STATE OF NEW HAMPSHIRE

PUBLIC UTILITIES COMMISSION

DW 15-199

In the Matter of:
Abenaki Water Company, Inc.
Petition for Permanent Rates

Direct Testimony

of

Mark A. Naylor
Director, Gas and Water Division

March 24, 2016

State of New Hampshire

Public Utilities Commission

Abenaki Water Company, Inc.

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I. INTRODUCTION

Q. Please state your name, occupation, and business address.

A. My name is Mark A. Naylor, and I am Director of the Gas & Water Division of the New Hampshire Public Utilities Commission (Commission). My business address is 21 South Fruit Street, Suite 10, Concord, New Hampshire.

Q. Please describe your qualifications.

A. I have been employed by the Commission since 1990, and for a substantial portion of my career I have been involved in the regulation of water and sewer utilities. My qualifications are attached to this testimony as Attachment MAN-1.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to offer Staff comments and recommendations with respect to three issues raised in this case. These issues are related to the request of Abenaki Water Company, Inc. (Abenaki or the company), to consolidate the water rates of its Belmont and Bow water systems; Abenaki's cost of capital request; and the company's request for deferral and recovery of increases in sewer fees paid to the City of Laconia, as well as a cost tracker and reconciliation mechanism for future increases in those sewer fees.

II. RATE CONSOLIDATION

Q. What is the Staff's view of Abenaki's request for consolidating the water rates of its two water systems into a single tariff?

A. Staff believes that rate consolidation (or single tariff pricing) is not supported by the company's filing. Consolidating the rates of the two systems would create a significant subsidy to Bow customers at the expense of the Belmont customers. This can be seen by comparing the company's proposed rate increase on a combined basis with that which would result from calculating cost of service on an individual system basis. Belmont water customers would see an average rate increase on a stand-alone basis of 8.63%, but an average increase of 23.41% with consolidated rates. Filing Tab 5. Consequently, Staff believes that single tariff pricing would not result in just and reasonable rates for Abenaki at this time.

Q. Has this Commission considered requests for single tariff pricing in the past?

A. Yes. There are several cases since 1998 in which the Commission has considered this issue.

In Docket DR 97-058, a Pennichuck Water Works, Inc. (PWW) rate case, the Commission approved PWW's proposal for single tariff pricing. *Pennichuck Water Works, Inc.*, Order No. 22,883, 83 NH PUC 197 (March 25, 1998). PWW had a large core system serving in excess of 20,000 customers in the City of Nashua and certain portions of adjacent towns, and over time it had acquired ten community water systems in outlying communities. The community systems ranged in size from 29 to 458 customers. In approving consolidated rates, the Commission cited the high annual water rates that would result in certain of the smaller systems with stand-alone rates, and the relatively low level of subsidy (*i.e.*, $8 annually per customer) provided by PWW's core customers to its community water system customers under single tariff pricing. As the Commission stated, "stand alone rates in this case produce results for some customers that are well beyond the zone of 'just and reasonable.'" For the PWW community systems, stand-alone rates would have caused "extreme" results if "significant investments" were mandated by "environmental enactments," and would inhibit PWW's ability to provide "safe and adequate water service to their customers." *Id*. at 200-201.

In 1999, in Dockets DR 97-188 and DR 98-112, the Commission approved the request of Lakes Region Water Company, Inc. (LRWC), to consolidate water rates in its nine community water systems. *Lakes Region Water Co., Inc*., DR 97-188, 98-112, Order No. 23,146, 84 NH PUC 125 (1999). Concluding that "the benefits of rate consolidation … outweigh the negative impacts", the Commission cited "the wide disparity in rates among customers of the individual systems that would result from denying [LRWC's] request" and found that stand alone rates were "outside the zone of 'just and reasonable.'" *Id*. at 128. In addition, the Commission observed that single tariff pricing enhanced the viability of small water systems, and "will have the salutary effect of encouraging financially sound utilities to acquire community systems that are not otherwise attractive acquisitions in the short term. Rate consolidation is therefore a policy that promotes the expansion of public water systems, which we believe is in the overall public good." *Id*.

Hampstead Area Water Company, Inc. (HAWC) included a request for single tariff pricing in its 2005 rate case, Dockets DW 05-112 and DW 05-177. At that time, HAWC operated sixteen separate community water systems. In its order approving the request, the Commission determined that "eliminating [wide] disparities among the individual systems is …

consistent with the long-term best interests of the utility's customers" as it will "insulate those individual systems from future rate shock" when significant capital investments are made in any one system. *Hampstead Area Water Company, Inc*., Order No. 24,626, 91 NH PUC 225, 230 (May 26, 2006).

Q. How are Abenaki's present circumstances different from the circumstances the Commission considered in those dockets resulting in rate consolidation?

A. Abenaki only owns two systems that together serve about 254 water customers. Abenaki has provided no evidence that consolidation is necessary to support the viability of either system or that the system-specific rates would be unjust and unreasonable or would cause rate shock. Consolidating the rates of these two systems serves few of the criteria the Commission has established in the cases just described. It does not contribute to the viability of these systems; it does not mitigate rate shock; and the level of subsidy necessary to implement single tariff pricing is substantial.

Q. Is it possible that consolidated rates would be appropriate for Abenaki another time?

A. Yes, it is possible. If Abenaki continues to acquire systems, as it has stated is a part of its business plan, another review of single tariff pricing in the future may be appropriate. I have testified in past proceedings that I believe further consolidation of the regulated water industry in New Hampshire is appropriate, and I do not wish to discourage a company such as Abenaki from pursuing this objective. At this time, however, there is not enough of a customer base such that rate consolidation can produce just and reasonable rates.

III. COST OF CAPITAL

Q. Does Staff have concerns with the company's cost of capital request?

A. Yes. The company has requested a return on its equity capital of 10.75%. In support of its request, Abenaki cites the need to maintain an optimal capital structure; to maintain experienced management and other important personnel; and to attract investment capital. In addition, Abenaki posits that the risk related to its business is "clearly and "significantly" greater than that of larger water utilities this Commission regulates. Vaughan testimony at 5.

Q. Did the company file a cost of capital study in this rate case?

A. No, it did not. The company indicated it did not obtain a cost of capital expert in order to minimize rate case expenses. While it is not unusual for small water utilities under this Commission's jurisdiction to forgo a cost of capital analysis, in those instances the typical practice is to use the last-approved cost of equity in a water utility case in New Hampshire. In this instance, that was Docket DW 12-085, and the equity rate authorized was 9.60%. *Aquarion Water Company of New Hampshire*, Inc., Order 25,539 (June 28, 2013).

Q. What is Staff's recommendation with respect to cost of equity?

A. Staff believes the 9.60% authorized in DW 12-085 is the return that should be used. A utility seeking new customer rates carries the burden of proof that its request is justified based on the company's cost to provide service, and that those rates will be just and reasonable. In this instance, the request for a 10.75% return on equity is arbitrary and unsupported.

IV. SEWER TREATMENT COSTS

Q. Please discuss the issue of deferral and recovery of previously-incurred sewer fees.

A. Abenaki's sewer division of its Belmont franchise discharges sewage to the City of Laconia for treatment at the City's treatment plant. Abenaki pays a fee to the City for those services based on the volume collected. Abenaki states that Laconia's rates increased as of September 1, 2014, and the company has deferred that increased amount in order to seek recovery through a surcharge over 12 months. In addition, Laconia implemented a further increase in those rates effective September 1, 2015. Abenaki states that, due to the likelihood of future fee increases by the City, and the uncertainty of the magnitude of the increases, it should be permitted to implement a rate adjustment mechanism in order to pass through future sewer fee increases to Belmont sewer customers without having to file a full rate case.

Q. What is Staff's view of this request?

A. Staff does not support Abenaki's request. Utilities incur a number of costs over which they have little or no control between rate cases. Changes in both expenses and revenues are part of the risk of engaging in the utility business, and a utility is compensated for that risk with a return on its equity capital. In traditional ratemaking, a utility has the opportunity to earn its authorized revenue requirement, but there is no guarantee; in that respect, utility management is incented to operate efficiently, and allowing full recovery of costs between rate cases eliminates that incentive. Also, permitting the automatic pass-through of one expense without accounting for other factors and circumstances, such as reduced expenses or increased revenues, amounts to single-issue ratemaking.

Q. Does this conclude your testimony?

A. Yes it does.