THE STATE OF NEW HAMPSHIRE
BEFORE THE
PUBLIC UTILITIES COMMISSION

DW 13-171

IN RE EASTMAN SEWER COMPANY, INC

Sale of Assets and Liabilities to the VILLAGE DISTRICT OF EASTMAN

LIST OF EXHIBITS
For Geraldine Logan

Exhibit AA DW 04-013 Eastman Sewer Company, Inc.
Staff Investigation into Over-earnings
Order Approving Stipulation Agreement
ORDER NO 24.368
September 2, 2004

DW 04-013

EASTMAN SEWER COMPANY, INC.

Staff Investigation into Over-earnings

Order Approving Stipulation Agreement

O R D E R N O. 24,368

September 2, 2004

APPEARANCES: Stephen P. St. Cyr for Eastman Sewer Company, Inc.; and Amy L. Ignatius, Esq. for Staff of the New Hampshire Public Utilities Commission.

I. BACKGROUND

On January 29, 2004, the New Hampshire Public Utilities Commission (Commission) opened an investigation into the earnings of Eastman Sewer Company, Inc. (Eastman). Commission Staff (Staff) stated in a memo dated January 29, 2004, that a review of Eastman's 2001 and 2002 Annual Reports to the Commission showed that Eastman was earning a return greater than the last return authorized by the Commission. Staff also reported that it had held informal discussions with Eastman regarding its apparent over-earnings, which initially centered on a restructuring of the components of Eastman's rates to customers. Eastman's current rate comprises an amount for operation of the sewer system as well as an amount for a capital reserve fund, as approved by the Commission in Eastman's initial rate case in DR 90-170. Staff indicated, however, that Eastman preferred to initiate a project to locate, inspect and clean its sewer mains as a way of reducing or eliminating its over-earnings.

On June 25, 2004, Staff advised the Commission that it had reached a Settlement Agreement (Settlement) with Eastman in order to eliminate its over-earnings position. On July 9, 2004, the Commission issued an Order of Notice, establishing a hearing on the Settlement for August 17, 2004.

II. SETTLEMENT AGREEMENT

Mark A. Naylor, Director of the Commission's Gas & Water Division, and Stephen P. St. Cyr, consultant for Eastman, jointly testified in support of the Settlement. The Settlement sets forth the background of the Staff's review of Eastman's earnings, which is summarized below.

Staff had determined through a review of Eastman's 2002 Annual Report that Eastman had achieved a rate of return on its rate base of 38.68% for that year. In Eastman's only rate proceeding, DR 90-170, Eastman had been authorized to earn a rate of return of 11.14%. *Eastman Sewer Company, Inc. 77 NH PUC 93 (1992)*. Staff requested a meeting with Eastman to discuss its earnings, and as a result of that meeting learned that upon the sale of Eastman to the Eastman Community Association (ECA), approved by the Commission in DW 00-153, Eastman had significantly reduced its operating expenses. Mr. St. Cyr testified that the ECA was charging the utility significantly less in management fees than had the previous owner. As a result, the utility's net operating income was significantly higher, resulting in over-earnings.

Mr. St. Cyr testified that Eastman and Staff had discussed reducing rates to customers, but considering that Eastman's current customer rates of $224 annually are low, and that Eastman had system improvement needs to consider, Staff and Eastman developed the Settlement to resolve the issue in another fashion. The Settlement calls for Eastman to begin, in 2004, a 10-year program of locating, inspecting and cleaning its sewer mains. Based on the bid Eastman received from vendors, Staff and Eastman agreed that Eastman would incur an annual expense of $15,000 for this project. Because of this additional expense, it is expected that Eastman's return on rate base would be reduced to approximately 12%, which is in line with the rate of return last authorized for Eastman, 11.14%. Eastman agreed to report annually on the work done on the project. Staff and Eastman also agreed that, if for any reason Eastman were to discontinue the project, it would notify the Staff immediately. In that event, Staff and Eastman acknowledge that other actions may be needed if Eastman were to begin to over-earn again.

At hearing, Mr. Naylor and Mr. St. Cyr also discussed the existence of Eastman's capital reserve fund, established in Order No. 20,390 in DR 90-170. That fund was established by the Commission in order to address the Commission's concerns that the utility might be undercapitalized due to the small rate base approved by the Commission for Eastman. Eastman is required to deposit the amount of $10,010 annually into a capital reserve fund for meeting future capital needs of the sewer system. This amount is part of the utility's revenue requirement collected through rates from its approximately 525 customers. Eastman may use these funds only with advance notice to the Commission. The Settlement specifically provides that the cost of locating, inspecting and cleaning be paid from revenues derived from customers, and not from funds deposited to the capital reserve fund. At hearing, the witnesses agreed that, in the event the project revealed a need for a major repair to the system, Eastman could request approval from the Commission to use capital reserve funds for that purpose.

III. COMMISSION ANALYSIS

At hearing the witnesses explained the maintenance process that is the heart of the Settlement, namely the locating, inspecting and cleaning of Eastman's sewer mains. Considering that Eastman's witness indicated that Eastman does not have maps which fully detail the location of all sewer mains, this is an important project to ensure future system reliability. Furthermore, conducting this project over a 10-year span allows Eastman to spread the cost over that period, thus reducing the impact of the total cost of the project if it were to be conducted all at once. Accordingly, we find the Settlement Agreement presented by Staff and Eastman is a reasonable approach to the over-earnings of Eastman.

We acknowledge that Eastman's rates to its customers remain as first established by this Commission in 1992, and we note that the Eastman Community Association has assisted in keeping costs down to Eastman's ratepayers. We accept the testimony of the Staff and Eastman witnesses as to the necessity of the locating, inspecting and cleaning project. We therefore approve the Settlement Agreement as a reasonable means of substantially eliminating Eastman's over-earnings while at the same time increasing the overall reliability of the sewer system.

Based upon the foregoing, it is hereby

ORDERED, that the Settlement Agreement presented by Staff and Eastman Sewer Company, Inc. is APPROVED.

By order of the Public Utilities Commission of New Hampshire this second day of September, 2004.

Thomas B. Getz
Chairman

Graham J. Morrison
Commissioner

Attested by:

Michelle A. Caraway
Assistant Executive Director