

DW 06-094

AQUARION WATER COMPANY OF NEW HAMPSHIRE

Petition for Approval of Indirect Acquisition by Macquarie Utilities, Inc.

Order Approving Acquisition and Settlement Agreement

ORDER NO. 24,691

October 31, 2006

APPEARANCES: McLane, Graf, Raulerson & Middleton, P.A. by Steven V. Camerino, Esq. for Joint Petitioners Aquarion Water Company of New Hampshire and Macquarie Utilities, Inc.; Town of Hampton by Mark S. Gearreald, Esq.; Town of North Hampton Water Commission and Town of North Hampton by Mr. Henry Fuller; Office of the Consumer Advocate by Rorie Hollenberg, Esq. on behalf of residential ratepayers; and Marcia A. B. Thunberg, Esq., on behalf of Staff of the New Hampshire Public Utilities Commission.

I. BACKGROUND

On June 22, 2006, Aquarion Water Company of New Hampshire, Inc. (Aquarion-NH) and Macquarie Utilities, Inc. (MUI) filed a joint petition with the New Hampshire Public Utilities Commission for approval of the indirect acquisition of Aquarion-NH by MUI. Aquarion-NH is a public utility providing water service to approximately 8,400 customers in Hampton, North Hampton, and Rye.

Aquarion-NH is also a subsidiary of Aquarion Water Company, which owns water utilities in New Hampshire, Connecticut, New York, and Massachusetts. Aquarion Water Company, in turn, is owned by Aquarion Company, a subsidiary of Kelda Group, Inc. The proposed transaction involves the sale of Kelda Group's shares in Aquarion Company to MUI.

MUI is a member of Macquarie Group, a diversified international provider of investment banking and financial services with approximately 8,600 employees in 23 countries. The parent of Macquarie Group is Macquarie Bank Limited, an Australian bank with a market capitalization

of about \$12 billion. Macquarie Bank Limited manages over 20 funds around the world including Macquarie Utilities, LP and Macquarie Infrastructure Partners.

Kelda Group and MUI entered into their stock purchase agreement on February 24, 2006. The agreement calls for MUI to pay an aggregate purchase price of \$615 million and repay a \$10 million loan made by Kelda. At the completion of the sale, Aquarion Company will be wholly owned by entities that are managed or controlled by the Macquarie Group. According to the petition, this transaction would mark the first investment activity of Macquarie Infrastructure Partners, which plans to contribute approximately \$165 million in equity. Macquarie Utilities, LP would contribute approximately \$135 million of equity to the transaction.

The petition recites that the Macquarie Group is one of the world's largest global investors and managers of infrastructure assets with over \$24 billion of infrastructure and infrastructure-like equity currently under its management. According to the petition, the Macquarie Group is responsible for servicing customers in the following sectors around the world: gas distribution, 3.8 million households; water, 1.9 million households; electricity distribution, 550,000 households; electricity transmission, approximately 3 million people; airports, 110 million passengers per year; toll roads, approximately 2.4 million cars per day; and rail, 2.5 million people per year. In addition to requesting regulatory approval in New Hampshire, the joint petitioners have already obtained the approval of the Connecticut Department of Public Utility Control and are awaiting an order of the New York Public Service Commission on their request for approval in that jurisdiction.

II. PROCEDURAL HISTORY

The Commission issued an order of notice on July 3, 2006. The Office of Consumer Advocate (OCA) entered an appearance on behalf of residential ratepayers pursuant to RSA

363:28 and the Commission received intervention petitions from the towns of Hampton and North Hampton.¹ Following a prehearing conference on July 14, 2006 at which the intervention requests were granted without objection, the Commission received an additional intervention request, from the Rye Beach Village District. By Order No. 24,651 (July 28, 2006), the Commission granted the late-filed intervention petition and approved a procedural schedule that had been developed by the parties and Staff at the technical session that followed the prehearing conference.

As noted in Order No. 24,651, the procedural schedule was inconsistent with certain procedural deadlines set forth in RSA 369:8, II, designed to expedite Commission review of utility mergers and acquisitions. In approving the procedural schedule, the Commission deemed the joint petitioners' assent to the schedule as a waiver of their rights to a decision on the timeline set forth in the statute. Order No. 24,651, slip op. at 3. No party objected to this determination.

Pursuant to the procedural schedule approved in Order No. 24,651, the parties and Staff conducted three rounds of discovery and the Commission convened a public statement hearing at the Winnacunnet High School in Hampton, New Hampshire on September 11, 2006. The joint petitioners and Staff entered into a settlement agreement, which they filed on September 14, 2006.² A duly noticed hearing was held on September 20, 2006.

¹ Initially, this intervention was sought in the name of the North Hampton Water Commission. The town later clarified that (1) the water commission is an instrumentality of the town, and (2) the municipality itself is the party that requested party status.

² N.H. Code Admin Rules Puc 203.20 requires settlements to be filed no less than five days prior to the hearing, unless the Commission determines that a late-filed settlement will (1) promote the orderly and efficient conduct of the proceeding, and (2) not impair the rights of any party to the proceeding. At hearing, there were no objections to the settlement based on timeliness or impairment of rights. Any such objections are therefore deemed to have been waived.

III. POSITIONS OF THE PARTIES

A. Aquarion-NH, MUI, and Staff

The position of Staff, Aquarion NH and MUI is embodied in the settlement agreement, which recommended Commission approval of the transaction subject to certain conditions. Specifically, the settlement would involve a Commission determination that the indirect acquisition of Aquarion-NH by MUI, as set forth in the verified petition, will not result in an adverse impact on the rates, terms, conditions or operations of Aquarion-NH and is consistent with the public interest. Further, Aquarion-NH, MUI, and Staff agreed that the transaction meets the applicable standards set forth in RSA 374:33 and RSA 369:8, II.

Aquarion-NH and MUI agreed that Aquarion-NH would continue to maintain an office for bill payments and customer inquiries subsequent to the acquisition of Aquarion-NH by MUI. Aquarion-NH and MUI further agreed that Aquarion-NH would not eliminate such office without giving at least six months' prior written notice to the Commission, OCA and the municipalities within Aquarion-NH's service territory.

Aquarion-NH and MUI agreed to maintain the current management structure of Aquarion-NH and reaffirmed that they intend to remain aware of and responsive to local issues relating to the service provided by Aquarion-NH. Aquarion-NH and MUI agreed that they have no plans to change the terms or conditions on which service is provided by Aquarion-NH for any reason relating to the acquisition of Aquarion-NH by MUI.

Aquarion-NH and MUI reaffirmed that it is their plan for Aquarion-NH to continue to maintain a customer advisory council to obtain direct information from customers and otherwise have direct access to customers who can act as a sounding board. Aquarion-NH and MUI agreed

not to eliminate the advisory council without at least ninety days' prior written notice to the Commission, OCA, and the municipalities within Aquarion-NH's service territory.

Aquarion-NH agreed not to seek recovery in rates of any acquisition premium on its books or those of any affiliated entity resulting from Aquarion-NH's acquisition by MUI. To the extent that any portion of the acquisition premium is required for financial accounting purposes to be reflected on the books of Aquarion-NH, Aquarion-NH agreed to reflect the amount "below the line" for ratemaking purposes. Aquarion-NH, MUI, and Staff request the Commission allow Aquarion-NH to record a corresponding regulatory asset or liability, as the case may be, equal to the amount necessary to adjust its financial statements to reflect the fair value of its pension and post-retirement benefits as required by generally accepted accounting principles and pursuant to SFAS (Statement of Financial Accounting Standards) No. 141, *Business Combinations*. The exact amount of such pension and OPEB (other post-employment benefits) asset or liability and the offsetting regulatory asset or liability will be determined as of the closing date of acquisition of Aquarion Company by MUI.

B. Office of Consumer Advocate

OCA did not oppose the settlement agreement. OCA expressed its support of the customer advisory council and the maintenance of stakeholders' ability to provide Aquarion-NH with local input. OCA requested that the Commission approve the accounting treatment for pension benefits on the condition that such treatment not affect rates. OCA requested that the Commission's order recognize the commitment to allow some process and input of stakeholders, as well as the Commission's authority over any closure of the local customer service center or the termination of the customer advisory council.

C. Town of Hampton

The Town of Hampton joined in the OCA's concerns. In addition, the Town of Hampton referenced a letter dated September 11, 2006 to the Commission from the Town of North Hampton and clarified that it is not involved in trying to purchase Aquarion-NH. Two years ago, Town of Hampton voters defeated a warrant article to explore buying Aquarion-NH.

D. Town of North Hampton

The Town of North Hampton spoke about the history of Hampton Water Works, Inc. and the company's response to a request made by the Town in 1987 to supply water to residents adversely affected by a local superfund waste site. The Town of North Hampton stated that the company refused to extend water service and that the town had to extend the main instead. The Town of North Hampton referenced a water source being explored by the company known as Hobbs well, and that the Town worked to defeat use of that well. Town of North Hampton also stated that it is a good steward of the watershed and works closely with the regional planning commissions to review watersheds and wellheads. The municipality asked the Commission to grant it a right of first refusal as to the sale of Aquarion-NH to MUI. The Town of North Hampton opposed the settlement agreement stating that it intends to file a petition to purchase Aquarion-NH.

E. Rye Beach Village District

Rye Beach Village District intervened in this docket but did not participate in the proceeding.

IV. COMMISSION ANALYSIS

Two separate statutory provisions define the Commission's responsibility to review transactions that involve merger or acquisition of New Hampshire public utilities. First, pursuant

to RSA 369:8, the Commission is charged with reviewing whether a transaction will “adversely affect rates, terms, service, or operation of the public utility within the state.” This provision is designed to allow for streamlined review of transactions that clearly will have no such adverse impacts. In such cases, RSA 369:8 makes clear that the Commission’s review ends at that point. However, as noted in *New England Electric System*, 84 NH PUC 502 (1999) and *Energy North Natural Gas, Inc.*, 85 NH PUC 361 (2000), a petitioner’s mere representations that no adverse effect on the rates, terms, service or operation of the utility will occur are insufficient to warrant approval of a merger transaction under RSA 369:8.

In cases that require further inquiry, the petitioners must satisfy not just the “no adverse impacts” standard in RSA 369:8 but also the requirements of RSA 374. Under the authority granted by RSA 374:33, the Commission reviews acquisitions of 10 percent or more of the stock of any public utility to ensure such acquisitions are “lawful, proper and in the public interest.” Additionally, pursuant to RSA 374:30, a public utility may transfer its franchise, works, or system only upon our finding that “it will be for the public good.” In light of these statutory requirements, the Commission has evaluated the assertions of petitioners that there are no adverse effects, and no net harm, associated with the transaction. See, *Hampton Water Works, Inc.*, 87 NH PUC 104 (2002) (approving acquisition of Hampton Water Works by Aquarion-NH); *Consumers New Hampshire Water Co.*, 82 NH PUC 814 (1997); and *Eastern Utilities Associates*, 76 NH PUC 236 (1991).

We begin by reviewing how the proposed transaction will affect operations of Aquarion-NH. At hearing, Aquarion-NH and MUI witnesses testified that there will be no changes in Aquarion-NH’s operations as a result of the Kelda Group, Inc.-MUI stock purchase. 9/20/06 Tr. at 41, lines 11-19. The settlement agreement, however, is unclear to the extent Aquarion-NH

and MUI “plan” to maintain offices in New Hampshire for handling bill payments and customer inquiries but also contemplate that this could change upon six months’ notice to the Commission.

In the 2002 order approving the acquisition of Hampton Water Works by Aquarion-NH, the Commission approved the transaction based in part on the commitment of Aquarion-NH to “maintain a level of staffing at its local office that is sufficient to provide across the counter service to customers and to respond to customer calls and correspondence that are directed to the local office” as opposed to Aquarion’s offices in Connecticut. Hampton Water Works, 87 NH PUC at 109. The Commission stressed that this condition “should help ensure that New Hampshire customers’ voices are heard by the parent company.” *Id.* We regard MUI as stepping into the shoes of Aquarion-NH’s previously made commitments, including those that paved the way for Aquarion-NH itself becoming a New Hampshire public utility. To eliminate any confusion or ambiguity, we clarify here that we interpret the pending settlement agreement involving Aquarion-NH and MUI to include a commitment by MUI to honor the conditions related to customer service that were imposed in connection with the 2002 sale of Hampton Water Works. In other words, a condition of New Hampshire approval of the transaction is a commitment that MUI will maintain a customer service presence in New Hampshire absent explicit Commission approval to do otherwise.

As contemplated in the settlement agreement, Aquarion-NH and MUI also commit to maintaining the present management structure and customer advisory council. Aquarion-NH testified that it had found the customer advisory council useful and MUI testified that it has no plans to change processes that work well for Aquarion-NH. 9/20/06 Tr. at 45, lines 14-18 and at 46, lines 8-11. We agree that this is an important component to maintain under MUI ownership.

Aquarion-NH and MUI agreed in connection with the settlement that they have no plans to change any terms or conditions of water service. Based on these representations and testimony that there will be no change in critical aspects of Aquarion-NH's operations, we find that the proposed transaction will not adversely affect the service or operation of Aquarion-NH consistent with RSA 369:8.

We next consider how the proposed transaction may affect rates or terms. According to the Joint Petitioners, the transaction will be beneficial because access to capital markets is a key factor to successful infrastructure management and that the Macquarie Group can positively influence an efficient capital structure by (1) arranging additional debt facilities to enable further investment in existing infrastructure, (2) arranging additional financing such that Aquarion may grow via acquisitions, and (3) refinancing existing debt. Exh. 1 at 7. The Joint Petitioners further state that MUI will fund needed capital additions to meet federal and state standards governing drinking water and to maintain and improve customer service through access to internal and external sources of capital. Exh. at 8. When asked to comment on whether the proposed transaction would provide benefits, Staff witness Mark A. Naylor, director of the Commission's gas and water division, testified that there were potential financial benefits in terms of access to capital. Mr. Naylor testified further: "I think it's clear, from the Joint Petition and the testimony...that there's a clear incentive on the part of the acquiring company to keep this company and the other Aquarion companies operating efficiently" to protect their investment. 9/20/06 Tr. at 76, lines 3-13.

An important question that arises in ownership transfers is whether the new owners will seek to recover from customers any premium they may have paid, above the acquired company's book value, in order to consummate the purchase. Here, the settlement agreement specifically

provides that MUI will not recover any of the applicable acquisition premium from New Hampshire customers. This commitment was reiterated at hearing by Mr. Christopher J. Leslie, chief executive officer of Macquarrie Infrastructure Partners, who testified that MUI did not “propose to seek the recovery of the acquisition premium in the rates of the Aquarion Company in the future.” 9/20/05 Tr. at 27, lines 15-20. Based on the representations and testimony regarding access to capital and the financial capability of MUI, and MUI’s firm commitment not to seek recovery of acquisition premium, we find the proposed transaction will not adversely affect the rates or terms of Aquarion-NH consistent with RSA 369:8.

We next consider the Joint Petitioners’ request that Aquarion-NH be allowed to record the fair value of its pension and post-retirement benefits as a corresponding regulatory asset or liability, as the case may be, equal to the amount necessary to adjust its financial statements as required by generally accepted accounting principles and pursuant to SFAS (Statement of Financial Accounting Standards) No. 141, *Business Combinations*. According to Aquarion-NH’s responses to Staff data requests Staff 2-4 through Staff 2-9, Aquarion-NH explained that it is required under SFAS 141 to value the pension benefit plan obligations at the date of acquisition. Exh. 5 at 7-14. For purposes of the joint petition, Aquarion-NH valued the obligations as of December 31, 2005, with the knowledge that the obligation would need to be adjusted at closing. Aquarion-NH anticipates the closing to occur during the last quarter of 2006. Exh. 5 at 9. At hearing, Linda M. Discepolo, director of rates and regulations at Aquarion Water Company of Connecticut, testified on behalf of Aquarion-NH that if the Commission were to authorize Aquarion-NH to create this asset on its books, that this accounting treatment would have no effect on expenses related to these plans for ratemaking purposes. 9/20/06 Tr. at 33, lines 11-16. We note this was a concern raised by OCA. We find Aquarion-NH’s explanation

reasonable and we will allow Aquarion-NH to record the fair value of its pension and post-retirement benefits as described above, consistent with SFAS 141.

We next address certain additional obligations undertaken by Aquarion-NH pursuant to *Hampton Water Works, Inc.* 87 NHPUC 104 (2002). Those commitments included (1) honoring the existing collective bargaining agreement with the United Steelworkers of America, AFL-CIO-CLC, (2) assuming obligations of pension payments, and (3) maintaining the current advisory board. In the order in that docket, the Commission did not relieve Aquarion-NH of any of these commitments nor were they set to expire at a date certain. In the instant docket, Mr. Naylor testified that Staff felt it important that MUI commit to obligations Aquarion-NH made in Docket No. DW 01-215. 9/20/06 Tr. at 75, lines 15-20. We agree that MUI's commitment to Aquarion-NH's obligations is important. We note that on September 11, 2006, we held an evening public statement hearing to solicit comments on Aquarion-NH and MUI's proposed transaction. Twelve people spoke at the hearing; four expressed support for Aquarion-NH and MUI and the remaining customers discussed specific concerns about the cost of sprinkler or hydrant service, discolored water, were skeptical that the merger would not raise rates, or expressed their desire to take the water utility through an eminent domain proceeding. These customer issues have a distinctively local character and we do not want, in approving the proposed transaction, to diminish the importance of these local issues. We find that maintaining a local presence and maintaining lines of communication such as through the advisory board are important means to addressing customers' issues. To that end, we deem MUI's acquisition of Aquarion Company and Aquarion-NH as assuming the obligations Aquarion-NH made in Docket No. DW 01-215.

Finally, we take up the request of the Town of North Hampton that we condition merger approval on granting the municipality a right of first refusal with respect to the sale of Aquarion-NH. New Hampshire law does not grant us the authority to impose such a condition. Rather, the Legislature enacted RSA 38 as a means of providing municipalities a mechanism for acquiring local utilities at fair market value, by order of the Commission if necessary. This municipalization process remains available to the Town of North Hampton regardless of whether the corporate transaction at issue in this proceeding goes forward.

V. CONCLUSION

After careful review of the settlement agreement, testimony, exhibits, and comments offered at the September 11, 2006 public hearing, and based upon the foregoing analysis, we find that the acquisition of Aquarion-NH by MUI will not adversely affect rates, terms, service or operation of the public utility. We further find that the proposed transaction is consistent with the public interest. We approve the transaction and do so with the understanding that MUI will abide by the commitments made in the settlement agreement in the instant proceeding and that MUI assumes Aquarion-NH's obligations which arose out of Docket No. DW 01-215, *Hampton Water Works, Inc.*, 87 NH PUC 104 (2002).

Based upon the foregoing, it is hereby

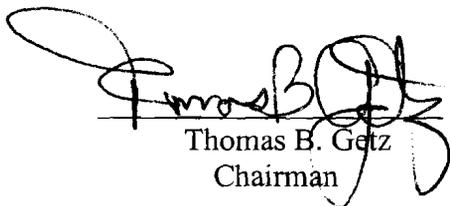
ORDERED, that the settlement agreement entered into in this docket between Aquarion Water Company of New Hampshire, Inc., Macquarie Utilities, Inc., and Staff, is **APPROVED**; and it is

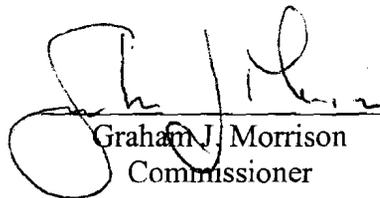
FURTHER ORDERED, that all of the terms and conditions of the settlement agreement are incorporated in our Order herein; and it is

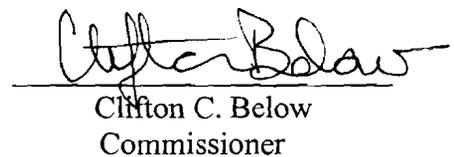
FURTHER ORDERED, that Aquarion Water Company of New Hampshire, Inc. and Macquarie Utilities, Inc. may consummate their proposed acquisition as contemplated by the verified petition and settlement agreement; and it is

FURTHER ORDERED, that the authority granted to Aquarion Water Company of New Hampshire, Inc. and Macquarie Utilities, Inc. by this Order to consummate the acquisition shall be exercised within one year, and shall not be exercised thereafter without further order of the Commission.

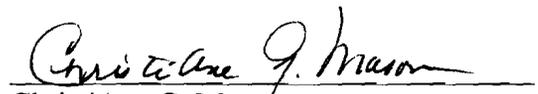
By order of the Public Utilities Commission of New Hampshire this thirty-first day of October, 2006.


Thomas B. Getz
Chairman


Graham J. Morrison
Commissioner


Clifton C. Below
Commissioner

Attested by:


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10/31/06 Order No. 24,691 issued and forwarded to all parties. Copies given to PUC Staff.

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Docket #: 06-094-1 Printed: October 30, 2006

FILING INSTRUCTIONS:

WITH THE EXCEPTION OF DISCOVERY (SEE NEXT PAGE) FILE 1 ORIGINAL & COVER LETTER, PLUS 8 COPIES (INCLUDING COVER LETTER) TO:

DEBRA A HOWLAND
EXEC DIRECTOR & SECRETARY
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