TAB 10

Petition for Specific Modifications to Ratemaking Structure

STATE OF NEW HAMPSHIRE

BEFORE THE

PUBLIC UTILITIES COMMISSION

Docket No. DW 19-084

Pennichuck Water Works, Inc.

Rate Proceeding

PETITION FOR FURTHER MODIFICATION TO RATEMAKING STRUCTURE

Pennichuck Water Works, Inc. ("PWW"), in accordance with N.H. Admin. Rule Puc 203.06 (relative to petitions) and N.H. Rev. Stat. Ann. 378:28 (relative to permanent rates), hereby moves the New Hampshire Public Utilities Commission (the "Commission") to grant certain further modifications to PWW's ratemaking methodology, as described below. In support of its petition, PWW states as follows:

Background

1. On May 14, 2019, PWW filed a Notice of Intent to file rate schedules, pursuant to N.H. Code Admin. R. PART Puc 1604.05. Pursuant to Puc 1604.05, utilities must give the Commission 30-days notice of its rate changes and must file any full rate case within sixty days of filing the Notice of Intent. Thirty days has elapsed since PWW filed its Notice of Intent and sixty days has not yet expired.

2. Contemporaneous with this petition, PWW is filing its rate schedules, pursuant to RSA 378:3, to effectuate an increase in its rates.

3. Pursuant to Puc 1604, PWW is also filing supportive testimony, filing requirement schedules, rate of return schedules, full rate case schedules, and its rate case expense summary.

Rate Increase and Causes of Deficiency

4. PWW seeks to increase its rates by an overall 11.91%. This equates to an increase in its revenue requirement of $3,778,139 ($35,510,803 less $31,732,664) as shown on Schedule A at Tab 11.

5. PWW is filing to increase its rates because, based on the Filing Requirement Schedules (at Tab 11) and Rate of Return Information (at Tab 12), PWW is in an earnings deficiency. The revenues collected in 2018 fell well below the revenue requirement PWW needs to maintain its operations, make its required payments to the City of Nashua ("City') under the City Bond Fixed Revenue Requirement ("CBFRR"), and make its debt payments. That deficiency is at 11.91%.

6. The reasons for the 11.91% revenue deficiency are multiple. They are more fully described in the pre-filed direct testimony of Donald L. Ware, Chief Operating Officer (at Tab 8).

A. The debt service on capital expenditures made in 2017 and 2018 accounts for 4.06% of the 11.91% increase. The increase is also due to compounded annual inflationary pressure on PWW's operating expenses since its last permanent rate case. For example, there have been increases in production expenses, which in turn, are driven primarily by increased purification chemical costs, power usage and rates, sludge removal, and labor expenses.

B. Increases in transmission and distribution expenses are also driving the increase. These expenses are the result of increased meter operating labor costs associated with labor expended to replace leaded brass meters (in accordance with regulatory requirements), which was capitalized in prior years, but is now replaced with labor expended to complete meter periodic tests as an operating expense.

C. Increased levels of main and service repairs, resulting from an increased focus on finding and repairing leaks for PWW's aging infrastructure. These projects have been beneficial in that they reduced PWW's unaccounted for water from about 18.5% (in the "Core" system) and 10.5% (in PWW's Community Water Systems) in 2015 to 13.6% and 8.9%, respectively, at the end of 2018.

D. Three additional full-time staff and the use of outside contractors to complete increased levels of gate and hydrant maintenance, along with water service line replacement work, created by increased levels of community paving as well as responding to increased levels of Dig Safe marking associated with increased construction activities throughout PWW's service territories. In addition, increases to engineering expense are driving the rate increase because PWW has hired two full time staff to manage, maintain and continually update PWW's Asset Management program.

E. Increases in property taxes had fueled the revenue deficiency.

F. Increases in payroll taxes associated with the additional employees referenced above, as well as annual increases in wages for PWW's staff has also contributed to the revenue deficiency.

7. PWW has worked hard to control its increased costs. For example, PWW's Department managers evaluate staffing levels annually as part of PWW's annual budgeting process. PWW has invested in its Asset Management and Geographical Information System programs. Once these programs are in full service, PWW will gain increased employee efficiency in the field as well as more streamlined office activities that support the field

operations. PWW continues to employ competitive bidding for services, where it is feasible: (bids for inventory, power supply, chemicals, print house services, insurances (health, dental, property and liability), and natural gas). PWW emphasizes safety training and has been able to decrease its Worker's Compensation costs, despite insuring a larger value of wages. PWW's management of its health care costs has resulted in only an average 2.46% increase per year over the past seven years, compared to other New Hampshire businesses who have experienced increases three and four times PWW's. PWW has also made wise use of seasonal employees to accomplish seasonal work, such as: station yard maintenance, hydrant painting, watershed inspections, water quality monitoring, water main inspection and other work that does not result in a year-round work load and does not require the skills of a certified operator.

Cost of Service Study Recommendations

8. PWW retained the services of Concentric Energy Advisors, Inc. ("Concentric") to conduct a cost of service study. The pre-filed direct testimony of Gregg H. Therrien describing his work on cost of service is at Tab 9. Mr. Therrien employed a Base Extra Capacity method in his cost of service study which is consistent with past PWW cost of service studies and is recognized by the American Water Works Association as a fair and equitable means of distributing the revenue requirement proportionally among customer classes.

9. Mr. Therrien noted that his study showed that 82.4% to 91.9% of PWW's costs are fixed costs, whereas variable costs accounted for 8.1% of PWW's costs. See, Tab 9, Pre-filed Direct Testimony of Mr. Therrien at pages 17 and 18. This ratio between fixed and variable costs is important to apportioning a water utility's revenue requirement among fixed and volumetric charges. For PWW, Mr. Therrien's work demonstrated that the fixed, system-related

costs associated with providing municipal and private fire protection service were not adequately supported by the revenues generated by those customer classes.

10. In light of those findings, Mr. Therrien recommended PWW increase the rates for the fire protection customer classes more than PWW's other customer classes. For this reason, as shown on the Report of Proposed Rate Changes located at Tab 5, PWW's General Metered class, and volumetric rates for PWW's special contracts with Anheuser-Busch, Town of Milford, Town of Hudson, Town of Tyngsborough, and Pennichuck East Utility, Inc. ("PEU") show a 7.85% rate increase whereas private fire protection rates show a 72.9% and municipal fire protection rates show a 24.2% increase. The fixed portion of the special contracts will not be increasing because those contracts are long-term and contain terms limiting rate increases to the volumetric rate.

Further Modifications to Ratemaking Structure Needed

11. As the Commission is aware, with the acquisition of Pennichuck Corporation ("Penn Corp") and its subsidiary utilities (PWW, PEU, and Pittsfield Aqueduct Company, Inc.) by the City, PWW has become heavily debt-weighted in its capital structure. Although this form of capital is cheaper than equity and, ultimately, benefits ratepayers, the major credit rating agencies have been cautious as PWW navigates its new capital structure and ratemaking methodologies. As described in the pre-filed direct testimony of Larry D. Goodhue, Chief Executive Officer, PWW's credit rating has been reduced from "A+ with a stable outlook" to "A+ with a negative outlook". See, Tab 7, Testimony of Larry D. Goodhue, at page 15. PWW learned from the credit rating agencies that the downgrade was due to PWW's cash coverage. In consultation with investment advisors, PWW concluded that further modification of its ratemaking structure would be necessary to improve its cash coverage, re-establish PWW's

"positive outlook" and, hopefully, allow the credit rating agencies to increase PWW's overall credit rating.

12. PWW's cash coverage is an important issue. In PWW's last rate case, Docket No. DW 16-806, the Commission approved modifications to the ratemaking structure first devised in Docket No. DW 11-026. These iterative changes have allowed PWW to gain experience with the methodologies and learn what works. Notwithstanding these past modifications, PWW's operating expenses have increased since PWW's last rate case, and in some cases, at rates above inflationary levels. This has caused PWW to nearly fully deplete its funds in the Material Operating Expense Revenue Requirement ("MOERR") Rate Stabilization Fund ("RSF"). As the Commission is aware, this fund is intended to act as a backstop to increases in expenses subsequent to PWW's last Commission-approved revenue requirement. Absent the ability to file the instant rate case at this time, PWW would have neither: (1) sufficient overall revenues to cover its prudent and necessary operating expenses[1], or (2) sufficient funds remaining in the MOERR RSF fund to provide support to its necessary cash operating requirements.

13. PWW proposes a series of targeted modifications to its ratemaking structure to address these issues. These modifications are more thoroughly described in Mr. Goodhue's testimony but are summarized as follows:

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[1] Pressure on operating expenses is expected to increase as additional water quality standards are set. As described in the testimony of Mr. Goodhue, the N.H. Department of Environmental Services has set PFAS standards along with a quick compliance deadline for water utilities. See, Tab 7, Goodhue Testimony at 31.

A. Create a Material Operating Expense Surcharge ("MOES") that the Company would file with the Commission on an annual basis, seeking a surcharge between rate cases for inflationary increases in its material operating expenses;

B. Include the actual cash basis of incurred Federal and State Corporate Income Taxes in the operating expenses of the Company Operating Expense Revenue Requirement ("OERR") allowed revenues;

C. Re-prioritization of the usage of the 0.1 Debt Service Revenue Requirement ("DSRR") funds collected each year;

D. Reallocate the imprest value of PWW's aggregate Rate Stabilization Fund ("RSF") funds per Exhibit DLW-2 attached to Mr. Ware's testimony in order to achieve an estimated two years of coverage for the individual funds;

E. Allow the current QCPAC process, and the proposed MOES process, increases to be implemented annually and at the same time; and

F. Treatment of Debt Issuance costs for long-term debt, other than tax-exempt and taxable bond issuances.

Again, all of these targeted modifications are aimed at addressing PWW's cash coverage and re-establishing PWW's "positive outlook" with the goal of increasing PWW's overall credit rating and, consequentially, its access to low-cost debt.

Conclusion

14. In light of PWW's revenue deficiency, its need to respond to its credit rating agencies, and its need for adequate cash in between rate increases, PWW respectfully requests the Commission allow it to further modify its ratemaking structure with the above-described targeted changes.

WHEREFORE, Pennichuck Water Works, Inc. respectfully requests the Commission:

A. Grant this petition for further modification of PWW's ratemaking structure; and

B. Grant such other relief as is just and equitable.

Respectfully submitted,

PENNICHUCK WATER WORKS, INC.

By its Attorneys,

N.H. Brown Law, PLLC

Date: July 1, 2019

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Certificate of Service

I hereby certify that on this day, a copy of this motion has been emailed to the Docket-Related Service List for this proceeding.

Date: July 1, 2019

Marcia A. Brown

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