

**STATE OF NEW HAMPSHIRE
PUBLIC UTILITIES COMMISSION**

DW 08-073

PENNICHUCK WATER WORKS, INC.

Permanent and Temporary Rate Proceeding

Order Approving Settlement Agreement and Permanent Rate Increase

ORDER NO. 25,006

August 13, 2009

APPEARANCES: McLane, Graf, Raulerson & Middleton, P.A. by Sarah B. Knowlton, Esq., for Pennichuck Water Works, Inc.; Upton & Hatfield, P.A. by Justin Richardson, Esq., for City of Nashua; Ransmeier & Spellman by John T. Alexander for Anheuser-Busch; Office of the Consumer Advocate by Rorie Hollenberg, Esq. on behalf of residential ratepayers; and Staff of the Public Utilities Commission by Marcia A. B. Thunberg, Esq.

I. PROCEDURAL HISTORY

On May 22, 2008, Pennichuck Water Works, Inc. (PWW) filed a notice of its intent to file rate schedules. On June 23, 2008, PWW filed revised tariff pages designed to increase its revenues from general metered customers by \$3,193,791, or 14.72%, on an annual basis over its current authorized level of rates. In support of its rate increase, PWW filed schedules, exhibits, and pre-filed testimony of Donald L. Ware, President of PWW; Bonalyn J. Hartley, Vice President of Administration of PWW, William D. Patterson, Senior Vice President, Treasurer, and Chief Financial Officer of PWW; and Harold Walker, Manager, Financial Studies of the Valuation and Rate Division, of Gannett Fleming, Inc. PWW also filed a petition for temporary rates.

PWW proposed that its permanent rate increase take effect on a service rendered basis as of August 1, 2008, or the date on which customers are notified, whichever is sooner. PWW also

requested two step increases for capital additions it expected to place in service in 2008. The first step increase, based on plant that was used and useful as of May 1, 2008, would require an additional \$1,095,263 in annual gross operating revenue and would result in a further 5.05% increase for general metered customers. The second step increase, based on plant that was expected to be used and useful as of November 1, 2008, would require an additional \$1,196,149 in annual gross operating revenues and would constitute a further 5.51% increase for general metered customers.

On July 23, 2008, by Order No. 24,876 and pursuant to RSA 378:6, the Commission suspended the proposed revisions to PWW's permanent rate tariffs pending its investigation and decision thereon, scheduled a hearing for August 27, 2008 to address procedural matters regarding the proposed temporary and permanent rate increases, and ordered that PWW publish notice of the proceeding and hearing.

On August 5, 2008, the Office of Consumer Advocate (OCA) filed a letter expressing its intent to participate in this docket on behalf of residential utility consumers pursuant to RSA 363:28. Anheuser-Busch, Inc. and the City of Nashua filed petitions to intervene on August 21 and 22, 2008, respectively, which were granted on August 27, 2008.

On September 5, 2008, PWW revised its request for the second step increase and lowered the amount sought to \$823,836 in annual gross operating revenues, which would represent a 3.80% increase over test year revenues. On the same day, PWW also filed a revised petition for a temporary rate increase in the amount of \$2,446,978, or 11.27% over current rates.

On November 10, 2008, Staff and PWW filed a settlement agreement on temporary rates and presented the agreement at the hearing held on November 12, 2008. On December 30, 2008, the Commission issued Order No. 24,926 approving the settlement agreement and granting

PWW's request for a temporary rate increase on a service rendered basis, effective July 28, 2008.

On March 24, 2009, Staff filed the permanent rates testimony of Utility Analysts James L. Lenihan and Jayson P. Laflamme, and testimony of David C. Parcell, President and Senior Economist of Technical Associates, Inc. On the same date, the OCA filed testimony of Utility Analyst Stephen R. Eckberg. On May 7, 2009, PWW filed rebuttal testimony of Bonalyn J. Hartley and Donald L. Ware responding to the OCA's testimony. PWW and Staff filed a settlement agreement regarding permanent rates on May 15, 2009, and presented the agreement at a hearing on the merits on May 19, 2009.

On June 15, 2009, Staff filed a letter stating that it had conducted an audit of PWW's capital improvements proposed to be funded through a step adjustment. Staff indicated that it had verified a total of \$12,121,317.00 in plant additions and enclosed a copy of the audit report as well as revised schedules provided by PWW. The schedules showed a revised proposed revenue increase for the step adjustment of \$2,257,425, or 10.40%, and Staff stated that it agreed with the revised amount.

On June 25, 2009, OCA filed a letter opposing Staff's recommendation with respect to the step adjustment. OCA stated that it understood that the step adjustment presented at the May 19, 2009 hearing was intended to compensate PWW for plant additions completed in 2008. OCA stated that Staff's recommendation seeks to allow PWW to recover the costs of capital additions completed in 2009. OCA claimed that the amount booked on January 1, 2009 was \$1,286,243.70 and that the sum of the projects booked in March and April 2009 was \$2,468,860.00. OCA stated that the incorporation of capital additions made in 2009 into the proposed step adjustment was inconsistent with the proposed settlement as well as PWW's filings. OCA asserted that the timing of the recommendation, after the final hearing and the

close of the record, is an inappropriate revision of the terms of the proposal pending before the Commission and is an unfair expansion of the closed record.

On June 30, 2009, Staff, on behalf of itself and PWW, responded to OCA's letter. Staff stated that PWW's initial filing included a request for two step adjustments to its rates. The first was to recognize plant additions relating to PWW's water treatment plant upgrade that were completed and in service by May 1, 2008. The second step adjustment was to recognize other plant additions that PWW expected would be completed and in service by November 1, 2008. As noted in the May 15, 2009 settlement agreement, the settling parties combined the two requested step adjustments into one because all the assets were completed and in-service at the time the settlement agreement was executed.

Staff agreed with OCA that, throughout the course of the proceeding, the assets being considered in the step adjustments were referred to as the 2008 additions. Staff stated that it is clear from the filings that PWW expected all of the assets to be completed and in service by the end of 2008. Staff observed that its audit and recommendation on the step adjustment concerned the same plant assets that were under consideration during the entire duration of the proceeding. According to Staff, there were no new plant additions proposed in the step adjustment that were not previously requested by PWW and subject to discovery by OCA and the parties in the docket. Staff disagreed that it had expanded the scope of relief sought by PWW.

II. POSITIONS OF THE PARTIES AND STAFF

A. PWW and Staff

PWW and Staff's position is represented in the terms of the settlement agreement described below.

B. City of Nashua

The City of Nashua took no position on the settlement agreement but requested that, if the Commission approves the agreement, the Commission order that the municipal fire protection rates be reconciled in accordance with RSA 378:29. Nashua stated that the settlement agreement did not expressly state how the reconciliation would be done, but noted that PWW had testified at hearing as to how it expected the reconciliation to occur. Nashua stated it wished to have the reconciliation occur as described at hearing.

C. Anheuser-Busch

Anheuser-Busch took no position on the settlement agreement.

D. Office of the Consumer Advocate

OCA stated it was pleased with the resolution of the pension expense and fuel cost expense issues, but that it disputed several other issues. OCA requested that the Commission disallow the entire amount of PWW's incentive compensation because it benefits shareholders and the goals are related to levels of income earned. OCA stated that the Commission has a policy that expenses recognized as part of a company's cost of service must be both necessary to providing service and provide a benefit to ratepayers and it avers that PWW has not demonstrated how the incentive compensation is necessary and provides a benefit.

At hearing, OCA disagreed with the Cash Working Capital rate used by PWW and recommended a rate of 16.56%. OCA stated that this rate would provide a more consistent treatment of changes in the post test year such as the annualization of certain costs. In its pre-filed testimony, OCA stated that the difference between its calculation and PWW's is approximately \$81,685 and that this corresponds to a reduction in PWW's proposed revenue requirement by an estimated \$6,380. Exh. 14 at 11.

OCA did not agree with PWW's annualization of monthly billing expenses. OCA stated that only known and measurable changes twelve months past the test year should be considered for setting rates and that PWW's test year expenses should only include two months of monthly billing expenses since migration to monthly billing did not occur until November 2008. OCA stated that PWW's desire to annualize expenses associated with monthly billing was inconsistent with PWW's proposed annualization of its Cash Working Capital. PWW's cash working capital reflects its receipt of revenues associated with the monthly billing. OCA also did not support PWW's proposal to annualize expenses associated with new employees.

With respect to Coburn Woods, OCA took the position that expenses included in the revenue requirement for this water system should be reduced in recognition of the savings OCA expected PWW to realize from the reduced production expenses associated with fixing leaks. In the alternative, OCA stated PWW ought to demonstrate how other expenses offset these savings in order to keep the current expense amount in the revenue requirement.

OCA was also critical of PWW's treatment of cell tower leases. OCA stated that PWW had agreed in a prior rate case to share the revenues from the cellular tower leases with customers, but that in this rate case PWW had found a way to avoid this treatment and keep all the profits for itself and its shareholders. OCA stated the Commission should require PWW to continue to share the revenues with customers consistent with the Commission's treatment of Verizon's directory publishing revenues. *See Verizon New Hampshire*, Order No. 24,345, 89 NH PUC 382 (July 9, 2004); and *Verizon New Hampshire*, Order No. 24,385, 89 NH PUC 582 (October 19, 2004); *affirmed in Appeal of Verizon New England*, 153 N.H. 50 (2005). OCA further recommended that the Commission disallow recovery of costs relating to a PWW employee's \$145 dues for a Rotary membership and \$35 for a United Way Annual Meeting

dinner. OCA stated that PWW had not demonstrated how these expenses benefited customers or provided a benefit to ratepayers.

III. TERMS OF SETTLEMENT AGREEMENT

Staff and PWW reached agreement on all issues as specified below.

A. Income Requirement

The settling parties agreed that PWW should be granted an increase of \$2,491,817, or 11.48%, in its adjusted test year water revenues of \$21,703,068 in order to produce a total revenue requirement of \$24,194,885. This amount was calculated utilizing a stipulated rate base amount of \$77,843,943 and provides for an overall rate of return of 7.38% which includes a stipulated cost of equity of 9.75% and a cost of debt of 5.46%.

The calculated revenue increase before income tax effect is \$1,504,809 and when federal and state taxes are applied, the increase in PWW's revenue requirement becomes \$2,491,817. Staff and PWW stipulated that this revenue requirement represents a reasonable compromise of all issues relating to the revenue requirement pending before the Commission for purpose of permanent rates, including allowed overall rate of return, return on equity, capital structure, *pro forma* adjustments, capital additions to PWW's rate base, and operating expenses.

B. Step Adjustment for Capital Additions

The settling parties recommended the Commission allow recovery of certain capital additions and approve the following adjustments: 1) an allocation of certain Unamortized Deferred Debits to PWW's affiliates, 2) an increase in PWW's Pension Expense to its 2008 level, and 3) an increase in Other Operating Revenue in order to reflect a proposed increase in customer fees as contemplated in Section III (H) of the Agreement. The settling parties agreed, and recommended to the Commission, that the two step adjustments originally proposed by PWW be combined into one step adjustment in the tentative amount of \$2,303,671 (subject to Commission audit) or an additional 10.61% increase in revenues, effective upon the Commission's approval of this Agreement on a bills rendered basis. As of the date of the Settlement Agreement, a final audit report from the Commission Staff regarding the 2008 capital additions has not yet been finalized. Therefore, once a final audit report has been issued, a recommendation by Staff will be submitted to the Commission relative to the ultimate level of the proposed step adjustment. It is the intent of the settling parties that the revenues from the combined step adjustment be calculated separately from the RSA 378:29 temporary-permanent rate reconciliation so as not to create any compounding effect relative to the agreed upon permanent rate. The combined step adjustment would be applied to all customer classes based on the rate design set forth in this Agreement.

C. Rate Design

For purposes of temporary rates, the Commission approved a change in rate design in which the amount of the temporary rate increase for fire protection customers was shared equally between private and municipal fire protection customers (FP-Hydrants). The remainder of the temporary rate increase was borne proportionally by the remaining customers.

The settling parties agreed to adopt the rate design set forth in the June 2008 Cost of Service Study. This Cost of Service Study was updated to reflect the revenue increases per the Settlement Agreement and was included as Attachment C.

D. Rate Impact

The settling parties recommended an overall increase for general metered customers of 11.27%. For the average residential customer with a 5/8 meter and based on average monthly usage of 953 cu. ft., the annual bill would be approximately \$502.81, an increase of approximately \$43.95 per year, or \$3.66 per month. With the step adjustment, there would be an additional increase of approximately \$48.14 per year or \$4.01 per month for the average residential customer. The increase for private fire protection services would be 80.17% and the decrease for public fire protection services would be 0.73%. Including the step adjustment, the increases for private fire protection service would be 97.32% and for public fire protection services is 8.72%. The results of the revenue increases by customer class are reflected in the Report of Proposed Rate Changes attached to the Agreement as Attachment D.

E. Effective Date for Permanent Rates and Step Increase and Recoupment

Staff and PWW recommended that for G-M customers, the Anheuser-Busch, Milford, and Hudson contracts, there should be a one-time surcharge amounting to the difference between temporary and permanent rates and that this surcharge should be shown as a separate item on customer bills. In the case of private fire protection and municipal fire protection customers, the settling parties recommended the surcharge occur over a 12 month period effective with the implementation of permanent rates and also be shown as a separate item on customer bills. For the average residential customer with a 5/8 meter and based on average monthly usage of 953 cu. ft., the one-time recoupment surcharge is approximately \$2.00. The settling parties recommended that the reconciliation of temporary and permanent rates for all customer classes be done consistent with the June 2008 cost of service/rate design study.

F. Rate Case Expense Surcharge

The settling parties recommended that PWW be allowed to recoup its rate case expenses for this docket in the form of a one-time surcharge of approximately \$4.00 per customer, shown as a separate item on all customers' bills. The settling parties expect rate case expenses to include, but not be limited to, PWW's cost of service study, legal expenses and administrative expenses such as copying and delivery charges associated with filing the case. PWW agreed to submit its final rate case expense request to Staff for review and recommendation to the Commission.

Upon receipt of the Commission's final order, PWW agrees to file a compliance tariff supplement including the approved surcharge relating to recoupment of the difference between the level of temporary rates and permanent rates and recovery of the amount of rate case expenses within 20 days. PWW agrees to file an accounting with the Commission of the amount of the rate case expenses recovered.

G. Tariff Fee Changes

The settling parties recommended that Pennichuck East Utility, Inc. (PEU) and Pittsfield Aqueduct Company, Inc. (PAC) file a petition for authority to increase certain tariffed charges consistent with the change in tariffed charges being recommended for PWW in this docket so that these charges will be uniform among all three utilities. The settling parties acknowledge that revenues from these increased charges have already been reflected in the calculation of the proposed revenue requirement. Hearing Transcript May 19, 2009 (5/19/09 Tr.) at 50, lines 4-22.

IV. COMMISSION ANALYSIS

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 the customers' 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). Additionally, in circumstances where a utility seeks to increase rates, the utility bears the burden of proving the necessity of the increase pursuant to RSA 378:8. 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. N.H. Code Admin. R. Puc 203.20 (b) requires the Commission to determine, prior to approving disposition of a contested case by settlement, that the settlement results are just and reasonable and serve the public interest.

A. Revenue Requirement

Staff and PWW propose a revenue requirement of \$24,194,885. This is an increase of 11.48% over PWW's test year revenues and is comparable to the revenue requirement for

temporary rate purposes of \$24,090,406, approved by Commission Order No. 24,926, (December 30, 2008). In its initial filing, PWW had sought to increase its revenue requirement by \$3,193,791, which would have represented a 14.75% increase. In its pre-filed testimony, Staff had recommended that PWW's revenue requirement increase by \$2,015,562, or by 9.29% for a total revenue requirement of \$23,718,630. Exh. 12 at 3 and 28. The agreed upon revenue requirement is an increase of \$2,491,817 over test year revenues. The settling parties have agreed to an overall rate of return of 7.38%, which reflects a cost of equity of 9.75% and a cost of debt of 5.46%. The settling parties propose a total rate base of \$77,843,943. Exh. 16 at 11. Staff has audited the plant additions and corroborates that they are used and useful in the provision of utility services.

The OCA does not agree with this revenue requirement. The OCA proposes that a portion of the revenues received from the sale of the cell tower leases be included in the calculation of PWW's revenue requirement commensurate with the settlement reached in Docket No. DW 04-056, which equitably allocated the annual lease revenues between ratepayers and shareholders. PWW argues that the previous 50% allocation of revenues was the result of a comprehensive settlement and that it was not legally required to share the revenues with ratepayers. It argues that shareholders are now entitled to the entirety of the proceeds from the sale of the cell tower leases. The benefit that flows from the cell tower leases derives from utility property used and useful in the provision of service to PWW's ratepayers. We agree with the OCA that PWW's revenue requirement should be adjusted but we will not make an adjustment at this time based on the sales price of the leases. Rather, we will effectively continue the arrangement as established in the previous settlement agreement and impute revenues equivalent to the historical annual payment and adjust the revenue requirement and

rates accordingly until the Company's next rate proceeding, at which time we will consider the propriety of the sale of the cell tower leases and the appropriate allocation of benefits between ratepayers and shareholders.¹

OCA also disagreed with PWW's annualization of expenses associated with its transition to monthly billing since PWW did not begin monthly billing until November of its test year. We do not find it reasonable to adopt this position. PWW has testified that it now bills customers on a monthly basis. 5/19/09 Tr. at 20, line 18. The Commission relies on historical test years to determine future revenue needs, but the Commission also recognizes that certain pro-forma adjustments or annualizations ought to be made so that the revenue requirement established accurately portrays a utility's total costs. PWW will not be billing monthly for only two months out of a year as it did in the test year. Rather, monthly billing is an expense that it will incur for twelve months in every year going forward. As such, we conclude that annualizing test year monthly billing expenses is reasonable in determining PWW's revenue requirement.

OCA also raises the issue of pension expense and contends that the Staff's position has been inconsistent. It notes that Staff opposed use of PWW's 2009 pension expense level, but agreed to incorporate other annualized expenses in the settlement agreement. We do not share OCA's view that these positions are necessarily contradictory. The adjustment of, or annualization of, certain expenses is typically permitted for changes to those expenses which are known and measurable in the twelve months following the test year. In the case of pension expense, we understand that the proposal for adjusting pension expense based on the 2009 level was not only speculative, but that no portion of that expense level was to occur within twelve months of the end of the test year.

¹ The revenue requirement contained in the proposed settlement contained \$39,579 in cell tower revenues as a result of an oversight by PWW in failing to remove those revenues from the test year. See 2007 Annual Report for PWW. In order to match prior full year revenues we impute an additional \$12,610 to operating revenues.

With respect to OCA's position that \$269,955 for PWW's executive officer incentive compensation ought to be disallowed, we have reviewed the testimony and do not agree that the incentive compensation program does not provide a benefit to customers. PWW states that its "primary compensation objective is provide a total compensation package that enables the Company to attract, retain, and motivate highly qualified and dedicated executives." Exh. 19 at 33. As part of total compensation a properly constructed incentive compensation program rewards managers and executives for achieving individual goals and company goals, and is therefore a reasonable business tool for regulated utilities. PWW employs an incentive compensation plan that generates a bonus pool that varies with the level of company-wide income. Certain executive officers and managers are then awarded bonuses that have an automatic feature and a discretionary feature: 55% of the bonus pool is distributed on an automatic basis to covered employees, while 45% of the bonus pool is allocated by the Compensation Committee of the Board of Directors for accomplishment of specified goals and objectives. The OCA asserts that the criteria for establishing the bonus pool does not benefit ratepayers and it proposes an adjustment to rates to eliminate \$269,955 for incentive compensation for executive officers and senior managers.

We find as a general matter that the expense for executive compensation is a reasonable component of rates and we will approve the settlement agreement as it incorporates such an expense. We are interested, however, as a prospective matter in reviewing more closely how incentive compensation will accrue and be distributed. Accordingly, we will direct PWW to discuss the details of its incentive compensation plan with Staff and the OCA to determine whether refinements to the plan are appropriate and require that a report on incentive compensation be filed within 90 days of the effective date of this Order.

With respect to the \$35 incurred for a United Way dinner meeting, we agree that such charitable contributions ought to be booked below the line and that such expenses should not be included in the calculation of PWW's revenue requirement. With respect to PWW's membership in the local rotary club, we will allow that expense. We encourage water utilities to foster healthy relationships with their customers. Membership in local organizations such as the rotary club allows PWW an opportunity to hear first hand the concerns of its customers and to promote goals such as water conservation.

Having reviewed the proposed revenue requirement and its components, as well as the proposed pro-forma adjustments, we find that the revenue requirement presented by Staff and PWW in the settlement agreement, except as noted above, represents a reasonable compromise of the issues and that it will produce just and reasonable rates. Further, we find that the rate base used to calculate the revenue requirement is prudent, used, and useful in accordance with RSA 378:28.

B. Rates and Rate Design

The settling parties propose that permanent rates be applied according to the rate design set forth in the June 2008 Cost of Service study. Most notable in the study was a recommendation to increase the allocation of the revenue requirement to private fire protection customers, which would have increased those rates by 85.29%. This compares to PWW's initial overall rate increase of 14.72%. For temporary rates, this study was not fully implemented due to the need to conduct additional discovery. Staff testified at hearing that it had fully investigated the study and that it was satisfied with the study's recommendations. 5/19/09 Tr. at 34, lines 5-13. No other party objected to implementation of the study's recommendations.

Having considered Staff and PWW's recommendation to fully implement the study and having reviewed the study itself as well as the testimony offered in this proceeding, and absent any objection, we find that the study is sound. We further find that implementation of the proposed rate design will result in just and reasonable rates and we will authorize PWW to change its revenue requirement allocation among its customer classes to reflect the recommendations in the June 2008 Cost of Service study.

Staff and PWW also recommend approval of other increases to PWW's tariff. Specifically, PWW charges \$28.00 for service connections and disconnections during regular business hours and it seeks to raise that amount to \$46.00. During non-regular hours, PWW presently charges \$40.00 and it seeks to raise that amount to \$63.00. It seeks to raise its service pipe connection fee from \$85.00 to \$160.00. 5/19/09 Tr. at 54. PWW testified that it had not updated its service fees since 1999 and that labor and truck charges had increased during that time. 5/19/09 Tr. at 50 and 51. PWW also testified that its wages and fuel costs had increased. Exh. 9 at 7-9. PWW does not plan to change its other service fees, such as initiation of service at \$20.00, returned check fee of \$15.00, and the main pipe inspection fee of \$3.00 per foot. Having considered these increases and the increased costs presented by PWW, we find these increased service fees to be reasonable and we will authorize PWW to implement these permanent rates and service fees on a service-rendered basis as of the date of this order.

C. Recoupment

We approved temporary rates for PWW by Order No. 24,926 (December 30, 2008). Pursuant to RSA 378:29, temporary rates are effective until the final determination of the rate proceeding. If the final rates are in excess of the temporary rates, the public utility is permitted to amortize and recover the sum of the difference. In the event permanent rates are less than

temporary rates, we will order a refund pursuant to our authority under RSA 378:7 to determine just and reasonable rates. In the temporary rate phase of this docket, the settling parties recommended a partial implementation of the June 2008 Cost of Service study. Specifically, the settling parties recommended that the increase for the private fire protection class be evenly split between the private and municipal fire protection customer groups in an effort to minimize rate shock to private fire protection customers and pending full review of the study. This split resulted in private fire protection rates increasing by 41.5% and municipal fire protection increasing 6.41% under temporary rates. 5/19/09 Tr. at 23, lines 22-24. Under the permanent rates proposed in the settlement, and fully implementing the Cost of Service study, private fire protection rates will increase by 80.17% and public fire protection rates will decrease by 0.73%. General metered customers' rates will increase by 11.27%. To fully reconcile these permanent rate increases with temporary rates, PWW will be filing a reconciliation report that will identify the funds to be recouped for each customer class and will propose a surcharge to recover the funds. Although the specific surcharge is unknown at this time, Staff and PWW anticipate recommending a one-time surcharge for General Metered customers, and the Anheuser-Busch, Milford, and Hudson contracts, and a twelve-month surcharge for fire protection customers. We will render a decision on this issue after the parties have made the proposed filings.

D. Step Adjustment

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, which increase the utility's rate base. Step adjustments avoid placing a utility in an earnings deficiency immediately after a rate case in which the revenue requirement was based on an historic test year and a smaller rate base.

Staff and PWW recommend a step adjustment to revenues for certain capital improvements made by PWW. PWW testified at hearing that the capital improvements included \$9.4 million in improvements to the water treatment plant, \$2.3 million for the Fifield Tank, and approximately \$365,000 for other infrastructure improvements to a pumping station and to existing pipeline. 5/19/09 Tr. at 39, lines 18-24. In PWW's initial filing, it had requested recovery of \$14,946,720 in improvements in the form of two step increases. *See* Initial filing, Tab 14, Schedule 3. Later, in supplemental direct testimony filed on September 5, 2008, PWW deferred certain step two capital additions. Exh. 10 at 4. PWW thus sought step increases for improvements totaling only \$12,336,380. The settlement agreement recommended an increase to PWW's revenue requirement of \$2,303,671, which was based on an estimated additional rate base of \$12,072,611. Staff's audited recommendation, filed on June 15, 2009, was that PWW be allowed to recover on \$12,121,317 in plant additions and that its revenue requirement be increased by \$2,257,425.

Subsequent to Staff's recommendation, the OCA filed an objection to the recommendation, and Staff filed a reply. The crux of the disagreement pertains to whether Staff and PWW's reference to the step adjustment capital additions as "2008 additions" during the permanent rate hearing was meant to limit recovery to capital improvements that were, in fact, used and useful during calendar year 2008 or whether, in effect, "2008 additions" was a short hand reference to certain capital improvements.

As a threshold matter, RSA 378:28 requires us to make a finding that plant, equipment, or capital improvements are prudent, used, and useful before including such items in permanent rates. Having reviewed Staff's recommendation and audit, we find that the capital improvements proposed in the step adjustment were prudently incurred and are now used and useful. The

remaining issues are whether the capital improvements that became used and useful after calendar year 2008 ought to be allowed in rate base and whether such inclusion is an inappropriate revision of the terms of the settlement agreement or an unfair expansion of a closed record, as OCA contends.

We first consider whether the assets placed in service in 2009 were properly included in the step adjustments considered in this docket. RSA 541-A:31, III governs adjudicative proceedings and requires reasonable notice of the issues. In Order No. 24,876 (July 23, 2008) the Commission suspended PWW's proposed tariffs and stated that PWW sought two step adjustments; one for plant used and useful as of May 1, 2008 and a second for plant that PWW expected would be used and useful as of November 1, 2008. PWW sought a combined revenue increase of \$2,291,412 for these step adjustments. We conclude that the step adjustment capital additions were properly noticed in this docket.

As to the issue of when the capital improvements would be used and useful, Staff submitted a discovery response with its reply, Staff 2-22, dated January 8, 2009, wherein PWW identified which capital improvements proposed in step two were completed and used and useful and which capital additions were not. In that response, PWW stated that "Filter #5 will be completed and used and useful by the end of January 2009" and that "[t]he Fifield Tank will be completed and used and useful by the end of January 2009." We conclude that during discovery the parties received notice that some of the capital improvements comprising the second step adjustment would not be used and useful by the anticipated November 1, 2008 date.

We next turn to whether the settlement agreement limited the capital additions proposed in the second step adjustment to those improvements that were completed in calendar year 2008. The settlement agreement states that "PWW has expanded its rate base with certain capital

additions placed in service in 2008.” Exh. 16 at 4. At hearing in support of the settlement agreement, PWW testified that the step increases were “for capital additions that were to be put in service in 2008 and completed in the – completed near the beginning of 2009.” 5/1/9/09 Tr. at 16, lines 7-10. Finally, the amount of capital improvements contemplated under the settlement agreement was \$12,072,611 and the audited amount totaled \$12,121,317.

OCA states that Staff and PWW impermissibly expanded the second step adjustment capital additions to include \$3,755,103.70 worth of capital additions that became used and useful in 2009. We do not find this contention supported by the record. The record supports the conclusion that PWW initially requested recovery of approximately \$12 million in capital improvements and that Staff and PWW entered into a settlement agreement to allow recovery of these same capital improvements, subject to audit. Notwithstanding the delay until early 2009 for some of these capital improvement to be placed in service, our consideration of the \$12 million in capital improvements is not a change or modification to the settlement agreement, nor an expansion of the scope of the second step adjustment. The subject assets were noticed in this proceeding and have been used and useful in the provision of service to customers for a number of months. Accordingly, we find that it is reasonable to allow PWW to recover on the capital improvements referred to in the settlement agreement and that recovery occur through a step increase to PWW’s revenue requirement.

These step adjustment revenues will not be reconciled with temporary rates. The settling parties have requested that PWW be allowed to implement the step increase to rates on a bills rendered basis, notwithstanding N.H. Code Admin. Rules Puc 1203.05 which requires that changes in rates occur on a service rendered basis. In support of the waiver request, we note that PWW bills on a monthly basis. Allowing PWW to implement the rate change coincident with its

normal billing cycle will eliminate the cost associated with reading the meters mid-cycle. We find that this waiver serves the public interest and is a benefit to customers. We, therefore, find it reasonable to allow the rate change for this step adjustment to occur on all bills issued on or after the effective date of this order.

E. Conclusion

Taking into account the two adjustments to the revenue requirement discussed above, i.e., \$35 is being reclassified below the line for the cost of the United Way Dinner and \$12,610 is being added to pro-forma operating income to make up for the annual amount to be recognized by the Company for the cell tower lease income annual revenue stream, the permanent rate revenue requirement is now \$24,182,240. This represents an annual increase of \$2,479,172 or 11.42%. The permanent rate revenue requirement combined with the finalized step increase is estimated to result in an approximate annual bill of \$549.95 for the average residential rate payer using 9.53 ccf of water annually. This is an increase over current rates of approximately \$91.17 annually or \$7.50 per month.

Having reviewed the record, including the settlement and evidence presented at hearing, we find that the revenue requirement proposed by Staff and PWW, as modified above, is reasonable and will produce just and reasonable rates. We find that the terms of the settlement, with the modifications made herein, represent an appropriate balancing of ratepayer interests and the interests of PWW's investors under current economic circumstances and are consistent with the public interest. We further find that PWW's investments in rate base used to serve its customers are prudent and used and useful, pursuant to RSA 378:28. We will adopt and approve the terms of the settlement agreement subject to the adjustments discussed herein.

Based upon the foregoing, it is hereby

ORDERED, that the terms of the Settlement Agreement presented by the parties are hereby adopted and approved as discussed herein; and it is

FURTHER ORDERED, that Pennichuck Water Works, Inc. is authorized to collect from customers permanent rates, as discussed herein; and it is

FURTHER ORDERED, that Pennichuck Water Works, Inc. shall file within fourteen days its calculation of the temporary rate recoupment from July 28, 2008 to the date of this order as well as its proposed method of recovering the difference; and it is

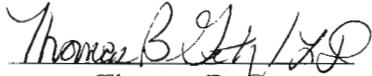
FURTHER ORDERED, that Pennichuck Water Works, Inc.'s request for waiver of N.H. Code Admin. Rules Puc 1203.05 is hereby granted; and it is

FURTHER ORDERED, that Pennichuck Water Works, Inc. is authorized to raise customer rates in the form of a step increase, as discussed herein, as of the date of this order for all bills issued on or after the date of this order; and it is

FURTHER ORDERED, that Pennichuck Water Works, Inc. shall file within thirty days its calculation of its rate case expenses and proposed surcharge, as discussed herein, and it is

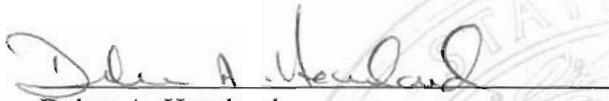
FURTHER ORDERED, that Pennichuck Water Works, Inc. shall file with the Commission a compliance tariff within fourteen days of the date of this order; and it is

By order of the Public Utilities Commission of New Hampshire this thirteenth day of
August 2009.


Thomas B. Getz
Chairman


Clifton C. Below
Commissioner

Attested by:


Debra A. Howland
Executive Director

