

**STATE OF NEW HAMPSHIRE
PUBLIC UTILITIES COMMISSION**

DW 08-052

PITTSFIELD AQUEDUCT COMPANY, INC.

Notice of Intent to File Rate Schedules

DW 09-051

PENNICHUCK EAST UTILITY, INC.

**Request to Transfer Assets and Franchise Rights and
Assumption of Long-Term Indebtedness**

**Order Approving Permanent Rates for Pittsfield Aqueduct Company, Inc.,
Transfer of Assets and Franchise Rights, and Assumption of Debt**

ORDER NO. 25,051

December 11, 2009

APPEARANCES: McLane, Graf, Raulerson & Middleton, P.A., by Sarah B. Knowlton, Esq. for Pittsfield Aqueduct Company, Inc.; Locke Lake Colony Association by Lisa Sprague; Sunrise Lake Estates Association by Jerri Waitt; Mitchell Municipal Group, P.A., by Laura A. Spector, Esq. for Town of Pittsfield; Birch Hill Water District by Kirk W. Smith; Hage & Hodes, P.A. by Jay L. Hodes, Esq. for Town of Litchfield; Office of the Consumer Advocate by Rorie E. P. Hollenberg, Esq. on behalf of residential utility ratepayers; and Staff of the Public Utilities Commission by Marcia A. B. Thunberg, Esq.

I. PROCEDURAL HISTORY

Pittsfield Aqueduct Company (PAC) provides water service to customers in 1) the Town of Pittsfield, and 2) the “North Country systems:” Birch Hill in North Conway, Sunrise Lake Estates in Middleton, and Locke Lake Colony in Barnstead. Pennichuck East Utility, Inc. (PEU) provides water service to approximately 5,000 customers in parts of the towns of Atkinson, Bow, Chester, Derry, Exeter, Hooksett, Lee, Litchfield, Londonderry, Pelham, Plaistow, Raymond, Sandown and Windham. PAC and PEU are wholly owned subsidiaries of Pennichuck Corporation.

On May 2, 2008, PAC filed a request for a permanent rate increase as well as a petition for temporary rates in Docket No. DW 08-052. PAC presently charges consolidated rates to all its customers and in its rate filing PAC requested that the Commission allow it to charge separate rates for customers in the Town of Pittsfield and customers in the North Country systems. PAC proposed a permanent rate increase of 44.01% for Pittsfield customers and a 311.91% rate increase for North Country customers.

The procedural history of this docket is more fully described in Order No. 24,929 (December 31, 2008). In that Order, the Commission approved temporary rates for PAC, increasing rates for Pittsfield customers by 40% and for North Country residential customers by an amount that would result in average residential bills being 25% higher than the average Pittsfield residential bill.

On January 9, 2009, Staff filed a request to modify the procedural schedule and, on January 14, 2009, PAC filed a motion to stay the procedural schedule to allow the company to revise its request for permanent rates. Staff and intervenors Locke Lake Colony Association, Birch Hill Water District and Sunrise Lake Estates Association assented to the motion to stay. The Office of the Consumer Advocate (OCA) and the Town of Pittsfield did not oppose the motion. On January 30, 2009, the Commission approved PAC's motion to stay.

On March 13, 2009, PAC filed a motion to modify its rate case. In support of its motion, PAC filed the testimony of Donald L. Ware, President, and Bonalyn J. Hartley, Vice President of Administration and Regulatory Affairs. PAC seeks to move its North Country customers to its affiliated utility, PEU, and charge those customers PEU rates as well as a capital recovery surcharge to recover all capital costs, including the purchase price, for the North Country systems. The surcharge would be based on system-specific capital improvement costs and would

be recovered over thirty years. The modified filing would raise permanent rates for Pittsfield by 39.79%, Locke Lake Colony by 170.57%, Birch Hill by 291.45%, and Sunrise Estates by 128.85%. The proposed rates for Locke Lake Colony, Birch Hill and Sunrise Estates include a capital recovery surcharge specific to each system. Staff, Sunrise Estates Association, Locke Lake Colony Association, Birch Hill Water District and the Town of Pittsfield assented to the motion to modify. OCA also assented to the motion, but took no position as to the substance of the proposed modifications.

Also on March 13, 2009, PAC and PEU filed a petition for Approval of the Transfer of Assets and Franchise Rights and Assumption of Long Term Indebtedness, which was docketed as Docket No. DW 09-051. On May 18, 2009, the Town of Litchfield, a customer of PEU, filed a motion to intervene in DW 09-051. Concurrent with its transfer petition, PAC and PEU filed a motion to consolidate Dockets DW 08-052 and DW 09-051, which the Commission granted by Order No. 24,975 (June 5, 2009).

Following the consolidation of the two dockets, the parties engaged in additional discovery on the Company's modified filing and the PAC/PEU joint petition. Staff conducted an audit on a proposed step increase, which concluded with an audit report on June 2, 2009. The Office of Consumer Advocate filed testimony of Stephen R. Eckberg on July 31, 2009, and Locke Lake filed testimony of Deana Cowan on that same date. On August 31, 2009, PAC filed joint rebuttal testimony of Ms. Hartley and Mr. Ware.

On September 29, 2009, Staff filed a settlement agreement on behalf of PAC, PEU, Birch Hill, the Town of Pittsfield and Staff; while PAC filed a request for waiver of Puc 203.20(e), which the Commission granted. The hearing was held as scheduled and on October 2, 2009 PAC and PEU filed responses to record requests made at the hearing.

II. SUMMARY OF THE SETTLING PARTIES' TERMS OF AGREEMENT

A. Transfer of Assets

The settling parties agree that it is in the public interest and consistent with RSA 374:22, 26, and 30 for PAC to transfer to PEU the assets PAC uses to provide service to its North Country customers, and for PEU to be granted the franchise rights necessary to serve those customers. The assets consist of all of the assets used to provide water service to the North Country customers. The assets do not include the assets necessary to serve customers in Pittsfield.

The settling parties recommend the transfer be effective for accounting purposes as of January 1, 2010 (the Transfer Date). PAC and PEU agree that 30 to 60 days prior to the Transfer Date, they shall meet with Staff to allow Staff to confirm the nature of the assets to be transferred, the tracking of the Capital Recovery Surcharge assets and related depreciation, and the accounting entries necessary to accomplish the transfer, including the resulting changes to PAC's and PEU's debt and equity levels. This meeting will be conducted using proforma amounts based upon asset and liability values as of September 30, 2009, to facilitate an agreement between the parties on the accounting method for this transfer. Once this methodology is agreed upon by the parties, it will be utilized with the actual results as of December 31, 2009, in completing the January 1, 2010 transfer of assets.

B. Assignment of Indebtedness

The settling parties agree that it is in the public interest and consistent with RSA 369:1 for PAC to assign to PEU, and for PEU to assume, all of PAC's obligations under its July 3 and September 14, 2007 loans from the State of New Hampshire Revolving Loan Fund, and for the intercompany acquisition note of May 9, 2006 between PAC and its parent, Pennichuck Corporation as of the Transfer Date. Additionally, a portion of the short term intercompany advances and the long term intercompany note issued on March 3, 2008 to PAC in the amount of \$2,500,000 will be allocated to Pittsfield and North Country as of the Transfer Date consistent with the methodology reflected in the agreement.

C. Rate Increase

1. North Country Base Rates: The settling parties recommend the Commission authorize PEU to charge North Country customers a monthly amount equal to the customer charge for PEU's General Metered customers plus an amount equal to the greater of the volumetric charge for 4 ccf of consumption or the volumetric charge for the customer's actual consumption based on PEU's volumetric rates.

2. Pittsfield Base Rates: The settling parties recommend the Commission grant PAC an increase to PAC's revenue requirement of \$181,265, or 39.79%, to produce a total revenue requirement of \$636,829. The proposed revenue requirement is based on a stipulated rate base amount of \$2,031,791, an overall rate of return of 8.07%, a cost of equity of 9.75%, and a cost of debt of 6.70%. The settling parties stipulate that this revenue requirement represents a

reasonable compromise of all issues relating to the revenue requirement pending before the Commission for purpose of permanent rates.

D. Capital Recovery Surcharge

The settling parties recommend that customers of Locke Lake, Birch Hill, and Sunrise Estates shall be charged a Capital Recovery Surcharge as illustrated in the agreement. The surcharge would be recalculated in each general rate case for PEU to reflect changes in the number of customers in each system. In the interim, new customers added to the North Country water systems between rate cases would pay the Capital Recovery Surcharge in effect at that time.

The settling parties agree that there shall be no System Upgrade Fee, as initially proposed. In the next rate case for PEU, the rate base, debt, depreciation expense and revenues associated with the Capital Recovery Surcharge shall not be included in PEU's rate base and net operating income for ratemaking purposes. All other rate base, debt, equity, revenues and operating costs for North Country systems will be merged and included in PEU's rate base and net operating income and accounted for in the same manner as the other water systems of PEU. Notwithstanding the foregoing, the capital additions included in the Capital Recovery Surcharge are agreed to be used and useful in providing service to customers and were prudently incurred.

E. Capital Structure

The settling parties agree that, for ratemaking purposes and in the test year, PAC shall be deemed to have a capital structure following the transfer of North Country assets to PEU of 55.18% long term debt and 44.82% equity.

PEU shall have a capital structure following the transfer of the North Country assets to PEU of 39.53% long term debt, .16% short term debt, and 60.31% equity. The settling parties understand that PEU has undertaken, and will continue to undertake, efforts to reduce the amount of equity in its capital structure.

F. Depreciation Rates

The settling parties agree to adopt the recommended depreciation rates in PAC's February 25, 2008 depreciation study and as updated by PAC's response to Staff Data Request 2-8 (issued on November 13, 2008) for customers in Pittsfield only. The settling parties recommend that existing PEU depreciation rates be applied to the assets used to serve North Country customers.

G. Rate Design

The settling parties recommend the Commission approve the rate design set forth PAC's May 12, 2008 cost of service study, as updated in September 2009, to its Pittsfield customers.

H. Rate Impact

If approved, the proposed rates would result in an overall increase for general metered customers in Pittsfield of 57.89%. For the average residential customer with a 5/8 meter and based on average monthly usage of 7.3 ccf, the annual bill would be approximately \$651.53, an increase of approximately \$239.21 per year, or \$19.93 per month. No increase for municipal and private fire protection services in Pittsfield is requested. The proposed PEU rates would result in an overall increase for general metered customers of 170.57% for Locke Lake customers, 291.48% for Birch Hill customers, and 128.85% for Sunrise Estates customers. For the average residential customer with a 5/8 meter and based on average monthly usage of 4 ccf, the annual bill will be approximately \$671.16 for Locke Lake customers, \$1,033.68 for Birch Hill customers, and \$599.28 for Sunrise Estates customers, an increase of approximately \$32.46, \$62.67, and \$26.47 per month respectively. For the average residential customer with a 5/8 meter and based on average monthly usage of 2 ccf, the annual bill would be approximately \$671.16 for Locke Lake customers, \$1,033.68 for Birch Hill customers, and \$599.28 for Sunrise Estates customers, an increase of approximately \$39.06, \$69.27, and \$33.07 per month respectively. For customers with an average monthly usage of 7 ccf, the annual bill would be approximately \$873.12 for Locke Lake customers, \$1,235.64 for Birch Hill customers, and \$801.24 for Sunrise Estates customers, an increase of \$39.39, \$69.60 and \$33.40 per month. The settling parties provided a Report of Proposed Rate Changes that depicted the revenue increases by customer class.

I. Effective Date for Permanent Rates and Recoupment

The settling parties propose that permanent rates be effective as of the date of the Commission's final order in this docket and be reconciled back to June 6, 2008, consistent with Commission Order No. 24,929 on temporary rates. In order to reconcile the difference between temporary rates and permanent rates, the settling parties agree that the difference between the revenues that would have been generated under permanent rates and the amounts charged to customers under temporary rates shall be recovered through a surcharge or a credit on customers' bills, whichever the case may be, over a period of 18 months, except for Birch Hill customers. In the case of Birch Hill, the settling parties propose that recovery occur over 24 months. The surcharge will be calculated based on the actual usage, customer and fire protection charges for each General Metered and fire protection customer during the relevant period of time. The settling parties agree that the reconciliation of temporary and permanent rates for Pittsfield customers be implemented in a manner that is consistent with the September 2009 updated cost of service/rate design study.

J. Rate Case Expense Surcharge

The settling parties recommend that PAC be permitted to recoup its reasonable rate case expenses associated with this proceeding in the form of an equal per customer surcharge on all Pittsfield and North Country customers' bills, recoverable over the course of 18 months. Rate case expense shall include, but not be limited to, PAC's cost of service and depreciation studies, legal expenses and administrative expenses such as copying and delivery charges associated with filing the case, and publication and other notice expenses. PAC agrees to submit its final rate

case expense request to Staff for review and recommendation to the Commission. Upon receipt of the Commission's final order, PAC and PEU agree to file a compliance tariff including the approved surcharge relating to recoupment of the difference between the level of temporary rates and permanent rates and recovery of the amount of rate case expenses within 20 days.

K. Tariff Fee Change

The settling parties recommend the Commission authorize PEU to adopt an amendment to its tariff in which North Country customers whose meters are removed on a temporary basis at their request for more than one month continue to be charged the monthly charge (customer charge), the minimum volumetric charge of 4 ccf, and the capital recovery surcharge.

III. POSITIONS OF THE NON-SETTLING PARTIES

A. Locke Lake Colony Association

In its pre-filed testimony, Locke Lake Colony Association raised concerns about the use of a four hundred cubic feet (4 ccf) minimum usage level proposed for all North Country customers. The association stated that the 4 ccf level hurts customers who only use 0 to 3 ccf per month and those customers are typically on fixed incomes. The association stated that although local aid programs exist, such programs only offer assistance to residents with electric or fuel bills; they do not offer aid for water bills. Seasonal customers are being asked to pay for 4 ccf of use when they are not there and pay an additional fee to disconnect their meters. The association was concerned that customers would in effect be double billed by having to pay a capital recovery surcharge, a minimum 4 ccf usage charge, and a disconnection and reconnection fee.

B. Sunrise Lake Estates Association

Sunrise Lake Estates expressed its opposition to the 4 ccf minimum charge and stated that its inquiry of its residents confirmed that most use less than 4 ccf per month. The association stated that at the time of the acquisition of the North Country systems by PAC in Docket No. 05-132, it was only concerned that Sunrise Lake Estates be metered so that single customers would not be paying the same flat rate for water as customers, such as families, who use more water.

The association stated that Sunrise Lake Estates now has meters but that with the 4 ccf minimum charge, single customers are back to paying the same amount as families.

C. Town of Litchfield

The Town of Litchfield did not take a position on rates. Litchfield acknowledged that the North Country water systems were in poor shape and it acknowledged that the systems have been operating at a \$700,000 loss. Litchfield stated that the company seeks to shift that loss to ratepayers of PEU. Litchfield stated that the shift is unfair and that there is no hydrological connection between the PEU and North Country systems. Litchfield stated that PEU ratepayers are unrepresented. It stated it was skeptical of PEU's argument that benefits would flow to the existing PEU customers in the future and that the acquisition of the North Country systems by PEU would have a minimal impact on rates. Litchfield asked that if the Commission approves the acquisition that it hold PEU to its word that there will be a minimal impact upon PEU ratepayers.

D. Office of the Consumer Advocate

In its pre-filed testimony, OCA deferred to Staff on the issues of: whether PAC's investments since the last rate case were prudent; whether PAC and PEU's request to transfer the North Country systems is consistent with the public good; and whether the rates proposed for PAC are just and reasonable. As to the issue of rates for the North Country customers, OCA stated that the proposed rates were not just and reasonable. OCA stated it was concerned that future rate cases by PEU would raise North Country customer rates further. Recoupment surcharges for temporary and permanent rates as well as rate case expenses could be an onerous burden. OCA recommended the Commission consider longer than usual recovery periods for these surcharges to mitigate the burden on customers. OCA did not oppose the transfer of North

Country customers to PEU. OCA opposed the proposed capital recovery surcharge but later withdrew its opposition at hearing.

At hearing, OCA expressed concern over the impact that financing \$4 million in debt could have on rates. OCA also expressed concern over how the rate increase and minimum 4 ccf charge will impact low-income and fixed-income customers. OCA suggested the Commission review the issue of assistance to low-income water customers in a generic docket. OCA stated it viewed favorably the proposed extended recovery periods for the temporary and permanent rate recoupment contained in the settlement agreement. OCA encouraged PAC to communicate with customers through the use of a bill insert explaining how the recoupment surcharge was calculated.

IV. COMMISSION ANALYSIS

As indicated above, the Commission opened Docket No. DW 08-052 to investigate PAC's proposed rate schedules. PAC's proposed increase to its revenue requirement would have resulted in a rate increase of 311.91% for North Country customers. PAC modified its proposal, with the support of the settling parties, to mitigate the rate increase for North Country customers by transferring those customers to PAC's sister company, PEU.

A. Transfer of North Country Systems to PEU

The transfer of water utility assets and franchises is governed by RSA 374:22 and RSA 374:30. Pursuant to RSA 374:22, I, "[n]o person or business entity shall commence business as a public utility within this state . . . or shall exercise any right or privilege under any franchise not theretofore actually exercised in such town, without first having obtained the permission and approval of the commission." The Commission grants requests for franchise authority and allows an entity to engage in the business of a public utility when it finds that the exercise of the

right, privilege, or franchise is for the public good. *See* RSA 374:26. Pursuant to RSA 374:30, “[a]ny public utility may transfer or lease its franchise, works or system, or any part of such franchise, works or system, exercised or located in this state ...when the commission shall find that it will be for the public good and shall make an order assenting thereto,....” In determining whether a proposed franchise or franchise transfer is for the public good, the Commission assesses, among other things, the managerial, financial, and technical expertise of the petitioners. *See Lower Bartlett Water Precinct*, Order No. 23,562, 85 NH PUC 635, 641 (2000).

In this case, the North Country systems are proposed to be transferred to PEU, a regulated water utility previously found to possess the requisite technical, managerial, and financial capability to operate community water systems. *See, Pennichuck East Utility, Inc.*, Order No. 24,620, 91 NH PUC 204 (2006). PEU has been providing water service to customers since 1998 and, through an affiliate agreement, utilizes similar personnel as PAC to provide water service in this State. We find, therefore, that PEU possesses the requisite managerial, financial, and technical expertise to operate the North Country water systems.

Among the specifics of the transfer, the settling parties requested that the indebtedness associated with the North Country systems follow the assets and also be transferred to PEU. Exh. 12 at 6 and 16. The total value of assets to be transferred is \$4,752,397; \$3,264,074 in debt associated with those assets will be transferred. *Id.* at 18. The loans for the North Country purchase and capital improvements have been approved by this Commission.¹ PEU has agreed not to collect a return on the equity portion of the transferred assets. Instead, that equity is to be transferred to PEU’s books and become part of its capital structure.

¹ *See Pittsfield Aqueduct Company, Inc.*, Order No. 24,610 (March 31, 2006); *Pittsfield Aqueduct Company, Inc.*, Order No. 24,739 (April 13, 2007); *Pittsfield Aqueduct Company, Inc.*, Order No. 24,818 (January 11, 2008); and *Pittsfield Aqueduct Company, Inc.*, Order No. 24,827 (March 3, 2008).

Assets subject to transfer necessarily involve treatment of debt and equity and affect the acquiring entity's capital structure. *See e.g., National Grid plc*, Order No. 24,777, 92 NH PUC 279 (2007) and *Verizon New England, Inc. et als.*, Order No. 24,823, 264 P.U.R.4th 185 (2008) (N.H.P.U.C.). In this case, PEU's capital structure will be approximately 40% debt and 60% equity immediately after the transaction. Staff witness Mark A. Naylor testified that although Staff would prefer to see equity in the 40% to 45% range of a utility's capital structure, Staff supported the transaction partly because PEU's Board of Directors recently declared a dividend, which will help lower the equity component. 9/30/09 Tr. at 125 lines 11-24. Mr. Naylor added that PEU has pending before the Commission a request for financing that would result in an additional \$1.5 million in new debt, which will bring the capital structure more in line with acceptable ratios. 9/30/09 Tr. at 126 lines 1-12. We find these efforts by PEU to make its capital structure more balanced, as well as its treatment of indebtedness associated with the transfer, to be reasonable. We will approve this accounting of the transaction with the understanding that Staff and the parties will meet prior to the transfer to confirm the nature of the assets to be transferred, the tracking of the Capital Recovery Surcharge assets and related depreciation, and the accounting entries necessary to accomplish the transfer, including the resulting changes to PAC and PEU's debt and equity levels. We expect Staff and the parties to report their agreement on these issues prior to the January 1, 2010 transfer date.

Staff, OCA, PAC, PEU, the Town of Pittsfield and Birch Hill Water District support the transfer of the North Country water systems. Locke Lake Colony Association and Sunrise Estates Association do not oppose the transfer and noted that the rates proposed in the modified filing are lower than what PAC had initially proposed. The Town of Litchfield expressed concern that PAC and PEU will be shifting approximately \$700,000 in losses to existing PEU

customers and asked that, if the acquisition were approved, PEU be held to its word that there will be a minimal impact upon PEU ratepayers.

By way of clarification, PAC and PEU will not be recovering the \$700,000 in losses from PEU customers. According to Ms. Hartley, since PAC acquired the North Country systems in 2006, it has experienced an aggregate loss of approximately \$740,000. 9/30/09 Tr. at 297 lines 17-24. Ms. Hartley testified that although PAC has temporary rates in place, it still has approximately \$700,000 in losses. *Id.* PAC's modified rate case is based on a 2007 test year for expenses associated with operating the water system in the Town of Pittsfield only. Any losses incurred by PAC in its operation of the North Country systems will not be included in the test year used for determining PAC's rates. Additionally, PEU is not changing its general tariff rates in the instant docket. It is increasing its customer base by 20% and these new customers will share in PEU's costs. PAC's accumulated operating losses remain on PAC's books as a reduction to equity and thus PEU customers will not be charged for recovery of the \$700,000 in PAC losses.

Having considered the record and testimony at hearing, we find that granting PEU the franchise to serve the North Country customers is in the public good. PEU possesses the requisite managerial, financial, and technical expertise to operate water systems, the accounting treatment of the indebtedness following the assets is reasonable, and PEU customers will not be subsidizing the losses suffered by PAC. Accordingly, we will approve the petition to transfer assets and franchise rights.

B. Pittsfield Aqueduct Company, Inc. Rates

RSA 378:7 authorizes the Commission to fix rates after a hearing upon determining that the rates, fares, and charges are just and reasonable. In determining whether rates are just and

reasonable, the Commission must balance the customers' interest in paying no higher rates than are required with the investors' interest in obtaining a reasonable return on their investment.

Eastman Sewer Company, Inc., 138 N.H. 221, 225 (1994). Additionally, in circumstances where a utility seeks to increase rates, the utility bears the burden of proving the necessity of the increase pursuant to RSA 378:8. Pursuant to RSA 378:28, the Commission shall not include in permanent rates any return on any plant, equipment, or capital improvement which has not first been found by the Commission to be prudent, used, and useful. Pursuant to RSA 541-A:31, V(a), informal disposition may be made of any contested case at any time prior to the entry of a final decision or order, by stipulation, agreed settlement, consent order or default. N.H. Code Admin. R. Puc 203.20 (b) requires the Commission to determine, prior to approving disposition of a contested case by settlement, that the settlement results are just and reasonable and serve the public interest.

1. PAC Revenue Requirement

Staff and the settling parties propose a revenue requirement of \$636,829, an increase of 39.79% over PAC's test year revenues. Exh. 8 at 36. This compares to the 44.01% overall rate increase PAC proposed in its initial filing when it sought to increase revenues from Pittsfield customers by \$200,503. The revenue requirement includes an agreed-to overall rate of return of 8.07%, cost of equity of 9.75%, and cost of debt of 6.70%. Exh. 12 at 7. It is based on test year revenues of \$455,564 and a revenue deficiency of \$181,265. Exh. 8 at 36. The settling parties propose a pro forma rate base of \$2,031,791. The settling parties agree to adopt the recommended depreciation rates identified in PAC's depreciation study dated February 25, 2008 and, as updated in PAC's response to Staff Data Request 2-8. *See* Exh. 14.

The increase in the revenue requirement is due in part to PAC's expenditure of approximately \$500,000 in net investments on the Pittsfield water system. Some of these investments included PAC's installation of a direct intake from Berry Pond into the existing water treatment plant to eliminate turbidity problems and to ensure compliance with the new, lower 0.3 NTU standard. Exh. 16 at 59. *See also*, N.H. Code Admin. Rule Env-Ws 380.27(b)(1). PAC coated and sealed the concrete roof of the finished water storage tank at the Pittsfield water treatment plant. PAC also rehabilitated steel chambers in its Microfloc Package plant. *Id.* at 60.

The plant additions and PAC's accounts and records have been fully audited by Staff. Exh. 20. Additionally, Staff testified that the assets in the agreed-upon rate base are prudent, used, and useful in the provision of utility service to the Pittsfield customers. 9/30/09 Tr. at 116 lines 2-5. At hearing, no evidence was offered to contradict the prudence of PAC's investments. No party opposed the revenue requirement proposed by the settling parties for the Pittsfield customers.

Having reviewed the record and evidence presented at hearing as to the proposed revenue requirement for customers in the Town of Pittsfield, we find that the revenue requirement represents a reasonable compromise of the issues. Further, we find that the rate base used to calculate the revenue requirement is prudent and used and useful in the provision of utility service, in accordance with RSA 378:28.

2. PAC Rates and Rate Design

The settling parties propose to change the present allocation of the revenue requirement among customers. The settling parties propose that permanent rates be imposed according to the rate design set forth in PAC's May 12, 2008 cost of service study, as updated in Appendix D to

the settlement agreement. The cost of service study evaluated the present allocation of PAC's revenue requirement among its general metered customers, municipal fire protection customers, and private fire protection customers and found that PAC was over-earning as to its fire protection customers. The study found that present revenues were 8.3% greater than the cost to serve municipal fire protection customers and 37.5% greater than the cost to serve private fire protection customers. Exh. 12 at 22. We note that PAC's sole municipal fire protection customer is the Town of Pittsfield. 9/30/09 Tr. at 86 lines 21-23. PAC provides private fire protection service to 11 customers. Exh. 12 at 28. The cost of service study recommends that the proposed 39.79% increase, or the proposed \$181,276 revenue increase, be allocated only among the general metered customers in light of the fact that both the municipal and private fire protection classes were generating revenues more than sufficient to cover the cost of service for fire protection. This allocation would result in a 57.89% effective rate increase to the approximately 634 general metered customers. Staff, PAC, and the Town of Pittsfield support this change in allocation.

We find this allocation among PAC's customer classes to be reasonable. The record demonstrates that PAC's fire protection classes are currently providing adequate revenues to compensate PAC for the service provided. The Commission supports contribution of the true cost of service by each rate class, as determined through periodic updates to a utility's cost of service study. These updates avoid undue shifting of revenue responsibilities from one class of customers to another. We will, therefore, approve the recommended revenue allocations and we find that the proposed rates are just and reasonable.

3. North Country Rates and Rate Design

North Country customer rates are proposed to comprise PEU's existing approved tariff rates as well as an additional charge to cover the original purchase price and system-specific capital improvements. The additional charge is referred to by the settling parties as a Capital Recovery Surcharge. Because the existing PEU tariff rates are not changing and no additional plant is being recovered under those rates, we need not conduct a new analysis pursuant to RSA 378:7 and RSA 378:28.

As to the Capital Recovery Surcharge, however, recovery of new plant is being proposed and thus we must review whether the plant, equipment or capital improvements are prudent, used, and useful. The settling parties propose to recover the following capital: \$2,705,841 from Locke Lake customers; \$1,878,504 from Birch Hill customers; and \$168,052 from Sunrise Lake Estates customers.

At hearing Mr. Ware testified that PAC made substantial capital improvements at Locke Lake, which included an additional well, storage, a booster station, pumps and treatment for arsenic, iron, and manganese. 9/30/09 Tr. at 26 lines 3-24. PAC also installed meters and valves. *Id.* PAC testified that each lot shares a ¾-inch service line with one other lot and that, as service lines fail, PAC has been installing individual service lines, one per lot. *Id.* at 27 lines 1-8. In Birch Hill, PAC constructed a 5,000 foot interconnection main with the North Conway Water Precinct to replace the six individual wells that had served Birch Hill. The well water contained high levels of fluoride and had bacteria issues. *Id.* at 27 lines 9-16. PAC also installed meters. In Sunrise Lake Estates, PAC replaced 3 well pumps, installed flushing units to address water color problems, and installed meters. *Id.* at 28 lines 3-12.

The settling parties represent that these plant assets are used and useful in providing service to customers and that they were prudently incurred. We note that the assets were also subject to Staff audit. *See*, Exh. 20. Furthermore, testimony corroborated that these additions were necessary to meet water quality standards and improved water quality for customers. Based on our review of the record and testimony presented at hearing, we find that the plant, equipment and capital additions that form the basis of the proposed Capital Recovery Surcharge for the North Country customers are prudent, used, and useful in accordance with RSA 378:28.

We now address whether the proposed North Country rates are just and reasonable. The settling parties, including Birch Hill, recommend the Capital Recovery Surcharge be collected over the course of 30 years and be recalculated at each rate case to account for fluctuations in the customer count. The 30-year term of the surcharge mitigates the rate impact to customers and reasonably approximates the composite life of the assets. The monthly surcharges would be: \$17.00 per customer for Locke Lake; \$47.21 per customer for Birch Hill; and \$11.01 per customer for Sunrise Lake Estates.

We note that PEU's return on the plant for this surcharge is proposed to be at 4.68%, the weighted cost of the debt used to finance the acquisitions and subsequent capital improvements, rather than at PEU's last allowed overall rate return of 7.60%. This low rate of return results from foregoing collection of any return on the equity portion of this transferred plant, as noted above. If this plant were being recovered through a traditional return consisting of both debt and equity, North Country customers would be paying significantly more and we consider PEU's forbearance of its rate of return to be a benefit to customers. Staff testified that it had no concerns that PEU's forbearance of its return would adversely affect PEU's ability to provide

safe and adequate service to the North Country customers. 9/30/09 Tr. at 119 line 2. Thus, the benefit to customers does not appear to be at a detrimental cost to the company.

At hearing, Locke Lake expressed concern that customers might be effectively double charged by the imposition of the Capital Recovery Surcharge. We do not find, based on our review of the rate method proposed by the settling parties, that PEU is recovering twice on its investment. Pursuant to the settlement agreement, the fixed assets, debt, depreciation expenses and revenues associated with the Capital Recovery Surcharge will not be included in PEU's rate base and net operating income for purposes of determining its rates in future proceedings. Thus, PEU's future tariff rates will be calculated based on plant and investments other than those recovered through the Capital Recovery Surcharge. Having considered the evidence and testimony, we find that the Capital Recovery Surcharge is just and reasonable, consistent with RSA 378:7.

Although the settling parties do not propose changing the existing general metered rates in PEU's tariff, the parties propose to establish a minimum usage associated with the volumetric rate. In particular, the settling parties propose that, for North Country customers only, the volumetric rate be calculated based upon a minimum of 4 ccf of usage per month. At hearing, Ms. Hartley explained that after the North Country systems became fully metered, PAC realized that there were a large number of low usage customers and that the average usage was just over 4 ccf per month per customer. 9/30/09 Tr. at 21 lines 14-24 and at 22 line 1. Average usage in Pittsfield is just over 6 ccf per month. Average usage in the existing PEU systems ranges between 8 and 9 ccf per month per customer. 9/30/09 Tr. at 64 lines 5-7. Ms. Hartley stated that adopting the existing PEU tariff rates without a minimum usage for the North Country systems would result in PEU not collecting revenues sufficient to cover its operating expenses. Id. at 63

lines 9-11. As Mr. Ware testified, the variable cost of producing water accounts for 10% of the operating cost while fixed costs account for 90% of the operating costs. 9/30/09 Tr. at 35 lines 14-20. Thus, a reduction in usage would not result in a significant reduction in operating costs. *Id.* If North Country customers were charged the existing PEU tariff rates, then those customers would not be paying their fair share of the fixed costs that existing PEU customers pay and the effect would be a subsidy to North Country customers.

We find this explanation of why the 4 ccf minimum usage was chosen to be persuasive. We understand that, if PEU did not adjust the minimum usage, it would need to charge North Country customers a tariff rate different from the existing PEU customers in order to generate sufficient revenues to cover its operating costs, plus its return on investment. Having considered the settling parties' proposal to set a minimum usage for the PEU volumetric charge for North Country customers, we find the rate to be just and reasonable, consistent with RSA 378:7.

4. Temporary and Permanent Rate Recoupment

We approved temporary rates for PAC by Order No. 24,929 (December 31, 2008) and in this order we find the permanent rates proposed by the settling parties to be just and reasonable in accordance with RSA 378:7. Pursuant to RSA 378:29, temporary rates are effective until the final determination of the rate proceeding. If the final rates are in excess of the temporary rates, the public utility is permitted to amortize and recover the sum of the difference. In the event permanent rates are less than temporary rates, we will order a refund pursuant to our authority under RSA 378:7 to determine just and reasonable rates.

In the temporary rate phase of this docket, we approved a 40% increase in Pittsfield customer rates; general metered and fire protection customers alike. We approved rates for North Country customers that were 25% above Pittsfield customers' rates. As noted above, the

settling parties propose no increase to PAC's municipal and private fire protection customers, thus, as PAC testified at hearing, its fire protection customers will receive a refund. 9/30/09 Tr. at 87 lines 13-20. PAC's general metered customers will pay a surcharge representing the difference between the 40% temporary rate increase and the 57.89% effective permanent rate increase. North Country customers will pay a surcharge representing the difference between the PAC temporary general metered rate and the PEU general metered residential rate. The recoupment for North Country customers will be at the 4 ccf minimum usage and will also include the Capital Recovery Surcharge. Exh. 12 at 30.

The settling parties recommend that recovery of the difference between the temporary and permanent rates occur through a surcharge or credit to customer bills over a period of 18 months, except for Birch Hill customers. In the case of Birch Hill, the settling parties propose that recovery occur over 24 months. Exh. 12 at 10. OCA also supports this extended recovery period.

Spreading the recoupment over 18 or 24 months may be reasonable for the general metered customers; however, PAC has yet to file its calculation of the recoupment and thus we cannot make a finding on this issue at this time. For fire protection customers, it may be more reasonable for PAC to issue the credit over a period shorter than 18 months and we will direct PAC to calculate such options for our consideration. We will await PAC's temporary and permanent rate recoupment calculation filing, and Staff and the parties' recommendations before determining the surcharges and credits.

C. Conclusion

Having reviewed the record, including the settlement and evidence presented at hearing, we find that the terms of the settlement represent an appropriate balancing of ratepayer interests

and the interests of PAC and PEU's investors under current economic circumstances. We further find that the settlement results are just and reasonable and serve the public interest, pursuant to N.H. Code Admin. R. Puc 203.20 (b). We will adopt and approve the terms of the settlement agreement.

We find that PEU possesses the requisite managerial, financial, and technical expertise to provide water service and we find that it is in the public good for PEU to provide water service to the North Country customers. We will, therefore, approve the transfer of assets and franchise rights for the North Country water systems from PAC to PEU.

We find that the plant, equipment, and capital improvements comprising PAC's rate base and PEU's Capital Recovery Surcharge to be prudent, used, and useful. We find that the revenue requirement proposed by the settling parties for PAC is reasonable and that it will produce just and reasonable rates for Pittsfield customers. We find that the rates proposed for the North Country customers, including the 4 ccf minimum usage and Capital Recovery Surcharge, to be just and reasonable and we will approve these rates.

Based upon the foregoing, it is hereby

ORDERED, the terms of the settlement agreement are hereby adopted and APPROVED as discussed herein; and it is

FURTHER ORDERED, that Pittsfield Aqueduct Company, Inc. is authorized to collect from customers, permanent rates as discussed herein; and it is

FURTHER ORDERED, that Pittsfield Aqueduct Company, Inc. is authorized to recover from all customers the difference between its temporary and permanent rates, subject to the submission of documentation within twenty (20) days of this order, and further subject to review and approval; and it is

FURTHER ORDERED, the Pittsfield Aqueduct Company, Inc. shall file an accounting of its rate case expenses for the temporary and permanent phases of this proceeding within twenty (20) days of this order; and it is

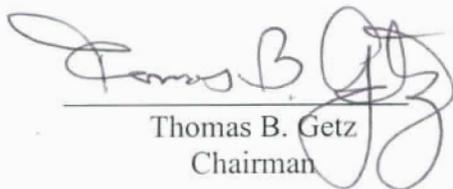
FURTHER ORDERED, that Pittsfield Aqueduct Company, Inc. file with the Commission a compliance tariff within twenty (20) days of this order; and it is

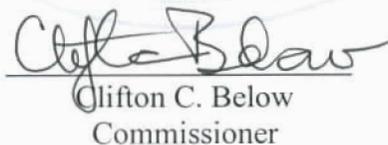
FURTHER ORDERED, that the petition for Approval of the Transfer of Assets and Franchise Rights and Assumption of Long Term Indebtedness is hereby APPROVED; and it is

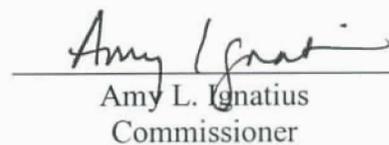
FURTHER ORDERED, that upon the transfer of the North Country systems effective January 1, 2010, Pittsfield Aqueduct Company, Inc. is authorized to discontinue the provision of water service in the towns of North Conway, Barnstead, and Middleton; and it is

FURTHER ORDERED, that upon the transfer of the North Country systems effective January 1, 2010, Pennichuck East Utility, Inc. is authorized to charge its North Country customers a Capital Recovery Surcharge and shall file a compliance tariff within twenty (20) days of this order.

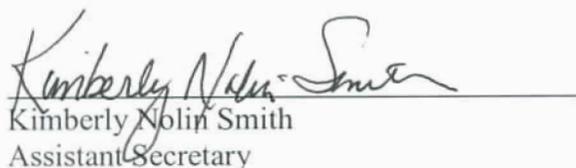
By order of the Public Utilities Commission of New Hampshire this eleventh day of December, 2009.


Thomas B. Getz
Chairman


Clifton C. Below
Commissioner


Amy L. Ignatius
Commissioner

Attested by:


Kimberly Nolin Smith
Assistant Secretary