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NHPUC 4NOV19AM11:56

November 4, 2019

Debra A. Howland
Executive Director
New Hampshire Public Utilities Commission
21 South Fruit Street
Concord, NH 03301

Re: IR 19-005 Investigation to Determine a Method for Setting a
Generic Return on Equity for Small Water Utilities
Commission Staff Report on Technical Session

Dear Ms. Howland:

Commission Staff (Staff) met with representatives of Lakes Region Water Company, Abenaki Water Company, Hampstead Area Water Company and the Office of Consumer Advocate at a technical session held at the Commission's offices on October 1, 2019. The parties reviewed written comments from the water companies and discussed further changes and clarifications to the draft rule N. H. Code of Admin. Rules, Puc 610.

As a result of discussions held at the technical session, Staff has further revised its suggested rule and submits the attached rule for the Commission's consideration. Changes to calculating the generic return on equity (ROE) include, using the minimum number of quarters that total at least 10 rate cases, using a weighted average of the prior ROEs and updating the ROE before hearing.

Staff believes that these changes further clarify and improve the rule and recommends that the Commission adopt this draft rule as its initial proposal.

Very truly yours,

A handwritten signature in blue ink, appearing to read "F. Anne Ross".

F. Anne Ross

cc: Service List
Stakeholder List

Attachments

b. The rate impact on the average customer's annual bill;

e. The capital additions and the federal or state mandates that necessitated the need for rate relief; and

d. The customers' right to participate in the review of the requested rate increase;

(5) A copy of the notice required in (4), along with an affidavit of mailing, shall be filed with the commission within 15 days of the acceptance of the petition as referred to in (b) below.

~~_____ (b) Failure to comply with any of the provisions and requirements set forth in (a) shall result in the immediate rejection of the petition if the utility has failed to respond to any notice issued by the commission required by RSA 541-A:29-I.~~

~~_____ Pue 610.03 Generic Return on Equity.~~

(a) At least once during any 12 month period following the adoption of these rules the commission shall establish a generic return to be applied to the equity invested in the a small water distribution system using the discounted cash flow methodology. A small water distribution system may elect to use the generic rate of return in any rate proceeding and, if it elects to use the generic rate of return, it shall update the calculation before a final hearing in the rate case.

(b) For the purposes of this section, the commission shall assume that the return on equity for regulated gas and water utilities as published by the Regulatory Research Associates for recent calendar years DCF model is based on the concept that are representative of what value stockholders currently value place on a share of stock for water distribution systems at the present value of the expected cash flow from that share of stock, and that cash flow will grow at the same rate from the present to perpetuity.

(c) For purposes of this section, the commission shall assume that the value placed on utility preferred stock plus 350 basis points as published by Value Line is representative of what value stockholders place on a share of stock for water distribution systems.

(de) For the purposes of this section, the generic return on equity, rounded down to 2 decimal places, shall be derived as follows: sample of companies used in computing k shall consist of non-California water utilities listed in the most current issue of Value Line Investment Survey or other recognized financial source that have consistent data for at least a 10 year period of time.

(1) The baseline return on equity will be calculated using the average of the weighted average of the authorized return of water utility rate cases during the most recent calendar quarters with a total minimum of 10 observations and the weighted average of the median authorized return on equity for gas utilities during the most recent calendar quarters with a total minimum of 10 observations. Observations are the number of rate cases in the quarter used to calculate the average water and median gas returns on equity and weighted by the number of observations in a quarter divided by the total observations over the number of quarters with a minimum of 10 observations. Following that calculation, the resulting return will be averaged with an amount resulting from adding 350 basis points to the value of the preferred utility stock as most recently reported by Value Line. The result of the 2 calculations shall yield the baseline return on equity for this section.

(2) For purposes of this section, the authorized average return of equity for water utilities and the number of cases will be as reported by the Regulatory Research Associates, 'RRA Water Advisory: Major Rate Case Decisions.' The median of authorized return on equity for gas utilities will be as reported by the Regulatory Research Associates, 'RRA Regulatory Focus: Major Rate Case

Decisions.¹ Utility preferred stock values will be the Value Line estimated yield on "Utility A" preferred stocks published weekly.

(3) Rate Case Expense Savings Adder: 50 basis points will be added to the baseline return on equity;

(4) Capital Structure Adder will be added to the baseline return on equity for a balanced capital structure:

- a. For a capital structure with equity of 35 to 40 percent, the adder will be 10 basis points;
- b. For a capital structure with equity of 40 to 44 percent, the adder will be 15 basis points;
- c. For a capital structure with equity of 45 to 55 percent, the adder will be 25 basis points; and
- d. For a capital structure with equity of 56-60 percent, the adder will be 10 basis points.

(5) An Exemplary Performance Adder of up to 50 basis points shall be added to the baseline return on equity if the commission determines that a small water utility substantially exceeds utility performance of similarly situated small water utilities in a rate filing in any of the following areas:

- a. Development of an Asset Management Program for achieving and maintaining the desired level of service at the lowest appropriate cost to customers;
- b. Reduction in system leaks and unaccounted for water;
- c. Cost containment initiatives;
- d. Improved water quality;
- e. Improved customer service.

(6) A Non-compliance Deduction: up to 50 basis points may be deducted from the baseline return on equity when a small water utility files for a rate increase if the commission determines that the utility has repeatedly not complied with regulatory requirements within the past 2 years.

- a. Staff or any party to the rate proceeding may request a deduction for non-compliance;
- b. There will be no deduction for non-compliance of an acquired utility if the acquired utility was materially out of compliance when acquired and the acquiring utility has implemented an approved plan to achieve compliance. Compliance plans must be approved by the by the regulatory authority with jurisdiction.

—— (d) For the purposes of this section cash flow shall be measured using both dividends and earnings, with a 3:1 weighting of dividends to earnings, reflecting the view that investors discount that which they receive, but are also concerned with the source of the cash flow.

Puc 610.034 ~~Eligibility~~ Right to Challenge Use of the Generic Return on Equity. The commission staff, the office of consumer advocate, a customer or other interested party, may challenge the generic return on equity used by a small water distribution system in a rate filing with the commission. A small water system shall not be eligible for rate relief pursuant to this section within 2 years after the issuance of a final order under Puc 610 or Puc 1600.

Baseline ROE
Minimum Number of Quarters w/ at Least 10 Observations
Calculated on 05/04/2021
(Based on most recent publications)

	1st Quarter 2021	Number of of Rate Observations*
Gas median ROE (Note 1)	9.74	10
Water average ROE (Note 2)	9.35	12
Average of Gas/Water	9.541	
Average (rounded down)	9.54	
Utility A Preferred Stock (Note 3)	6.22	
Adder: 350 basis points	3.50	
	9.72	
Baseline ROE (Average of Gas/Water & Preferred Stock)	9.63	

* Number of observations indicates the number of ROE datapoints available, not the number of rate cases completed during the period.

Notes (Source Document)

- 1) Most recent source: RRA Regulatory Focus, Major Rate Case Decisions, Jan-Mar 2021 (04/28/2021)
Weighted average ROE of 1 quarter, ending 1st quarter 2021 **
Weighted by # of observations in the quarter as percent of total observations
- 2) Most recent source: RRA Water Advisory, Major Rate Case Decisions — January – March 2021, 04/28/2021
Weighted average ROE of 9 quarters ending 1st quarter 2021 **
Weighted by # of observations in the quarter as percent of total observations
- 3) Value Line Selection & Opinion (May 7, 2021)
(p. 485) Preferred Stock - Utility A

1) Most recent source: RRA Regulatory Focus, Major Rate Case Decisions, Jan-Mar 2021 (04/28/2021)

Weighted average ROE of 1 quarter, ending 1st quarter 2021 **

Weighted by # of observations in the quarter as percent of total observations

Median authorized ROEs by quarter, January 2021-March 2021

Year	Period	ROE (%)	Number of Observations *	Weighted ROE (%)
	Quarter			
2021	1	9.74	<u>10</u>	9.74
			10	
	Weighted Average Median ROE			9.74

* Number of observations indicates the number of ROE datapoints available, not the number of rate cases completed during the period.

** **Based on minimum number of quarters with at least 10 observations**

- 2) Most recent source: RRA Water Advisory, Major Rate Case Decisions — January – March 2021, 04/28/2021
 Weighted average ROE of 9 quarters ending 1st quarter 2021 **
 Weighted by # of observations in the quarter as percent of total observations

Year	Quarter	ROE (%)	Number of Observations *	Weighted ROE
2019	1	9.57%	3	2.39%
2019	2	9.70%	2	1.62%
2019	3	9.80%	1	0.82%
2019	4	NA	0	NA
2020	1	8.48%	2	1.41%
2020	2	9.50%	1	0.79%
2020	3	8.80%	1	0.73%
2020	4	9.50%	2	1.58%
2021	1	NA	0	NA
			<hr/> 12	

Weighted Average ROE of 9 quarters. 9.35%

* Number of observations indicates the number of ROE datapoints available, not the number of rate cases completed during the period.

**Based on minimum number of quarters with at least 10 observations