STATE OF NEW HAMPSHIRE

BEFORE THE

NEW HAMPSHIRE PUBLIC UTILITIES COMMISSION

DW 21-___

Pennichuck Water Works, Inc.

Petition for Approved Modification of Accounting Treatment of Leases

Pennichuck Water Works, Inc. ("PWW" or the "Company"), a corporation duly organized and existing under the laws of the State of New Hampshire and operating therein as a public utility subject to the jurisdiction of the New Hampshire Public Utilities Commission (the "Commission"), hereby petitions the Commission for approval and authority under RSA 374:8 for PWW to account for its lease obligations on a "cash requirement basis" rather than the accrual methodology required by Financial Accounting Standards Board (FASB) leasing standard ASC 840 and new FASB standard ASC 842. As is noted in the pre-filed testimony of George Torres, the Company is seeking the authority to use the modified accounting treatment for its operating lease obligations, as opposed to treating leases over one (1) year as capital leases, which is consistent with current regulatory accounting treatment basis in conjunction with the Company's approved allowed revenue rate structure, as approved in Dockets No. DW 13-130, DW 16-806 and DW 19-084. The Company believes that the capitalized expenses of its facility lease at 25 Walnut Street, Nashua, NH and other facility or equipment leases exceeding one (1) year on a straight-line accrual basis will impact its pro-forma and rate base calculations, and could also impact compliance with its existing and future debt covenants. Given the pending deadline for implementation of FASB 842, the Company respectfully requests that PUC issue an order maintaining PWWs existing accounting treatment of leases by **Wednesday, December 15,**

2021; however, an order by December 31, 2021, will allow for sufficient time to address this issue with the Company's auditors. In support of its Petition, PWW respectfully represents as follows:

BACKGROUND

1. PWW is a New Hampshire public utility corporation providing retail water service to customers in the towns of Nashua, Amherst, Merrimack, Milford, Hollis, Bedford, Derry, Plaistow, Epping, Salem, and Newmarket New Hampshire. PWW is wholly-owned by Pennichuck Corporation ("Pennichuck"), which, in turn, is wholly-owned by the City of Nashua.

2. The Commission previously approved the existing revenue rate structure for PWW in Dockets DW 13-130, DW 16-806 and DW 19-084. In Order 26,070 in Docket DW 16-806, the Commission allowed the revenue structure of PWW to reflect the cash flow needs and requirements tied to the service of debt payment obligations for the Company that is nearly 100% funded by debt for its operations. See *Pennichuck Water Works*, Order 26,070, DW 16-806 at 6 (2017). The new methodology created three (3) buckets of fixed revenue requirements including:

a. CBFRR – City Bond Fixed Revenue Requirements

b. OERR – Operating Expense Revenue Requirements

c. DSRR – Debt Service Revenue Requirement

The OERR is further composed of the Material Operating Expense Revenue Requirement (MOERR) and a Non-Material Operating Expense Revenue Requirement (NOEER). See *Id*. at 6.

3. The original lease accounting standard, Accounting Standard Codification ("ASC") Topic 840 set by the United States Generally Accepted Accounting Principles

("GAAP"), which has been in effect since January 1, 1977. This previous standard provided guidance for public and private companies on the treatment of "capital" and "operating" leases on their financial statements. Under the old lease disclosure regulations, (ASC 840) only capital leases were required to be recorded as a liability on the balance sheet, whereas operating leases were included as an element of expense on the income statements of companies, with full disclosure of future payment obligations included in the footnotes of the financial statements. Additionally, ASC 840 also required a straight-line accounting of the total lease expense over the entirety of the lease term.

4. On February 25, 2016, the FASB issued Accounting Standards Update ("ASU") No. 2016-02 Leases (Topic 842). The new standard requires consideration of the future financial impacts of <u>all</u> operating leases onto the balance sheet, along with capital leases, for the first time and, as such, requires *all leases with a term over one year to be capitalized* and is effective for years beginning after December 15, 2021. The ASC 842 records <u>all</u> leases on the balance sheets for increased visibility and comparability into the leasing obligations of an entity, and the future operating expense and cash payment requirements under those agreements. This standard replaces standard ASC 840 which accounted for leases as either: (1) capital leases or (2) operating leases.

<u>ANALYSIS</u>

5. This requested approval is especially important as it relates to the accounting for the Company's current lease for its main office facility located on 25 Walnut Street in Nashua. This approval would allow the Company to account for this lease in alignment with its actual monthly and annual cash requirements under that agreement. This is opposed to an accrual basis in the new rule which would require a "straight line" methodology over the entirety of the term

of the lease and its extension periods available, and cause numerous pro forma adjustments be prepared and considered in the rate cases for the Company throughout that entire term in order to properly align the Company's true cash needs in its revenue requirements being sought in those future rate cases.

6. As the lease costs for the 25 Walnut Street facility, as well as other de minimis equipment leases exceeding one year, are in the allocable expenses in the Company's approved Management Fee Allocation to its sister subsidiaries, the pro form impact of these cash to accrual adjustments would in-turn, flow through to rate cases for those other entities (Pennichuck East Utility Inc. and Pittsfield Aqueduct Company, Inc.) throughout the term of the lease obligations.

7. Under the ASC 840 standard, capital leases were previously recorded on the balance sheet; however, operating leases were disclosed only as a footnote in the financial statements as an operating expense, along with the disclosure of future cash payments requirements, and thus could be excluded from balance sheet based financial ratios and bank covenants that would make it difficult to accurately judge a company's indebtedness, and current credit worthiness.

8. Notwithstanding this treatment, it was not considered to be adverse by most lending institutions, as operating leases, based upon the multi-factor test, were for leased facilities or equipment which would not eventually accrue to the benefit of the lessee as an asset, or would be owned by that lessee entity.

9. The new accounting treatment of leases under ASC 842 will have financial impacts by significantly increasing the reported assets and liabilities of the Company, could affect the Company's financial covenant compliancy due to increased debt to equity ratios, and/or cause the Companies GAAP basis financial statements to be presented in a manner that is

inconsistent with the basis for which the Company's revenue requirements are calculated and approved under prior Commission orders.

10. Full adoption of this new standard would also result in a monthly/annual lease expense recorded in the financial statements that would differ from the cash actually being paid on a monthly basis throughout the term of the lease. Since the current rate methodology is based upon dollar-for-dollar cash flow coverage of the Company's actual operating expenses, the straight-line method under the new standard could result in over-reported expenses in the early years of lease impacting MOERR expenses with under-report cash flow outlays. The straight-line method may also impact future MOERR RSF coverage due to reported expenses being lower than actual cash outlays in later years.

11. Given the actual cash flows versus straight-line accrual differing from the current regulatory accounting treatment, this new method could create a potential impairment to the Company's Rate Stabilization Funds and rate methodology (due to a mismatch of GAAP basis operating expenses between rate cases). It would also require an ongoing need to pro-form the differential between the allowed basis for the lease expenses included in the OERR portion of allowed revenues in all future rate cases, and require a reconciliation of these amounts in the Company's annual reports filed with the Commission to present the true regulatory basis for these significant operating costs.

12. Since the Company no longer has access to private equity markets as a method of financing, any shortfalls must be recovered through debt financing. As described above and in Mr. Torres' testimony, the new lease standard could negatively impact the Company's traditional bank/lender coverage ratios due to the required recognition of leases over 12 months in length, on the balance sheet. The straight-line recognition of lease expenses will therefore influence the

Company's Debt Service Coverage and Rate Covenants, as reported lease expenses will be inconsistent with the actual cash outlays for the remaining life of the lease. These changes to debt-to-equity ratios may limit the Company's access to future debt financing or may increase the costs of those future financings.

13. Any increased costs of borrowing due to debt covenant compliance or increased debt-to-equity rations due to recognition of the long-term lease obligations, as included in DSRR portion of the Company's approved rate revenues, could result in increased rates for the Company's ratepayers.

14. Attached to Mr. Torres' testimony are Exhibits GT-1 (Balance Sheet Assets and Liabilities), GT-2 (Operating Income Statement) and GT-3 (Analysis of Impacts of ASC 840 and ASC 842) which are proforma financial statements and analysis showing the impact of this request, and conversely the impact of the FASB rule changes should this request not be approved.

15. The Commission is empowered by RSA 374:8(a) to establish a system of accounts and records to be used by public utilities for their business within the state and prescribe a system of accounts for each class of utility and the manner in which the accounts are kept. See *RSA 374:8(a)*, see also, *Appeal of Concord Natural Gas Corporation*, *et al*., 121 N.H. 685, 690 (1981) (holding PUC has authority to adopt rules to establish a system of accounts and records to be used by public utilities, specifically rules excluding advertising and activities from operating expenses). In certain circumstances, the Commission has also departed from its Uniform Classification of Accounts when departure from norms can be justified. See *Re Pennichuck Water Works*, 65 NH PUC 363, 367, DW 80-134, Supplemental Order No. 14,406 (1980), citing *Re Gas Service, Inc*., 64 NH PUC 113 (1979). For the reasons stated above and in

the pre-filed testimony, the Company asserts that the Commission has the authority to establish modified accounting treatment of leases for the Company and the potential impacts of ASC 842 justify the departure from accounting norms in this matter.

16. The Company avers that the Commission granting the authorization for PWW to utilize the modified accounting treatment of leases on a cash requirements basis will be consistent with public good because the cash requirements accounting will be consistent and conform with existing rate structures and regulatory accounting and will not likely result in increased borrowing costs for the Company or its ratepayers. See *Appeal of Easton*, 125 N.H. 205, 211 (1984). In addition, lease costs related to the 25 Walnut Street office are shared with sister subsidiaries of PWW (Pennichuck East Utility, Inc. and Pittsfield Aqueduct Company) through the approved 2006 Cost Allocation Agreement, therefore granting the modified treatment of that lease will not impact rate payers in those systems.

CONCLUSION

17. For the reasons described above and in Mr. Torres' testimony, and given the pending deadline for implementation of ASC 842 by December 15, 2021, PWW respectfully requests that the Commission issue an order granting approval of the modified accounting treatment of leases no later than **Wednesday, December 15, 2021**; however, an order by December 31, 2021, will allow sufficient time to address this issue with the Company's auditors.

WHEREFORE, by this petition, PWW requests that the Commission:

(a) Grant authorization to PWW to adopt a modified accounting treatment of lease obligations on a "cash requirements basis" for operating leases going forward because it prevents potential impacts to both future rate expenses and current and future debt financings, as described in this petition and in the pre-filed testimony;

(b) Pursuant to RSA 374:8, approve and authorize the Company to adopt modified accounting treatment of leases other than FASB leasing standards ASC 840 or ASC 842; and,

(c) Take such further action and make such other findings and orders as in its judgment may be just, reasonable, and in the public good.

Respectfully submitted,

PENNICHUCK WATER WORKS, INC.

By Its Attorneys

RATH, YOUNG AND PIGNATELLI, P.C

Dated: November 12, 2021 By: ______________________________

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Certificate of Service

I hereby certify that a copy of this petition for approval of financings, including the pre-filed testimony referred to in the Petition and exhibits, have this day been forwarded to the Office of Consumer Advocate via electronic mail at ocalitigation@oca.nh.gov.

Dated: November 12, 2021 ______________________________

James J. Steinkrauss