

DW 04-215

HAMPSTEAD AREA WATER COMPANY, INC.

Petition for Approval of Previously Incurred, but not Approved Debt and Authority to Borrow Long Term Debt to Purchase Various Water Systems and to Upgrade and/or Add to Existing Water Systems

Order Approving Previously Incurred Debt and Granting Authority to Issue Additional Debt for Water System Improvements

ORDER NO. 24,584

January 27, 2006

I. BACKGROUND

A. Hampstead Area Water Company Inc.'s Petition

Hampstead Area Water Company, Inc. (HAWC) is a New Hampshire public utility serving approximately 2,500 customers in several communities throughout southeastern New Hampshire. On November 23, 2004, HAWC filed a petition with the New Hampshire Public Utilities Commission (Commission) requesting approval for debt previously issued by HAWC but not approved by the Commission. HAWC also requested approval for additional long term debt to be used to purchase new water systems as well as upgrade existing water systems.

HAWC made this filing in compliance with Commission Order No. 24,362 (August 19, 2004) wherein, among other things, the Commission required HAWC to file a petition seeking approval of any unauthorized debt that it had previously issued.

In its petition, HAWC seeks approval, *nunc pro tunc*, for \$288,741 of previously issued debt as well as approval for \$625,869 of new debt. HAWC is a growing water utility and has made a series of recent filings seeking financing approval, some of which overlap the instant

request. These other filings include: DW 04-184 – Cricket Hill/Maplevale; DW 05-051 – Eastwood Place; DW 05-053 – Putnam Place; DW 05-070 – Waterford Village; DW 05-086 – Angle Pond; and, DW 05-154 – Granite Village Phase V.

On April 4, 2005, Staff requested clarification and confirmation of the financing amount in the instant filing in light of the other financing requests. On June 23, 2005, HAWC revised the instant financing request by withdrawing \$352,500 relating to the purchase of new water systems and added a request for approval of \$274,400 relating to arsenic treatment equipment for three water systems. These amendments thus revise the instant financing request to \$547,769; the \$288,741 of previously issued debt remains unchanged.

B. Staff's Recommendation

On November 29, 2005, Commission Staff (Staff) filed a letter with the Commission recommending approval of the requested financing. Staff stated that it had conducted discovery concerning HAWC's filing and had thoroughly reviewed the initial and amended filings, and conducted discovery. Staff attached HAWC's discovery responses to its letter. Staff's recommendation differed from HAWC's instant financing request and is more fully described below.

1. Unauthorized Prior Debt

After evaluating the instant filing and past HAWC dockets, Staff concluded that, as of December 31, 2004, HAWC had a total of six previously issued but unauthorized notes amounting to an outstanding balance of \$551,043. This amount is substantially higher than HAWC's figure of \$288,741. According to Staff, all six of these notes as well as the fixed plant financed by the notes are currently recorded on HAWC's books. Staff recommended the

Commission approve the notes and averred that approval will further the goal of Order No. 24,362 to bring HAWC into compliance with its financings. The notes are described below.

The first note was for \$19,000, dated March 1, 1988, at 9.50% interest with Lewis Builders of New Hampshire, an affiliate of HAWC. Staff stated this amount was borrowed to pay 1987 federal and state income taxes resulting from the recognition of Contributions in Aid of Construction for that year.

The second note was for \$73,679, dated July 20, 1992, at 9.50% interest with Ruma, Inc. According to Attachment B to Staff's recommendation letter, the outstanding balance, as of December 31, 2004, was \$57,582. Staff stated this note was originally issued to Lewis Builders Inc. (LBI), an affiliate of HAWC, when the Kent Farm water system was purchased from Ruma, Inc. in 1986 and was approved by the Commission at that time. See *Kent Farm Water Company*, 72 NH PUC 43 (1987). In 1992, pursuant to a U.S. District Court case (No. C-89-318-L) between Kent Farm Water Co. and Ruma, Inc., the note was assigned to Ruma, Inc. Staff found no Commission approval for this assignment and thus Staff recommended the Commission approve the assignment.

The third note was for \$270,531, dated December 1, 1992 with LBI. According to Attachment B to Staff's recommendation letter, the outstanding balance, as of December 31, 2004, was \$95,524. Staff stated this note is actually a combination of four previously issued notes payable to LBI and that two of the four received prior Commission approval. One note, originally issued in the amount of \$84,052, was approved in *Bryant Woods Water Company, Inc.*, 73 NH PUC 465 (1988) and another note in the amount of \$41,578 was approved in *Walnut Ridge Water Company, Inc.*, 62 NH PUC 190 (1977). The remaining two unapproved notes

include a \$89,492 loan taken out in 1991 to finance the construction of interconnecting mains on Sawyer Avenue in the Town of Atkinson and a \$47,004 loan which represented operating advances from LBI to HAWC during 1984 through 1992. Staff stated the combined note is not evidenced in writing and that HAWC is amortizing the debt over a period of 15 years at an interest rate of 9.25%. Staff recommended that the Commission order HAWC to formally document the amount and terms of this note and to approve the combined total of \$270,531.

The fourth note was for \$245,991, dated December 1, 1993 at 8.50% interest with LBI. According to Staff, this note had an outstanding balance of \$215,103 as of December 31, 2004 and it is a combination of a series of previously approved and unapproved loans from LBI. \$17,652 was approved by the Commission in *Squire Ridge Water Company, Inc.*, 70 NH PUC 996 (1985), and \$69,929 was approved in *Woodland Pond Water Company, Inc.*, 73 NH PUC 26 (1988). The unapproved portion includes a \$124,231 note for the purchase of the Village Green system in the Town of Hampstead, a \$25,220 note for the installation of meters at Emerson Trailer Park in Hampstead, a small loan from LBI in the amount of \$3,850, as well as accrued interest on a tax loan in the amount of \$5,109. Staff stated that although this combined note is not evidenced in writing, HAWC is amortizing this debt over a period of 30 years at an interest rate of 8.50%. Staff recommended the Commission order HAWC to formally document the amount and terms of this note and approve the unapproved portion of the \$245,991 loan.

The fifth note was for \$70,504, dated January 1, 1994, with LBI. According to Staff, this note had an outstanding balance of \$30,589 as of December 31, 2004. This note was originally issued in the amount of \$91,752 at an interest rate of 10.00% in 1984 and was approved in *Lancaster Farms Water Company, Inc.*, 69 NH PUC 655 (1984). The interest rate

of the loan, however, was subsequently amended to 9.00% without Commission approval. Since the Commission previously found this note consistent with the public good, Staff recommends the Commission approve this loan at the revised interest rate of 9.00% and that the Commission order HAWC to produce a revised executed note payable reflecting this revised interest rate.

The sixth note was for \$133,245, dated December 31, 1999, with Lewis Builders Development, Inc. (LBDI), an affiliate of HAWC. According to Staff, the outstanding balance, as of December 31, 2004, was \$133,245. This note was for the purchase and installation of wells, a well house, pumping and treatment equipment and tanks associated with the Midpoint system in the Town of Atkinson, New Hampshire. Staff concluded the note is not evidenced in writing but that HAWC indicated the interest rate of the loan is 8.50%. Staff recommends the Commission approve the loan with a term of 30 years to coincide with the approximate composite service lives of the assets financed by this loan. Staff also recommends the Commission order HAWC to produce an executed note reflecting the amount and terms of the loan.

2. HAWC's Request for Additional Financing

HAWC proposes to borrow \$547,769 from its affiliate, LBDI. According to its filing, HAWC attempted to obtain financing through a bank rather than through LBDI but was denied due to insufficient cash flow and a deficit net worth position. The proposed loan includes a 20 year term at an interest rate based on the Wall Street Journal Prime Rate plus 2.25%. According to Staff, the current prime rate is 7.00%, and thus the initial interest rate of the loan would be approximately 9.25%. The interest rate will be adjusted on each third anniversary date of the loan closing.

HAWC intends to use the proceeds of the financing to pay for system improvements; \$115,987 will be used to purchase meters in its newly purchased water systems. To mitigate increasing iron and manganese levels, HAWC intends to purchase and install two pressure greensand filters at its Cranberry Meadow system at a cost of \$51,094. HAWC plans to retrofit on-site filter backwash infiltration beds at various systems. HAWC plans to purchase meters for new customers in existing systems at an estimated cost of \$41,216. Lastly, HAWC plans to purchase and install arsenic treatment equipment at three of its systems at an estimated cost of \$339,472.

In support for these projects, HAWC stated that the U.S. Environmental Protection Agency (EPA) has promulgated new arsenic rules and that HAWC's Cricket Hill/Maplevale, Oak Hill, and Tanglewood water systems did not meet the more stringent arsenic standards. HAWC has tentatively selected ArsenX as the treatment technology and correspondence from U.S. Filter indicates that treatment by ArsenX will cost approximately \$106,800 per water system. In response to data requests, HAWC supplied documentation that, beginning January 23, 2006, public water systems must comply with a 10 parts per billion arsenic standard.

In its recommendation letter, Staff averred that the proposed use of the proceeds of the financing were in the public good and that the terms and conditions of the loan were comparable to other financings recently approved for HAWC by the Commission. Staff recommended the Commission approve HAWC's modified financing request up to \$547,769 under the terms and conditions proposed in HAWC's filing. Notwithstanding this recommendation, Staff expressed concern over HAWC's significant debt position. Staff

indicated that in HAWC's rate case proceeding, Docket No. DW 05-112, Staff argued that HAWC should mitigate its debt position.

3. Hampstead Area Water Company, Inc.'s Revised Request

On January 17, 2006, HAWC filed a letter concurring with Staff's recommendation. HAWC concurred that it had \$551,043, rather than \$288,741 of previously issued unapproved debt. HAWC agreed to prepare notes for the presently undocumented financings. HAWC also stated it shared Staff's concern about its increasingly leveraged position and that, in December 2005, HAWC's shareholder made a capital contribution of \$225,000 to HAWC. HAWC reiterated that HAWC's shareholder had made other capital contributions totaling \$750,000 over the prior two years. HAWC stated that, given these contributions and the recent rate relief in Docket No. DW 05-112, it expected its cash and earnings positions to improve.

4. Request for Transfer

On January 26, 2006, HAWC filed a letter requesting that the Commission "approve the transfer of an existing financing, owed by HAWC, dated March 1, 1988, from Lewis Builders of New Hampshire, Inc. to its successor corporation, Lewis Builders, Inc." HAWC points out that the obligation "in the amount of \$19,000 with an interest rate of 9.5% and is a debt originally owed by Kent Farm Water Company." Attached to HAWC's request is a certificate of merger issued by the New Hampshire Secretary of State indicating that Lewis Builders, Inc. is the surviving entity of the merger.

II. COMMISSION ANALYSIS

Pursuant to the provisions of RSA 369:1, public utilities engaged in business in this State may issue evidence of indebtedness payable more than 12 months after the date thereof

only if the Commission finds the proposed issuance to be “consistent with the public good.” The New Hampshire Supreme Court has further provided that the public good consideration involves looking beyond the actual terms of the proposed financing to the use of the proceeds of those funds and the effect on rates to insure that the public good is protected. See *Appeal of Easton*, 125 N.H. 205, 211 (1984).

In the case at hand, two distinct issues need to be addressed. The first involves a request for Commission approval of certain debt that has already been issued by HAWC. The second issue pertains to HAWC’s request for new financing in order to fund various system improvements.

We address HAWC’s previously issued debt first. We note that we have in various cases approved portions of HAWC’s debt, approved use of the proceeds, or approved the original terms and conditions of the financing. Accordingly, we affirm the previous findings by this Commission with regard to that portion of the existing debt under consideration in this case. With regard to the use of those funds, we note HAWC has used the funds to purchase assets, construct mains, install meters and other system facilities, and fund operating advances. We find these uses necessary to the proper operation of a water utility and that they are in the public good. With regard to the amounts and terms of HAWC’s existing debt that have not been previously approved by the Commission, we note the terms and conditions of the loans are similar to other financings this Commission has previously approved for HAWC. We thus find the instant terms and conditions reasonable. Accordingly, we will approve the six existing notes recommended by Staff, which total \$551,043 as of December 31, 2004, under the terms and conditions for each note specified previously in this order. We will also approve the transfer to

Lewis Builders, Inc. of the \$19,000 obligation originally undertaken with respect to Kent Farm Water Company. We agree that the proposed resolution of this matter will move HAWC closer to the degree of regulatory compliance envisioned in the stipulation we approved in Docket No. DW 02-128.

We next address HAWC's proposed new financing. HAWC requested approval to borrow up to \$547,769 from its affiliate, Lewis Builders Development, Inc. (LBDI), in order to fund various system improvements. According to the filing, HAWC intends to purchase meters, install treatment equipment to mitigate iron, manganese and arsenic levels, and to retrofit on-site filter backwash infiltration beds at various systems. These improvements are intended to further ensure safe and reliable water service to its customers. Staff concurred that the use of the funds are prudent and in the public interest and we agree. We find that the proposed uses of the proceeds of the financing are reasonable and will assist HAWC in ensuring a safe and reliable water system. As with HAWC's previously issued debt, we note the terms and conditions of the loans are similar to other financings previously approved for HAWC and thus we find the instant terms and conditions reasonable.

We note that plant proposed to be funded from these new financings will not immediately impact customer rates. Prior to being included in rate base, the Commission must find, pursuant to RSA 378:28, that such plant is deemed prudent and used and useful in the provision of utility service. That assessment is customarily performed in a rate proceeding and thus we will defer consideration of plant additions to HAWC's rate base until such time as the plant is in service.

Lastly, we consider the possible effects of the financing on HAWC's overall cost of capital to ratepayers. We note from HAWC's testimony that it made an attempt to obtain financing for these projects from a source other than its affiliate, but was denied due to an insufficient cash flow and a deficit net worth position. Nevertheless, we find the terms of the loan from LBDI are equitable and in the public good since they are comparable to the terms of other loans recently approved for HAWC and other water utilities. We share Staff's concern that this financing is adding to HAWC's already excessive debt obligation. Thus, we are encouraged that HAWC's shareholder has recently made significant capital contributions. We also note that HAWC's present rate case, Docket No. DW 05-112, has the potential to provide HAWC with access to additional funds to pay down its debts and a base for consistent growth in shareholder equity. We find that the financings will not adversely affect HAWC's overall cost of capital to ratepayers and, therefore, we approve HAWC's financing request.

Based upon the foregoing, it is hereby

ORDERED, that subject to the effective date below, the existing financings recommended by Staff, totaling \$551,043 as of December 31, 2004, that were previously issued by Hampstead Area Water Company, Inc. without prior approval by the Commission are hereby approved under the terms and conditions for each note reported above; and it is

FURTHER ORDERED, that subject to the effective date below, that HAWC's request for additional financing in an amount up to \$547,769 is approved under the terms and conditions stated in HAWC's filing; and it is

FURTHER ORDERED, that within 30 days from the date of this order, HAWC will produce executed, amended, or otherwise corrected notes pertaining to financings with

Lewis Builders, Inc. having outstanding balances as of December 31, 2004 of \$95,524, \$215,103, \$133,245, and \$30,589 and will submit copies of these to the Commission; and it is

FURTHER ORDERED, that HAWC will file true copies of the loan documents pertaining to its new financing executed or otherwise finally issued in connection with the closing of the transactions contemplated hereby.

By order of the Public Utilities Commission of New Hampshire this twenty-seventh day of January, 2006.

Thomas B. Getz
Chairman

Graham J. Morrison
Commissioner

Clifton C. Below
Commissioner

Attested by:

ChristiAne G. Mason
Assistant Executive Director & Secretary