

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

**DW 13-130**

**PENNICHUCK WATER WORKS, INC.**

**Permanent Rate Proceeding**

**SETTLEMENT AGREEMENT**

**I. PROCEDURAL BACKGROUND**

The Settlement Agreement approved by the New Hampshire Public Utilities Commission (Commission) by Order No. 25,292 (November 23, 2011) in Docket No. DW 11-026, Re *City of Nashua*, required that Pennichuck Water Works, Inc. (PWW), Pennichuck East Utility, Inc. (PEU), and Pittsfield Aqueduct Company, Inc. (PAC) (jointly, the Companies) file with the Commission full rate cases simultaneously by June 1, 2013. On May 31, 2013, the Companies filed the required rate cases.

The Commission issued Order No. 25,524 on June 20, 2013 in this docket and suspended PWW's proposed tariff and scheduled a prehearing conference on July 17, 2013 immediately followed by a technical session. The Office of Consumer Advocate (OCA) had previously filed a letter of participation in this docket on May 9, 2013. The prehearing conference and technical session were held as scheduled and on July 17, 2013, the Commission Staff (Staff) filed on behalf of the parties in this case a proposed procedural schedule. On July 18, 2013, the Commission approved the proposed procedural schedule for PWW which, among other things, provided for three rounds of discovery followed by a technical session and settlement conference.

## **II. RATE CASE FILING**

PWW requested a permanent rate increase of \$34,016, or 0.12%, in its gross operating revenues, effective July 1, 2013, based on the test year ending December 31, 2012. PWW also requested that temporary rates be set at the rates currently in effect, which the Commission approved by Order No. 25,598 (November 22, 2013).

## **III. TERMS OF AGREEMENT**

PWW, Staff, and the OCA (the Settling Parties) met on February 25, 2014 to discuss terms of settlement in this rate proceeding. During that meeting, the Settling Parties reached agreement on the following issues:

### **A. Permanent Rates**

The Settling Parties agree to a 0.0% rate increase and therefore no modifications to the revenue requirement recognized by PWW during the test year consisting of water revenues in the amount of \$27,689,214. The Settling Parties agree that the revenue requirement for permanent rates set forth above represents a reasonable compromise of all issues relating to the revenue requirement pending before the Commission for purposes of permanent rates, including, but not limited to, allowed overall rate of return, return on equity, capital structure, *pro forma* adjustments, capital additions to rate base, and operating expenses. As the sum expressed above is the result of compromise and settlement, it is a liquidation of all adjusted net operating income requirement and revenue requirement issues and does not constitute precedent regarding any particular principle or issue. The Settling Parties agree that the revenue requirement recommended to the Commission results in permanent rates for PWW's customers that are just and reasonable.

**B. Clarification of Certain Ambiguities Contained within the DW 11-026 Settlement Agreement**

During the course of discovery, certain ambiguities contained within the DW 11-026 Settlement Agreement relative to the rate making process became apparent for which the parties had differing interpretations. For the sake of future rate proceedings, the Settling Parties have sought to reach a common understanding with regard to clarifying these ambiguities, as follows:

1. **Valuation of “Equity-Related Items”:** The DW 11-026 Settlement Agreement at Section III, B, 1, c (pg. 9) states:

*“Under the proposed Ratemaking Structure . . . the value of each utility’s equity at the closing of the Merger shall be removed from its rate base and the related portion of net operating income (the “Equity-Related Items”) shall also be removed from the traditional computation of revenue deficiency . . .”*

The Settling Parties agree and propose that in future rate proceedings the value of the “Equity-Related Items” shall be inclusive of the value of common stock at the time of the merger, which for PWW was \$30,000.

2. **Determination of Return on Equity:** The DW 11-026 Settlement Agreement at Section III, B, 1, e (pg. 10) states:

*“. . . If there is any equity reflected on a utility’s financial statements at the time of a future rate case . . . the Ratemaking Structure would apply a formula cost of equity based on the average of the interest rates on 30-year Treasury bonds for the most recent 12 months ending prior to the filing of the rate case, plus 3.0 percentage points.”*

However, Exhibit B to the DW 11-026 Settlement Agreement, with specific reference to PWW (Page 8 of 9), contains the following footnote:

*“The component cost rate (allowed ROE) with respect to any Common Equity in any future rate case shall be equal to (i) the most recent 12-month average of thirty-year United States Treasury bond interest rates as derived from the Federal Reserve Statistical Release, H.15(519). “Selected Interest Rates”, or a successor or equivalent publication, including the interest rate published on, or as close as*

*possible after, a date four months following the proposed effective date of proposed changes in the utility's rates as set forth in the rate filing, plus (ii) 3.0% . . .”*

The Settling Parties agree and propose that in future rate proceedings Return on Equity shall be equal to:

- 1) 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
- 2) 3.0%.

**3. Valuation of Rate Stabilization Fund (RSF) and the Deferred Debit / Credit to the Rate Stabilization Fund in Rate Base**

The DW 11-026 Settlement Agreement at Exhibit C, Paragraph 2 states:

*“The PWW RSF amounts will become part of PWW’s rate base and will be treated as working capital . . . PWW will be authorized to earn a rate of return on the amount of the RSF at a rate equal to PWW’s weighted average cost of capital . . .”*

Also, at Paragraph 4 of Exhibit C states:

*“. . . At the time of each PWW rate case, the PWW RSF Account will be subject to replenishment or reduction to an amount equal to the Initial RSF Amount less the amount of any then outstanding loan to PEU or PAC. The replenishment or reduction amount will be reflected in PWW rates through a deferred debit or credit amortized over a three-year period.”*

The Settling Parties agree and propose that in future rate proceedings the RSF should be reflected in rate base at its actual 13-month average valuation and the Deferred Debit/Credit to the RSF should be reflected in rate base at its *pro forma* prospective 13-month average valuation. See Attachment A.

**C. Treatment of Non-Revenue Producing Assets**

“Non-revenue Producing Assets” are defined as plant assets that have been placed into service during the test year and receive special rate-making treatment in that they are reflected in rate base at their year-end value rather than at the 13-month test year average value. In order to be

eligible for such treatment, such assets must meet certain qualifying criteria. During the course of this proceeding, it became apparent that a diversity of understanding existed among the parties relative to the specific qualifying criteria required in determining whether an asset(s) qualified as “non-revenue producing.” Therefore, the Settling Parties have devoted their efforts to clarifying the qualifying criteria of non-revenue producing assets on a prospective basis. As a consequence, the Settling Parties agree that in future rate cases, non-revenue producing assets shall be recognized in rate base at year-end value when:

1. The underlying project which establishes the acquired or installed asset(s) is in response to a regulatory mandate. Such mandates shall include but not be limited to: NH Department of Environmental Services (DES) rules or enforcement actions, i.e., Letters of Deficiency (LOD’s); Environmental Protection Agency (EPA) directives; or Safe Drinking Water Act (SDWA) requirements. Projects which emanate from a municipality’s ongoing sewer and drain construction projects shall also constitute a regulatory mandate.
2. The underlying purpose of the project shall not be to increase the Company’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 PWW, incidental and negligible annual revenues shall be defined as that which results in an increase in annual revenues of less than 1% of a project’s expended cost during the test year. Further, when incidental revenues do result from a non-revenue producing asset(s), these should be *pro formed* into test year revenues.
3. The expended cost during the test year on the project must be significant, i.e., the resulting asset(s) placed into service shall have 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 PWW, the expended cost must exceed \$150,000 (\$100,000 x 1.5).

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

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

#### **D. Rate Stabilization Fund**

Pursuant to the Settlement Agreement approved in Docket No. DW 11-026 regarding the City of Nashua's acquisition of Pennichuck Corporation, a Rate Stabilization Fund (RSF) was established to provide holders of City Acquisition Bonds reasonable assurance that cash would be available to pay debt service on the bonds. The DW 11-026 Settlement Agreement anticipated that \$5 million would be contributed into the RSF. See Settlement Agreement, Section III, C, at p. 13.<sup>1</sup> The \$5 million contribution was made by Pennichuck Corporation to PWW upon completion of the acquisition and reflected as debt on PWW's books. The Settling Parties agree to convert the \$5 million from debt to equity. The Pennichuck Corporation Board of Directors authorized the debt-to-equity conversion in a resolution dated March 28, 2014.

Exhibit C to the DW 11-026 Settlement Agreement is entitled, Methodologies and Procedures for PWW Rate Stabilization Fund. Among other things, Exhibit C, Paragraph 3, states that PWW shall maintain a separate ledger account for City Bond Fixed Revenue

---

<sup>1</sup> "The City and Pennichuck have proposed to contribute cash in the amount of \$5,000,000 to PWW upon consummation of the Merger to establish a fund that will be used to ensure stable rates in the event of adverse revenue developments (the 'PWW Rate Stabilization Fund')."

Requirement (CBFRR) revenues. Each month, PWW is required to allocate into the CBFRR Account a portion of its monthly water revenues, calculated in part based on “the total approved revenue requirement for PWW from its last approved rate case.” The Settling Parties have agreed that this calculation will be performed, beginning on the effective date of the Commission’s final order in the instant rate proceeding, utilizing a revenue requirement of \$27,689,214.

**E. Eminent Domain Costs**

Pursuant to the Settlement Agreement approved in Docket No. DW 11-026 regarding the City of Nashua’s acquisition of Pennichuck Corporation, the City was permitted to recover, from PWW, PEU, and PAC earnings and profits, up to \$5 million in costs that the City incurred from January 1, 2002 until August 2009, subject to Commission audit. See Settlement Agreement Section III, D, 4 at p. 16.<sup>2</sup> On October 1, 2013, the Commission Audit Staff issued its Final Audit Report, concluding that \$540,344 in costs should be disallowed and that the recoverable eminent domain amount from PWW, PEU and PAC is \$4,507,978. See Attachment B. As noted in the Final Audit Report, Pennichuck Corporation did not agree at the time with certain of the Audit Staff’s recommended disallowances. However, for purposes of settlement in this proceeding, the Companies do not oppose the Audit Staff’s recommended recoverable amount.

**F. Municipal Acquisition Regulatory Asset (MARA)**

---

<sup>2</sup> “The Settling Parties agree and recommend that the Commission require PWW, PEU, and PAC to not pay or distribute funds in any fiscal year with respect to their common stock, through dividends or other distributions to Pennichuck, in excess of an amount equal to the sum of;

(i) the amount of the utility’s then applicable CBFRR, and  
(ii) an amount from current earnings and profits with respect to such fiscal year to provide funds to allow the City to reimburse itself for costs incurred by the City relating to its efforts to pursue the eminent domain proceeding from January 1, 2002 until August 2009 (the ‘Eminent Domain Amount’), provided, however, that the distribution in respect of such Eminent Domain Amount with respect to any fiscal year shall not exceed \$500,000, and, provided further, that the aggregate of all distributions in respect of such Eminent Domain Amount shall not exceed \$5,000,000.”

The Settlement Agreement approved in Docket No. DW 11-026 authorized the MARA and provided that the final actual amount of the MARA, as well as the actual acquisition costs, would be subject to Commission audit in the first rate cases filed by the Companies. The Commission Audit Staff issued its Final Audit Report in Docket No. DW 11-026 on November 19, 2013. The Audit Staff verified the components of the MARA as of the January 25, 2012 acquisition date, with no exceptions. See Attachment C.

**G. Rate Design**

Temporary rates for PWW were approved at current rates and the Settling Parties agree to a 0.0% rate increase, therefore, PWW rates shall be unchanged.

**H. Effective Date for Permanent Rates and Recoupment**

The Settling Parties agree to no change in PWW's permanent rates. The Commission's Order No. 25,598 established current rates as temporary rates. Accordingly, there will be no effective date of permanent rates or any recoupment between temporary and permanent rates pursuant to RSA 378:29. PWW agrees to file tariff pages replacing the temporary rate schedules.

**I. PWW WICA**

In Order No. 25,230 in PWW's last rate case, Docket No. DW 10-091, the Commission approved a pilot Water Infrastructure and Conservation Adjustment (WICA) mechanism. The Commission also stated it would review the WICA program in PWW's next rate case and terminate the WICA pilot at the conclusion of that case unless the Commission specifically extended the pilot. The Settling Parties agree that PWW's WICA program is relatively young and still evolving and that the Commission should extend the pilot and reschedule its evaluation



to occur in the Company's next general rate case.<sup>3</sup> PWW, Staff, and other parties are making efforts to work out issues that have arisen particularly in regard to coordination with municipal projects. PWW, Staff, and the OCA recommended PWW file a notice with the Commission in the event it substituted projects after the Commission has approved certain construction projects and their associated budgets. The Settling Parties recommend the Commission authorize the pilot to continue.

**J. Rate Case Expense Surcharge**

The Settling Parties agree that PWW should be allowed to recover its reasonable rate case expenses for this proceeding through a surcharge. PWW's rate case expenses may include, but are not limited to, its legal and consultant expenses, as well as its incremental administrative expenses such as copying and delivery charges. PWW agrees to file its final rate case expense request, pursuant to Puc 1905.02, no later than thirty (30) days from the date of the final order in this docket. Staff and the parties will have an opportunity to review the rate case expenses and provide recommendations to the Commission for approval.

**IV. CONDITIONS**

The Settling Parties expressly condition their support of this Agreement upon the Commission's acceptance of all its provisions, without change or condition. If the Commission does not accept the provisions in their entirety, without change or condition, any party hereto, at its sole option exercised within thirty (30) days of such Commission order, may withdraw from this Agreement, in which case it shall be deemed to be null and void and without effect, and shall

---

<sup>3</sup> See Settlement Agreement in DW 10-091 Pennichuck Water Works, Inc., at p. 7, paragraph H., and p. 10, paragraph 8, which discuss, respectively, evaluation and extension of the WICA.

not be relied upon by Staff or any party to this proceeding or by the Commission for any purpose.

The Commission's acceptance of this Agreement does not constitute continuing approval of, or precedent regarding, any particular principle or issue in this proceeding, other than the prospective application to PWW of the Settling Parties' agreements indicated under Section III(B) regarding clarification of various ambiguities contained in the DW 11-026 Settlement Agreement and Section III(C) regarding the rate base treatment of non-revenue producing assets, but such acceptance does constitute a determination that the adjustments and provisions set forth herein in their totality are just and reasonable and that the revenues contemplated will be just and reasonable under the circumstances.

The Commission's approval of the recommendations in this Agreement shall not constitute a determination or precedent with regard to any specific adjustments, but rather shall constitute only a determination that the income requirement, rates, rate base, rate of return, and other provisions of this Agreement, when considered as a whole, are just and reasonable except the Settling Parties' recommendations applicable to PWW in:

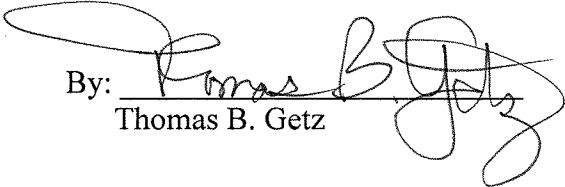
- 1) Section III(B) regarding certain clarifications;
- 2) Section III(C) regarding treatment of non-revenue producing assets;
- 3) Section III(E) regarding recoverable eminent domain costs; and
- 4) Section III(F) regarding the MARA.

The discussion that produced this Agreement was conducted on the explicit understanding that all offers of settlement relating thereto are and shall be confidential, shall be without prejudice to the position of any party or participant representing any such offer or

participating in any such discussion, and are not to be used in connection with any future proceeding or otherwise.

IN WITNESS WHEREOF, the Settling Parties have caused this Agreement to be duly executed in their respective names by their fully authorized agents.

Pennichuck Water Works, Inc.  
By its attorneys,  
Devine, Millimet & Branch

By:   
Thomas B. Getz

Staff of the New Hampshire  
Public Utilities Commission

By: \_\_\_\_\_  
Marcia A. Brown  
Staff Attorney

Office of the Consumer Advocate

By: \_\_\_\_\_  
Rorie E.P. Hollenberg  
Staff Attorney

IN WITNESS WHEREOF, the Settling Parties have caused this Agreement to be duly executed in their respective names by their fully authorized agents.

Pennichuck Water Works, Inc.  
By its attorneys,  
Devine, Millimet & Branch

Dated: May \_\_\_\_\_, 2014

By: \_\_\_\_\_  
Thomas B. Getz

Staff of the New Hampshire  
Public Utilities Commission

Dated: May 14, 2014

By: Marcia A. Brown  
Marcia A. Brown  
Staff Attorney

Office of the Consumer Advocate

Dated: May 14, 2014

By: Rorie E.P. Hollenberg  
Rorie E.P. Hollenberg  
Staff Attorney