

**STATE OF NEW HAMPSHIRE
PUBLIC UTILITIES COMMISSION**

DW 19-035

PENNICHUCK EAST UTILITY, INC.

Petition for Approval of 2019 Qualified Capital Project Adjustment Charge

Order *Nisi* Granting Petition

Q R D E R N O. 26,313

December 6, 2019

This order approves a 2.98 percent Qualified Capital Project Adjustment Charge on Pennichuck East Utility customer bills. As a result, an average single-family residential customer using 7.29 hundred cubic feet of water per month will pay an additional \$2.25 on their monthly bill. The Commission issues this order on a *nisi* basis to ensure that interested persons receive notice of the decision and have the opportunity to request a hearing before the order becomes effective.

I. PROCEDURAL HISTORY

Pennichuck East Utility, Inc. (PEU or the Company), is a regulated public utility that provides water service to customers in several communities throughout New Hampshire. On February 15, 2019, PEU filed a petition to recover the cost of certain capital projects completed in 2018 through the Qualified Capital Project Adjustment Charge (QCPAC), and for preliminary approval of its 2019 QCPAC budget. The Company's petition included testimony from Donald L. Ware, PEU's Chief Operating Officer, and John J. Boisvert, Chief Engineer, Pennichuck Water Works.¹ PEU's filing also included estimated QCPAC capital budgets for 2020 and 2021.

¹ Pennichuck Water Works is an affiliate of PEU and provides various services to Pennichuck East Utility.

The Office of the Consumer Advocate (OCA) filed a letter of participation on February 26, 2019. There were no other intervenors.

On August 12, 2019, PEU submitted its first quarterly update to its 2019 QCPAC capital budget. Commission Staff (Staff) submitted its recommendation on September 20, 2019. PEU submitted its second quarterly update on November 14, 2019, following which Staff filed a supplemental recommendation. The petition and subsequent docket filings, other than any information for which confidential treatment is requested of or granted by the Commission, are posted at <http://www.puc.nh.gov/Regulatory/Docketbk/2019/19-035.html>.

II. PEU AND STAFF POSITIONS

A. 2019 Surcharge

In February 2019, PEU requested approval of a 3.29 percent surcharge on customer bills for investments made in 2018. PEU's proposed surcharge would have recovered \$272,201 in additional annual revenues. That additional revenue would have included \$308,979 in additional debt service and \$143,722 in additional property tax expense, offset by an anticipated decrease in purchased water expense of \$180,500 associated with the completion of specific 2018 capital projects.

PEU requested preliminary approval of a 2019 QCPAC budget in the amount of \$2,391,500. PEU proposed that, in conjunction with its 2020 QCPAC filing, the Company include the interest expense incurred on its Fixed Asset Line of Credit (Line of Credit) in its annual debt issuance. That would allow PEU to recover its Line of Credit interest costs through the QCPAC mechanism. PEU also submitted 2020 and 2021 QCPAC capital budgets totaling \$4,770,580 and \$1,750,760, for informational purposes only.

During the course of this proceeding, PEU and Staff recalculated the surcharge, and settled on a final request of 2.98 percent. According to Commission Staff Engineer, Joe Vercelotti, the Company's 2018 qualified capital projects on which the surcharge is based are in service, prudent, and used and useful.

There were several reasons for the recalculation, which are discussed below. First, PEU's actual 2018 capital expenditures differed from budgeted expenditures. Below is a detailed comparison of PEU's actual 2018 capital expenditures compared to the budget amount preliminarily approved in *Pennichuck East Utility, Inc.*, Order No. 26,228 (March 21, 2019).

Description	Budget per DW 18-174	Actual per DW 19-035	Variance
PEU/PWW Interconnection	\$ 3,889,775	\$ 3,708,867	\$ (180,908)
Water Main Replacements	\$ 838,000	\$ 873,843	\$ 35,843
Services, Hydrants, Meters	\$ 334,972	\$ 294,626	\$ (40,346)
Booster, Treatment, Wells	\$ 105,200	\$ 92,476	\$ (12,724)
Miscellaneous, SCADA	\$ 13,741	\$ 13,787	\$ 46
Short-term Interest	\$ 0	\$ 39,547	\$ 39,547
Total	\$ 5,181,688	\$ 5,023,146	\$ (158,542)

The actual project expenditures indicated above reflect the elimination of a \$95,807 Allowance for Funds Used During Construction (AFUDC) component originally recorded on the PEU/PWW Interconnection project. PEU and Staff agreed that because return on rate base is no longer applicable to the Company's current ratemaking structure, the AFUDC mechanism does not accurately reflect the financing costs that PEU incurs during the period of actual project construction. PEU and Staff further agreed that the actual interest expense incurred on the Company's Line of Credit during construction is a more accurate measure of costs than AFUDC. The \$39,547 of interest incurred by PEU on its Line of Credit during construction of 2018 QCPAC projects therefore replaces \$95,807 of AFUDC.

The Company originally estimated the debt service on its 2018 capital additions to be \$308,979. PEU based that amount, in part, on a long-term loan from CoBank, ACB (CoBank) with an estimated interest rate of 5.50 percent. PEU later closed on the CoBank loan at an interest rate of 4.38 percent. As a result, PEU revised its debt service amount on its 2018 capital projects to \$287,225.

PEU originally proposed a property tax expense component based on its 2018 capital additions of \$143,722. The Company subsequently revised that amount to \$139,634.

PEU's filing proposed that the 2019 QCPAC should also reflect the calculated decrease in the Company's annual purchased water expense of \$180,500 resulting from the completion of the PEU/PWW Interconnection project. The QCPAC mechanism approved in *Pennichuck East Utility, Inc.*, Order No. 26,179 (October 4, 2018), however, only contemplated incremental property taxes as an operating expense component in the formulation of the surcharge. PEU and Staff agree it is just and reasonable that incremental expense savings resulting from the completion of the PEU/PWW Interconnection project should also be included in the calculation of the surcharge. There was no subsequent adjustment made to PEU's originally proposed reduction in purchased water expense of \$180,500.

The debt service and associated property tax expense, offset by the decrease in the Company's annual purchased water expense, result in a net combined addition to PEU's revenue requirement of \$246,359. Based on that amount, the calculated surcharge would be 2.98 percent of the base rate charges indicated on customers' bills. For an average single-family residential customer using 7.29 hundred cubic feet of water per month and paying a base charge of \$75.45, the QCPAC will reflect an additional \$2.25 on their monthly bill.

The QCPAC mechanism approved by Order No. 26,179 also includes a “one-time annual recoupment charge covering the period between the approved effective date of the QCPAC surcharge … and the date of the Commission’s order approving the surcharge.” Order No. 26,179 at 12. “The annual recoupment charge is necessary because the financing associated with the prior year’s capital projects begins accruing interest as of the date of issuance of such debt.” *Id.* Absent the ability to recoup the funds necessary to pay both the accrued interest and principal payments on the debt for the period between the effective date and the date of the Commission’s order, the Company will experience a cash shortage which it will not be able to recover. *Id.* Therefore, PEU’s recovery of the QCPAC surcharge should coincide with the initial issuance of the debt and accrual of the associated interest. *Id.*

Order No. 26,179 also granted a waiver to PEU of N.H. Code Admin. Rules Puc. 1203.05(b), which requires that implementation of all Commission-ordered rate changes be on a service-rendered basis commencing on or after the effective date of the change. *See Id. at 2 and 16; see also*, Settlement Agreement at 24, Docket No, DW 17-128 (July 18, 2018) (“the QCPAC shall become eligible for annual recoupment for bills rendered after the date for which bonded debt or other financing incurred with respect to the specific eligible projects is issued or consummated”). In its filing, PEU requested an alignment of its QCPAC recoupment process with Puc 1203.05(b) in order to implement the rate change on a service-rendered basis.

PEU made this request to avoid the possibility of a significant loss in revenue resulting from a bills-rendered recoupment versus a service-rendered recoupment. If allowed, PEU would recover the revenue associated with the authorized 2.98 percent surcharge on a service-rendered basis between July 22, 2019, and the date of implementation of the 2019 QCPAC surcharge. To mitigate the potential rate impact of a one-time recoupment on customers, PEU and Staff agreed to a recovery over

a two-month period. The Commission Audit Staff would examine the recoupment charge assessed during PEU's next QCPAC filing, and any exceptions found would be reconciled as part of the surcharge approved in that proceeding.

B. 2019 QCPAC Budget

PEU originally proposed a 2019 QCPAC capital budget of \$2,391,500, but subsequently filed updates as of June 30, and September 30, 2019. As a result of certain adjustments, the Company indicated a revised 2019 QCPAC capital projects budget of \$2,058,625. Staff recommended the Commission preliminarily approve the updated 2019 QCPAC budget, as follows:

2019 Qualified Capital Project Adjustment Charge Budget Updates			
Description	Original 2019 Budget	September 2019 Update	Change
Locke Lake Improvement Projects	\$ 1,512,500	\$ 1,267,939	\$ (244,561)
Other Water Main Replacements	\$ 260,000	\$ 210,000	\$ (50,000)
Booster, Treatment, Wells	\$ 185,000	\$ 289,486	\$ 104,486
Miscellaneous, SCADA	\$ 231,000	\$ 120,500	\$ (110,500)
Services, Hydrants, Meters	\$ 203,000	\$ 170,700	\$ (32,300)
Total	\$ 2,391,500	\$ 2,058,625	\$ (332,875)

C. Inclusion of Line of Credit Interest in Annual Long-term Debt Issuances

PEU requested approval to pay the annual interest incurred on its Line of Credit borrowings through the Company's annual long-term debt issuances. Currently, only the principal portion of the Line of Credit is included in the long-term debt issuances. PEU makes monthly interest payments on its Line of Credit borrowings using its 0.1 Debt Service Revenue Requirement (0.1 DSRR) reserve account.

The Company argued that including the interest incurred on its Line of Credit as part of its annual long-term debt financings, instead of drawing on its 0.1 DSRR reserve account, would provide PEU with greater financial flexibility. If the Commission approves the proposal, PEU would use its 0.1 DSRR reserve account instead of short-term borrowings to prefund annual capital projects and replenish its other reserve accounts. According to the Company, the resulting reduction in future financings will reduce future QCPACs and other rate base adjustments. PEU further stated that, if approved, it would capitalize the Line of Credit interest incorporated into the Company's annual long-term debt financings over the lives of the underlying qualified capital projects associated with the particular financing. Staff recommended approval of that change.

III. COMMISSION ANALYSIS

The Commission approved the QCPAC mechanism to enable PEU to make necessary capital improvements to its systems while maintaining sufficient cash flow to meet debt service and operating requirements. Order No. 26,179 at 16. Each year, the Commission reviews and approves the proposed surcharge so that PEU may recover the debt service and property taxes associated with projects completed during the prior year.

In addition, PEU files budgets for capital projects for the next three years. The Commission reviews, and if appropriate, preliminarily approves the capital budget for the current year, and accepts the two subsequent year capital budgets for informational purposes. We note our initial approval of a budget is not a prudence finding. The evaluation of prudence occurs after the projects are completed, when the Company seeks recovery of the investment in the following year's QCPAC proceeding.

PEU and Staff request approval of a 2.98 percent surcharge for 2019, to be applied to customer bills on a service-rendered basis as of July 22, 2019. This surcharge represents debt service and property tax recovery on 2018 QCPAC projects reduced by anticipated annual purchased water savings.

Based on the recommendation of Staff, we find the plant additions constructed in 2018 to be prudent, as well as used and useful, under RSA 378:28. In addition, we find that PEU's recovery of debt service and property taxes on its 2018 plant additions, reduced by realized annual savings on purchased water expense, through a 2.98 percent surcharge is just and reasonable under RSA 374:2 and RSA 378:7.

PEU and Staff also requested approval of an additional two-month recoupment charge applied to customer bills, which represents the approved QCPAC surcharge that would have been collected from the time that the underlying debt was issued, until the effective date of this order. We find that the two-month recoupment charge is just and reasonable under RSA 374:2 and RSA 378:7.

PEU also asked that it be authorized to recoup the QCPAC revenue on a service-rendered basis from the date the debt was incurred. The underlying Settlement Agreement which established the QCPAC process, approved by Order No. 26,179, allowed PEU to recoup the QCPAC revenue on a bills-rendered basis, thus waiving Puc 1203.05(b). Here the Company requested a modification of the Settlement Agreement, allowing the Company to collect the surcharge consistent with our rules.

We find recoupment of the surcharge on a service-rendered basis from the date of debt issuance will allow the Company to avoid the loss of revenue necessary to cover its expenses and grant PEU's request to modify that provision of the Settlement Agreement. The Commission

Audit Staff will examine the recoupment charge assessed to customers during PEU's next QCPAC filing, and any exceptions found will be reconciled as part of the surcharge approved in that proceeding.

On November 14, 2019, PEU updated its 2019 QCPAC capital budget as of September 30, adjusting the amount to \$2,058,625. As in recent years, water main replacements represent a substantial portion of the 2019 budget. PEU continues to coordinate street-opening opportunities with municipal sewer and road projects. Staff recommended preliminary approval by the Commission. We find that the 2019 capital budget is appropriate and that the projects listed appear to fulfill the objectives of the QCPAC program by enabling PEU to effectively maintain its capital improvements program. Accordingly, we approve the 2019 QCPAC budget on a preliminary basis. We will review the 2019 QCPAC projects after they are constructed and put into service, and make the required prudence determination, pursuant to RSA 378:28, in PEU's next QCPAC filing.

PEU has requested approval to include the annual interest incurred on its Line of Credit in its annual long-term debt issuances beginning in 2020. That change will provide greater financial flexibility for the Company by making more funds available from its 0.1 DSRR reserve account to prefund capital projects and replenish other reserve accounts, resulting in cost savings for customers. We find the Company's proposal an appropriate adjustment and approve it.

PEU also provided revised estimated QCPAC budgets for the years 2020 and 2021 in the amounts of \$2,470,580 and \$3,328,000, respectively. We accept the revised estimated QCPAC budgets for 2020 and 2021 submitted by PEU for informational purposes only.

Based upon the foregoing, it is hereby

ORDERED NISI, that subject to the effective date below, PEU's surcharge implementing the 2019 QCPAC of 2.98 percent is APPROVED for service rendered on or after July 22, 2019; and it is

FURTHER ORDERED, that a two-month recoupment charge, which includes revenues from the period between the debt issuance of July 22, 2019, and the effective date of this order, is APPROVED; and it is

FURTHER ORDERED, that PEU's QCPAC budget for 2019 capital improvements as detailed in its filing and adjusted in this order, is APPROVED on a preliminary basis, subject to further review when PEU makes its 2020 QCPAC filing; and it is

FURTHER ORDERED, that PEU's request to pay the annual interest incurred on its Line of Credit through annual long-term debt issuances, as detailed in its filing and in this order, is APPROVED; and it is

FURTHER ORDERED, that PEU shall cause a summary of this order to be published once in a statewide newspaper of general circulation or of circulation in those portions of the state where operations are conducted. Such publication to be no later than December 16, 2019, and to be documented by affidavit filed with this office on or before January 3, 2020; and it is

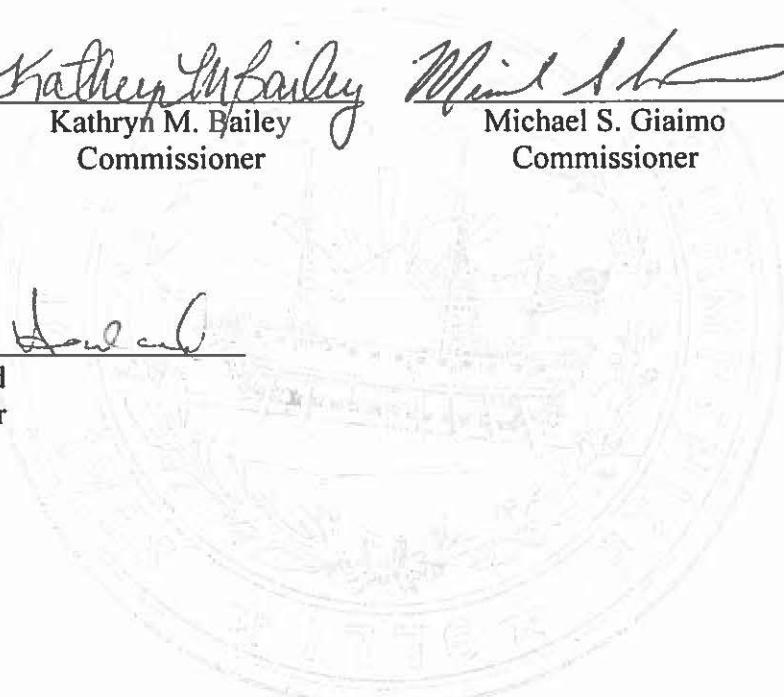
FURTHER ORDERED, that all persons interested in responding to this order be notified that they may submit their comments or file a written request for a hearing which states the reason and basis for a hearing no later than December 23, 2019, for the Commission's consideration; and it is

FURTHER ORDERED, that any person interested in responding to such comments or request for hearing shall do so no later than December 30, 2019; and it is

FURTHER ORDERED, that this order shall be effective January 6, 2020, unless PEU fails to satisfy the publication obligation set forth above or the Commission provides otherwise in a supplemental order issued prior to the effective date; and it is

FURTHER ORDERED, that PEU shall file a compliance tariff with the Commission on or before January 16, 2020, in accordance with N.H. Code Admin. Rules Puc 1603.05(d).

By order of the Public Utilities Commission of New Hampshire this sixth day of December, 2019.


Kathryn M. Bailey Michael S. Giaimo
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Commissioner Commissioner

Attested by:

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