

**STATE OF NEW HAMPSHIRE
BEFORE THE
PUBLIC UTILITIES COMMISSION**

**Pennichuck Water Works, Inc.
Petition for Special Contract for Service to Anheuser-Busch, Inc.**

DW 11-_____

Direct Testimony of Donald L. Ware

January 21, 2011

1 **Professional and Educational Background**

2 **Q. What is your name and what is your position with Pennichuck Water**
3 **Works, Inc.?**

4 A. My name is Donald L. Ware. I am the President of Pennichuck Water Works,
5 Inc. (the "Company"). I have worked for the Company since 1995. I am a
6 licensed professional engineer in New Hampshire, Massachusetts and Maine.

7 **Q. Please describe your educational background.**

8 A. I have a Bachelor in Science degree in Civil Engineering from Bucknell
9 University in Lewisburg, Pennsylvania and I completed all the required
10 courses, with the exception of my thesis, for a Masters degree in Civil
11 Engineering from the same institution. I have a Masters in Business
12 Administration from the Whittemore Business School at the University of New
13 Hampshire.

14 **Q. Please describe your professional background.**

15 A. Prior to joining Pennichuck, I served as the General Manager of the Augusta
16 Water District in Augusta, Maine from 1986 to 1995. I served as the District's
17 engineer between 1982 and 1986. Prior to my engagement with the District, I
18 served as a design engineer for the State of Maine Department of
19 Transportation for six months and before that as a design engineer for
20 Buchar-Horn Consulting Engineers from 1979 to 1982.

21 **Q. What are your responsibilities as President of the Company?**

22 A. As President, I am responsible for the overall operations of the Company,
23 including water quality and supply, distribution, engineering and water system

24 capital improvements. With regard to capital improvements overseen by the
25 Company's Engineering Department, I work closely with the Department and
26 the Company's Chief Engineer regarding project selection, project design,
27 project management and construction management.

28 **Q. What is the purpose of your testimony?**

29 A. The purpose of my testimony is to describe the Company's history with regard
30 to special contracts with Anheuser-Busch ("AB"), to explain why the Company
31 has entered into a new special contract with AB, to summarize the terms and
32 conditions of the proposed new contract, and to explain why the proposed
33 contract is in the public interest and should be approved.

34 **Q. Please describe the historical background of PWW's relationship with**
35 **AB.**

36 A. In 1969, Pennichuck entered into a 25 year special water supply contract with
37 AB which became effective March 15, 1970 (the "First Contract") which was
38 approved by Commission Order 9,685 in Docket IR 12,984. Under the First
39 Contract, AB compensated Pennichuck for the installation of a 24 inch water
40 main to a point opposite AB's new brewery in Merrimack, as well as related
41 water supply equipment. Under the First Contract and continuing under the
42 Second Contract (described below), PWW has delivered water to AB at a
43 discounted price, consistent with the costs shown in PWW's cost of service
44 study. Initially, the rate charged to AB (referred to as the "AB Rate") was one-
45 half of PWW's lowest, or tailblock, rate (at that time, Pennichuck's general
46 metered rate had three blocks or levels). Subsequently, and to this day under

47 the existing Third Contract, the AB Rate has been approximately 51% of the
48 volumetric rate for general metered service per 100 cubic feet. In addition to
49 the volumetric rate, AB also pays the tariffed meter charge.

50 When the First Contract was expiring, PWW was able to negotiate the
51 Second Contract, under which PWW agreed to continue to provide service to
52 AB at a rate that reflected the cost to provide service and AB agreed to a
53 minimum level of annual charges as well as minimum payments even if AB
54 were to shut down its operations or otherwise stop taking water service from
55 PWW. That contract had a term of ten years, beginning on July 1, 1995 and
56 ending on June 30, 2005 and was approved by the Commission in Order No.
57 21,681 in Docket DR 95-046. When the Second Contract was expiring, PWW
58 was able to negotiate the Third Contract, under which PWW agreed to
59 continue to provide service to AB at a rate that reflected the cost to provide
60 service and AB agreed to a minimum level of annual charges as well as
61 minimum payments even if AB were to shut down its operations or otherwise
62 stop taking water service from PWW. That contract had a term of ten years,
63 beginning on July 1, 2005 and ending on June 30, 2015 and was approved by
64 Commission Order 24,441 in DW 04-228.

65 **Q. What caused AB to seek to terminate the Third Contract two years**
66 **early?**

67 A. In preparing for the filing of the current PWW rate case ("DW10-091"), PWW
68 had a cost of service study ("COSS") completed. Based on the terms of the
69 Third Contract, which required PWW to deliver certain flows under certain

70 operating conditions, the COSS concluded that AB's current rates were
71 insufficient to pay for the cost of the water service it was being provided.
72 Based on the recommendations of the COSS, AB's rates would have
73 increased by 64%. AB believed that the increase was not warranted and
74 sought to terminate the Third Contract and began to evaluate its supply
75 alternatives.

76 **Q. What is the primary reason why the current rates are insufficient to**
77 **cover AB's cost of water service?**

78 A. The Third Contract was dependent upon AB using large volumes of water to
79 cover its share of the fixed costs of the assets providing its water service as
80 well as paying for a share of PWW's administrative and general costs and the
81 variable costs associated with producing water to AB. When the AB contract
82 was developed in 2005, AB used an average of 1,950,556 gallons per day
83 (GPD) for the year ending in 2004. In 2010, AB used an average of 987,407
84 GPD. At the same time AB's usage was dropping dramatically, the
85 Company's water supply facility expenses that AB's rates were supposed to
86 support were increasing greatly in value. During the same period, the
87 variable rate paid by AB increased from \$0.795 per hundred cubic feet (CCF)
88 to a projected rate of \$1.793 per CCF (assuming the Third Contract remained
89 in effect and PWW was granted its requested 19.91% increase sought in
90 DW10-091). The result of the projected increase in AB rates (from 2004 to
91 2010) in conjunction with the actual decreases in AB usage (from 2004 to
92 2010) is a projected net increase in the revenues to be paid by AB of 14.2%.

93 This net increase to PWW revenues would just barely cover any inflationary
94 increases in PWW's operating expenses over the 6 years between the end of
95 2004 and 2010, leaving no additional revenues required to cover AB's share
96 of fixed expenses associated with improvements that were made over that
97 time frame to the Water Treatment plant, the replacement of one the Fifield
98 tanks and the rebuild of the Supply Pond Dam. The Net Book Value
99 associated with these assets increased from \$9,308,196 at the end of 2004 to
100 \$46,670,612 at the end of 2009 or over a 500% increase. It is clear that the
101 use of the pure volumetric rate as developed for AB under the Third Contract
102 is insufficient to cover AB's share of the expenses required to provide AB
103 water service given the large drop in AB's usage.

104 **Q. The Third Contract required that AB buy a minimum amount of water**
105 **each year. Didn't this provide a way for PWW to react to the revenue**
106 **loss from AB through the rate making process?**

107 A. The Third Contract provided a way for PWW to recover lost AB revenues via
108 the rate making process. However, this minimum revenue mechanism did not
109 anticipate that there would be over a 500% increase in the water supply rate
110 base associated with providing water service to AB in the ensuing years at
111 the same time that AB's usage would be dropping dramatically. If AB's
112 volumes had not dropped by over 50% since the last COSS, the revenues
113 collected under the Third Contract would have been sufficient to pay for AB's
114 cost of water service.

115 **Q. Please summarize the key provisions of the Fourth Contract.**

116 A. The key provisions of the Fourth Contract are as follows:

117 1. AB's contract requires PWW to provide up to an average annual flow of
118 1.0 MGD, a peak day flow of 1.5 MGD and a maximum hourly flow rate of 2.0
119 MGD.

120 2. AB will pay a monthly bill consisting of three parts, a monthly meter
121 charge, a monthly fixed charge and a monthly volumetric charge which will be
122 based on the actual volume of water used during the month.

123 3. In the event that AB's annual usage averages less than 650,000 Gallons
124 per Day (GPD) then AB will be required to make a payment at the end of the
125 contract year known as the Annual Volume Shortfall charge. The Annual
126 Volume Shortfall charge will be calculated by taking the volumetric rate in
127 effect for AB at the end of the contract year times the difference between
128 650,000 GPD times the number of days in the contract year less the actual
129 usage during the contract year.

130 **Q. Please explain how each of the charges comport with the**
131 **recommendations of the Cost of Service Study.**

132 A. The charges match those detailed in the amendment to the COSS based on
133 the AB Contractual rates of 1.0 MGD Average Day, 1.5 MGD Maximum Day
134 and 2.0 MGD Maximum Hour.

135 The monthly meter charge provides PWW with the vehicle to collect the
136 customer related charges associated with the meter charge that are not
137 collected elsewhere in the AB charges. The costs associated with this charge

138 are primarily variable and as such this charge will increase at the same rate
139 as the 6" meter charge for PWW's General Metered customers in this and
140 future rate cases. The COSS set this rate at \$1,122.67 for a 6" water meter.
141 The initial rate set in the Fourth Contract for each of AB's two six inch meters
142 will be set equal to the permanent rate approved by the Commission as part
143 of DW10-091 and will be based on the final accepted COSS. This rate will be
144 subject to the proposed Step Increase being sought in DW10-091.

145 The monthly fixed charge insures that that AB will pay its share of the
146 expenses associated with the water supply facilities that provide service to AB
147 regardless of its actual usage. This charge is fixed for the length of the
148 contract unless PWW is required to make an investment in the water supply
149 facilities required to service AB in which case a new COSS will be completed
150 to determine the proper allocation of PWW's expenses and return on the
151 investment in its water supply facilities that would be allocable to AB. The
152 COSS set this rate at \$30,952.54 per month based on the allowed usage
153 volumes specified in the proposed Fourth Contract. The final fixed monthly
154 charge for AB will be established as part DW 10-091. This rate will not
155 change during the duration of the Fourth Contract unless PWW must make
156 additional investment in the water supply facilities that service AB and a new
157 COSS that establishes the appropriate sharing of the new investment that is
158 approved by the Commission. Finally, this rate is charged each month
159 regardless of whether AB uses any water or not.

160 The AB volumetric charge was determined in the COSS as the rate

161 necessary to pay for the variable costs associated with producing AB's water
162 as well as providing a prorated contribution from AB toward PWW's
163 Administrative and General costs. The volumetric rate established for AB by
164 the COSS was \$0.9178 per CCF. The initial AB volumetric rate for the Fourth
165 Contract will be established as part of DW 10-091. This rate will be subject to
166 the proposed Step Increase being sought in DW 10-091.
167 The Annual Minimum Annual Usage charge provides rate stability in the event
168 AB uses less water than the minimum amount.
169 The term of the Fourth Contract is ten years running from its effective date
170 which will be the date that the final rate in order is issued in DW 10-091.

171 **Q. Why is it important that this special contract be approved in conjunction**
172 **with the permanent rate order issued in DW 10-091?**

173 A. By approving the AB special contract simultaneously with the final permanent
174 rate order in DW 10-091, a proper reconciliation of the final permanent rates
175 and AB's special contract rates as set in the Fourth Contract can be made
176 back to June 16, 2010.

177 **Q. Why should AB have a special contract? Please explain how they are**
178 **different from PWW's other customers.**

179 A. As was the case when the Third Contract was approved by the Commission,
180 AB is far and away PWW's largest customer in terms of demand. During
181 calendar 2010, AB used approximately 360,405,100 gallons of PWW water,
182 which amounts to an average per day take of approximately 0.987 million
183 gallons, or about 8.3% of PWW's total average daily usage in 2010. By way

of contrast, PWW's second largest customer used 59,742,760 gallons of water in 2010, an average per day take of 163,679 gallons.

Besides being PWW's largest customer, AB also has on site storage which results in AB's usage being relatively steady without troublesome peaks during seasonal peaking periods. In addition, AB paid for the entire cost of constructing the water main that provides water service to it directly from the plant to AB. As noted above, the AB Rate was arrived at using a cost of service approach and is appropriate under the circumstances because it is more reflective of the cost to serve AB based on the facts detailed above than the tariffed rate that would otherwise apply absent a special contract. Finally, PWW is convinced that if it does not provide fair rates to a large water user such as AB, it will ultimately either obtain its water supply independently from its own premises or simply leave the State of New Hampshire. The loss of AB as a customer would result in its share of the fixed costs associated with PWW's water supply facilities having to be paid for by the general metered customers.

Q. What is the economic advantage of the proposed Fourth Contract to AB?

A. If AB were to be billed as a GM customer, it would be billed a monthly meter charge for two 6" water meters at a rate of \$1,122.67 per month and a volumetric rate \$3.016 per CCF (based on the permanent rates established by the COSS) which would result in annual bill to AB for a 2009 test year, based on 551,400 CCF of usage, in the amount of \$1,667,513. If AB had not

207 terminated the Third Contract, the COSS had determined that AB's annual bill
208 for 2009 would have been \$1,390,148. Under the provisions of the Fourth
209 Contract, AB's annual bill for 2009 would have been \$904,449.

210 **Q. What are the termination provisions in the proposed Fourth Contract?**

211 A. AB may terminate the Fourth Contract in any of the following three ways:

212 1. Providing Two Years notice. Notice may be issued without cause.

213 2. If the Company requests that the Commission increase AB's volumetric
214 rate above \$1.50 per CCF, AB has the right to terminate the Fourth Contract if
215 it notifies PWW of its intent to terminate within 90 days of the PWW rate filing.

216 The Fourth Contract would terminate 1 year after the notification of
217 termination. In the event AB terminates under this clause, it would allow
218 PWW to make a pro forma adjustment to its filed rate case reflecting the loss
219 of AB as a customer.

220 3. If the Company requests that the Commission increase AB 6" meter rate
221 above \$1,830 per 6" meter, AB has the right to terminate the Fourth Contract
222 if it notifies PWW of its intent to terminate within 90 days of the PWW rate
223 filing. The Fourth Contract would terminate 1 year after the notification of
224 termination. In the event AB terminates under this clause, it would allow
225 PWW to make a proforma adjustment to reflect the loss of AB as a customer.

226 **Q. What is the purpose of the minimum payment obligation and early
227 termination provisions of the Fourth Contract?**

228 A. With these provisions, PWW is attempting to protect its financial integrity
229 while allowing some flexibility to AB to reduce its costs. In exchange for the

230 continuation of a special rate, AB is agreeing to accept the minimum payment
231 provisions. Among other things, the two year notice period would give PWW
232 time to file for a rate case to recover the portion of the AB revenues required
233 to cover the fixed expenses associated with the water supply facilities that
234 provide service to AB.

235 **Q. Do you have anything else you would like to add?**

236 A. Yes. PWW believes that the Fourth Contract is just and reasonable for both
237 AB and all of PWW's customers. The Fourth Contract results in AB paying its
238 fair share of PWW's costs to serve it while allowing AB the benefit of further
239 conservation efforts regarding its water usage. Retaining AB as a customer
240 for the next 10 years provides PWW and its customers a guaranteed
241 contribution to the fixed expenses associated with its water supply facilities
242 that will not change regardless of whether AB is a customer or not. The
243 annual minimum usage requirement insures that AB will pay its fair share of
244 PWW's Administrative and General Costs for the duration of the Contract. In
245 sum, PWW believe that the Fourth Contract is just and consistent with the
246 public interest.

247 **Q. Are there approvals other than the Commission's that are required for**
248 **the Fourth Contract?**

249 A. Yes. PWW has entered into an Agreement and Plan of Merger ("Merger
250 Agreement") with the City of Nashua, New Hampshire whereby the City will
251 purchase all the outstanding stock of PWW's parent company, Pennichuck
252 Corporation, and will own and operate what is now PWW's water system.

253 Under Section 5.01(b)(xii) of the Merger Agreement, the City must approve
254 any material contract entered into by PWW prior to the closing of the stock
255 purchase. The City's Board of Alderman will be voting on the Fourth Contract
256 at a meeting next week. The Company will provide the Commission with a
257 copy of that vote once it occurs.

258 **Q. Does that complete your testimony?**

259 **A.** Yes.