's property used and useful

in the public service less accrued depreciation, as shown by the reports of the Company that have been filed with the Commission.

Analysis of Current Returns

Q. Mr. Patterson, would you please recap the present returns authorized by this Commission from the Company's last rate case?

A. Yes. In DW 06-073, this Commission authorized the Company to earn an overall rate of return of 7.89%, based on an authorized return on common equity of 9.75%. This compares to an overall rate of return of 7.81% being requested in this docket. The Company's current revenue requirement is based on a rate base of approximately $78.0 million and an operating expense level of approximately $9.8 million.

Q. Please describe the changes to the Company's plant in service and its earned return since the conclusion of its last rate case.

A. As shown in the following graph, the Company's plant in service during the past two years alone has increased by $30.6 million to approximately $134.4 million at the end of 2007.

1 Just as important, its operating expenses increased by $1.3 million over
2 the December 2005 operating expense level. Actual operating expenses,
3 comprised of operations and maintenance costs, depreciation and
4 amortization and taxes other than income taxes and non-recurring gains,
5 were $14.7 million for the calendar year ended December 31, 2007.
6 **Q. Mr. Patterson, what has been the effect on the Company's overall**
7 **rate of return on investment ("ROI") as a result of the increased**
8 **investment in rate base and increased operating costs?**
9 A. The additional investment in rate base and operating expenses have had
10 a significant adverse impact on the Company's ROI. For the test year
11 ended December 31, 2007, the Company's actual ROI was 6.64%, or 125
12 basis points ("bps") below its authorized ROI of 7.89%. The following
13 graph illustrates the Company's historical ROI as compared to its allowed
14 ROI from December 2006 to April 2008.

Furthermore, as of April 30, 2008, its ROI continued to decline even further to 6.47%, which is 142 basis points below its authorized ROI.

Q. During the time that the Company has been experiencing a deteriorating ROI has it not been able to book AFUDC on upgrades to the water treatment plant as an offset?

A. Yes, but the nature of the Contract 4 work at the water treatment plant is such that components of the upgrade have become used and useful over a two-one half year time frame and once a component has become used and useful the Company can no longer book AFUDC on the upgrade but must service the capital required to complete the upgrade without rate support until the next rate case. By way of example, Filter #1 was completed and became used and useful on October 1, 2007 requiring a

total investment of just over $1.6 million (excluding AFUDC). The Company stopped booking AFUDC on this filter at this time. By the time rate relief is granted on this investment it will have been in use for almost a year without rate support. This same problem with a significant mismatch in timing between components becoming used and useful at the water treatment plant and the Company's ability to earn on its investment of over $19 million (including engineering) in these assets applies to each of the discrete components that make up Contract 4 of the water treatment plant upgrades.

Q. Ms. Hartley, Would you please explain Schedule A, Exhibit A entitled "Pennichuck Water Works, Inc. Computation of Revenue Deficiency, Temporary Rates"?

A. Yes. Schedule A, which is filed in conjunction with this temporary rate testimony, was prepared to illustrate the revenue deficiency for the twelve months ended December 31, 2007, which is the test year used in this docket. The calculation is based on the following:

- year end rate base average of $78,047,810;
- pro forma to annualize 2007 non-revenue producing assets
- authorized overall rate of return of 7.89%;
- actual net operating income of $4,680,242

As shown on Schedule A, the Company's revenue deficiency for the twelve months ended December 31, 2007 was $2,446,978 using the

1 Company's last authorized overall rate of return. Based on that calculation
2 alone, the Company would be entitled to an increase in rates on a
3 temporary basis at a level that is 11.27% above its current level. This
4 revenue deficiency calculation is based on the Company's actual
5 performance during the test year and a pro forma adjustment for the
6 annualization of significant capital improvements that were placed into
7 service on or before December 31, 2007. Specifically, the Company
8 expended $7.0 million on new non-revenue producing assets primarily
9 associated with its upgrade to the water treatment plant by December 31,
10 2007. These improvements are described in Mr. Ware's Prefiled Direct
11 Testimony. The Company has also made a pro forma adjustment of $390,
12 072 for water revenues which reflects the annualization of the rate
13 increases that occurred in 2007 from the Company's prior rate case, DW
14 06-073.
15 **Q. Ms. Hartley, please explain the principal reasons for the decline in**
16 **the Company's overall rate of return.**
17 A. The deterioration in the Company's overall rate of return is primarily due to
18 significant capital improvements made by the Company in order to
19 maintain compliance with the Safe Drinking Water Act. Through
20 December 31, 2007, the Company spent approximately $9.7 million in
21 new capital improvements. A majority of these improvements are non-
22 revenue producing. The Company has also experienced increases in

1 some of its operating expenses during the test year including the cost of
2 chemicals, fuel costs and purchased water.
3 **Q. Ms. Hartley were all of these capital expenditures included in this**
4 **schedule used and useful by December 31, 2007?**
5 A. Yes.
6 **Q. Ms. Hartley, are you recommending a Temporary Rate increase for all**
7 **classes of customers?**
8 A. No. The attached schedule entitled "Report of Proposed Rate Changes,
9 Temporary Rates" reflects a temporary increase across each customer
10 class in accordance with the recommendations of the Cost of Service
11 Study. The Cost of Service study recommends that the Company recover
12 86.2% of its required revenues from water service revenues, 3.68% from
13 private fire protection revenues and 10.12% from municipal fire revenues
14 as part of its permanent rate structure. The Cost of Service Study
15 recommends that Municipal fire protection rates not be changed as part of
16 the temporary rate structure in order to avoid a decrease in municipal fire
17 protection rates. If the Company proposed the 10.12% of the temporary
18 rate revenue requirement from Municipal Fire protection followed by an
19 increase in the Municipal Fire protection revenues with the Permanent rate
20 increase, the result would be the collection of the reduced Municipal Fire
21 protection revenues from the temporary rates in the form of recoupment.
22 The collection of revenues from each of the customer classes of revenue
23 as defined above results in an 11.07% temporary increase in GWS water

service revenues, an 11.09% temporary increase in Contract water service revenues, a 69.72% temporary increase in private fire protection revenues and a 1.11% temporary increase in municipal fire revenues (there is no proposed increase in the rate to be charged for municipal fire service; the 1.11% revenue increase of 2007 revenues reflects an increase in fire hydrants and inch-feet at the end of 2007 versus the beginning of 2007). The overall result of these increases is an effective increase of 11.27%. The increase resulting from the requested temporary rate increase for the average single family residential customer will be approximately $3.59 per month.

Conclusion

Q. What level of temporary rates is the Company requesting and why?

A. The Company is requesting a level of temporary rates that is 11.27% higher than its current rates. For the pro forma test year ended December 31, 2007, the Company's ROI has declined to 6.64%, which is 125 basis points lower than its authorized ROI of 7.89%. Temporary rates at a level of 11.27%, which reflects a $2,446,978 revenue deficiency, would be sufficient to enable the Company to currently earn its allowed rate of return. The Company cannot continue to incur this magnitude of revenue deficiency going forward and, accordingly, it seeks approval of this temporary rate request on a service rendered basis as of August 1, 2008. This increase will permit the Company (i) to begin to earn a more

1 reasonable return on its rate base investments, (ii) to recover increased
2 operating expenses incurred during the test year and (iii) to mitigate a
3 significant rate increase for customers, as a result of the request for a
4 permanent rate increase of 14.72%, followed by two step increases of
5 5.05% and 5.51% based on capital improvements that will have become
6 used and useful as of May and November 2008. Furthermore, by
7 approving temporary rates at the level requested, the need for a significant
8 surcharge at the conclusion of the permanent rate case will also be greatly
9 reduced.

10 **Q. Does this conclude your testimony on temporary rates?**

11 A. Yes.

PENNICHUCK WATER WORKS, INC.
COMPUTATION OF REVENUE DEFICIENCY
For The Twelve Months Ended December 31, 2007

Schedule A
Temporary

	TEST YEAR	PRO FORMA ADJUSTMENTS	PRO FORMA TEST YEAR
Consolidated Rate Base **(1)**	$ 72,945,003	$ 5,102,807	$ 78,047,810
RATE of Return	7.89%		7.89%
Income Required	$ 5,755,361		$ 6,157,972
Adjusted NOI	$ 4,680,242	$ -	$ 4,680,242
Deficiency	$ 1,075,119		$ 1,477,730
Tax Factor	60.39%		60.39%
Revenue Deficiency	$ 1,780,293		$ 2,446,978
Water Revenues	$ 21,312,996	$ 390,072	$ 21,703,068
Proposed Revenue Inc	8.35%		11.27%

Note:
(1) For purposes of the temporary rate increase, a pro forma adjustment is reflected for the annualization of 2007 non-revenue producing assets per Schedule 3, Attachment A of the permanent rate filing schedules.

RATE SCHEDULE
GENERAL SERVICE - METERED
SCHEDULE G-M
11.27% PROPOSED TEMPORARY INCREASE

Availablitiy

The rate is available for metered water service in the franchised area subject to the terms and conditions of this tariff.

Character of Service:

Nashua Core System: Water is fully treated, filtered, and purified and is transmitted by gravity and pumps to the individual service pipes.

Community Water Systems: Water is ground water from a well size. Water quality meets or exceeds all federal and state standards for drinking water. Outdoor use of water may be restricted during dry summer periods.

Rates: **Quarterly**

The standard customer charge per quarter based on meter size will be shown below.

Meter Size	Quarterly Customer Charge	Proposed Temporary Increase	
5/8"	$ 46.08	$ 49.77	(I)
3/4"	$ 66.33	$ 71.64	(I)
1"	$ 106.83	$ 115.41	(I)
1 1/2"	$ 208.17	$ 224.88	(I)
2"	$ 340.80	$ 368.13	(I)
3"	$ 624.96	$ 675.09	(I)
4"	$ 1,030.71	$ 1,113.36	(I)
6"	$ 2,045.22	$ 2,209.26	(I)
8"	$ 3,262.92	$ 3,524.61	(I)
10"	$ 4,683.18	$ 5,058.78	(I)

In addition to the standard customer charge, the quarterly volumetric charge based on usage will be show below:

Volumetric Charge:	$ 2.40	per 100 cu. Ft.	
Proposed Temporary Increase	$ 2.647	per 100 cu. Ft.	(I)

Terms of Payment:

Bills under this rate are net; will be rendered quarterly, and are due and payable at the office of the Company on the due date as stated on the water bill.

Issued: _____

Effective: August 1, 2008

Issued by _____
Bonalyn J. Hartley
Title: Vice President Administration

Authorized by NHPUC Order No. 24,771 in Docket No. DW 06-073, dated June 29, 2007

RATE SCHEDULE
GENERAL SERVICE - METERED
SCHEDULE G-M
11.27% PROPOSED TEMPORARY INCREASE

Monthly

The standard customer charge per month based on meter size will be shown below.

Meter Size	Monthly Customer Charge	Proposed Temporary Increase	
5/8"	$ 15.36	$ 16.59	(I)
3/4"	22.11	$ 23.88	(I)
1"	35.61	$ 38.47	(I)
1 1/2"	69.39	$ 74.96	(I)
2"	113.60	$ 122.71	(I)
3"	208.32	$ 225.03	(I)
4"	343.57	$ 371.12	(I)
6"	681.74	$ 736.42	(I)
8"	1,087.64	$ 1,174.87	(I)
10"	1,561.06	$ 1,686.26	(I)

In addition to the standard customer charge, the monthly volumetric charge based on usage will be as follows:

Volumetric Charge:	$ 2.40	per 100 cu. Ft.	
Proposed Temporary Increase	$ 2.647	per 100 cu. Ft.	(I)

Terms of Payment:

Bills under this rate are net; will be rendered monthly, and are due and payable at the office of the Company on the due date as stated on the water bill.

Issued: _____

Effective: August 1, 2008

Issued by Bonalyn J. Hartley
Bonalyn J. Hartley
Title: Vice President Administration

Authorized by NHPUC Order No. 24,771 in Docket No. DW 06-073, dated June 29, 2007

RATE SCHEDULE
MUNICIPAL FIRE PROTECTION SERVICE
SCHEDULE FP-M
11.27% PROPOSED TEMPORARY INCREASE

Availablitiy

This rate is applicable to general fire protection.

Character of Service:

The Company will make every effort to maintain normal pressures at all times on the distribution system, but shall not be held liable for the failure of either the supply or distribution division of its system to adequately furnish its normal quantity of water when such failure is due to the elements, natural causes, breaks, leaks, unusual or concurrent droughts, or the waste or unlawful use of water.

Rate:

The charge shall be made up of two parts as follows:

1) Hydrant charge

For each hydrant connected to the distribution system		Proposed Temporary Increase	
$ 41.52 per quarter		$ 41.52 per quarter	(I)
or		or	
$ 13.84 per month		$ 13.84 per month	(I)

2) Inch-Foot Charge

The number of "inch-foot" units in the distribution system is to be obtained by multiplying the number of linear feet of pipe of each diameter (4" and larger) by the diameter in inches. The total number of "inch-foot" units in the distribution system will be determined as of January 1st each year, and will be the base for computing the "inch-foot" charge for the entire year with one-fourth to be billed each quarter or one-twelfth to be billed each month.

	Proposed Temporary Increase	
Charge for each "inch-foot" unit to be		
$ 0.1137 per year	$ 0.1137 per year	(I)

Terms of Payment:

Bills under this rate are net; will be rendered monthly or quarterly, and are due and payable at the office of the Company on the due date as stated on the water bill.

Issued: _____

Effective: August 1, 2008

Issued by: Bonalyn J. Hartley

Bonalyn J. Hartley

Title: Vice President Administration

Authorized by NHPUC Order No. 24,771 in Docket No. DW 06-073, dated June 29, 2007

RATE SCHEDULE
PRIVATE FIRE PROTECTION SERVICE
SCHEDULE FP-NM
11.27% PROPOSED TEMPORARY INCREASE

Availablitiy

This rate is available for private fire protection and sprinkler service subject to the Private Fire Protection Regulations of paragraph 13 of this tariff.

Character of Service:

The Company will make every effort to maintain normal pressures at all times on the distribution system, but shall not be held liable for the failure of either the supply or distribution division of its system to adequately furnish its normal quantity of water when such failure is due to the elements, natural causes, breaks, leaks, unusual or concurrent droughts, or the waste or unlawful use of water.

Rate:

The charge shall be determined by the size fo the pipe entering the property as follows:

	Per Quarter	Per Month	Proposed Temporary Increase Per Quarter	Per Month	
4" or smaller connection	$ 88.05	$ 29.35	$ 144.03	$ 48.01	(I)
6" connection	147.75	49.25	241.71	$ 80.57	(I)
8" or larger connection	217.53	72.51	355.86	$ 118.62	(I)

Terms of Payment:

Bills under this rate are net; will be rendered monthly or quarterly, and are due and payable at the office of the Company on the due date as stated on the water bill.

Issued: _____

Effective: August 1, 2008

Issued by: Bonalyn J. Hartley

Title: Vice President Administration

Authorized by NHPUC Order No. 24,771 in Docket No. DW 06-073, dated June 29, 2007

Pennichuck Water Works, Inc.
Report of Proposed Rate Changes
For the Twelve Months Ended December 31, 2007

Pro Forma
Schedule 9
Temporary

DOCKET NO: DW 08-073 DATE FILED: 6/23/2008
TARIFF NO.: 5 or PAGE NOS. 39-42 EFF. DATE: 8/1/2008

Rate or Class of Service	Effect of Proposed Change	Average Number of Customers	Pro Forma Present Rates	Proposed Rates	Proposed Change Amount	Proposed Change %
G-M	Increase	24,787	$17,225,355	$19,131,487	$1,906,132	11.07%
Present Rate Adj			-	-		
Private FP	Increase	780	494,186	838,754	$344,568	69.72%
FP - Hydrants	Increase	5	2,466,483	2,493,950	$27,467	1.11%
Anheuser-Busch Contract	Increase	2	1,059,315	1,194,361	$135,046	12.75%
Milford Contract						
Contract Charges	No Increase	1	81,000	81,000	-	0.00%
Volumetric Charges	Increase	-	63,090	70,655	$7,565	11.99%
Hudson Contract						
Contract Charges	No Increase	1	32,800	32,800	-	0.00%
Volumetric Charges	Increase	-	280,838	306,484	$25,646	9.13%
TOTALS		**25,576**	**$21,703,068**	**$24,149,491**	**$2,446,423**	**11.27%**

Notes:
(1) The Proposed rates and the amount of the increase is based on the Cost of Service Study. On Schedule 13 Temp, page 5 of 5, of the Cost of Service Study, a slight difference is noted in the allocation of the proposed revenue vs. the revenue requirement shown in the rate filing schedules.
(2) No actual increase is proposed for the municipal fire service. The increase reflected represents the increase in fire hydrants and inch-feet at the end vs. the beginning of the test year.

Signed by: Bonalyn J. Hartley
Title: Vice President - Administration