STATE OF NEW HAMPSHIRE

PUBLIC UTILITIES COMMISSION

February 26, 2018 - 9:08 a.m.
Concord, New Hampshire

RE: **DW 17-128**
PENNICHUCK EAST UTILITY, INC.:
Request for Change in Rates.
(Hearing regarding temporary rates)

PRESENT: Chairman Martin P. Honigberg, Presiding
Commissioner Kathryn M. Bailey
Commissioner Michael S. Giaimo

Jody Carmody, Clerk

APPEARANCES: **Reptg. Pennichuck East Utility, Inc.:**
Richard W. Head, Esq. (Rath Young...)

Michael Ranaldi, *pro se*

Reptg. Residential Ratepayers:
Brian D. Buckley, Esq.
James Brennan, Finance Director
Office of Consumer Advocate

Reptg. PUC Staff:
Alexander F. Speidel, Esq.
Jayson Laflamme, Asst. Dir./Gas&Water
Robyn Descoteau, Gas & Water Division

Court Reporter: Steven E. Patnaude, LCR No. 52

I N D E X

E X H I B I T S

EXHIBIT NO.	D E S C R I P T I O N	PAGE NO.
1	Settlement Agreement - Temporary Rates, including attachments (02-07-18)	6
2	PEU responses to Staff Data Requests 1-5, 1-22, 1-27, 1-28, 1-30, 1-32, 1-34, 1-35, 1-38, 1-44, 1-45, 1-50, 1-51, 1-54, 1-58, 1-59, 1-60, 1-61, 1-67	30

P R O C E E D I N G

CHAIRMAN HONIGBERG: We're here this morning in Docket DW 17-128, which is Pennichuck East Utility's rate case. There's a request for temporary rates. A Settlement Agreement has been filed. We're here to consider the Settlement.

Before we do anything else, let's take appearances.

MR. HEAD: Good morning. Richard Head, from the Rath Young Pignatelli, on behalf of the Applicant, Pennichuck East Utility. Seated at counsel's table here with me are Larry Goodhue, CEO; Don Ware, COO; and behind me are Carol Ann Howe, Director of Regulatory Affairs; and Jay Kerrigan, Financial Analyst.

MR. RANALDI: I'm Michael Ranaldi, from Locke Lake. I'm representing myself.

MR. BUCKLEY: Good morning, Mr. Chairman, Commissioners Bailey and Giaimo. My name is Brian D. Buckley. I'm a staff attorney with the Office of the Consumer Advocate. To my left is Mr. James Brennan, Director of Finance with the Office of the Consumer

Advocate. And we are here representing the collective interests of residential ratepayers.

MR. SPEIDEL: Good morning, Commissioners. Alexander Speidel, representing the Staff of the Commission. And I have with me Jayson Laflamme, the Assistant Director of the Gas and Water Division, newly appointed; and also Robyn Descoteau, Utility Analyst, Gas and Water Division.

CHAIRMAN HONIGBERG: All right. How are we going to proceed this morning?

Mr. Head.

MR. HEAD: We'll do a panel. Mr. Goodhue will be on for the Applicant, and I think Mr. Laflamme will be on for the Staff.

We have as an exhibit the Settlement Agreement. And we'll proceed with testimony.

CHAIRMAN HONIGBERG: Any other -- any preliminary matters before we get started?

Mr. Speidel.

MR. SPEIDEL: Yes, Mr. Chairman. There's a second exhibit that I will be introducing the old way, essentially distributing around the hearing room, some supplementary material from data requests in support of Staff's testimony regarding the Settlement Agreement. And that will be Hearing Exhibit 2.

CHAIRMAN HONIGBERG: Off the Record.

[Brief off-the-record discussion ensued.]

CHAIRMAN HONIGBERG: All right. So, Exhibit 1 will be the Settlement Agreement.

(The document, as described, was herewith marked as **Exhibit 1** for identification.)

CHAIRMAN HONIGBERG: And then, when you introduce your exhibit, Mr. Speidel, it will be number "2"?

MR. SPEIDEL: Yes.

CHAIRMAN HONIGBERG: All right. Why don't the witnesses go up to the witness box then.

Off the record while that's happening.

[Brief off-the-record discussion ensued.]

CHAIRMAN HONIGBERG: Mr. Patnaude.

(Whereupon ***Larry D. Goodhue*** and ***Jayson P. Laflamme*** were duly sworn by the Court Reporter.)

CHAIRMAN HONIGBERG: Mr. Head.

MR. HEAD: Thank you. And I'll direct my questions initially to Mr. Goodhue.

LARRY D. GOODHUE, SWORN

JAYSON P. LAFLAMME, SWORN

DIRECT EXAMINATION

BY MR. HEAD:

Q Mr. Goodhue, can you please state your name and your role with the Company?

A (Goodhue) My name is Larry Goodhue. I am the Chief Executive Officer of Pennichuck East Utility.

Q And can you describe what that means in terms of your job duties?

A (Goodhue) I'm responsible for the overall financing, management, and operations of the corporation, along with our management team. I report directly to the Board of Directors of Pennichuck Corporation and each of its subsidiaries, including Pennichuck East Utility. I also act as the liaison to outside stakeholders and reporting agencies on behalf of the corporation, including any outside stakeholders for Pennichuck East Utility.

Q And can you very briefly describe the corporate structure of Pennichuck Corporation and the regulated subsidiaries?

A (Goodhue) Yes. Pennichuck Corporation, prior to January 25th, 2012, was a publicly traded entity on the NASDAQ Exchange. Pursuant to Commission Order 25,292, which authorized the City of Nashua acquiring Pennichuck Corporation and becoming the sole shareholder of Pennichuck Corporation. Pennichuck Corporation is the parent company for five wholly owned subsidiaries. Three regulated subsidiaries being Pennichuck Water Works, Incorporated; Pennichuck East Utilities, Incorporated; and Pittsfield Aqueduct Company, Incorporated. And two unregulated subsidiaries: Pennichuck Water Services Company and the Southwood Corporation, which is a real estate holding company.

Q And can you also briefly describe how the City's acquisition affected the way in which Pennichuck East Utility, which we'll refer to

as "PEU" frequently in this hearing, --
A (Goodhue) Yes.
Q -- how it operates as a utility?
A (Goodhue) Yes. One of the key things that happened out of that transaction is that the corporate group, including Pennichuck East or PEU, no longer has access to the private equity markets as a method of financing its capital needs. As such, PEU finances it's ongoing capital needs entirely through the issuance of debt.
As a result, cash flow becomes the most important factor in our utility rate structure. In that we must comply with debt instrument covenants and coverage requirements, and the mismatch between depreciation lives in traditional ratemaking versus the debt lives of the repayment of debt becomes a very important component. In traditional ratemaking, your depreciation would be the funding mechanism for cash flow to repay principal. The debt that PEU is able to obtain is anywheres between 20 and 25 years in maturity. We've yet to be able to find external debt exceeding 25 years. The

average depreciation lives of PEU's assets, however, exceeds 40 years, and as such, under traditional ratemaking, that cash flow coverage was not there.

So, it's one of the key factors, in that cash flow becomes absolutely important in the rate structure for PEU relative to it's being able to fund and repay its debt obligations for the replacement of infrastructure.

Q And is there a correlation with any benefits to ratepayers of the Company?

A (Goodhue) Yes, there is. Again, under that traditional ratemaking model, and prior to 2012, PEU had roughly -- roughly a 50/50 debt/equity mix. You know, it approximated that. And prior to that acquisition, our return on equity allowed rates had been in the 9.5 to 9.75 percent post tax range, which equates to about a 16 percent pre-tax cost of funds. Whereas the debt PEU was able to obtain, depending on what the source is, the State Revolving Fund debt is somewhere in the mid 2s, and if it's external bank debt, it's somewhere in the 4 to 5 percent range. So, there's a great deal of positive that comes out of this for ratepayers. The difference is is how you fund that repayment.

Q And in this case that's currently pending before the Commission, the Petition also seeks to implement the rate methodology that the Commission recently approved for the other subsidiary, PWW. Is the -- can you briefly explain what that means?

A (Goodhue) Yes. Under DW 16-806 for Pennichuck Water Works, a sister subsidiary of PEU, a modified rate methodology was adopted. The modifications to PEU's ratemaking structure will increase PEU's required access to the credit markets, provide adequate cash flows to repay their debt, give them the ability to meet lender covenant requirements, and will provide lenders with the confidence in PEU's ability to repay those debt obligations. All of which is fundamental for PEU to be able to continue to access its needed capital in the form of debt for infrastructure replacements and operations.

Q And in this hearing we're here for today, we're asking the Commission to implement temporary rates pending an order on permanent rates. In the Temporary Rate Settlement, are you asking for the Commission to approve under the old rate methodology for PEU or are you asking them to now adopt the new methodology that's from PWW's approval?

A (Goodhue) In general, because the 16-806 methodology that was adopted for PWW has not yet been approved for PEU, the parties concluded that the existing methodology would be used as the basis to calculate temporary rates.

Q And are there any exceptions to that in this Settlement Agreement?

A (Goodhue) There are.

Q And can you explain that?

A (Goodhue) One of the factors in that rate methodology is using a five-year historical average for revenues relative -- in place of just a test year of a single year. That is being asked to be implemented or agreed upon by the parties in the Settlement Agreement. The advantage of adopting this at this time, it gives comparative revenues based on a normalized consumption year, to minimize the variability for high or low consumption based on prevailing weather patterns in any given year.

CHAIRMAN HONIGBERG: Mr. Goodhue, could you slow down just a bit?

WITNESS GOODHUE: I will. Thank you. Sorry. Have you caught up with me?

MR. PATNAUDE: I'm okay.

CONTINUED BY THE WITNESS:

A (Goodhue) This is important for the Company, as we no longer have a return on equity component to provide additional revenues or profits to cover the Company's fixed costs and debt service needs, as a debt-only financed company. So, you know, that variability has much greater impact in the structure that the Company finances itself.

BY MR. HEAD:

Q So, in your prefiled testimony, you also described a couple steps that PEU has taken to reduce the overall impact of the proposed rate on its customers. And there were two of them I want to focus on in your temporary rate testimony. One of them is the elimination of the 4 ccf minimum on the North Country systems, and the other is the reduction on the Capital Recovery Surcharge also on the North Country systems.

Taking those two, just as a general matter, are you also asking to implement those two reductions on a temporary rate basis?

A (Goodhue) We are.

Q Okay. And let's talk about those two in order. First one was the request to eliminate the 4 ccf minimum. Can you briefly describe that for the Commission?

A (Goodhue) Yes. There are three water systems in PEU that we refer to as our "North Country water systems". They are Birch Hill, in North Conway; Sunrise Lake Estates, in Middleton; and Locke Lake Colony, in Barnstead. These three water systems used to be a portion or a part of the Pittsfield Aqueduct water system, but were merged from PAC into PEU as a part of Pittsfield Aqueduct's 2009 rate case as of 12/31/2010. Because they had a high percentage of seasonal customers in those systems, versus permanent residents throughout the remainder of the systems that would be in PEU, there was a fear that there would not be enough cash generated under those systems to cover their actual cost relative to the other communities that are served.

So, since that 2010 timeframe, however the prevailing mix of customers in those systems has really shifted more towards permanent residents versus a high percentage of seasonal residents. So, having this 4 ccf minimum in place to ensure a revenue level has really changed in its dynamics underlying that. PEU believes it can cover the operating expenses based on actual usage without the 4 ccf minimum.

Q And just to be clear, is the elimination of the 4 ccf minimum in those North Country systems built into the Temporary Rate Settlement?

A (Goodhue) It is.

Q And then the -- well, and then will the elimination of the 4 ccf minimum affect the rates to customers in those North Country systems?

A (Goodhue) It will. Certain individual homes in those systems that use less than 4 ccfs per month who are paying based on a 4 ccf minimum will benefit. Also, the elimination of the 4 ccf minimum allows PEU's rates with its overall water conservation and stewardship issues in conformity with DES regulations and requirements. An interesting dynamic, if you looked at the year 2016, with the drought, we had imposed a great deal of watering restrictions, and yet these folks were being required to pay for a 4 ccf minimum. Many times we got a comment from people is "why can't I just use what I'm paying for?" Which seemed counterintuitive. And, so, eliminating this we feel has got a long-term benefit for our customers, and is more consistent in our rate structure, tying to our regulatory requirements relative to water conservation and stewardship issues.

Q And then the second step that you had identified in your testimony for the permanent rates was a reduction in the North Country Capital Recovery Surcharge. Can you briefly explain that?

A (Goodhue) Sure. The North Country Capital Recovery Surcharge was first implemented with the merger of those North Country water systems from PAC into PEU. A great deal of capital improvements had been done in those systems prior to that merger. And as such, in that order, a surcharge was imposed on those systems coming into PEU, in order to absorb some of those historical costs.

PEU plans to reduce the North Country Capital Recovery Surcharge on both the Locke Lake and Birch Hill systems only, not Sunrise Estates, by refinancing the existing intercompany loans that were directly tied to those surcharges when those systems moved from Pittsfield Aqueduct to PEU. The improved terms from the refinancing will allow the Company to reduce the North Country Capital Recovery Surcharge for two of those systems in a fairly significant manner.

Q Why would the reduction not apply to Sunrise Lake Estates?

A (Goodhue) Because the refinancing would actually result in an increase in the surcharge to Sunrise Estates, and we did not feel that that was an appropriate action to take.

Q And why is it a reduction, as opposed to an elimination of the surcharge?

A (Goodhue) PEU is unable to achieve a complete elimination of the surcharge at this time because of the resulting negative impact it would give on the balance of PEU's other customers in all the other communities and systems that we serve.

Q And what would be the effect of the reduction on customers if the Commission approves the reduction?

A (Goodhue) The reduction in the surcharge for Locke Lake and Birch Hill customers will be substantial. PEU's overall revenue requirement reduction is calculated to be $121,070.

Q And you're asking for this to be approved in the Temporary Rate Settlement?

A (Goodhue) Yes. The reduction in the North Country Capital Recovery Surcharge for temporary rates, however, can only on occur if the Commission approves the intercompany debt refinancing that we have sought and is currently in pendency in Docket DW 17-157.

Q And just to be clear, is that a condition of that reduction going into effect on the temporary rates?

A (Goodhue) It is. Those are tied at the hip.

Q And what would be the effect of the reduction on the average bill for Locke Lake and Birch Hill customers?

A (Goodhue) Currently, the Locke Lake surcharge is $16.36 per month and the Birch Hill surcharge is $46.05 per month. The reduced surcharge for both will bring them both down to $12.81.

Q Just to make sure, did you say Locke Lake was -- can you tell us -- do those two charges again?

A (Goodhue) Yes. Birch Hill is $46.05 per month and Locke Lake is $16.36 per month.

Q Okay. Sorry about that. Thank you.

CHAIRMAN HONIGBERG: Mr. Head, were you, as I, looking at the terms of the Settlement Agreement and seeing them in reverse order?

MR. HEAD: Right.

CHAIRMAN HONIGBERG: And thinking that the numbers probably were listed respectively?

MR. HEAD: Yes. I had that wrong.

CHAIRMAN HONIGBERG: I think we all had that wrong. So, what Mr. Goodhue has just put on the record are the correct numbers?

MR. HEAD: That's correct.

CHAIRMAN HONIGBERG: All right.

WITNESS GOODHUE: And just for clarification purposes, as I'm looking at my own notes, as I was reading those, I was saying to myself "Boy, those are backwards. I better fix that right now." So, --

MR. HEAD: Thank you, Mr. Chairman. Thank you.

BY MR. HEAD:

Q If the refinancing in 17-157 is not approved, what would be the effect on those two systems relative to the surcharge?

A (Goodhue) The surcharge for both Locke Lake and Birch Hill will stay at their current rates, being $46.05 per month for Birch Hill and

$16.36 per month for Locke Lake.

Q And are you aware of whether Staff has recommended the approval in Docket 17-157?

A (Goodhue) Yes, they have. A letter dated 12/13/2017, noting the three loans that would be refinanced into two loans, the Staff has recommended approval.

Q And we've discussed the two reductions that the Company is seeking in the Settlement. Can you please describe what the temporary rate increase is that the Company is seeking in this Settlement?

A (Goodhue) Yes. The proposed revenue increase is $816,868. Taking from a current allowed revenue of 5,777,610 to a proposed revenue of 6,594,478, and that's all exclusive of the CBFRR and the North Country Capital Recovery Surcharge.

MR. HEAD: And for the record, Jayson will be testifying about the proposed revenue requirement. So, we're going to not go into the detail right now.

BY MR. HEAD:

Q Mr. Goodhue, when the North Country Capital

Recovery Surcharge is factored in, what is the net temporary revenue requirement that is proposed in the Settlement Agreement?

A (Goodhue) The net requirement after that adjustment is 695,798, which represents 55 percent of PEU's revenue request for permanent rates.

Q And what is the effect of temporary rates on the average single-family residential monthly bill that are not affected by the reduction in the North Country Capital Surcharge?

A (Goodhue) Sure. So, the effect on all of those that are not impacted by the reduction in the North Country Capital Recovery Surcharge, those rates would go from an average of $62.68 per month to a rate of $70.35 per month. This is based on an average single-family residential billing.

Q And looking at the two systems that would be affected with the North Country Capital Recovery Surcharge, what would be the average effect on their temporary rates?

A (Goodhue) For the Locke Lake system, the average residential bill would go from an average of $58.51 a month, down to $55.14 per month.

Q And how about with Birch Hill?

A (Goodhue) For the average resident bill -- residential bill for Birch Hill customers in North Conway, they would go from $88.20 per month, down to $64.07 per month.

Q And can you also explain for the Commission the Settlement terms regarding the effective date and reconciliation?

A (Goodhue) Yes. Our request includes temporary rates to be effective for bills rendered on or after January 8th, 2018. This is less than what the rules technically allow for, in that they're generally on a service rendered basis. But this would allow the Settlement to be effective for services rendered on or after December 8th, 2017, by putting it in for a bills rendered basis on or after January 8th, 2018. Any difference between the temporary rates and permanent rates ultimately approved by the Commission will be subject to reconciliation back to those dates.

Q And by asking the Commission to do it on a bills rendered basis, what would be the effect on whether or not it is more or less confusing to customers?

A (Goodhue) It is much less confusing to customers. We bill on weekly billing cycles, so roughly one quarter of our customers get a bill each week during a given month. So, when you're dealing with revenue adjustments based on a service rendered basis, their bills could be a bifurcated bill, in that a portion of the bill would be under an old rate and a portion of their bill would be under a new rate. And we have found that bringing rate increases to bear on a bills rendered basis, even though it is impactful for the Company on a negative basis, is much clearer and cleaner for residents, in that the entire bill is now subject to that change.

Q And how does it affect the Company in terms of the cost to implement?

A (Goodhue) The cost to implement is less as well, in that custom programming and labor time in doing these billings and calculations again is much more seamless.

Q And does it have any effect on the Company's ability to more closely match its revenue and expenses?

A (Goodhue) That is where it would probably be a little bit detrimental for us, in that we understand, by offering this up for the benefit of our customers, we are giving up a small amount of revenue relative to that.

Q And has the Company provided customers notice of the changes in its rates applicable to their usage?

A (Goodhue) We have provided any notices in accordance with the regulations, yes.

MR. HEAD: And, Mr. Chairman, we don't have a written motion. But, after the hearing, we'll follow up with a written motion asking for a waiver of Rule 1203.05.

CHAIRMAN HONIGBERG: Okay.

MR. HEAD: Thank you.

BY MR. HEAD:

Q Can you, Mr. Goodhue, can you explain the -- your opinion whether or not the Settlement is just and reasonable and in the public's interest?

A (Goodhue) We do feel so.

Q And can you explain that?

A (Goodhue) Again, if we go back to the point of the capital structure of the Company as it exists now, one of the key things that we must do to sustain the entity is to be able to continue to invest in infrastructure. The Company's ability to do that is on a debt-only basis now. And so, the rate structure that we're pursuing and the temporary rates we're pursuing at this time are in conformity with our ability to meet our debt obligations and needs relative to that.

MR. HEAD: Thank you. Mr. Chairman, that will conclude Mr. Goodhue's direct testimony.

CHAIRMAN HONIGBERG: Mr. Speidel, do you have questions for Mr. Laflamme?

MR. SPEIDEL: As a matter of fact, I just wanted to ask Mr. Head, you kind of zoomed right in to the direct questioning of your witness. Would you like to go through the mechanics of having the Exhibit 1, the Settlement Agreement, adopted by your witness, and have it noticed to the Commissioners as one of the exhibits?

MR. HEAD: Sure.

BY MR. HEAD:

Q Mr. Goodhue, you have reviewed and -- you've reviewed the Temporary Settlement Agreement?

A (Goodhue) I have.

Q And you've executed it on behalf of the Company?

A (Goodhue) I have.

Q And are the terms of that Settlement Agreement, as clarified by your testimony here today, the Settlement Agreement that you're asking the Commission to approve?

A (Goodhue) They are.

MR. HEAD: Mr. Chairman, I would ask that the Temporary Settlement Agreement be entered as "Exhibit 1" in this hearing?

CHAIRMAN HONIGBERG: All right. I think it's already been marked. I think we'll strike ID at the end, but it is Exhibit 1.

MR. HEAD: Thank you.

MR. SPEIDEL: And one more question, Mr. Head. I may ask a clarifying question in the form of friendly cross to Mr. Goodhue regarding the effective date of the service rendered/bills rendered basis issue.

Hopefully, I'll have the scope to do that, but I'd like to begin my direct of Mr. Laflamme, if it's possible.

CHAIRMAN HONIGBERG: And I don't think there will be any objection to your following up with Mr. Goodhue on something. And you can do it in whichever order you'd prefer.

MR. SPEIDEL: Okay.

BY MR. SPEIDEL:

Q Mr. Laflamme, could you please state your full name for the record.

A (Laflamme) My name is -- excuse me. My name is Jayson Laflamme. And I am the Assistant Director of the Gas and Water Division of the New Hampshire Public Utilities Commission.

Q What has been your involvement with this rate proceeding?

A (Laflamme) I've reviewed and analyzed the Company's rate filing in this proceeding, in conjunction with reviewing recent annual reports that have been submitted by PEU and are on file with the Commission. And I've submitted discovery relative to PEU's filing, reviewed the discovery responses by the Company, and have also taken part in the formulation of the Settlement Agreement being proposed this morning.

Q So, you are familiar with the Settlement Agreement and, in general terms, you support the Settlement Agreement, correct?

A (Laflamme) Yes, I do.

Q And you mentioned some discovery requests and responses that came from the Company in response to Staff's questioning?

A (Laflamme) Correct.

MR. SPEIDEL: Okay. I'm just going to approach the Bench now and the witness stand.

[Atty. Speidel distributing documents.]

BY MR. SPEIDEL:

Q Do you see this document right here, Mr. Laflamme, that I've just handed out?

A (Laflamme) Yes.

Q Are you familiar with the materials submitted herein?

A (Laflamme) Yes.

Q And these are essentially a series of responses from the Company and supporting schedules related to the discovery that you just referred to, correct?

A (Laflamme) That is correct.

MR. SPEIDEL: Staff would like to have this marked for identification as "Exhibit 2"?

CHAIRMAN HONIGBERG: Okay. It's marked.

(The document, as described, was herewith marked as **Exhibit 2** for identification.)

MR. SPEIDEL: Thank you.

BY MR. SPEIDEL:

Q Mr. Laflamme, in your review of the Company's rate filing, as well as the Company's reports on file with the Commission, do you believe that the Company is currently under earning so as to warrant a temporary rate increase?

A (Laflamme) Yes, I do. In Staff's review of the

Company's rate filing, as well as recent annual reports on file with the Commission, we've determined that the Company is currently in an under earnings position. This is based by and large by virtue of the fact that, since the Company's last rate increase, which was based on a 2012 test year, the Company has -- the Company's operating expenses have increased significantly. Staff has determined that overall the Company's operating expenses have increased by 18 percent. Most significantly, in the operating expenses, it has been a -- has been a 33 percent increase in the Affiliate Management Agreement that the -- that the Company pays. And that's mainly a result of increases in salaries and benefits to employees.

Another significant increase has been in the area of property taxes. And since 2012, the Company's property tax expense has increased by 24 percent.

In conjunction with increases in its operating expenses, the Company has also experienced almost 30 percent increase in net utility plant since -- from 2012 to 2016. And all of which has contributed to the conclusion that the Company is under earning at this time and warrants a temporary rate increase throughout the pendency of this rate case.

Q What would be the benefits of implementing a temporary rate increase in this case, Mr. Laflamme?

A (Laflamme) As I just mentioned, the Company is under earning at this time. And, so, a rate increase would assist the Company in making up at least a portion of the shortfall that it's experiencing right now.

Number two, for permanent rates, the Company has requested approximately a 20 percent increase in permanent rates, as well as around a one plus percent step increase, so a combined 21 -- approximate 21 percent increase in rates. The implementation of a temporary rate would mitigate rate shock by customers relative to the potential rate increase that may occur as a result of this rate proceeding.

Q Turning now to Section II of the Settlement

Agreement, Hearing Exhibit 1, and the section on "Ratemaking Methodology". Could you please explain that section, in kind of layman's terms for the benefit of the Commission and the folks here at the hearing?

A (Laflamme) Sure. As already indicated by Mr. Goodhue, in -- for PEU's permanent rate, they also requested a change in its ratemaking methodology and are asking for adoption of the same ratemaking methodology as was approved for Pennichuck Water Works in DW 16-806, and that resulted in an approximate 20 percent permanent rate increase that was requested by the Company.

In the Company's original filing for temporary rates, it was asking that temporary rates would be based on 80 percent of what it was requesting for permanent rates, or approximately 16 percent. As Mr. Goodhue indicated, because that ratemaking methodology that was approved for Pennichuck Water Works in 16-806 has not been fully evaluated or approved for PEU in this case, the Parties agreed that the ratemaking methodology in order to derive temporary rates should be based on what has been currently approved for PEU, from DW 11-126 and modified by DW 13-126.

Q Could you please provide a little bit of further detail regarding the Settlement Agreement's proposal for temporary rates?

A (Laflamme) Yes. As I think has also been indicated by Mr. Goodhue, the temporary rate increase that is being proposed this morning is $816,868. And the calculation of that amount is found in Attachment 1 of the Settlement Agreement, which is -- starts on Page 009 of the Settlement Agreement.

And just to briefly -- just to briefly go through that, the Parties to the Settlement Agreement have agreed on a rate base amount of $9,873,201, which has been calculated on Schedule 2 of Attachment 1. To the rate base amount, a 3.94 percent rate of return has been applied. That rate of return has been calculated on Page 010 of the Settlement Agreement. By application of that rate of return to rate base, an operating income requirement of $388,568 has been determined.

And that amount, compared to the proforma operating income, which has been calculated on Page 15, results in a calculated revenue deficiency before taxes of $494,924. And on a -- on a pre-tax basis, that increase becomes $816,868. And that amount added to the proforma water revenues not subject to the North Country Capital Surcharge or the City Bond Fixed Revenue Requirement of $5,777,610 results in the proposed water revenues not subject to the North Country Capital Recovery Surcharge or the CBFRR of $6,594,478.

The bottom part of the schedule is a calculation of the revenue requirement inclusive of the North Country Capital Recovery Surcharge and the City Bond Fixed Revenue Requirement, that results in a overall revenue requirement of $7,672,256, or an overall 9.97 percent increase in revenues.

Q Mr. Laflamme, in examining the supporting schedules, it appears that a number of adjustments have been made by Staff. Could you please briefly summarize these adjustments?

A (Laflamme) Yes. Those are basically two categories of adjustments. The first category relates to corrections and updates to the Company's filing. And throughout the schedules, specifically Schedule 2 and Schedule 3, for rate base and operating income, those adjustments have been identified, and they relate to various discovery responses that have been submitted by the Company. And that the purpose of Exhibit 2 is to explain in further detail the nature of the adjustments and updates that have been made to rate base and operating income.

The second category of adjustments, and Mr. Goodhue explained this earlier, is that the Parties have agreed, while to use the ratemaking methodology in existence currently, with the exception that we are implementing the five-year trailing average for water revenues and certain -- and certain production expenses, which are related to volumetric demand. And for purposes of it in its original filing, the Company only included 50 percent of that adjustment in its schedules. And what has been reflected in the temporary rate schedules is the other 50 percent, so that a full -- a full five-year average for volumetric usage is reflected in the temporary rates being proposed this morning.

Q Thank you, Mr. Laflamme. Mr. Goodhue, as I alluded to this earlier, the Company is seeking through its waiver request an effective date for the temporary rates for bills rendered as of January 8th of 2018?

A (Goodhue) That is correct.

Q So, not necessarily bills rendered as of the date of the order?

A (Goodhue) That is correct.

MR. SPEIDEL: Just wanted to clarify that. Thank you.

WITNESS GOODHUE: Yes.

CHAIRMAN HONIGBERG: Is that it, Mr. Speidel?

MR. SPEIDEL: Yes. Thank you.

CHAIRMAN HONIGBERG: All right. Mr. Ranaldi, you're on the Settlement, correct?

MR. RANALDI: Yes, I am.

CHAIRMAN HONIGBERG: Do you have any questions for either Mr. Goodhue or Mr.

Laflamme at this time?

CROSS-EXAMINATION

BY MR. RANALDI:

Q Well, on the methodology that you're using, can I question about the type of methodology, Mr. Goodhue, that you're actually using? Because the methodology you're using actually was more than just the 20 percent. Actually, it was about 24 percent, and some of it was supposed to be kicked down later at the next rate hike, 1.5 percent or something like that.

A (Goodhue) What we're talking about today is our temporary rates.

Q Right.

A (Goodhue) Which the Settlement Agreement is based on the existing methodology. In the permanent rate portion of this case, we will be talking about gaining approval for a modification of the rate structure. And that includes a certain number of elements of modified rate structure as adopted for Pennichuck Water Works in DW 16-806.

Q Okay. Will the Company be open to changing the methodology, as far is what you're proceeding with?

A (Goodhue) We filed based on a methodology that we are seeking approval for, as approved in 16-806, and in support of the capital structure for PEU being very similar to the capital structure of Pennichuck Water Works.

Q Well, why I'm bringing this up is, if you're basing it on volume, why can't, instead of going up to 20 percent, you go up by the old rate, which is much lower from what I've seen. And then, if -- I think I saw some calculations to the OCA about, over the past five years, on how much volume of water has gone from 2,000, whatever, up to now, it was like a big dip and up. So, the methodology that we're talking about is going to be affected by that.

A (Goodhue) In the modified rate methodology, and I'm a little hesitant, in that we're not talking about the modified rate methodology in this temporary rate request, other than the fact that we are looking at the five-year historical average, and that is a part of this temporary rate request. The five years --

Q Okay. I'll wait --

A (Goodhue) The five-year average is based on narrowing the volatility for weather fluctuations as it is impactful on the test year.

MR. RANALDI: Okay. I'll wait to check it, Mr. Chairman.

WITNESS GOODHUE: Thank you.

CHAIRMAN HONIGBERG: Mr. Buckley, do you have questions?

MR. BUCKLEY: Thank you, Mr. Chairman. Just one clarifying question for Mr. Goodhue.

BY MR. BUCKLEY:

Q Would the proposed North Country Recovery Surcharge reduction impact non-North Country customers?

A (Goodhue) It does not.

MR. BUCKLEY: Thank you.

CONTINUED BY THE WITNESS:

A (Goodhue) It will just directly impact on those communities.

MR. BUCKLEY: Thank you, Mr. Goodhue.

WITNESS GOODHUE: Yes.

MR. BUCKLEY: No further questions.

CHAIRMAN HONIGBERG: Commissioner Bailey.

CMSR. BAILEY: Thank you. Good morning, gentlemen.

WITNESS GOODHUE: Good morning.

WITNESS LAFLAMME: Good morning.

BY CMSR. BAILEY:

Q Can you turn to Page 013? Can you explain to me why you used the old tax rate and not the new tax rate?

A (Laflamme) Yes. The reason for that is that we are currently in the midst of reviewing the impact of the effect of the new tax rate that's been recently passed by Congress and signed by the President. And I think, from Staff's point of view, we, for purposes of temporary rates, that we want to really, really take a hard look at that, what the impact is of the reduction in the tax rates will be on the Company. As the rate structure that's been proposed by the Company, and which will be reviewed by -- during the -- which will be reviewed during the permanent rate phase, there is currently really some question whether income taxes will even have an impact on the revenue requirement.

So, I think, for purposes of temporary rates, I think it's Staff's belief that first we need to determine if the change in income taxes will, in fact, have an effect on the overall revenue requirement for the Company, and then -- and then determine exactly what that impact will be.

Q How could it not have an impact on the overall revenue requirement? We issued, as you're aware, an order early in January that said to change the Business Profits Tax rate to 7.9 percent and the Federal Income Tax rate to 21 percent, which would -- it's almost a $200,000 difference in the revenue requirement. So, how could it not have an impact?

A (Laflamme) The Company wants to adopt the same ratemaking methodology as was adopted in DW 16-806. The revenue requirement approved in that docket for Pennichuck Water Works does not include -- does not include a component for income taxes.

A (Goodhue) I could speak to that as well, yes. And just to follow on with Mr. Laflamme's comments here. In the 16-806 methodology, you've got three buckets of revenue that are tied directly to cash flow requirements: One being the City Bond fixed revenue requirement; one being the actual principal and interest for debt; and one being operating expenses exclusive of income taxes.

PWW, PEU, PAC, subsequent to the City's takeover of us, we, in essence, do not have an ROE component that would be in traditional ratemaking, which would then feel the full impact of an income tax rate change. So, we do not have that as a direct impact in our rate structure as would be in traditional ratemaking.

When I talked about the fact that, prior to 2012, as a rule, PEU had a 9.75 percent ROE on a post tax basis as a part of its weighted average cost of capital. We do not have that in our rate structure any longer as a debt-only financed organization.

So, the impact of the income tax change in the State of New Hampshire, relative to regulated utilities and how it's impacting every other regulated utility, versus the three regulated utilities within the Pennichuck group are really at odds with each other. The Company is working on drafting its response to the Commission relative to that request. And our response is probably going to be different than just about any other one that the Commission receives, because our rate structure is unique.

Q Do you pay income tax today?

A (Goodhue) We are, as a consolidated group, we file a consolidated return for Pennichuck Corporation and all of its subsidiaries. We are currently in a net operating loss position with the federal government, because we've got a large number of deferred taxes relative to that. We are working with our tax accountants and tax consultants as to the impacts long term. But it will not change our current tax paying status in the current year, but it may change the timeframe for which our net operating losses turn around over time.

Q But you have taxes in your current rates, at 34 percent?

A (Goodhue) We do book our property taxes based on those statutory rates. But, as Mr. Laflamme said, in the 16-806 methodology, which is what the permanent rates are talking about, the effective income taxes is not a part of that rate structure.

Q Yes. But you have income tax in your rate right now?

A (Goodhue) Correct.

Q Why? If you don't pay it?

A (Goodhue) If you look at the consolidated method of accounting for things under a GAAP methodology, you would book the provision or benefit on a individual corporation basis and on a consolidated basis as a consolidated taxpayer.

Q So, on a consolidated basis, you pay income tax?

A (Goodhue) We are subject to income tax.

Q Do you pay any?

A (Goodhue) We are currently in a net operating loss position. So, we are currently not paying federal taxes, but our deferred tax liability is being reduced over time relative to that.

And the general -- the largest component of our deferred taxes is related to the difference between the tax basis and the book basis for depreciational lives of assets. For federal tax purposes, water utility assets are taxed at a 25-year life, and then our average life of our assets on a book basis is in excess of 40 years.

Q Okay. I want to hear more about that in the permanent phase.

A (Goodhue) Sure.

Q On the bills rendered as of January 8th --

A (Goodhue) Yes.

Q -- question, you have obviously already rendered your bills for January. So, how do you -- how do you make up that difference?

A (Goodhue) We would actually look at those exact bills that were issued for January 8th, and we would be able to take those bills, which are based on an entire month's worth of consumption and do the adjustment based on that.

Q So, in the next bill, you'll be recouping what you didn't collect as of January 8th?

A (Goodhue) Correct.

Q Okay.

(Commissioner Bailey conferring with Chairman Honigberg.)

BY CMSR. BAILEY:

Q Okay. A few questions about the refinancing.

A (Goodhue) Yes, ma'am.

Q You said that the merger happened as of December 31st, 2010.

A (Goodhue) That was the timeframe for when the North Country systems were transferred from Pittsfield to PEU.

Q So, I looked at the order this morning that the Commission issued about the surcharge, and that was in December of 2009. So, was there a whole year in between?

A (Goodhue) Well, as far as the effective date for the transfer. So, whether it was 2009 or '10, it was based on the Pittsfield case from 2009. But the effective date that we actually, through the order, were authorized to move those systems is my recollection was 12/31/2010.

Q Would you have been collecting that surcharge before the system was transferred?

A (Goodhue) We would not have collected the surcharge prior to receiving an order authorizing us to issue the surcharge.

Q Well, that author was in December of '09.

A (Goodhue) Okay.

Q So, could you have been collecting the surcharge before the Company was merged?

A (Goodhue) I don't believe so, no.

Q Okay. I think it's Order 25,051. The order that you reference in the Settlement Agreement on Page 004 is about consolidating some dockets, didn't really have anything to do with the surcharges.

The other thing you said was that, under the refinancing, you had "improved terms" of the inter-company loan. Do you remember that?

A (Goodhue) Uh-huh. Yes, ma'am.

Q And was the original loan that the $46 surcharge was based on for Birch Hill, was that a 10-year loan?

A (Goodhue) It was, but it was an "interest only" obligation. So, it was a term loan. So, --

Q Okay. So, was the idea or your plan always to refinance it?

A (Goodhue) When it was -- when that was put in place, we were still an investor-owned utility at the Pennichuck Corporation level. And, so, your sources of capital were not only debt, but equity. There was a high likelihood that when that loan matured, the cash to do that would have been raised through an equity raise at Pennichuck Corporation to satisfy that debt, rather than doing a debt refinancing at that time.

Q So, then was the $46 surcharge intended to recover the full amount of the investment over that 10-year period?

A (Goodhue) It was.

Q Then why would you refinance it over 30 years, if that charge started early in 2010, we're eight years into the full recovery, and now you're going to take a small -- the small amount that's left and refinance it over 30 years?

A (Goodhue) Because the principal amount was going to be remaining there right until maturity relative to that surcharge.

Q Okay. And because you don't have equity --

your equity investors would have paid for that?

A (Goodhue) Most likely. At Pennichuck Corporation, you know, again, one of the sources of financing for PEU is debt only at this point in time. And in order to satisfy that term obligation, they would have to have a source of cash at maturity to actually satisfy that obligation and/or forgive it from the parent company. And chances are, that would have been converted at that time from a debt obligation of Penn. Corp. to PEU to an equity infusion from Penn. Corp. to PEU.

Q Seems like the customers would have expected to have it paid off in ten years. And now, because of the ownership by Nashua, they have to pay it off, rather than the investors?

A (Goodhue) I guess so, ma'am. I mean, what it comes down to is the structure is there to repay that obligation through a term. And what we're just doing through this refinancing is elongating the period of time for which it gets paid. The total amount being repaid is not changed as far as on a present value basis. But it is being stretched out and actually being fully amortized.

I think that if the capital structure at the time the inter-company loans were put in place and the surcharge was put in place was what it is today, it never would have been put in place as a balloon maturity. This is very similar to the bonded debt that we had in place for PWW at the time of the acquisition by the City. And that all that debt was put in place as balloon maturity debt, and with the whole thought process that it could be refinanced at maturity and/or it could be replaced with equity at maturity. That note -- the second piece of that is no longer possible. In two different dockets at PWW, we moved all of our balloon maturity onto debt, to fully amortizing debt. And that's the only type of debt we incur any longer is fully amortizing debt.

Q And if the investors had paid for the -- for the maturity -- for the investment at maturity, then would have continued to earn a 9 percent return on that, so that --

A (Goodhue) Exactly. There would be a penalty to customers in their general rates, in the fact

that they would be paying this much higher return relative to equity in the future.
Q Okay.
A (Goodhue) Yes, ma'am.
Q That helps. By making the surcharge the same for Locke Lake and Birch Hill, --
A (Goodhue) Uh-huh.
Q -- does that mean that Locke Lake will ultimately pay more than its share of the investment and Birch Hill will pay less?
A (Goodhue) No. Again, because it comes down to their relative shares of the principal amount. And, so, there's multiple loans. There was three loans being refactored into two. And when we looked at that, that was based on their shares of that overall principal being refinanced.
Q Okay. And back to your comment about that the "terms are better going forward on the inter-company loan", the rate is higher. So, what's better?
A (Goodhue) The actual monthly surcharge is much lower. So, as far as the impact on a monthly bill is what is more favorable to customers.

Q   Okay. So, it's not the term of the loan that is better. It's the --
A   (Goodhue) The term of the repayment, I guess you might say.
Q   Okay.
A   (Goodhue) Yes.

CMSR. BAILEY: All right. Thank you. That's all I have.

Commissioner Giaimo.

CMSR. GIAIMO: Good morning.

WITNESS GOODHUE: Good morning.

WITNESS LAFLAMME: Good morning.

CMSR. GIAIMO: Relative to Commissioner Bailey, --

[Court reporter interruption.]

CMSR. GIAIMO: I'm sorry. Relative to the questions posed by Commissioner Bailey, mine should be easy.

BY CMSR. GIAIMO:
Q   In discussing the 4 ccf minimum, there was a discussion that now there are more full-time residents in those areas.
A   (Goodhue) Yes.
Q   Can you provide some magnitude as to the

change?

A (Goodhue) And I'm going to look to the audience, just so I can get kind of a high sign here. Percentage of seasonal residents when this first went in was in excess of 50 percent seasonal, and now it's less than probably 25 percent seasonal, maybe 30 percent. So, there's been a fairly significant change. Again, those are relative numbers. I don't have the exact numbers with me. But I know that it was -- it was in that order of magnitude, as far as a shift.

Q That's helpful. Thanks. I think I also heard you, and I'm paraphrasing part of this, so, DW 17-157 and this docket, 17-128, and this is the part I don't believe I'm paraphrasing, you said that they are "tied at the hip"?

A (Goodhue) Yes. Yes, I did say that. Yes.

Q So, given that they're tied at the hip, I'd like just to make sure I understand --

A (Goodhue) Yes.

Q -- how they're tied at the hip and why they're tied at the hip. So, if the Commission approves the inter-company debt refinancing that the Company is requesting in DW 17-157, and they approve this Settlement, then the NCCRS rate per month, for Locke Lake and Birch, will be 12.81 per month, yes?

A (Goodhue) That is correct. So, DW 17-157 is a financing docket that has three components to it. It has two external financing components: One being a $400,000 or up to $400,000 term loan with CoBank. I think it's a $3 million fixed asset line of credit for CoBank, 3 or 3 and a half million. I apologize, I don't have the numbers right in front of me. As well as the refinancing of the inter-company loans. The reduction in the surcharge for the two North Country water systems we are talking about here would not be able to be achieved absent getting an approval of the refinancing of the inter-company loans as a part of DW 17-157.

Q Okay. So, if either the Settlement or 17-157 don't come to fruition, the numbers will stay at the $46 range, as well as -- which is $33 more than being proposed, as well as the $16 range, which is 3 and a half dollars?

A (Goodhue) That is correct. So, the authorization of the inter-company refinance we are seeking under 17-157, that would open the door for the possibility of the reduction of the North Country Capital Recovery Surcharge in this docket.

Q Thank you for clarifying that.

A (Goodhue) Yes.

Q And I have a better understanding as to why they're tied at the hip.

A (Goodhue) Yes.

Q You've said you went through, I'm sure you have them maybe in your notes, you talk about customer impacts. And what I heard was that the customer impact for the average single-family non-North Country customer would go from $66 a month to 70 or so? I just want to make sure I heard that.

A (Goodhue) Bear with me a moment. I want to just turn to my notes here so I can state this correctly.

Yes. The average PEU customer not directly impacted by any reduction in the North Country Capital Recovery Surcharge would be that rates for those customers would go from an average of $62.68 per month, to $70.35 per month. And that is based upon an average single-family residential billed amount.

Q Thank you for clarifying that. I thought I heard $66, which the delta didn't seem --

A (Goodhue) Right.

Q -- large enough to represent a 12 percent increase.

A (Goodhue) It's nearly -- nearly an $8.00 increase, $62.68 up to $70.35.

Q Thank you for that clarification.

A (Goodhue) Yes.

Q My last question, but, Mr. Laflamme, I think you said that the temporary rate being considered here will mitigate the rate shock that could occur at the end of the proceeding. I'm wondering if you could just remind us of the potential magnitude of the rate shock?

A (Laflamme) Yes. The Company is requesting a 20 percent approximate increase in their permanent rate, plus a one plus percent increase for a step increase. So, overall, it would be a 21 -- approximate 21 percent

increase. And what's being proposed this morning is a 12.24 percent increase for temporary rates.
Q Okay. So, halfway there, 50 --
A (Laflamme) More than half.
Q Fifty-five (55).
A (Laflamme) Fifty-five (55) percent. Fifty-five (55) percent.

CMSR. GIAIMO: Thank you. I have no further questions.

CMSR. BAILEY: Mr. Head, do you have any redirect?

MR. HEAD: No redirect. Thank you.

CMSR. BAILEY: Okay. Thank you for your testimony.

WITNESS GOODHUE: Thank you.

CMSR. BAILEY: We'll strike ID. I assume there are no objections?

MR. HEAD: No objection.

CMSR. BAILEY: And we'll have closing comments. Mr. Ranaldi.

MR. RANALDI: No. I'm all set with the Settlement as it is. Thank you.

CMSR. BAILEY: Okay. Mr. Buckley.

MR. BUCKLEY: Thank you. The Office of the Consumer Advocate views the terms set forth in the Temporary Rate Settlement Agreement as just and reasonable, and recommends their approval by the Commission.

CMSR. BAILEY: Mr. Speidel.

MR. SPEIDEL: Thank you. The Staff of the Commission also supports the approval of the Settlement terms as just and reasonable and the temporary rate schedules therein.

Thank you.

CMSR. BAILEY: Mr. Head.

MR. HEAD: Thank you. As we heard in the testimony, the Company is currently under earning. And as we'll hear in the permanent rate case, we believe that they would continue to under earn under the existing rate structure. But, because we have not gone through that process yet, we're asking to continue with the existing rate structure with the increases as have been described in the testimony and as described in the Settlement Agreement.

To clarify and to make sure that we

understood, though, the Settlement would also eliminate the 4 ccf minimum. There are no contingencies on that aspect of it. It would also result in a reduction in the Capital Recovery Surcharge as that is billed to the customers, but that would be dependent upon approval of the 17-157 docket, intercompany loan that is pending before the Commission.

The Settlement Agreement, as we heard in the testimony, is just and reasonable for temporary rates. And we would ask that the Commission approve it.

Thank you.

CMSR. BAILEY: All right. Thank you. I'll note for the record that we have one public comment that mentions dissatisfaction with the temporary rates, and numerous public comments about the permanent rate increase and its relative size, compared to what they perceive as a cost of living increase in whatever costs.

So, I will look forward to hearing from you in the final hearing. And we'll close the record for today and take the matter under advisement. Thank you.

MR. HEAD: Thank you.

(Whereupon the hearing was adjourned at 10:18 a.m.)