STATE OF NEW HAMPSHIRE

PUBLIC UTILITIES COMMISSION

July 25, 2018 - 10:06 a.m.
Concord, New Hampshire

RE: DW 17-128
PENNICHUCK EAST UTILITY, INC.
REQUEST FOR CHANGE IN RATES
(Hearing on the Merits)

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

Sandy Deno, Clerk

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

MICHAEL RANALDI, Intervenor, *pro se*

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

Reptg. PUC Staff:
F. Anne Ross, Esq.
Jayson Laflamme, Gas & Water Division

Court Reporter: Susan J. Robidas, NH LCR No. 44

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I N D E X (CONT'D)

PROCEEDINGS

CHAIRMAN HONIGBERG: Good morning, everybody. Please be seated. We are here this morning in Docket 17-128, which is Pennichuck East Utilities' rate case, hearing on the merits. We have a settlement that has been filed. We're here to consider that.

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

MR. HEAD: Thank you. Richard Head from Rath, Young & Pignatelli, on behalf the Company. Also with me at counsel table are Larry Goodhue and Don Ware. And also here from the Company we have Carol Ann Howe and Jay Kerrigan.

MR. BUCKLEY: Good morning, Mr. Chairman and Commissioners. My name is Brian D. Buckley. I am a staff attorney with the New Hampshire Office of the Consumer Advocate. To my left is Mr. James Brennan, director of finance with the Office of Consumer Advocate. We are here representing the interests of residential ratepayers.

MS. ROSS: Good morning,

Commissioners. Anne Ross for Commission Staff. And with me today is Jayson Laflamme, who's the assistant director of the Gas & Water Division.

MR. RANALDI: Michael Ranaldi. I'm representing myself.

CHAIRMAN HONIGBERG: Refresh my memory, Mr. Ranaldi. Did you intervene in the case, or did you --

MR. RANALDI: I did intervene on the case.

CHAIRMAN HONIGBERG: Okay.

MR. RANALDI: I tried to get a representative of Locke Lake, but they refused to show up, so I decided to show up independently. And you agreed that would be okay, that I can represent myself and it would be helpful to the other customers, the 8,000 customers.

CHAIRMAN HONIGBERG: Understood. Thank you.

How are we proceeding this morning?

MR. HEAD: For the Company, we'll have one witness on the panel, Mr. Goodhue;

and for Staff, Jayson will be the witness for the Staff. I believe that's the panel.

CHAIRMAN HONIGBERG: Are there any preliminary matters we need to deal with?

MR. HEAD: We have marked as an exhibit the settlement, which will be Exhibit 3.

(The documents, as described, were premarked as Exhibits 3 for identification.)

MR. HEAD: There is pending, also, a Motion for Waiver as part of the settlement relative to the effective date of the settlement. So that Motion for Waiver is also pending as part of the settlement agreement.

I also have, just for convenience, within the settlement agreement there's an Exhibit 3 to Appendix A. We'll be referencing it through the testimony. And I thought, just as a demonstrative, so you'd have it in front of you, I have a separate copy of it so you don't have to flip back and forth.

CHAIRMAN HONIGBERG: If there's nothing else, then the witnesses should probably move into the witness box.

I guess for the order of questioning, what we'll do is have those who are on the settlement do the questioning of the witnesses, and then, Mr. Ranaldi, you can ask whatever questions you have before we ask our questions.

You can swear them in.

(WHEREUPON, *LARRY GOODHUE AND JAYSON LAFLAMME* were duly sworn and cautioned by the Court Reporter.)

CHAIRMAN HONIGBERG: Mr. Head, before you start, will you be marking the original filing and the testimony that was included there?

MR. HEAD: You know, I guess I hadn't planned on it. But I certainly can if that's the better protocol.

CHAIRMAN HONIGBERG: You guys know the case better than we do. If that testimony is necessary for our understanding of the request in the settlement, then --

MR. HEAD: I don't believe so. I think we're going to -- Mr. Goodhue will be testifying here today as to the essential elements that were in his original testimony in the filing. So I don't think it's necessary from that perspective.

CHAIRMAN HONIGBERG: Okay. You may proceed.

MR. HEAD: Thank you, Mr. Chairman.

DIRECT EXAMINATION OF LARRY GOODHUE

BY MR. HEAD:

Q. Mr. Goodhue, starting generally with your background, can you describe your role with Pennichuck East Utilities?

A. (Goodhue) Yes. I am the CEO of Pennichuck Corporation and all of its subsidiaries. I assumed that role on November 6th, 2015. Prior to that, I was the CFO of the corporation from April 2012, and I still actually hold that title. Prior to that, I was the comptroller of the Company from December 2006 through April 2012. I currently hold the titles of CEO, CFO and treasurer for Pennichuck Corporation and all of its subsidiaries.

Q. And in terms of just a general description, what does that mean as to your job duties?

A. (Goodhue) I'm responsible for the overall financing, management and operations of the Company, along with our management team. I report directly to the board of directors of Pennichuck Corporation and each of its subsidiaries.

Q. And you had referenced the subsidiaries of Pennichuck Corporation. Can you just briefly describe the subsidiaries of Pennichuck Corporation and their role relative to the regulatory environment?

A. (Goodhue) Yes. There are five wholly-owned subsidiaries of Pennichuck Corporation, three of which are regulated water utilities in the state of New Hampshire: Pennichuck Water Works, Inc.; Pennichuck East Utility, Inc., which this case is for, and Pittsfield Aqueduct Company, as well as two unregulated subsidiaries, Pennichuck Water Service Company and the Southwood Corporation. The Pennichuck Water Service Company contract operates other water systems for small systems owned by others and/or municipalities, and the Southwood Corporation is a real estate holding company that holds land in the state of New Hampshire.

Q. And as we know, the City of Nashua is the sole shareholder of Pennichuck Corporation. Can you describe very briefly how the City's acquisition affected the way in which PEU operates as a utility?

A. (Goodhue) Yeah. The acquisition by the City of Nashua of Pennichuck Corporation affected Pennichuck East Utility, or PEU, in much the same way it affected Pennichuck Water Works and the other subsidiaries. The modifications basically are that -- the corporation as a whole does not have access to the equity markets any longer. It is a debt-funded operation for any operations and infrastructure; and as such, the modifications we are seeking through this settlement for PEU are consistent with the changes that were requested and authorized for PWW in its ratemaking methodology in

Docket DW 16-806.

Q. Given the similarities between the settlement agreement in this case and the settlement agreement in Docket 16-806, can you describe some of the important similarities in the way that the City's acquisition of Pennichuck Corporation affected those two utilities in a way that's similar?

A. (Goodhue) Yes. As I mentioned, we no longer have access to the private equity markets like an investor-owned utility would have, where they could access capital through both debt and equity. This is strictly debt-financed at this point. So, no longer is a desirable 50/50 debt-equity ratio not only [sic] available, which would be optimal for the Company, as far as the ability to raise funds, but also it has within it an elevated cost to customers relative to the cost of equity. After the acquisition, both PEU and PWW, as well as PAC, are expected to finance their ongoing capital needs entirely through the issuance of debt.

Q. And how does that affect PEU's customers?

A. (Goodhue) One of the things that it does is it lowers the overall weighted cost of capital for PEU on its capital structure. Prior to the acquisition by the City of Nashua, PEU had an ROE on an after-tax basis of 9.75 percent related to about 50 percent of its capital structure. Now you're looking at an overall cost of capital that is far below that because it's a debt-only financed structure, something south of 5 percent.

Q. So, going back to Pennichuck Water Works and the 16-806 docket and the rate methodology that was approved in that case, can you just briefly give an overview of that rate case and then talk about that how that applies to PEU?

A. (Goodhue) Yes. In that rate case, what we sought was further modification to the rate structure that was authorized under DW 11-026, when Pennichuck Corporation acquired -- was acquired by the City of Nashua. That was already an alteration from traditional ratemaking. In this case, we are seeking a similar methodology for PEU, where the rate structure is directly tied to cash flow and the cost of operating the company and cost of building infrastructure covering operating expenses and paying PEU's obligations under its CBFRR, city bond fixed revenue requirement, which are the dollars that are necessary to pay up to the City of Nashua in order to service the debt that was used to acquire the corporation.

Q. And when the 16-806 settlement for PWW was approved, was it anticipated at that time that the methodology would be transferred to the other subsidiaries?

A. (Goodhue) Yes. In the testimony in the final hearing for PWW, it was explained by myself and other parties that the facets of that modified methodology were intended to be applied to the sister subsidiaries of Pennichuck East Utility and Pittsfield Aqueduct in their next prosecuted case.

Q. Before we get into the details of the new methodology for PEU, what do you believe the changes that we're about to describe, how will that affect PEU and its customers?

A. (Goodhue) There's a few things. One is we feel that it's going to allow for more favorable rates over time for customers, as we'll have access to debt at lower rates of interest relative to this methodology. We'll have a rate structure that will go up ratably over time rather than with specific spikes at each rate case filing. It will adequately provide EBITDA, earnings before interest taxes depreciation and amortization, to meet covenant requirements on its debt; so, basically, the cash-basis proxy for net income which is required when you're borrowing money from the debt holders, that they have a minimum threshold that they would seek to expect relative to securitizing that debt. It will also provide adequate cash to continue to meet the operating needs of the Company. And finally, the rate structure would be tied to cash flow and not to the generation of excess profits, and would allow for coverage relative to variations in consumption patterns specifically tied to weather anomalies in the summer months.

Q. And using 16-806 as the base, but understanding that that same methodology will be applied to PEU under this settlement, can you briefly describe how federal taxes are accounted for under the methodology that we're going to be talking about?

A. (Goodhue) Sure. Because our regulated utilities, PWW, PEU, PAC, will no longer have an effective ROE component out of DW 11-026, that rate methodology is determined without any adjustment for tax cost factors. There's no -- and as such, there's no impact on rates. And any impact on the BPT, that's considered to be immaterial.

Because there's no ROI component under the 16-806 rate methodology which is being pursued in this case, tax costs are not included in either the MOERR, the NOERR component, and certainly not in the DSRR or the CBFRR components of the rate -- the allowed revenue calculation. As such, they don't include or factor in any component of income taxes.

Q. And are there some potential future impacts that may arise out of the tax code changes relative to PEU?

A. (Goodhue) There are. One specifically is the new tax legislation passed by the Federal Government putting in place an interest expense deduction limitation for both individuals and for corporations. And so we're still evaluating what that impact is going to be. There is a particular section under the IRS code that does allow for a waiver of that interest expense deduction limitation for regulated utilities, which is a positive. The one thing it is silent on at this point in time is how that can be truly utilized in a situation where you have a consolidated group that includes regulated utilities with a non-regulated parent corporation.

Our corporation filed a consolidated tax return at the Pennichuck Corporation level for Pennichuck Corporation and all five of the subsidiaries, regulated and unregulated. As a good portion of our interest expense is outside of the regulated utilities, it is still undetermined right now what that full impact is going to be. As of yesterday morning, I convened with our tax consultants once again to see if there had been any further guidance and interpretation issued by the IRS relative to the new tax law and how that particular provision could be applied, and there is nothing at this point in time specific. In fact, I was told by them that there's a great many areas of the tax code where they're waiting for interpretations from the IRS that have not yet been released.

The first real impact of this is going to show itself to us when we have to file our 2018 tax return in late 2019. So we're very hopeful that guidance will come to bear prior to that filing.

Q. In terms of the methodology that we're seeking approval of today, do those future tax consequences affect the methodology that we're talking about today?

A. (Goodhue) They do not affect the methodology as it is today. There may be a future impact should there be a taxation that is levied because of this interest expense deduction, for which we may need to collect cash in order to pay those taxes.

Q. Okay. So let's turn to the settlement agreement and briefly go through the terms and conditions as they are outlined in the settlement agreement.

Skipping over the first couple pages where it has the procedural history and the background of the Company -- and when I'm talking page numbers in my questions here today, I'll be referring to Bates page numbers in the settlement agreement.

On Page 7, Section III.A.1, there's a description of the revenue requirement. Can you both describe the total revenue requirement that's described there without, though, in this case, consideration of the NCCRS, the North Country cost recovery surcharge?

A. (Goodhue) The total revenue requirement without consideration of the North Country capital recovery surcharge is a total revenue requirement of $8.276,261 million. That's comprised of a permanent rate increase of $1,304,272, or 18.97 percent. It also is inclusive of a step increase of $97,973, or 1.43 percent for 2017 used and useful capital additions.

Q. And briefly, can you describe what are some of the primary cost drivers to the revenue requirement that's being sought in this settlement?

A. (Goodhue) PEU had its last promulgated rate case for test year 2012. So, this case represents four years' worth of activity since that last filed rate case. The rate increase is comprised of a number of factors, inclusive of capital additions for fixed assets for the years '13, '14, '15, '16, and inclusive of the step addition '17, as well as inflationary increases in operating expenses for the four years since the last test case, as well as there has been some customer growth within the Pennichuck East Utility subsidiary, most specifically in the later years relative to this case, relative to some addition of customers in some of the systems we operate. Specifically, over 400 customers were added in the town of Litchfield alone during the last couple of years relative to the PFOA mitigation efforts, where our water system has been expanded through the payment of that expansion by a responsible party, but now we have operating costs and provide provision of water to those additional customers. That alone represented almost a 15 percent increase in customer base.

Q. Just to clarify on that, the cost of that construction itself was borne by the responsible party?

A. (Goodhue) one hundred percent, yes.

Q. So that's not part of this cost driver?

A. (Goodhue) It is not. However, what happens is that you've got now the cost of providing the water to those folks, the cost of treating the additional water, the additional cost of property taxes related to that property. That was paid for by somebody else, but now owned by us.

Q. So those costs going forward will be borne by the Company?

A. (Goodhue) That is correct.

Q. Also within the structure of PEU is a management fee allocation; is that correct?

A. (Goodhue) That is correct.

Q. And can you describe what that is and how that's determined?

A. (Goodhue) Yes. Our management fee allocation is based on a formulaic approach first put in place, I believe in 2002, and it is applied on a regular basis in a very formulaic approach. It is comprised of a number of tiers of expenses, and it's based on a number of underlying factors. It's the allocation of certain costs that are borne just at the Pennichuck Corporation level, which are actually fairly immaterial at this point in time, which were much more material when we were a publicly-traded company, and then a great deal of expenses at the Pennichuck Water Works Corporation level, where 100 percent of our employees and 100 percent of our fleet is there. So all of those assets and manpower assets are used in support of sister subsidiaries.

The formulaic approach looks at all of those actual costs and allocates them based on this formula. Some of the bases for the allocation is assets, pro rata assets, overall assets between the subsidiaries, pro rata customers, pro rata work order activity, which is a direct cost relative to operating activities within those subsidiaries.

Q. What are those work order activities like relative to PEU?

A. (Goodhue) Based on the fact that PEU is a water company that is geographically dispersed within the state, we represent or serve 19 different communities geographically spaced within the state. Those work order costs are related to maintenance activities and other water-testing activities on a very specific basis, including travel time to those various sites where that activity is taking place.

Q. And I don't remember you mentioning it, so I apologize if this is repeating. How do property taxes affect the driver of the costs?

A. (Goodhue) Our property taxes have gone up at or above inflation during that period of time. Property taxes for our regulated utilities include both the statewide utility tax, as well as local property taxes levied by the communities that we serve. To the extent property taxes go up disproportionately, we do have a process of regularly filing abatements relative to those. We are successful on some, not as successful on others. If they're very material, we've actually approached litigation on those. We actually had a case in our town of Litchfield where we got to the threshold of actually litigating a case and actually went through an arbitration settlement on those taxes during the last year.

Q. Moving on through the settlement. On Page 8, the North Country capital recovery surcharge reduction, just describe what are the three North Country systems that we're talking about here.

A. (Goodhue) There are three North Country water systems: One is Locke Lake in Barnstead, New Hampshire; another is Birch Hill in North Conway, New Hampshire; and the third is Sunrise Estates in Middleton, New Hampshire.

Q. And actually, I forgot. Before we get to the NCCRS, in the temporary settlement there was the -- that included an elimination of the 4 CCF minimum that had previously been applied to those three North Country systems. Does the settlement that we're talking about here today continue or alter that?

A. (Goodhue) It does not alter that. It does continue the elimination of the 4 CCF minimum that was approved in the temporary rates settlement, so it's continuous and consistent with that.

Q. And then going back to the NCCRS, the North Country capital recovery surcharge, how was that treated in the settlement agreement?

A. (Goodhue) In the settlement agreement, it permanently implements the temporary rates settlement, whereby the NCCRS for both Locke Lake and Birch Hill would be reduced. They were reduced consistent with an approved refinancing of existing intercompany loans that Pennichuck East Utility had with Pennichuck Corporation under Docket DW 17-157. It does not apply to any reduction to Sunrise Estates, as any alteration relative to that refinancing would have caused a surcharge on those customers to increase, which we felt was contrary to our overall intent in that process.

Q. And what is the -- why are you unable to completely eliminate that surcharge at this stage?

A. (Goodhue) We're unable to completely eliminate that surcharge at this time because the resulting negative impact on all of PEU's customers would have been significant.

Q. So, before we had talked about the revenue requirement without the NCCRS. Can you describe the revenue total, overall revenue requirement now including the NCCRS?

A. (Goodhue) Yes. The overall revenue requirement, inclusive of the NCCRS, is $8,455,176, a net increase of $1,281,175, or

17.86 percent.

Q. And then you had also described in the revenue requirement the step increase. And this is on Page 8 of the settlement agreement. Can you describe that step increase and what goes into that?

A. (Goodhue) It is for 2017, used and useful capital additions. Prior to implementation, it will be audited by Staff. In fact, the audit of those assets has already been scheduled between the PUC Audit Staff and the Company staff relative to the audit of that.

If the audit report reveals a material difference, an adjustment to the step increase will be recommended to the Commission for approval.

Q. Okay. And then going on to Page 9 of the settlement agreement, it describes the proposed effective date of the permanent rate. Can you describe what we're -- what the settlement proposes relative to the revenue requirement for an effective date?

A. (Goodhue) Yes. The effective date revenue requirement of 1,304,272. We are requesting it be effective for the bills-rendered basis on or after January 8, 2018.

Q. There's a motion pending to seek a waiver of PUC Rule 1203 in order to implement those bill -- or the effective date of the bills-rendered process. What's your view as to why that is in the customers' best interest to waive that rule?

A. (Goodhue) Two primary bases, or benefits, and that is: No. 1, it is far less confusing for our customers when you implement a rate change on a bills-rendered basis. The entire bill that is impacted is now calculated for that rate increase. When it's on a service-rendered basis, you have calculations that bifurcate that rate increase within that bill, and it is extremely confusing for customers relative to how that has been implemented and whether it's been correctly calculated. So this is done in an effort, No. 1, to make it much more appealing and favorable for our customers, and it also actually has a reduced cost for the Company because the direct or indirect cost of implementing that, as well as explaining that to our customers, is something that we can eliminate by using it on a bills-rendered basis.

Q. And relative to the step increase, what is the proposed effective date of the step increase?

A. (Goodhue) Within 30 days after the order, a calculation of the temporary/permanent revenue recoupment will be recommended to the Commission, and the step increase will be effective as of the date of the Commission's order on this settlement.

Q. And can you describe the impact on the increases that are being proposed in the settlement agreement on average customers? And I'll just note this is also described in Exhibit 2 of the settlement agreement.

A. (Goodhue) I'll describe it in four different subsets.

For any of our non-North Country residential customers -- so, for the 16 different communities that we serve outside of those -- an average customer uses 7.29

CCFs, or 100 cubic feet of water per month. Their bill would increase from an average of $62.68 per month to $75.47 per month, inclusive of the step adjustment, or a $12.79 increase per month, or on an annual basis, $153.48.

For our Locke Lake customers in Barnstead, New Hampshire, using an average of 3.5 CCFs, their bill would increase from $58.51 per month to $59.79 per month, a net increase $1.28 per month, or $15.36 per year.

For our customers in Birch Hill, North Conway, New Hampshire, again, a customer using an average of 3.5 CCFs per month, their bill would go from $88.20 per month down to $59.79 per month, or a decrease of $28.41 per month, or $340.92 per year.

And lastly, for our customers in Middleton, New Hampshire, at Sunrise Estates, again using an average of 3.5 CCFs per month, their bill would go from $52.89 per month to $57.72 per month, or an increase of $4.83 per month, or $57.96 per year.

Q. So let's turn to the modifications to the methodology that are included within the settlement which begins on Page 11 of the settlement agreement, or Section III.C. Briefly describe for the Commission why the settlement proposes to modify the ratemaking methodology that is currently in place.

A. (Goodhue) Number one, the modified ratemaking methodology is consistent with the methodology that was approved in PWW's last rate case of DW 16-806. The basis for that was explained in that case, and we talked at that time about seeking that implementation for the other subsidiaries. One of the key drivers is that PEU currently has lender covenants in place that it cannot meet under its existing rate structure and fully recover its cash flow obligations. The primary driver there is that depreciation lives of the fixed assets of the corporation are well in excess of its debt instrument lives. So the cash flow that can be provided under existing rate methodology from depreciation is not sufficient to cover the principle repayments on the underlying debt.

Additionally, the new methodology is intended and is needed to provide adequate EBITDA coverage for PEU, as it relates to its covenant requirements.

It also will provide adequate cash flows from revenues to pay debt service, PEU's share of the CBFRR, as well as its operating expenses, and it will provide adequate support funds in the form of the RSF accounts being established to provide for cash funding during times of revenue shortfalls and expense growth above inflationary levels between rate case filings.

And I guess, lastly, most importantly, if PEU was to continue operating just under the rate methodology as established under DW 11-026, the Company will become financially insolvent relative to the ability to pay its debts and obligations.

Q. In the PWW settlement, the five-year trailing average was adopted in that methodology. Can you explain, one, whether that's also requested in this methodology for PEU in the settlement agreement, and how it differs from what we saw in the PWW settlement?

A. (Goodhue) Yes. Consistent with the PWW settlement, the calculation of the five-year trailing average is consistent, and that is based on average consumption determined. It's based on the four calendar years immediately preceding the designated test year. So inclusive of the test year, it's a five-year trailing set of data. All direct test-year expenses which are affected by the differences in consumption are included in that calculation, including, but not limited to, purchased water, electricity and chemical treatment expenses. And so those are pro forma as a part of that calculation.

(Court Reporter interrupts.)

A. (Goodhue) The one fundamental difference between what we are requesting in this case versus what we requested in the DW 16-806 case for PWW is that we would not fully implement the five-year trailing average totally within this case. We are recommending -- or we filed for, and the settlement agreement includes, phasing that in over two rate cases.

Q. And why is that?

A. (Goodhue) When we looked at implementing it fully within this rate case, we felt that the impact was overly onerous of customers in one rate case, and as such, by phasing it 50 percent in this case and the remaining 50 percent in the next rate case was the proper thing to do. Had we phased it in 100 percent in this rate case, it would have represented approximately an additional 2.5 percent increase in customer rates.

Q. Looking to the structure of the new methodology and using Exhibit 3, Appendix A to that, which is on Page 37 of the settlement agreement, I just want to briefly talk through the structure of the settlement agreement -- or of the new methodology. And do you have that in front of you?

A. (Goodhue) I do.

Q. So, going left to right on what is Bates Page 37, Appendix A, can you describe, starting with the CBFRR, what that is?

A. (Goodhue) Yes. So the CBFRR which was originally authorized in DW 11-026, and then further supported in DW 16-806, is a revenue component tied to each of our three regulated utilities' portion of their revenue requirement in order to cash flow and fund the repayment of money to the City of Nashua to meet their obligations to repay the debt service on the promissory note, the bonds that they floated in order to purchase Pennichuck Corporation in 2012.

Q. And then moving to the right, to the OERR, operating expense revenue requirement, can you describe that?

A. (Goodhue) That is the portion of the allowed revenue requirement that is tied to the cash flow needed to provide for the payment of allowed operating expenses for the corporation.

Q. And what are the buckets associated with that?

A. There are two buckets: The material operating expense revenue requirement and the non-material operating expense revenue requirement. I'll speak to the second one first.

The non-material operating expense requirement identifies a select number of operating expenses that are inclusive in a case relative to their prudency for that test year, but are not supported by a rate stabilization fund backing them up. In this case, the NOR -- NOERR expenses for PEU are inclusive of outside services, public relations, meals and charitable contributions. The MOERR covers the balance of the PEU's operating and maintenance expenses, property taxes and all the other operating expenses of the Company.

Q. And by virtue of an expense being listed, the NOERR, the non-material, does that preclude the Company from seeking recovery of those in a future rate case?

A. (Goodhue) It does not. But they would be included in the test-year operating expenses as pro forma, be subject to PUC audit, and tested for prudency in those cases.

Q. And then moving to the third bucket, the DSRR, can you describe that and what falls under that?

A. (Goodhue) The DSRR component of revenues is comprised of two subsets as well. One is the DSRR 1.0, the other is the DSRR 0.1. The DSRR 1.0 is the portion of the revenue requirement that is tied to the actual cost of debt service for debt already in place for the Company during the test year. The 0.1 is a collection of revenue at 10 percent above what that is -- or that factor is, related to the ability to cover actual debt service, but also meet certain covenants in cash flow requirements for the corporation relative to its debt covenants.

Q. And, again, very briefly describe how those buckets will be drawn from and replenished as the Company uses them.

A. (Goodhue) They will operate in the same manner as PWW under the 16-806 settlement. Cash will be transferred weekly into the revenue requirement bank accounts, specific bank accounts, based upon their pro rata shares of cash collections during each week. At the end of each month, the Company's revenue performance will be tested based on actual versus allowed levels in order to transfer additional funds into the RSF accounts, or bring funds back from the RSF accounts into the Company's main operating account. And then as payments are made weekly and monthly, quarterly, semi-annually, relative to the various buckets from those revenue requirement bank accounts, if funds are deficient, they will be transferred from the main operating account, and if in excess, they will be transferred back into the main operating account.

So, again, it's the same operation in theory that was established under 11-026 and then reaffirmed but bifurcated under 16-806 for PWW.

Q. And the three rate stabilization funds that would exist under the new methodology, how do those get initially funded in the settlement agreement?

A. (Goodhue) Under DW 11-026, a rate stabilization fund was funded and established at $5 million. It was actually established by money borrowed by the City of Nashua and actually put in place into that structure. Initially, that entire fund was one fund under the PWW subsidiary. Under the DW 16-806 case, we include in the settlement agreement and petition to take and bifurcate that fund, not only into separate buckets for PWW, but to actually bifurcate and hold to the side a sum of that money for further allocation and distribution to PEU and PAC.

Of the original $5,000,000, $3.92 million was retained by PWW, with $1,080,000 being held aside for PEU and PAC. Of that $1,080,000, $980,000 was being held for PEU and $100,000 for PAC. Of the $980,000 for PEU, based on an analysis included in the settlement agreement schedules, further analyzes how that $980,000 will be broken down into its component parts, with $31,000 being allocated to the CBFRR RSF; $898,000 to the MOERR RSF; and $51,000 to the DSRR 1.0 RSF.

Q. And without going into the specifics, does that allocation fully fund those three RSFs?

A. (Goodhue) We do not feel that it does fully fund those, based on those numbers. It is an allocation of the 980,000 currently available for the RSF. But the settling parties agree that additional funds may be required in order to ensure that the value of these three RSF accounts are at appropriate levels in order to sufficiently account for inflationary increases which may incur until PEU's next rate case, when new permanent rates will become effective.

Q. And are the estimates of the fully funded amounts in those RSFs described on Page 19 of the settlement agreement?

A. (Goodhue) They're included in the settlement agreement, also as Exhibit 5 within that agreement.

Q. Okay. The settlement agreement also incorporates the QCPAC process that was first approved for PWW in 16-806. Can you just briefly describe what that QCPAC process is?

A. (Goodhue) The QCPAC process creates for PEU an ongoing annual surcharge between rate cases based upon essentially all of the capital projects undertaken and used and useful by PEU each year. It avoids rate shock to customers, in that you would have ratable increases based on capital expenditures on an annual basis rather than waiting until the next rate case.

It has three components: It's a surcharge based on the previous year's used and useful completed projects; it requests preliminary approval of the current year's capital project; and for information purposes only, the preliminary budget or plan for the next two years' worth of projects succeeding that.

Q. So, taking those three briefly, just separately, what is the process that goes into determining the previous year's used and useful projects that goes into the QCPAC?

A. (Goodhue) That process involves not only the finance department for PEU, but all of the line managers and project managers within the Company working on these projects. And it's part of the year-end closing of the Company's books and records. Projects are analyzed for completeness and accumulation of costs, and for the timing of their transfer from CWIP to used and useful capital projects. Reports are prepared by the Company to supply or submit in compliancy with the timing and requirements of the QCPAC filing process, and those reports are ready for review by the PUC Staff, and the underlying asset records are ready for audit by the PUC Audit Staff based on that process.

Q. And then the QCPAC filing also would have the current year's preliminary budget; is that right?

A. (Goodhue) That is correct.

Q. And what goes into determining that preliminary budget for the current year?

A. (Goodhue) Pennichuck Corporation and all of its subsidiaries go through a very comprehensive budgeting process on an annual basis. Along with the other companies in the Pennichuck consolidated group, a detailed capital budget on an annual basis is prepared and presented to our board of directors, and it's approved by the end of January of each year. The capital budgets are prepared on a detailed basis, and certain large projects are identified in a specific manner as it relates to timing and the overall estimated cost to complete those projects.

Other projects relate to "run rate" types of capital projects based upon historic trends and data as it relates to reactionary projects that the Company may have to fund in that budget year. For example: If a pump fails at one of our booster stations, we have to replace that. We have to supply water. If a hydrant fails, we have to replace that. If a meter fails, we have to replace that. So, again, we budget based on "run rate" and historical information, but we know that that's never going to be 100 percent accurate. It's based on a prediction of what we think may occur. But when something like that occurs, they need as a regulatory utility to be able to provide water to our customers. We must undertake that capital project at that time.

And so other projects related to the

Company's ongoing main replacement program --

(Court Reporter interrupts.)

A. (Goodhue) Alterations may occur in the budget year relative to those projects, as certain projects are re-prioritized or substituted for other projects as it relates to perhaps operational issues; it may relate to road projects that are going on in the communities that we serve, and it may relate to basically the availability of contractors in order to provide and complete those projects within a budget year.

Q. When the board of directors approves the budget, are they necessarily approving each project and saying that those projects have to occur, or are they approving an overall budget?

A. (Goodhue) They're approving an overall budget. The one exception is if we've got certain large, identifiable projects, we do spend more time focusing on those. So they are looking at those in the nature of is this a project we're pursuing or is this a project worth pursuing. However, even with those projects, the dollars approved in the budget may still be just a best guesstimate at that time relative to completion of the design, implementation of that project, and/or all of our projects of a material nature go out through a bid process. And so despite the fact that we may have an engineering estimate that is based on good data and based on the best knowledge that we have, once we go out to bid, the actual dollar value of that project will be determined.

Q. So is it fair to say when the QCPAC is filed at the beginning of the year, there's a fair amount of flux that exists in that budget relative to the specific projects that will occur later on that year?

A. (Goodhue) That is correct.

Q. Okay. Does the QCPAC, given that flux and that variability, does the QCPAC provide a process for updating the Commission through the year as those projects progress?

A. (Goodhue) It does. We provide, actually, updates in the process at periodic times throughout the year, on August 15th, November 15th and January 15th, relative to actual costs incurred relative to capital projects for the periods ending June 30, September 30, and November 30 of each year.

Q. And the QCPAC, in addition to the used and useful from the prior year, the estimated projects for the current year also provides for information the following two years' worth of capital projects. How certain are those and what goes into that process?

A. (Goodhue) Those are done, again, as a part of our annual budgeting process as a forecast of the run rate of capital investments that the Company is planning to make over succeeding two years, again giving specific identification to material projects and the horizons that we feel need to be approached, and/or run rate capital needs are done for a few reasons. One is, as we're procuring debt with our lenders, sometimes we're procuring the ability to access funds on a multi-year basis, and as such, we need to have visibility towards what the overall magnitude of those dollars needed may be, and also relative to the planning for specific opportunities. Sometimes a project may take several years to actually fully come to bear.

We have a project going on right now in Locke Lake where we're needing to create additional source of supply of water for that system there in response to a corrective action plan that we're working on with the DES. That project is almost two years old at this point in time, and it's probably going to be another two years before it's completed. Relative to looking at actions and response to that corrective action plan, relative to what the alternatives are, relative to that additional source of water, we've done investigative work as to sites of property that might be able to have a well or source of water, where those geographically are located, are they available, are they geologically available to us, and what are the other alternatives that we need to evaluate relative to that whole study.

Q. And under the current methodology, does PEU have a mechanism for step increases for

capital projects, or is this new to the PEU?
A. (Goodhue) This is brand new. In PWW, the QCPAC process was really a migration from the former WICA process that PWW had prior to that. Prior to this case, PEU has had no mechanism like this, so the QCPAC process is new to PEU with this case.
Q. And in the PWW 16-806 docket, when the final order was issued, the Commission ordered that an interim QCPAC be filed at the end of that year. As a result the Company's experience with the 16-806, did the Company learn anything that may be useful to the Commission relative to that interim filing as compared to the first full QCPAC filing?
A. (Goodhue) Yes. As I previously described, while the total budget may be voted on by our board, individual projects cannot all accurately be predicted at the beginning of any calendar year. If an interim QCPAC petition is filed before the end of the year, there will inevitably be differences between the projects described in that interim petition and projects that will be described

in its first full QCPAC petition filed in early 2019. Thus, when the full QCPAC petition is filed, it will accurately describe all the projects from the prior year, but only provide an estimate of the projects for the current and future years. At that time, the Commission Staff and OCA can then seek out the details of the prior year's projects to ensure that the projects are just and reasonable and in the public interest. And then, as to future projects, however, the process would then -- should only be allowed to evolve as the projects become better defined throughout that year.

Q. So, you know, that describes sort of the overall methodology that is proposed in this settlement. What does the settlement describe on Page 24 relative to when a new rate case would be triggered for PEU under this agreement?

A. (Goodhue) In accordance with what's included in the settlement agreement, when the total amount of funds held in all of the Company's RSF funds -- so, the CBFRR RSF, the MOERR RSF and the DSRR RSF -- grow to be materially greater than the target for each of those funds, as most recently established in a rate case, then that would trigger an activity. And how it's defined is when the average amounts of cash held in the combination of those RSFs on 13-month prior ending period, as of December 31st of each year, is greater than 150 percent of the combined target amounts, then the Company, within six months following that year, shall file a rate case with the Commission.

Q. And does the settlement also provide for the recovery of rate case expenses as described on Page 25 of the agreement?

A. (Goodhue) It does. The settlement allows PEU to recover its reasonable rate case expenses for this proceeding through a surcharge. PEU agrees to file its final rate case expense request, pursuant to PUC 1905.02, no later than 30 days from the date of the Commission's order approving this settlement agreement. Staff, OCA and the intervenor will then have an opportunity to review the rate case expenses and provide recommendations to the Commission for approval.

Q. Turning to one of the reasons why the intervenor, Mr. Ranaldi, opted not to sign this settlement agreement. During the discussions that led up to this settlement, was there a proposal to incorporate an annual major operating expense, the MOE inflation surcharge?

A. (Goodhue) There was. There was a proposal to measure inflationary increases in certain major operating expenses to the Company based upon known and measurable changes to the 12/31/2018 test-year-ending MOE expenses. It included a defined number of expenses in production, distribution, customer accounts and collections, and admin and general expenses. So those defined number of expenses that were to be included and analyzed each year relative to the prudency of the surcharge to be approached on an annual basis.

Q. Essentially would it have created another step in the process?

A. (Goodhue) That is correct.

Q. And very briefly, can you describe why this proposal was not adopted into this settlement agreement?

A. (Goodhue) Sure. First off, the concept was discussed in connection with the question from the OCA about other ways to reduce costs. Because future cost increases due to inflation are not built into current rates, these inflationary costs wind up being funded through debt, and as such, with the greatest pressure for inflation upon the operating expenses of the Company in the MOERR portion of the revenue requirement, that's why we were looking at this. When you look at the CBFRR component of revenues, it's a fixed amount, and will be a fixed amount for the next 24 years.

The DSRR component has an allowed revenue component, and it has the QCPAC process to basically layer on a surcharge annually for incremental debt. So, both of those really have proper mechanisms in place to support them for any increases between rate cases or relative to their overall needs.

Absent means to increase the needed MOERR rate stabilization funds in support of those operating expenses, the Company would have to borrow these funds through the issuance of debt, and that incremental debt service cost now would need to be funded through revenue and rate increases, including the cost of interest on those funds. The parties to the settlement agreement discussed the possibility of avoiding these incremental costs through a surcharge, but it was determined that the proposal was raised too late in the process for this case for it to be adequately vetted, and thus the parties agreed that, while it has merit, it should be raised in the next full rate case to allow for discovery and analysis.

Q. Do you anticipate this might be an idea that does get built into a future rate case?

A. (Goodhue) Yes.

Q. And before we wrap up your testimony, in your opinion, is the settlement that is marked as Exhibit 3, and the subject of your testimony, is that just and reasonable and in the public interest?

A. (Goodhue) I do feel so.

Q. And why do you think that?

A. (Goodhue) PEU's request seeks some modifications to the methodology approved in the 2011 settlement. It also has changes that are consistent with the changes that were approved by the Commission for PWW in 16-806. The changes we are seeking will allow us to obtain financing at better terms and rates. And combined with the benefits of not having an equity ownership structure, we believe that the benefits in this temporary rate agreement and these permanent rates are in the public's interest. And under this settlement, the Company will be in a superior financial position, and the overall benefits of PEU's ownership structure can then continue to be passed on to its customers. And lastly, the continuation of a rate structure under 11-026 procedure and authorization would lead eventually to insolvency for the Company and an inability to provide cash flow to cover all its needs.

Q. Thank you.

MR. HEAD: With that, that would conclude Mr. Goodhue's direct testimony.

CHAIRMAN HONIGBERG: Ms. Ross, questions for Mr. Laflamme?

MS. ROSS: Yes, I do. It is going to take a while. Does the Commission wish to have a break before we go into this witness, or should we proceed?

CHAIRMAN HONIGBERG: How much do you think you have?

MS. ROSS: I probably have 20 minutes.

CHAIRMAN HONIGBERG: Okay. We can go 20 minutes. Go ahead. Proceed.

MS. ROSS: Go ahead? Okay.

DIRECT EXAMINATION OF JAYSON LAFLAMME

BY MS. ROSS:

Q. Mr. Laflamme, could you turn to Pages 7 and 8 of the settlement agreement, Section III.A, and explain in a little more detail what's being proposed as a revenue requirement for PEU in this case.

A. (Laflamme) Yeah. And I guess I would draw the Commissioners' attention to Page 28 of the settlement agreement, which is identified as Exhibit 1 which provides a breakout of how the revenue requirement was determined and details the three components of the revenue requirement that's being presented today.

Overall, as Mr. Goodhue explained, the overall revenue requirement being sought or proposed is eight thousand [sic] four hundred fifty-five thousand one hundred and seventy-six dollars. That consists of a permanent component, as well as a step increase. The permanent component is in the light gray box on the left, and the inclusion of the step increase is included in the darker gray box on the right.

Q. Just a moment ago you referred to "eight thousand," but you meant "eight million."

A. (Laflamme) Eight million. Sorry. Eight million four fifty-five one seventy-six.

The three components of the revenue

requirement are the city bond fixed revenue requirement of $926,309; the operating expense revenue requirement for permanent rates, that was $5,812,873; with the step, that's $5,851,582. That component is further detailed in Attachment JPL-1 at the back of the settlement agreement, on Schedule 3, 5Y average in Schedule 3 - Step.

The last component, the debt service revenue requirement for permanent rates, is $1,308,278; principle and interest payments multiplied by the 1.1 debt service coverage requirement, resulting in a debt service revenue requirement of $1,439,106; and inclusive of the step, the debt service is $1,362,154, multiplied by the debt service coverage requirement at 1.1, resulting in a debt service revenue requirement of $1,498,369. The calculated revenue requirement for permanent rates is 8,178,288, and including the step it's 8,276,261. And if you add the North Country capital recovery surcharge revenues of $178,915, the total proposed revenue requirement being proposed is 8,357,203 for permanent rates; including the step, it's 8,455,176.

Q. Could I stop you for a minute. And this is just a background question on this North Country capital recovery surcharge.

How long is that surcharge likely to exist, if you know?

A. (Laflamme) I believe it's a 30-year loan. And Mr. Goodhue is nodding in agreement.

Q. Okay. Thank you for that clarification.

Have you covered how the revenue requirement was calculated as you walked through this table with us do you think?

A. (Laflamme) Basically there's a separate calculation for each of the three components, and that's all further detailed in Attachment JPL-1. And so the three components are summed together in order to derive the total proposed revenue requirement.

Q. Okay. And what do you see as the most significant drivers leading to the proposed rate increase?

A. (Laflamme) I think it's as Mr. Goodhue alluded to in his testimony. Between the years 2012, which was the test year in PEU's last rate proceeding, and 2016, which is the test year in this rate proceeding, the Company experienced significant increases in its operating expenses. Specifically, these increases were in the areas the Company's management agreement, which increased approximately $450,000 between 2012 and 2016, or 33 percent, and this is mainly due to increases in salaries and benefits paid to employees of PWW. The management agreement also includes a lease of the facility, the Company's facility on Manchester Street, as well as other charges.

There was also a significant increase in the Company's property tax expense between 2012 and 2016 of approximately 200,000, or a 24 percent increase. And there was also an increase in the Company's source of supply expenses, specifically purchased water, which increased by approximately $280,000, or 38 percent.

Overall, the Company's operating expenses between 2012 and 2016 increased by approximately a million dollars, or 18 percent. In addition to that, the Company's utility plant in service increased by $11 million -- over $11 million in that same period of time, or an approximate 23 percent increase.

Q. Did Staff audit these various expenses?

A. (Laflamme) Yes, they did.

Q. And so in signing the settlement agreement, I assume you've determined that they are actual and reasonable costs?

A. (Laflamme) Yes.

Q. Could you briefly summarize the pro forma adjustments which were made by both the Company and Staff that are reflected in the proposed revenue requirement.

A. (Laflamme) Yes. A significant amount of the pro forma adjustments by both the Staff and the Company dealt with the Company's operating expenses, particularly in the area of compensation and benefits, as well as insurance. There were also a number of pro forma adjustments relative to property taxes expense. And the adjustment for property tax expense both created increases and decreases in the Company's property tax expense. And they included -- the Company actively pursues abatements in their property tax expense. There were certain abatements that were included in the Company's filing. And additionally, during the course of discovery, a decision came down in favor the Company, I believe the Town of Litchfield, which reduced the Company's property tax expense by an additional $32,000.

In addition to that, based on the Audit Staff's investigation of the Company, there were also a number of adjustments made based on the report that was filed by the Audit Staff in this case.

Q. Would you like a drink of water?

A. (Laflamme) Got one.

Q. You're getting a little hoarse.

Just a clarifying question. Do you know whether Audit Staff audits the money in and out of the RSF accounts when they do an audit of the Company? I know there was testimony earlier by Mr. Goodhue about the fact that there are a number of transfers that are made throughout the year in and out of those RSF accounts.

A. (Laflamme) Yeah, the Audit Staff does take a look at the activity in the RSF accounts, based on the documentation that's included in the settlement agreement. And I know that is -- they haven't obviously done that in terms of PEU because the RSF accounts will be new to PEU. But they have investigated the ins and outs with regard to PWW.

Q. Thank you for that clarification.

Does the revenue requirement presented in the settlement agreement include a provision for income tax expense? I know we had some discussion by Mr. Goodhue, but I would like Staff's view on the impact of changes to the income tax laws.

A. (Laflamme) Right. You know, hopefully I'll echo what Mr. Goodhue indicated this morning.

But, no, the revenue requirement does not include a provision for income tax expense. For purposes of ratemaking, PEU has virtually no equity investment; therefore, there's no return on equity and no profit, no income tax, no income tax expense. The modified ratemaking model is based essentially on the Company's cash flows; therefore, there is no provision for federal and state income taxes included in the revenue requirement.

Q. Could I ask for further clarification. It's a cash flow model. So let's assume that there's excess cash in an account at the close of the year, and this may have to go back to the Company. But isn't that considered income? So wouldn't there actually be some income to the Company? And if you want, we can hold that question for later for Mr. Goodhue, if that would be helpful.

A. (Laflamme) I think Mr. Goodhue is in a better position to answer that.

Q. Okay. We'll come back to that.

CHAIRMAN HONIGBERG: Wait, wait, wait. Why do you want to come back to it? You've got him right there.

MS. ROSS: Oh, okay.

BY MS. ROSS:

Q. Mr. Goodhue, could you just comment on excess cash. If there's a net excess overall in your accounts at year end, how that would be treated for income tax purposes.

A. (Goodhue) Yeah. Under the rate methodology that we're talking about, not only under DW 11-026, DW 16-806 and now this case, excess cash that is collected actually over-funds the rate stabilization funds since they're ready to go back to ratepayers.

When you look at how the tax code works, however, and if you look at a GAAP basis application towards taxes, even though we look at positive EBITDA, the corporate structure is set up towards pre-tax income that is negative. So, any cash is going to the rate stabilization fund, but does not create a taxable value that would create an income tax burden. The Company is currently on a corporate consolidated basis and in a net operating loss position, and will be for several years into the future. So that is really the basis for that.

Q. And let me, if I could clarify. So a rate stabilization fund is treated as if it's a debt that you're repaying? Is that why it's not --

A. (Goodhue) No, it's a cash account. So you almost have to divorce cash flow from actual operating or taxable income. So, depreciation is, you know, part of the accumulation of cash, in that you would have funded those capital expenditures in the past and now pay back debt. Relative to that, your interest expense is a component and deductions for income taxes. But depreciation, which is the amortization or, you know, periodic de-valuing of those assets, is allowed as a deduction for both GAAP purposes and for tax purposes.

Q. And so the RSF serves as sort of a depreciation substitute? Is that what you're suggesting?

A. (Goodhue) Not really. What I guess I'm saying is any excess cash we accumulate isn't the Company's cash, but it's there to either backstop the revenue requirements and/or to be refundable to customers. But, you know, even if we generate excess cash, based on our rate structure, because we're not like an IOU that has an ROE component, we don't produce enough excess profitability to create a tax burden.

Q. Okay. Thank you. Thank you for the clarification.

Does Staff believe that all of the Company's fixed plant reflected on its books at the end of the 2016 test year was in service, used and useful at that time?

A. (Laflamme) Yeah, based upon an examination of the Company's filing by the Staff, which included the examination by the Audit Staff relative to this proceeding, Staff believes that all the plant reported on the Company's books at 12/31/16 was in service, and used and useful.

Q. Thank you.

With regard to the proposed step adjustment, can you give a little more detail about what it's based on?

A. (Laflamme) Yeah, the step adjustment is based on the Company's fixed plant additions during 2017. And these fixed plant additions are detailed on Schedule 7 of Attachment JPL-1, which is Page 95, which I believe is the very last page of the settlement. And you'll see in that schedule there's a column of numbers, and it indicates -- the heading is "Estimated Investment Dollars Sought In Step Increase." And the total of that column is $765,577. As a result of that, PEU's required annual debt service will increase by $53,876. And that's indicated on Schedule 1C - Step of Attachment JPL-1, which is Page 59 of Attachment JPL-1, in the settlement agreement. And there, in the middle of that schedule, you'll see the addition of $765,577 of debt related to the 2017 additions. And then you take your finger and you go right across the page to the right side of the page, and you'll see the increase in the debt service resulting from that additional debt, which is $53,876. And when that amount is multiplied by the 1.1 debt service coverage requirement, it becomes essentially an addition to the DSRR of

$59,264.

Additionally, going back to Page 95, the additional fixed plant that was placed in service in 2017 will result in additional property tax expense increase of $17,485, which is indicated in the very last column on the right-hand side of the page for the 2017 additions.

And lastly, in addition to the additional debt service, the property taxes, there was also additional amortization expense included in the step increase, amounting to $21,224, which primarily pertains to legal costs that were incurred by the Company in obtaining the property tax abatements that it filed for.

In total, if you add those numbers together, the total amount is $97,973, which is the step increase component of the total overall revenue requirement.

Q. And will the plant additions associated with this proposed step adjustment be subject to New Hampshire PUC audit?

A. (Laflamme) Yes, and I believe that audit is taking place presently.

Q. And turning our attention to Section III.B on Page 9 through 11 of the settlement agreement, what are the effective dates for the proposed rates to be implemented?

A. (Laflamme) The permanent rate increase of $1,304,272, or 18.97 percent, will be effective on a bills-rendered basis on or after January 8, 2018, which is in accordance with the temporary rate settlement which was approved by Commission Order 26,136. The step adjustment increase in rates of 967,973, or 1.43 percent, will be effective as of the date of the Commission's order approving this settlement agreement.

Q. Will there be a recoupment of the difference in revenues under the temporary and permanent rates approved in this case?

A. (Laflamme) Yes. Under Section III.B.2 of the settlement agreement, which is on Pages 9 and 10, it states that within 30 days of a Commission order approving the settlement agreement, the Company will make a filing calculating the difference between temporary and permanent rates during the temporary rate period, as well as its recommendation for customer surcharge for the difference.

Staff, the OCA and the intervenor, after reviewing the PEU's calculations and recommendations, will have the opportunity themselves to make a recommendation to the Commission with regard to the Company's filing, and then the Commission will issue an order with regard to PEU's temporary rate recovery request.

Q. And what does the settlement agreement propose with regard to the recovery of rate case expenses in this case?

A. (Laflamme) Yeah, on Page 25, under the section identified as "D," the settlement agreement makes a recommendation that the Commission approve PEU's prudently-incurred rate case expenses relative to this rate proceeding. PEU will file a request for recovery of rate case expenses within 30 days of the Commission order approving this settlement. Again, Staff, the OCA and the intervenor will have the opportunity to review the Company's filing request and make a recommendation to the Commission, and then the Commission will issue an order regarding recovery of rate case expenses.

Q. And I believe we heard from Mr. Goodhue about the specific customer impacts. But could you reference the location of that information.

A. (Laflamme) Yeah, Mr. Goodhue detailed those, and that's found on Pages 10 and 11 of the settlement agreement.

Q. Does Staff believe that the settlement agreement being presented today results in just and reasonable rates?

A. (Laflamme) Yes, and the reason is the ratemaking mechanism presented in this settlement agreement upon which the proposed rates are based is essentially the same as that approved by this Commission for PWW in its last rate proceeding, DW 16-806. As is presently the case for PWW, this settlement agreement proposes moving to a cash flow model for purposes of rate setting, similar to municipal systems. However, the settlement agreement accomplishes this in a way that avoids Construction Work In Progress issues by requiring that all assets upon which rates are based must be complete and in service to customers. Moving to a cash flow model is necessary for the Company, as its sole source of capitalization is presently debt financing. There is virtually no equity in this company. As such, in the revenue requirement being proposed, principle and interest payments have taken the place of return on rate base and depreciation expense under the traditional ratemaking model. This is meant to give assurance to lenders that

PEU will be able to meet its debt obligations and loan covenant requirements. Further assurance is given to lenders through the creation of the various rate stabilization funds as a means to backstop the respective components of PEU's overall revenue requirement -- the CBFRR, the OERR and the DSRR -- should the Company experience down years in terms of revenues or rapidly increasing expenses, or both. This assurance

given to lenders provides PEU with the debt financing it needs at favorable terms for making capital improvements necessary to provide safe and adequate water service to its customers at the lowest possible cost.

The QCPAC mechanism proposed in this settlement agreement is similar to that which is presently in place for PWW. The QCPAC mechanism will assist PEU in maintaining the balance between making necessary capital expenditures in order to provide safe and adequate service to customers and the ability to pay for such expenditures during the intervening years between general rate proceedings.

As was the case for PWW, overall this settlement agreement attempts to balance PEU's cash outflows, its expenditures and debt service with its cash inflows, its rates. Therefore, it is Staff's opinion that the chances of PEU over-earning as a result of this settlement agreement are remote. However, the settlement agreement also contains safeguards against any potential over-earning on the part of PEU.

First, on Page 24, as Mr. Goodhue indicated in his testimony, Page 24 of the settlement agreement, PEU would be required to file a full rate case within six months if the 13-month average if the amounts held in the combined RSFs exceed 150 percent of the combined targeted amount for those accounts.

Q. Excuse me for interrupting. Where do you find the combined targeted amount for those accounts? Where would that be?

A. (Laflamme) That would be Exhibit 5.

A. (Goodhue) Bates 46.

Q. Thank you.

A. (Laflamme) Also, there is no language contained in the settlement agreement whereby the Commission relinquishes any of its ability to oversee this utility; secondly, to assure that PEU's expenditures are prudent; and thirdly, to ensure that the rates charged to PEU's customers are just and reasonable.

And most importantly, on Page 25 of the settlement agreement, under the paragraph identified as "E," contains essentially the same language as was contained in the settlement agreement approved for PWW in DW 16-806. Specifically, the language in this section makes it very clear that the settling parties re-affirm that which was agreed upon and understood coming out of the DW 11-026 Nashua acquisition settlement, whereby there will be no revenues collected from customers for the purpose of providing a special dividend or other distribution to the City of Nashua for reimbursement of eminent domain costs or for, quote, any other purpose whatsoever, unquote.

Given that, one, there is no equity investment on the part of the city in PEU, secondly, PEU's customers reside outside of the city of Nashua, and thirdly, PEU is moving to a cash flow model for rate setting, Staff sees this provision as the key safeguard against over-earning on the part the Company.

MS. ROSS: Thank you. I have no further questions for the witnesses.

CHAIRMAN HONIGBERG: All right. We're going to take a 10-minute break. When we come back, Mr. Buckley and Mr. Ranaldi and Commissioners will have questions for the panel.

(Brief recess was taken at 11:32 a.m., and the hearing resumed at 11:50 a.m..)

CHAIRMAN HONIGBERG: Mr. Buckley.

MR. BUCKLEY: Thank you, Mr. Chairman. I think I can start by offering an expression of gratitude to counsel for the Company and Staff for their rather detailed examination of the panel. It's safe to say that the list of questions I have before me has greatly diminished, so I should only be another two or three minutes, I think.

CROSS-EXAMINATION

BY MR. BUCKLEY:

Q. The first question I would pose here is for Mr. Goodhue. I think I heard you say on direct examination, as expressed in the settlement agreement, that one of the primary purposes of moving to this methodology for ratemaking, the 16-806 methodology primarily in this case, is to be able to procure debt at a lower cost of capital. Given that fact, we've now, in the case of PWW, had something like eight months, I think, to see if that has had the desired impact. Can you give me some indication of whether moving to the new ratemaking methodology has had that desired impact and how that's going with PWW?

A. (Goodhue) Sure, I can do that. Actually, since the completion of the 16-806 case with PWW on April 4th of this year, we did do a bond issuance for PWW. As part of that process, we have to go before the rating agency -- and in that case, Standard & Poor's -- to have a re-evaluation of the credit rating of Pennichuck Water Works. And in that review, there was very a favorable response in the diligence process that we went through with Standard & Poor's relative to what that rate structure was. It did not immediately create a percentage rate differential, but what it did do was reaffirm the A-plus stable rating for Pennichuck Water Works.

What we further discovered in that, the only down side to the rate structure that we had there, was just the overall value of the rate stabilization funds as they are existing to support the revenue buckets, which is kind of an interesting development given the discussion we had earlier about the potential for an MOES surcharge going forward, which we feel that, coupled with those rate stabilization funds, we'd take that one issue off the table relative to the overall adequacy of those funds and actually could create an incremental increase in the rating for PWW, which would directly relate to a reduction in interest expense. So that's what we did discover on the PWW side.

Q. And just to follow up here, the MOES surcharge, that's something that you mentioned in your earlier testimony that the Office of the Consumer Advocate was supportive of, but it didn't quite make it into the settlement agreement?

A. (Goodhue) That is correct. And what was agreed by the parties is that we would pursue that in an upcoming rate case. And most preferably it will be pursued in the next PWW rate case, which would be the most -- which would be the next case to be filed on behalf of the corporation and its consolidated group, and actually would be a good acid test for that bond rating process.

Q. And could you imagine in a scenario outside of this very unique ratemaking structure that we've adopted here for PWW, PEU and potentially PAC, how that type of, I guess you might almost call it an "escalator," could be concerning for, if let's say a strictly investor-owned utility that doesn't have this type of ratemaking methodology were to ask for its adoption?

A. (Goodhue) Yeah. In the case of a traditional investor-owned utility, like PWW, PEU and PAC were prior to 2012, you have that entire component of the return on equity, and you're looking at generally a 50/50 debt-equity contribution. So, when a corporation like that is running a utility, you've got the opportunity to fund your infrastructure, basically underlying overall asset costs with either debt or equity. So you've got the opportunity to seek funds in both of those marketplaces with those relative returns.

So, you know, an MOES surcharge like that, it's not necessarily needed there, No. 1, because of that equity return. And, you know, that helps cover the rate -- I'm going to say "rate lag" relative to operating expense increases relative to that. The reason that we would look for it in this company is all based on the structure, that our structure is directly tied to specific cash flow coverage. It's tied to specific dollars needed for the CBFRR, specific dollars needed for the DSRR, and specific dollars needed for the OERR, and as a result, because there isn't any over-cover relative to those, that's where inflationary impact can have a much greater impact on a company such as us.

Q. And let's just say, hypothetically, if such a surcharge were adopted, would that lower costs relative to things like the frequency of bond issuances or your line of credit approvals?

A. (Goodhue) In all likelihood, it would accomplish a couple things. It might reduce the frequency in which full rate cases need to be prosecuted because you'd have these ratable increases that are tied to inflationary increases over time. The cost of promulgating a case, both from the Company perspective and from the Commission perspective is quite costly. So if you can defer that and spread those out over a longer period of time, that's beneficial to customers.

Secondly, the MOEs, if that was put in place and you didn't have to borrow that money -- so, to borrow money to pay operating expenses just seems a bit illogical to me. It would be like me as an individual going out and borrowing debt for 30 years to pay for groceries. Doesn't make as much sense as it would appear to.

Q. I think I just have one final line of questioning, and that relates to the DSRR.1 account.

So, at Bates 36, I think it is, of the

settlement attachments, there's an explanation of how funds that are accumulated under that account will preferably be utilized. Can you just summarize how that works for the individuals in the room today?

A. (Goodhue) Sure. The .1 revenues are collected in a bank account throughout the year, and by the end of the year they're there for defined purposes. Under DW 16-806, it was spoken about in that settlement agreement in that case about those being used as, for lack of a better term, the "seed money" for capital expenditures in the next year.

One of the things that we've learned since 16-806, especially when it comes to, you know, used and useful projects, some projects require engineering and design study work to be done prior to a project even being able to be put in the ground or bid. So some of those costs are borne, and they are not used and useful, but they are truly costs that are expended. They're absolutely necessary in the process relating to those

projects. And so when we look at the use of that money, that's what we talked about, the basis for how those monies will be utilized. I think you said it was Page 36?
Q. I believe so. Yes.
(Witness reviews document.)
A. (Goodhue) Yeah, and so what we say there is upon approval, those funds... I guess I'm not seeing the exact reference on that. So I apologize. But basically, those funds would be used for engineering studies or those intangibles relative to projects and then "seed money" relative to capital projects.
Q. And do you now have an understanding of whether, for PWW, this has had a chance to occur as of yet?
A. (Goodhue) As far as the use of those funds? No, we are in the first year of actually collecting those funds this year, based on when that order was received. The order for DW 16-806 was not received until November 7th of this prior year. So we're in the first year of truly collecting those .1 funds.
Q. Can you think of any factors that might

preclude accumulation of revenues in the DSRR.1 account?

A. (Goodhue) Sure. If our actual revenues were below our allowed revenue levels, then you would not have excess collections there. I mean, you would have collection of funds, but they're going to be much lower than they would be if they were to be allowed at those levels.

Q. So, essentially, not necessarily guaranteed that there will be further funding to plow into those initial investments in capital investments in the early part of the year.

A. (Goodhue) Yeah, and I guess the way to say it is there will always be some dollars collected because they are a component of the actual revenues, but the actual dollars collected could be far less than what they were anticipated to be, as far as that component of the overall allowed revenue requirement.

MR. BUCKLEY: No further questions.

CHAIRMAN HONIGBERG: Mr. Ranaldi.

MR. RANALDI: Yes, thank you.

CROSS-EXAMINATION

BY MR. RANALDI:

Q. Mr. Goodhue, this is the second time you're using this new methodology; is that correct?

A. (Goodhue) That is correct. We applied it under DW 16-806 for PWW.

Q. Okay. When you sent out notices to the customers, the notice to the customers said 21.24 percent increase to be expected. But the methodology, according to your testimony earlier, has pushed a certain percentage to the next rate hike. So the methodology you're using is actually 23, 24 percent. Am I correct in that?

A. (Goodhue) When we did the original notice, as is the normal process, we have to file an Order of Notice in a timely manner so that we can preserve our rights as to when the new permanent rates can go into effect. We do our best efforts in looking at the overall structure and the components of the dollars that comprise those rates and in order to establish a high water mark for what is allowed in the case.

So that 21.24 percent, I believe is the number you quoted, Mr. Ranaldi, was based on our analysis of the numbers at that time and the rate structure at that time, but was inclusive of a phase-in of the five-year methodology in two phases, and inclusive of all of the components in the rate case filing. As this case is further prosecuted and the PUC Staff and Audit Staff goes through and reviews all of the pro formas that we have completed, there will be some alteration of those numbers, and/or perfection of certain numbers that are estimates that become actual numbers in the case. And as I understand the regulations, that 21.24 percent that we would have established in that Order of Notice sets a high water mark for what we can collect. The rate case could be maximized at that, but it could be somewhat less once all of the actual numbers are brought together in the case.

Q. So now that we are no longer involved with equity, just debt, to try to go three to four years -- actually four years, and trying to get some type of number so that those reserves that you named are very important so you don't have to borrow money, you have to come up with a number that would be higher so to get to that third or fourth year so you don't have to borrow; is that correct?

A. (Goodhue) That is correct. When you look at the rate stabilization funds, there is one number under the CBFRR, which is a fixed number for many years into the future. There's also a fund that's behind the DSRR, which is based on known and measurables in the test year. And then with the QCPAC, it's layered on relative to revenues that are tied to incremental debt that is incurred between rate cases. But when it comes to the OERR component of revenues, there is inflationary pressure upon those operating expenses, and sometimes some of those operating expenses increase above inflationary levels. A good example is in property taxes, where we have seen increases above inflationary levels. To the extent that we can get those abated, we do.

Now, what happens with inflation is it's not just a simple calculation, but it's a compounding calculation between rate cases, so as such, there is dollar pressure on that rate stabilization fund for operating expenses.

Q. And that just doesn't relate to property. I'm talking chemicals. Because I notice a few years you had problems with chemicals skyrocketing well above the inflation; is that correct?

A. (Goodhue) Yes. And, you know, when you look at all the chemicals that are used to process water, in many cases those products are byproducts of other things. One of the chemicals we use, ferric chloride that we use in our water-processing system, is a byproduct of the steel production industry. So, supply and demand in the steel production industry can determine fluctuation of a material nature in the cost of acquiring those chemicals. So there are a great many variables, I guess you might say, in that process. When you look at purchased water, it's not just the cost of purchasing water per gallon, but how many gallons do we need to procure. And it's based on the fact that you've got an abnormally dry year versus an abnormally wet year and however those water resources are being deployed.

Q. Well, that's the other part of the problem I have with the four-year test year.

On the revenue side, revenue can fluctuate quite a bit in the water based on what's going on. So why not go a year over year? Why go four years? I mean, I understand that today you did mention you want to do something about that. As a customer, how would that be for a customer, as far as reflecting -- I believe there was some people from Bow the first day that we met who were very concerned over the 20 percent increase.

If it was year-over-year rate hikes, would we still be looking at 20 percent, 22 percent increases, or would there be a better leveling-off so people from Bow don't get into a panic every three or four years?

A. (Goodhue) If we had annual increases in our overall revenues are you saying, Mr. Ranaldi, or in our operating expenses only?

Q. Well, somewhere -- right now you have people there on fixed income. And I am one of those. And our costs are going to be going up. We have to be careful what we're doing. Now, when you go two years, three years not getting nothing, then all of a sudden you get whacked 20 percent, whether it be just operating or overall, I mean, if you do it by step, just operating and then see how that works, then maybe the Commission can make that, and you can do even more to make it easier for those customers that have to watch their wallets. I'm just saying, would they be better off?

A. (Goodhue) The one advantage to what you're speaking about is that it would be ratable and much smaller increments on an annual basis, Mr. Ranaldi, versus having to have a rate increase that is based on a compounding factor for a number of years. So, would the overall increase be the same? I guess the dollars at the end of the day would be the same. But the way in which those are earned over time would be less based on the fact that it kind of mitigates that compounding factor in the overall equation.

Q. And finally, on the Company's side, if you're able to use actual numbers year over year, based on trying to go three or four years out, how would that help the Company?

A. (Goodhue) Well, as I mentioned earlier, one of the advantages of that process is the frequency with which we promulgate a full rate case would probably extend, you know, if not by a significant amount, by an amount. Rather than promulgating a case every two or three or four years, it might be four, five, six years. And there's a cost associated with that. There's also the regulatory lag, because when it comes to promulgating a case, it takes 12 to 18 months to complete a case from the time you start and finish it. So the immediacy of earning those revenues would be helpful, and the elimination of the cost promulgating those full cases on as frequent a basis would be beneficial.

MR. RANALDI: That's all. Thank you.

CHAIRMAN HONIGBERG: Commissioner Bailey.

INTERROGATORIES BY COMMISSIONERS:

BY COMMISSIONER BAILEY:

Q. Good morning. Can we start with Exhibit 3 that was handed out as a separate attachment? It says it's Bates Page 37 in the settlement agreement.

The city bond fixed revenue requirement, as you said, that's a fixed number for many years. Has that increased as a result of this restructuring of how you collect your money?

A. (Goodhue) It did increase slightly, because under DW 11-026, the actual funding of the initial rate stabilization fund was not included in the CBFRR calculation for any of the three regulated utilities. So there was already a modification for PWW in 16-806 relative to that and in this case for PEU relative to that.

Q. So is that the $31,000 in the RSF?

A. (Goodhue) No, it is not.

Q. So explain to me why the fixed revenue requirement increased.

A. (Goodhue) And I believe if you refer to Exhibit 4 on Bates 45, it speaks to the very precise calculation relative to that. And I can probably answer part of this, and Mr. Laflamme might want to weigh in as well.

But I believe, going back to that calculation in DW 11-026 originally, it did not include the $5 million for the rate stabilization fund in the overall calculation of the -- in the middle of the page, the $926,309. That number was $898,000 and change. I don't remember the exact number for PEU relative to the original calculation of that in that case. This 926,309 now just trues up the inclusion of the $5 million rate stabilization fund in the overall calculation of the CBFRR and the overall structure that we have. So this 926,309 would remain fixed until 2042.

Q. So you're adding the $980,000 of the original $5 million that has been allocated to PEU to the loan, and then you're spreading it out over the RSFs? Is that basically what's going on?

A. (Goodhue) There's really kind of a divorce between the RSF calculation and the CBFRR. The CBFRR is part of the allowed revenue calculation. The 31,000 is based on the allocation of the rate stabilization fund dollars that are needed to backstop the revenue requirement for the CBFRR in our allowed revenues.

Q. I get that. So if the CBFRR is 31,000 and the MOERR RSF is 890,000, and the debt service reserve is 59,000, that's 980,000.

A. (Goodhue) Correct.

Q. And you have added 980,000 on Exhibit 4, Page 45, to the CBFRR for PEU.

A. (Goodhue) You want to speak to that, Mr. Laflamme?

A. (Laflamme) No, the amount calculated on Exhibit 4 is our revised -- is the revised CBFRR component.

Originally, before this case, coming out of 11-026 that amount was calculated as $898,863. And as Mr. Goodhue has explained, the original calculation did not include the $5 million original RSF. That was because that -- those monies were being recovered through PWW's rate base calculation. PWW no longer has rate base, so now the $5 million needs to be added to the CBFRR component calculation. And so adding that $5 million, and taking into account the allocation to Pennichuck East, the CBFRR only increases by $27,446 from what it was coming out of 11-026 and what's being proposed today.

Q. So, the CBFRR on Page 45 that is PEU's pro rata share plus the $980,000, that 15,844,176 number, is that what the CBFRR requirement was before this case?

A. (Goodhue) The CBFRR requirement for PEU prior to this case, I believe, if I look back at that schedule, would have been the 14,864,176 for PEU alone, because the $5 million, as Mr. Laflamme spoke about a moment ago, was included only for PWW, as a component of the return on rate base for PWW.

Moving to the 16-806 methodology and the elimination of return on rate base requires the $5 million to be supported by CBFRR dollars that are shared between PWW, PEU and PAC. PWW has 3,920,000 of that obligation; PEU has 980,000 of that obligation, and PAC will have $100,000 of that obligation in their next rate case.

Q. Right. So you added 980,000 to your CBFRR requirement in this case.

A. (Goodhue) In this case.

Q. So now your CBFRR payments are based on 15,844,000 --

A. (Goodhue) 176.

Q. -- 176.

A. (Goodhue) That is correct.

Q. So part of the reason that this CBFRR increases is because you added $980,000 to that.

A. (Goodhue) Yes, ma'am.

Q. But you're also collecting that amount in the RSFs.

A. (Goodhue) Collecting that amount in the RSFs?

Q. Well, I asked you if you effectively collected -- added the 980,000 to the CBFRR --

A. (Goodhue) The basis of the calculation. Yes, ma'am.

Q. -- and then you funded the RSFs with that borrowed money, and you said, no, that's not what you did.

A. (Goodhue) That money is actually not borrowed money, it's allocated from PWW, which was originally borrowed by the City of Nashua in the acquisition. So, PEU has not borrowed that money. That money was borrowed by the City of Nashua as part of their overall bonding of $150,570,000. And that $5 million used to reside totally on PWW's books, and 980,000 has been allocated from that $5 million borrowed by the City of Nashua over to PEU.

Q. And that affects the revenue requirement that PEU has --

A. (Goodhue) It does.

Q. -- because it increased the city bond's revenue requirement --

A. (Goodhue) It does.
Q. -- by $980,000.
A. (Goodhue) That is correct.
Q. Isn't that kind of like a loan?
A. (Goodhue) I guess the CBFRR, yeah, was technically a loan in total, yeah, under 11-026.
Q. Okay.
A. (Goodhue) Sure.
Q. And now you've allocated that 800 -- I mean that 980,000 to the RSF accounts.
A. (Goodhue) Yes, ma'am, to fund those accounts.
Q. To fund those accounts.
A. (Goodhue) Yes, ma'am.
Q. So you've put the $980,000 in the CBFRR -- or you've -- sorry. You haven't put it. It's been allocated to you in the CBFRR. So your CBFRR payment is higher?
A. (Goodhue) It is.
Q. So we're going to fund those RSFs with money that is in the CBFRR?
A. (Goodhue) Correct. And those accounts are restricted cash accounts for that very designated purpose of backstopping the

components of allowed revenues.

Q. I understand that, yeah. Thank you.

All right. Let's talk about operating -- so let's talk about operating expenses.

Mr. Laflamme, I believe you testified, but I think you can corroborate this, that there was a $200,000 property tax increase. And is that -- is your obligation $200,000 more in 2016? What was the test year, 2017?

A. (Goodhue) 2016.

Q. So your property taxes are $200,000 more than in 2016 than they were in 2012?

A. (Goodhue) That is correct.

Q. And the same with the amount of money that you have to spend to purchase water?

A. (Goodhue) That is correct, ma'am.

Q. That's a cumulative number -- well --

A. (Goodhue) It's a period number. I mean, it's the dollars incurred in those particular years. I guess you could say the property taxes are cumulative, in that they go up over time based on existing property or incremental property. As a regulated utility in the state, we're not just taxed for real property, as you know, but also for personal property, utility and assets. So, as we have made investments in capital within the Company, that increases the base of those, as well as the rates have increased in tax rates within the various communities or their appraised values of our existing or new property.

Q. Okay. Let's talk about the $280,000 increase in water, purchased water cost. Can you show me what that -- where those increases came from?

A. (Goodhue) Again, the PEU system serves water to part of 19 different communities within the state. They're community water systems, some of which are through interconnections, mains, where we're buying water from other water companies -- i.e., the City of Manchester or other entities -- and some of them are based on large or community wells. And depending on whatever the conditions might be within a given year and/or the consumption patterns, we may have to purchase water because the adequacy of supply from our wells may not be sufficient to meet the basic needs required by the DES relative to our supply of water to our customers. 2016, as you know, was a particularly problematic year relative to drought conditions and things like that. But also, it's based on consumption patterns of people for water. So that can vary greatly, depending on the system and/or the particular customers and their consumption patterns relative to the purchased water. We've got some systems where purchased water occurs on a more frequent basis, or has had to, especially in 2016, relative to their consumption patterns.

Q. So, 2016 was a high purchase year. But this increase of $280,000 is an average, or is it just the comparison between 2012 and 2016?

A. (Goodhue) It was a comparison between those. So the dynamics there can be: What are the consumption patterns, what are the rate of purchasing water, what are the number of customers. You know, we've had significant customer growth actually in our Pennichuck

East Utility. The Town of Litchfield alone, by adding 400-plus customers, represented almost a 15 percent increase in our customer base for PEU.
Q. And a 15 percent increase in your revenue --
A. (Goodhue) Yes, ma'am.
Q. -- a commensurate amount.
A. (Goodhue) And an increase proportionately in our property taxes.
Q. Is it reasonable to use a 2016 -- the difference between 2012 and 2016 if 2016 was an outlier?
A. (Goodhue) Well, one of the things in this case and in 16-806 methodology is the five-year trailing average that we talked about. So we're not just looking at a spike in revenues. We're looking at an average of those revenues over five years.
Q. But we're talking about cost here.
A. (Goodhue) I understand. But to further add on to that, in that analysis is also an analysis of those costs directly related to water, including purchased water, relative to not just looking at a spike, but looking at

an average of those tied to those revenues as well. So there's a number of operating expenses that we look at relative to that revenue requirement based on the five-year trailing average that doesn't just look at the water revenues, but looks at certain of the direct costs, including purchased water, so that you're not just looking at a spike in expense, but you're looking at an average over five years relative to that expense.

Q. That sounds like a different answer than the first time I asked the question, which was is the $280,000 the difference between 2012 purchased water cost and 2016, and you said yes.

A. (Goodhue) And that is the correct answer. That 280,000 is the difference between the expense in those years. But what I'm indicating here is in the five-year trailing average calculation is a metric in there that mitigates the overall impact of that spike relative to both revenues and those direct costs.

Q. But your expenses -- what I thought -- I'm trying to understand why the increase in rates -- or the increase in your revenue requirement is 20 percent. And so what I heard was one of the big things was a $280,000 increase in your purchased water costs. And you're saying, well, yeah, there was -- it was $280,000 more in 2016 than it was in 2012, but somehow the five-year rolling average is going to mitigate that. So then it's not really a $280,000 increase.

A. (Goodhue) Correct. I mean --

Q. So what is it?

A. (Goodhue) There's two answers there. I mean, if you're just looking at the expense in 2016 versus 2012 and compare those numbers, there's a mathematical answer. But in the overall revenue requirement, that is tempered by the five-year trailing average component of the revenue requirement.

CHAIRMAN HONIGBERG: So the revenue requirement calculated here is not the pure 280. It's the five-year trailing average, of which 280 is one component.

WITNESS GOODHUE: Correct. And it

tempers that.

One of the things to focus on in our overall operating expenses for PEU from 2012 to 2016, the average annual increase in operating expenses was 3.84 percent, okay. So that's in total relative to that.

BY COMMISSIONER BAILEY:

Q. Each year?

A. (Goodhue) That's the average annual increase, yes. So when you look at a 20-percent increase and you have that 3.84 percent in there for four years, that explains a great amount of the percentage increase. That, in addition to the fact that we've got debt service on over $11 million worth of new capital that was not included in our revenue requirement in 2012, that is part of our revenue requirement in 2016, in that we had to debt-fund those capital improvements and had to repay both the principle and the interest on that. Those are the two major components relative to that.

Q. Okay. Under this rate structure, what incentive does the Company have to contain cost increases?

A. (Goodhue) Well, No. 1, any -- let me rephrase my answer here.

What incentive do we have? No. 1, we're still held to a prudency standard by the Commission, No. 1. Our QCPAC process on an annual basis requires a review of the prudency of our expenses.

Q. Those are capital.

A. (Goodhue) I understand that.

And then as far as operating expenses are concerned, there is an annual review of the annual reports that we file relative to the operating expenses of the Company.

Q. And that just shows what the numbers are.

A. (Goodhue) Right. But we have to explain any material modifications or variations on a year-on-year basis relative to the prudency of those operating expenses.

Q. But as long as you can explain them, it's okay, it sounds like.

And Jayson, do you -- or Mr. Laflamme, do you have any ideas on how -- what incentive the Company has to contain cost increases, operating cost increases?

A. (Laflamme) I think part of it is just the very nature of the new paradigm that they're operating under. This is a company that relies solely on debt financing, and therefore they are enslaved to their cash flow. And over the last number of years since 11-026, the Company has been very cognizant of the fact that their cash flow is limited. And so I think the Company has done a very good job over the last number of years in controlling their costs, simply due to the fact that they don't have access to equity markets anymore, that their sole source of financing is debt service, and so they really have to watch their dollars. And then, secondly, this company is still -- as I indicated, this company is still under the purview of the Commission, that every time they come in for rates, they are subject to audit, which includes a finding of prudency. And if there's any items which are deemed to be imprudent or excessive, then those costs are disallowed.

CHAIRMAN HONIGBERG: Can we be explicit here, Mr. Laflamme? Are you satisfied that the costs that the Company's incurred that are reflected in the rate filing in this settlement were prudently incurred?

WITNESS LAFLAMME: Yes.

BY COMMISSIONER BAILEY:

Q. Do you know what the average increase year over year for other water companies is for operating expense? Mr. Goodhue, you testified that, you know, they had about a 3.84 increase year over year. Do you know how that compares to other utilities?

A. (Goodhue) Not precisely, no.

Q. Is it in the ballpark, or do you know?

A. (Laflamme) It doesn't sound unreasonable.

A. (Goodhue) Could I respond more to your question, too? If you look at the modified rate structure we're talking about here, 98 percent of our revenues, a little over 98 percent is tied to the three revenue buckets that are supported by our rate stabilization fund. If we have revenues that are above the allowed revenues, those excess revenues go in to fill those rate stabilization funds. They are not used to pay for operating expenses. So we basically have a revenue structure that's based on test-year operating expenses. So if we have those extra revenues and we don't have the cash to pay for operating expenses above the allowed revenues, we have to borrow those. Our bank -- the only backstop we have for that is a working capital line of credit of $4 million at Pennichuck Corporation that is used specifically to backstop working capital activities for the regulated utilities. But it has an annual out of 30 days. It must be repaid in full every year within 30 days. So, if we imprudently incur operating expenses, we would not have the cash collected for revenues to pay for those. We'd have to borrow them from the bank. And then we would not subsequently have the revenues to repay the bank in compliance with our debt obligation. So we have no driving need to imprudently incur operating expenses, and we have no funding mechanism to imprudently incur operating expenses.

Q. Okay. How about the $450,000 increase in management cost?

A. (Goodhue) So, the corporation has a cost-sharing agreement that was actually brought to the Commission, you know, like I said, I think it was 2002. It's very formulaic in its approach. And the increase in operating expenses there are based on the underlying factors of those costs.

What would those costs be? In the last four years, we've had wage increases on an annual basis. We've had the cost of benefits go up over those years, the cost of insurance go up over these years, work order costs. All of our work force in our fleet is in Pennichuck Water Works. So any work that is done for maintenance of those water systems in PEU are based on direct costs from maintenance within those systems. So, those are the bases for those things. The work orders are directly related to operational activities. The other costs, and there's a bunch of them -- it's a very formulaic approach -- are based on those costs elevating. But they're also based on a tier, formulaic approach based on allocation of pro rata share of revenues, pro rata share of customer, pro rata share of assets, pro rata share of square footage, employees, the like.

One of the driving factors in the elevation of the management fee for PEU is, No. 1, the increase in those costs with inflationary movement over the last four years. No. 2 is actually the fact that their asset base has grown faster than their sister subsidiaries. We've invested more capital additions in PEU pro rata to their base than we have in PWW or PAC. And more customers have been added in PEU pro rata than in PWW or PAC. Our customer growth in PWW is less than 1 percent, whereas our customer growth in PEU is in excess of 15 percent. So, as a result, not only do you have the bases of dollars increasing, but the attraction of their pro rata share has increased because they have grown faster than the others

sharing in those shared costs.
Q. Mr. Laflamme, did you look at the allocation from -- is it from Penn Corp, Mr. Goodhue?
A. (Goodhue) It's both, Penn Corp. and PWW. The Penn Corp. costs are very immaterial now that are shared. When we were a public company, they were very material. They're very immaterial now. The lion's share of them are shared costs from Pennichuck Water Works.
Q. Okay. So what I think you just said is that the allocation of the shared --
A. (Goodhue) Shared costs.
Q. -- overhead costs basically have increased to PEU because you've increased your customer base and you've increased your capital investment --
A. (Goodhue) Correct.
Q. -- more than PWW.
A. (Goodhue) Pro rata. That is correct, ma'am.
Q. Mr. Laflamme, is that reasonable? Is that still a reasonable way to do it?
A. (Laflamme) Yes. And I brought with me today a copy of the allocation agreement that was -- that the Pennichuck utilities have

been operating under, and it was -- actually, it was filed on January 6, 2006. And that was docketed as DW 06-004. And so it was -- and I believe, if memory serves me correctly, at the time that it was filed, I think there was some concern relative to how costs were being allocated amongst the subsidiary utilities. And in response to that, Pennichuck utilities revamped their allocation methodology, which was -- and it was culminated in this filing in DW 06-004. And since that time, that allocation formula has -- is one of the areas specifically reviewed by both the Staff and the Audit Staff relative to whether the costs included in it are prudent and accurate. And so in every rate case for PWW, PEU and PAC, that allocation is reviewed.
Q. And when you say "reviewed," do you mean you look at the formula and make sure they did it right according to the formula?
A. (Laflamme) Yes. And we look at -- and also the Audit Staff looks at the costs that that formula is based upon. And in fact, in the

PWW case, the Audit Staff made a finding whereby the PWW was -- there was an over-allocation to PWW in the neighborhood of $200,000. There wasn't any such finding in this case, but it is looked at pretty closely.

Q. Mr. Goodhue, what was the rate increase for PWW customers? Was it about 10 percent?

A. (Goodhue) I'm thinking it was 10.81 percent. But don't hold me to that. I think if my memory serves me correctly.

Q. And they get allocated more of these costs -- well, they get allocated proportionately.

A. (Goodhue) They do get a larger share. Yes, ma'am.

Q. But they have a lot more customers to spread it over.

A. (Goodhue) That's correct.

Q. So do you think that it would make sense at some point in the future to see if the allocation formula is still reasonable?

A. (Goodhue) You know, I think that prudency review is always a good thing. I will say that one of the benefits of maintaining a formula that is based on, I'm going to say "pure numbers" versus "arbitrary allocations" is a good thing. You know, I mean, there's a share of these costs not just borne by our regulated utilities, but by our unregulated subsidiaries as well, you know. So there's revenues that are helping to pay for some of those costs. The accountant in me likes the fact that you've got something that is reliable, consistent and predictable and regular. The fact that we've actually invested a considerable amount of money into PEU and we have a considerable amount of activities going on to support those systems is consistent with actually operating that company. If PEU had its own work force and it was now driving people all over the state to serve 19 different geographically dispersed communities, there would be a cost of doing that. And I think the management fee allocation actually replicates that cost pretty accurately, in that when you've got work order activity that tracks the actual cost of going out to service those systems, that's the right thing to do.

One of the advantages, however, to our group is that our aggregate purchasing power for PEU is preferential to if they were a stand-alone organization. When you combine the purchasing power for PWW, PEU and PAC all into one, we've got the ability to purchase and incur expenses at a level that is lower than it would be if PEU was a stand-alone.

So, would a prudency review be in order? Yes. But I'm not so certain that I necessarily would support changing the methodology, because I think the basis for which it's established upon and how it's, you know, managed is appropriate.

Q. Okay. What was the wage increase that you mentioned? What percentage?

A. (Goodhue) Oh, okay. Our wage increase for our non-union staff was 3 percent this last year. And for our union Staff, we've got about 45 percent of our work force is union. So when you look at the average cost of wage increases, I'd have to remember exactly each year. It's somewhere between 2-1/2 to

3 percent.

One of the things the Company does on an annual basis is we also do a very in-depth analysis of national, regional and local wage studies, to make sure that our wage scales are in line with the market. And so we do that on an every-year basis. We have to support that to our compensation benefits committee on an annual basis. One of the things we have to maintain and that we reiterate is that we maintain a work force that is both skilled and qualified. One of the things I stress with our employees is that we're not a company that can be here today and gone tomorrow. We provide a necessary service for customers that has to go on well beyond our lifetimes. So, making sure that we are paying market wages, not above, not below, but market wages to make sure we can maintain and attract qualified employees to serve our customers is important.

Q. So the union employees get about 2-1/2 to 3 percent each year. Is that the same with management?

A. (Goodhue) Yes. Exactly, yes. So we look at both. There's a union contract that dictates what that is, and then there's a non-union wage increase that occurs on an annual basis. Yes, ma'am.

Q. Okay. I think Commissioner Giaimo had a follow-up?

COMMISSIONER GIAIMO: I have a question on this. You said you use a survey?

WITNESS GOODHUE: We use a number of different surveys.

COMMISSIONER GIAIMO: A number of different surveys that survey what? Mid-size --

(Goodhue) We look at some that -- we use a survey, actually, that's through American Water Works Association. We look at some data through the New England Water Works Association. We look at some wage studies that cut across different industries for size of company, location, geographics. So we try to triangulate several different data points as to what is appropriate.

COMMISSIONER GIAIMO: Thank you.

CHAIRMAN HONIGBERG: Let's go off the record for a minute.

(Lunch recess taken at 12:45 p.m., and the hearing resumed at 1:33 p.m.)

CHAIRMAN HONIGBERG: Commissioner Bailey.

COMMISSIONER BAILEY: Thank you.

BY COMMISSIONER BAILEY:

Q. All right. On the non-material operating expenses --

A. Yes, ma'am.

Q. -- you said there were four things, and I missed one. Outside services, meals, charitable contributions?

A. (Goodhue) Yes, I'm turning to it. Bear with me one moment because I don't recall them off the top of my head as well. Outside services, public relations, meals and charitable contributions.

Q. Okay. And why do you need to do public relations?

A. (Goodhue) Public relations, really, if you look at the National Water Chart of

Accounts --

(Court Reporter interrupts.)

A. That's where, if you had certain notifications that we had to put out to customers relative to, you know, water monitoring or different things, that those costs would be included in there. So I guess it's not public relations in the traditional sense of what you would consider public relations. It's really about what has got to go in there according to the chart of accounts relative to our communications with our customers and compliancy with the regulations.

Q. Okay. And do you know how much that is, roughly?

A. (Goodhue) Off the top of my head, no, I don't.

Q. Is it 10,000 or 100,000?

MR. WARE: The overall account --

MR. HEAD: I can get you the exhibit for that.

COMMISSIONER BAILEY: Okay. All right.

A. (Goodhue) And just to let you know, too, as far as meals and charitable contributions, those are, in essence, really kind of zero amounts. As a corporation, since 2012, any charitable contribution work that we would do for the corporation is all paid for out of our non-regulated subsidiaries. So there are no dollars that go through there.

Q. That was going to be my next question.

A. (Goodhue) Yeah. And as far as meals are concerned, it's really a zero-dollar account as well. Again, that would be either outside at the non-regulated subsidiary or the parent corporation. So we put them there because they are on our chart of accounts. But in actuality, they're zero-value dollar accounts.

The one that's really a material item potentially is the outside services. So that has to do with certain legal expenses. For the most part, it's legal expenses relative to that company.

MR. HEAD: For the record, on Page 44 is the listing of those accounts.

COMMISSIONER BAILEY: Thanks.

BY COMMISSIONER BAILEY:

Q. Legal expenses for things other than rate cases.

A. (Goodhue) Yes, ma'am. And other than things that might be pertaining to, say, financing. If we do a financing, the cost of issuance and the legal costs there winds up being put on the books as debt-issuance costs that are amortized over the life of that debt. So that would not be in those period expenses.

Q. Okay. Thank you. And I see from this exhibit that the total is only 8,000.

A. (Goodhue) Yes, it's fairly immaterial.

Q. Okay. Thank you.

All right. Let's move to debt service and capital expense. So, is there -- can you point to me in this settlement agreement, is there a list of capital additions for 2013 through 2017?

A. (Goodhue) I don't believe there is a listing for the full four-year slate within the settlement agreement of capital additions, no.

Q. Okay. Are we being asked to decide that those capital additions are prudent?

A. (Laflamme) I guess, to the extent that they're supported by debt service, the capital additions themselves, there's no rate base in the Company, so it's really the debt service associated with those capital additions that are going into rates. So...

Q. So, yeah, we have to -- we do have to make a prudence finding.

A. (Laflamme) To the extent -- yeah. Right.

Q. Can either of you tell me what the difference is between "in service" and "used and useful," and whether the investment was "prudent"? Well, I'll stop my question.

A. (Goodhue) The difference between "in service," "used and useful," I guess is after you would have a prudency evaluation, that hopefully any capital that we're investing in is prudent. It's because it's required relative to the replacement of aging infrastructure, the failure of a capital item -- i.e., a hydrant fails or a pump fails. So, you know, from the Company's

perspective, that would be prudent investment we had to make in order to provide water and service to our customers.
Q. So you have to show us that that was prudent; right?
A. (Goodhue) Sure.
Q. Okay.
A. (Goodhue) And then --
Q. How do we know?
A. (Goodhue) I guess I don't know how to answer that.
A. (Laflamme) Well, as part of -- in the past, you know, we had a water engineer who looked at the prudency of those items. And with the QCPAC for PWW at least, we have had a water engineer look at those, do a high-level view of the proposed capital additions. And that will continue.
Q. But for this case, we're being asked to put a certain amount -- to collect a certain amount of capital expense through debt for all the projects that have been put in service from 2013 to 2017.
A. (Goodhue) That is correct.

Q. And we have to determine that those were prudent. And I don't even know if it was a fire hydrant or bullet-proof glass for your customer service collection window.

A. (Goodhue) Yeah, that capital improvement was not in PEU, the one you specifically referenced there. I mean, when you look at the capital expenditures within PEU, they would be for water main replacements, water treatment replacements. They would be for pumps, for hydrants, would be for meters. You know, it really has to do with the distribution of water, the treatment of water and the supply of water, perhaps reconditioning a well because that well is now no longer producing the capacity that it needed to in compliance with DES regulations and standards.

A. (Laflamme) A number of the loans that PEU has are SRF loans, and so those -- the projects which those loans finance need to be reviewed by DES.

A. (Goodhue) Yes.

Q. But we have to make a prudency finding.

Usually when we approve those SRF loans, we even say we're not making a prudency finding, that that will be determined in a rate case, I think.

Maybe I could ask you to do this: Could you put together for a list for me of all your capital additions for the years that are included in those loans and a little explanation of why they were needed --

A. (Goodhue) Sure.

Q. -- and how much they cost?

A. (Goodhue) Sure.

CHAIRMAN HONIGBERG: So that's going to be a record request?

COMMISSIONER BAILEY: I think it has to be.

CHAIRMAN HONIGBERG: And the next exhibit is 4.

You understand the question, Mr. Head?

MR. HEAD: I do. Thank you.

(Exhibit 4 reserved for record request as described.)

BY COMMISSIONER BAILEY:

Q. Okay. Is one of the reasons for this necessary increase in revenue requirement because you've changed the way that you repay capital expenses?

A. (Goodhue) Yes.

Q. And I think what I understand is that the way it used to happen was based on depreciation expense. And the service lives are 40 to 80 years of these investments, but you can't get a loan for more than 20 years.

A. (Goodhue) Exactly, Commissioner. When we talk about the overall increase, part of that increase is because of the migration from 11-026 methodology to this new methodology. As I mentioned in my testimony earlier, the 11-026 methodology is not sustainable relative to our ability to repay our debt --

Q. So, basically you sped up the depreciation expense.

A. (Goodhue) In essence, to make sure that the cash flow is there in order to repay the principle in total on a timely basis.

Q. Is there any other way that you could do it? Could you refinance the loan at the end of 20 years so that you pay off the assets at the same, you know, at the same schedule that their lives are expected to --

A. (Goodhue) As Mr. Laflamme mentioned a moment ago, probably 50 to 60, maybe more, percentage of loans are SRF loans. And so the SRF program would be this is the project. It's an authorized and eligible project under those rules, and it must be paid off in this amount of time, 20 years or whatever. If we went to refinance it, we're not going to be able to refinance it with the SRF. We have to refinance it with another lending institution. And, you know, could you do that? Perhaps you could. It really comes down to whether there's another lending institution that's willing to do that and what their covenants might require relative to that. The SRF does not come with covenant requirements. It just comes down to repay the loan. You know, the only two sources of funding for PEU currently are the SRF for those loans, and/or if it happens to be migrated over to the drinking water and groundwater trust fund, now it's a joint application that you put in for. It can come out of either one of those. Same set of rules, basically. And/or Co-Bank is the other lender that we're able to acquire funding for, for PEU. And they have certain requirements relative to covenants and lives of loans. So, would they have an appetite to take something that was fully paid off and now give you the money for it? Because all of our loans are fully amortizing, so you don't have an amount to refinance. It's paid off. So, in essence, you're going to borrow money not based on hard assets, but based on a working capital need. So I'm not so certain they would be inclined to make that lending to us.

Q. Okay. It seems like your capital structure is all debt, so your costs should have decreased because you don't have a return on equity. You have economies of scale from PWW. There were a couple of other reasons why you said that the acquisition was really a great idea. But it seems like the rates have -- I mean, a 20 percent rate increase to me is a lot. Is there anything that you can do to mitigate that size rate increase, something that -- did you consider anything that you discounted or didn't implement?

A. (Goodhue) You know, we really worked diligently at trying to bring it down to that number. You know, actually offering up the two-part phase-in and a five-year trailing average was a movement in that regard. Looking to reduce the North Country capital recovery surcharge by getting approval to refinance those intercompany loans was all done to try and minimize the rate increase that we were seeking to recover.

You know, we do -- when it comes to operating expenses, one of the biggest operating expense we have is property taxes. We are diligent in trying to do everything we can to reduce those property taxes. There's a number of movements underfoot here in Concord relative to how utility property is being valued. We don't know where that's going to go and, you know, what that result's going to be. But, you know, absent that, we take and tackle that on an individual basis.

Now, one of the pushes on that is it costs a certain amount of money to actually promulgate it. Filing an abatement doesn't cost you any money. If they approve the abatement, you get the relief. If they don't approve the abatement and we still feel we've got a justified case, we've now got to pursue that through legal means. And unfortunately, the cost of promulgating a tax case is quite expensive. And so there is really kind of a balancing act there as to what the benefit is you're going to derive versus what is the cost you're going to incur to derive that benefit. But, you know, we evaluate that on an annual basis. You know, we go out and competitively bid all of our operating expenses that can be bid on an annual basis: Our chemical costs, our power -- we negotiate contracts to lock in rates for our power. So we take every opportunity that we can to attempt to do that.

You know, there is a certain basic

operation for a water system. The fact that we're in 19 different communities, and in the state of New Hampshire personal property can be taxed as real property, that's a detriment to our customers, to be very honest with you. A good portion of our revenue is truly, and really, though it doesn't show that way, a pass-through property tax through us to our customers. And that's unfortunate. But that is the reality that we live with. And so, you know, again, we did take some strokes in this case to say what can we do to reduce this, and that's why we came up with the some of elements in this case that we proposed because we do take it very seriously that we want to maintain as low rates as possible.

Now, the one thing to be said, and I don't have the numbers here in front of me, is we've done the analysis before as if we were still a publicly-traded company, what would that revenue requirement be at this time versus what it is now. And maybe Mr. Head has that in -- no? But I think that is part of -- it is lower than what it would have been had we still been a publicly-traded company.

Q. I think Commissioner Giaimo has a follow-up.

COMMISSIONER GIAIMO: I have a follow-up.

BY COMMISSIONER GIAIMO:

Q. So what I heard you say is you took "strokes" to keep costs down.

A. (Goodhue) As much as possible, yeah.

Q. As much as possible. And I think the word you used is you worked "diligently" to get to 20 percent to mitigate the risk and the cost.

So I think you mentioned the 50 percent of the five-year consumption as a method which you used.

A. (Goodhue) Yes.

Q. Just so I understand this right, on Page 13, Bates 13, the last sentence says, "By reflecting only 50 percent of the five-year consumption average in the instant rate proceeding, the total rate increase sought is approximately 2-1/2 percent less than it would have been by using 100 percent of the five-year consumption average."

A. (Goodhue) That is correct.
Q. So just to rephrase that, absent only using 50 percent of the five-year average, the request could have been the 2-1/2 percent?
A. (Goodhue) Yes, sir.
Q. Okay. And while talking about this, the 2-1/2 percent is effectively not being collected? We will see that in the next rate case?
A. (Goodhue) Correct.
COMMISSIONER GIAIMO: Okay. Thanks.

BY COMMISSIONER BAILEY (CONT'D):

Q. What was the original request? When you filed the case originally, what did you ask for?
A. (Goodhue) Was 21.24 percent, I believe. Counsel is looking that up.
Q. It was somewhere between what you settled and what you could have had if you used the five-year rolling average?
A. (Goodhue) But that was all inclusive of the step when I'm saying that number.
MR. HEAD: It's in the Factual

Background. I just need to find it.

COMMISSIONER BAILEY: Maybe on Page 3?

MR. HEAD: Yes.

BY COMMISSIONER BAILEY:

Q. So you requested an overall permanent increase of 1.26 million. And what was the settlement number?

(Witness reviews document.)

A. (Goodhue) If I see this without consideration for the North Country capital surcharge, it'd be 1 million -- all inclusive, I guess, 1,281,175.

Q. And where is that? Is that in the settlement? Let's see if we can --

A. (Laflamme) Exhibit 1.

A. (Goodhue) Yeah, Exhibit 1, Page 28.

Q. Exhibit 1? The settlement?

A. (Laflamme) Yeah.

Q. Okay. And what's the number on Bates Page 7, in the second sentence under A.1?

A. (Laflamme) That is the permanent rate increase, exclusive of the North Country capital recovery surcharge.

MR. HEAD: I think there's a disconnect here somewhere. I apologize. I've got to find it.

BY COMMISSIONER BAILEY:

Q. Was the number on Bates Page 3, the 1.26 million, inclusive or exclusive of the North Country surcharge?

(Witness reviews document.)

A. (Goodhue) I don't have the filing schedule in front of me. But based on what I read in the sentence following those numbers, it appears that that number is exclusive of North Country capital recovery surcharge.

MR. HEAD: Can I read from the original filing?

CHAIRMAN HONIGBERG: Sure.

MR. HEAD: "As set forth in the filing" --

CHAIRMAN HONIGBERG: Slowly.

COMMISSIONER BAILEY: And with the microphone on, please.

MR. HEAD: "As set forth in the filing, PEU seeks an increase in its annual gross operating revenues, exclusive of the

NCCRS and any adjustments thereto, of 1,339,075, or 20.35 percent over its revenues for the test period ending December 31, 2016."

COMMISSIONER BAILEY: And how does that compare to the number in the settlement on Page 3?

(Witness reviews document.)

MR. HEAD: You're talking about, just to make sure, the 1.26 million?

COMMISSIONER BAILEY: Yes.

MR. HEAD: Got to find that.

BY COMMISSIONER BAILEY:

Q. Do you know, Mr. Goodhue?

A. (Goodhue) I don't have that answer right here in front of me. I'm looking.

(Pause in proceedings)

MR. HEAD: I believe, if I'm getting this right, the $1.26 million is the total less the surcharge and less the step increase.

COMMISSIONER BAILEY: I mean, the sentence says it doesn't include the step increase, which was estimated at 80,000.

MR. HEAD: I think if I'm getting the math here right, the rest of it is the surcharge that's dropped out of it.

BY COMMISSIONER BAILEY:

Q. And by "surcharge dropped out," Mr. Goodhue, does that mean you refinanced the North Country surcharge, so you get less revenue -- no. Explain that to me.

A. (Goodhue) The debt obligation on that refinanced debt has been reduced, and as such, that reduced obligation is passed through on that North Country capital recovery surcharge. So there's a direct link. On the refinancing, the debt service on those intercompany loans was reduced, and that direct reduction was passed through at a reduction in the surcharge.

Q. So that reduced your revenue requirement?

A. (Goodhue) Overall, including the capital recovery surcharge, because that surcharge is only for the customers in those three North Country water systems.

Q. Okay. So the number that Attorney Head gave me that you originally asked for was

1.339,075 million. And that excluded the North Country surcharge. So what does that mean? Does that mean that that 1.339 million number was a revenue requirement that had accounted for the refinance and the reduced revenue requirement?

A. (Goodhue) I've got to imagine, based on the value of that number, that that number was an all-inclusive number. And I know they're thumbing through some schedules over there, the million 339, relative to everything added together. And I'm looking to my team over here that has schedules in front of them. I don't have any in front of me.

Q. Maybe they can point you to a schedule to answer the question.

(Discussion among Commissioners off the record.)

Q. Yeah. All right. While they're thinking about that, did PEU ever pay any income taxes after the acquisition?

A. (Goodhue) After the acquisition, no. So, again, we have a consolidated tax return. And after the acquisition, one of the things there is, on the consolidated return, including in the deductions that are allowable for federal taxes is the interest on the note payable from Pennichuck Corporation to the City of Nashua, New Hampshire; as such, the consolidated corporation has a net operating loss position they've had since 2012.

Q. Did the consolidated corporation ever pay any income taxes, or is the answer to that --

A. (Goodhue) Not since 2012.

Q. Because they have a net operating loss?

A. (Goodhue) Yes, ma'am.

Q. You mentioned in response to a question earlier that, if you had excess cash, it would be refundable to customers.

A. (Goodhue) How the rate stabilization funds were constructed under 16-806, is that, if those funds were over-funded in the next pending rate case, the over-funding would be refunded to customers over the succeeding three years after that new permanent rate structure is put in place. To the extent that they are deficient from their allowed levels, that deficiency would be collected in the succeeding three years to refill them to their impressed levels.

Q. Okay. And the target amount is that $980,000 that we talked about.

A. (Goodhue) In the aggregate. Yes, ma'am.

Q. If it goes 50 percent above that --

A. (Goodhue) We have to file a rate case --

(Court Reporter interrupts.)

Q. That requires you to file a rate case?

A. (Goodhue) Yes, ma'am.

Q. And that's when you would refund the money to customers.

A. (Goodhue) Once that rate case that was filed resulted in a permanent rate change, included in that permanent rate change is the cost of refunding to customers that excess.

Q. Okay.

A. (Goodhue) Yes.

BY COMMISSIONER GIAIMO:

Q. So that 150 percent number, is that 150 percent of $980,000 or $5 million?

A. (Goodhue) $980,000, because now the $5 million was originally a rate stabilization fund just for Pennichuck Water Works. As it's been bifurcated and given to the individual customers, it's on that granular level.

Q. It becomes granular.

A. (Goodhue) Yes.

Q. Okay. So, basically if the fund gets over about -- approaches 1.5 million, that's when you come in for another rate case.

A. (Goodhue) That's when we would be mandated to do that. That is correct. Chances are, we would probably be filing a rate case before that, depending on where our operating expenses go. And based on the status of the rate stabilization funds with that filing, that still may result in a refund to customers or a collection from customers based on the impressed value.

Q. And why the 150 and not 125 or 120?

A. (Goodhue) That was just a target that was discussed between the Staff, the OCA and the Company.

COMMISSIONER GIAIMO: Okay. Thank you.

BY COMMISSIONER BAILEY:

Q. I guess, you know, my last kind of question is what is the difference between what you originally asked for and what you achieved in the settlement agreement. And part of that may have to do with the answer of what --

(Court Reporter interrupts.)

Q. -- the attorney is trying to locate.

A. (Goodhue) My understanding, and they're pulling the data together, is that the request we have in total is less than what our original request was in the overall revenue requirement relative to a percentage increase. But we need to grab some numbers here to clarify that for you.

COMMISSIONER BAILEY: Okay. All right.

CHAIRMAN HONIGBERG: Mr. Head, can you clarify this now, or do you need a few more minutes?

MR. HEAD: I need to clarify I think the "150 percent" answer, just to make sure that's accurate on the record.

CHAIRMAN HONIGBERG: Okay. You can

do that on redirect. But I guess in terms of what Commissioner Bailey's trying to track down--

MR. HEAD: Let me just check with Mr. Ware.

CHAIRMAN HONIGBERG: I mean, Commissioner Giaimo has questions he can ask while you continue to work on that.

MR. HEAD: Right. Thank you.

BY COMMISSIONER GIAIMO:

Q. Good afternoon.

A. (Goodhue) Good afternoon.

Q. All right. So I'm going to go to Bates Page 10 of the settlement, Paragraph 4. And help me understand this because I'm not sure it's a fair apples-to-apples comparison being drawn. And I appreciate some of the caveats you put in your initial testimony, but let me make sure I understand this right.

For non-North Country residents, we're going to assume a 7.29 CCF number, and then there are other examples of other customers. Locke Lake, we have 3.5. All right. Then Birch Hill, 3.5, and all the rest is 3.5.

Can you explain to me why we're using 3.5 here?

A. (Goodhue) That's actually based on historical averages of their consumption patterns.

Q. Okay. Fair enough. But now I'm struggling with understanding how this is an apples-to-apples comparison when they use half as much water every month, but we seem to be comparing the customers. So I guess what I'm saying is the actual annual increase on an apples-to-apples comparison for Locke Lake is not $15 a year, it would be $30 a year; is that correct?

A. (Goodhue) No. The average customer there uses 3.5 CCFs. Their average bill has been $58.51. And based on the permanent increase, the reduction of the North Country capital recovery surcharge and the step increase -- or actually, this is -- yeah, it's inclusive of it -- their bill will go to $59.79. So this is based on looking at their actual bill history for the average customer in that water system.

Q. Okay. But in comparison to the non-North

Country residents, in order to get an apples-to-apples comparison of not their monthly bill, but -- if you compare the same amount of water withdrawal, you would need to double the 3.5.

A. (Goodhue) Understood. And I guess perhaps our intent here was just to give the basis for the calculation. But to explain the dollar impact for these customers based on their own consumption patterns, you know, rather than to normalize those, it's to say this is what they have been consuming, this is what they have been paying, and this is what the impact would be of the rate increase.

Q. Okay. Thanks for that distinction. I think I just needed to make sure that I was understanding it properly. And in order to get -- as opposed to the monthly bill, but to get a true apples-to-apples comparison, you would need to double the consumption for non-North Country --

A. (Goodhue) Correct.

Q. All right. Thanks.

I'll give you the opportunity to maybe re-answer a question that you answered already, say it a different way. Is there a more -- getting to the question the Commissioner asked.

Is there a more equitable way to blend these rates so that one subset of the same customers don't have a 40 percent decrease and the other percent see a 20 percent increase?

A. (Goodhue) The history on the North Country systems is that they are originally water systems that were included in our Pittsfield Aqueduct Company. And I believe it was the 2009 test-year case that, had they remained with Pittsfield Aqueduct, the amount of subsidy from the residents of Pittsfield to those water systems, because of the disproportionate amount of capital investments that we had to make to those systems, was going to be overly onerous. I'm remembering a number like 243 percent increase. It was to that magnitude.

Q. Okay.

A. (Goodhue) So, in settlement of that case, it was agreed between the parties, and approved by the Commission, to move those water systems from PAC to Pittsfield, but that the customers in PEU should also not be subsidizing that pre-existing capital, and as such, the capital recovery surcharge came over with them. So that was the reason for that. Other than the North Country capital recovery surcharge, they do all share the same, common rates.

Q. Okay. Would your answer be similar if you were suggesting blending of Penn Corp. as opposed to -- you just talked about PEU --

A. (Goodhue) And PAC, yes.

Q. And PAC. Now, if we were to say to blend them over the larger Penn Water --

A. (Goodhue) Pennichuck Water Works?

Q. Yes.

A. (Goodhue) It would be the same kind of thing. In fact, there would not be an advantage at this time to actually merge PEU in with PWW because of the amount of subsidization. PWW would be an incredible amount based on the disparities.

Q. Same as --

A. (Goodhue) Yes.

Q. The logic is the same as --

A. (Goodhue) Exactly.

(Court Reporter interrupts.)

Q. The logic to the question was the same.

BY COMMISSIONER BAILEY:

Q. Aren't the PWW rates a lot lower than the PEU rates?

A. (Goodhue) They are lower, but, you know, that has to do with the broadness of their customer base and the capital that's employed there, yes.

Q. And are all the customers in PWW residents of the City of Nashua?

A. (Goodhue) No, they are not. There's 11 communities served.

COMMISSIONER BAILEY: Okay. Thanks.

BY COMMISSIONER GIAIMO:

Q. Has the Company done any analysis with respect to what the rates would look like if it was just done on inflation? From your prior rate case from 2013 to 2018, would it look similar? Would it be a 20 percent increase if it was just inflation-based?

A. (Goodhue) Without a modification of the rate methodology? Is that what you're saying?

Q. Right.

A. (Goodhue) I think we did do that analysis, yes. The one caution there is, even with that, I mean, there would be a rate increase, but it would not be at a level that would support our ability to meet our covenants and our debt.

Q. Okay.

A. (Goodhue) And actually, Mr. Laflamme just passed this to me.

(Witness reviews document.)

A. (Goodhue) Let me see. It would have been I think this number right here.

(Witness reviews document.)

A. (Goodhue) Unfortunately, a case takes so long, that you're familiar with schedules initially and then you've got to re-address and re-familiarize yourself. Bear with me one moment if you could.

(Witness reviews document.)

A. (Goodhue) Yes, we were looking at a 23 percent increase if that was the case.

Q. So the actual delta between the two is significant, 20 as opposed to 23 percent; right?

A. (Goodhue) Correct.

COMMISSIONER GIAIMO: Okay. Thanks.

BY CHAIRMAN HONIGBERG:

Q. I just have one thing, or one area I wanted to ask about following up on Mr. Ranaldi's questions.

He hypothesized the situation where you'd have annual rate increases instead of one rate increase after a number of years. To do annual rate cases, you already talked about how long that takes; right?

A. (Goodhue) That is correct.

Q. It's also colossally expensive; is it not?

A. (Goodhue) It is. I think what Mr. Ranaldi was referring to was the discussion we had about material operating expense, annual surcharge --

Q. And that's something that counsel asked you about on direct; right?

A. (Goodhue) That's correct --

Q. But in addition to that possibility, you all have agreed to put this, what you all call a "QCPAC," but I like to call a "Quick PAC" system in place, and that helps to smooth out the increases as well; does it not?

A. (Goodhue) That's correct. If you look at -- and I appreciate the "Quick PAC." I've quoted you to other people, by the way. It's a great acronym.

The three buckets of revenue -- the CBFRR, again, is a fixed revenue component going forward. The debt service revenue requirement with the QCPAC really does take care of increases in debt service between rate cases. Fantastic. And what it leaves to the side is the OERR portion, which is what Mr. Ranaldi was speaking to.

CHAIRMAN HONIGBERG: That's all I had.

Mr. Head, have you got the numbers worked out?

MR. HEAD: I do.

CHAIRMAN HONIGBERG: How do you want to do this? Is it something you, as a lawyer, can point us to in the exhibits, or do you want to ask questions of the witness?

MR. HEAD: I think it's easier if I just identify where the numbers are coming from in the documents.

CHAIRMAN HONIGBERG: Okay.

MR. HEAD: I may have to mark the original filing, as you originally suggested, if the record needs to be clean. I'll say what it says.

CHAIRMAN HONIGBERG: Okay.

MR. HEAD: So in the original filing, on Bates Page 37, the Company was asking for annual revenue of approximately 1,380,060, or 20.08 percent.

Looking at the settlement agreement on Bates Page 3, where we were talking about where did the 1.26 million come from, or 17.55 percent, if you take the annual revenue total request that I read from Page 37 of the filing, subtract the 121,070 on Bates Page 3, you get the 1.26 million that's on Bates Page 3. So then you would compare the -- in the original filing, the 1,380,060 -- sorry -- to the settlement, Bates Page 7, where the settlement dollar amount is 1,304,272, or 18.97 percent. Oops, that's wrong. Sorry. Wrong one. No, that's right.

MS. ROSS: What was the second reference to, page what?

MR. HEAD: Seven.

MS. ROSS: Page 7 of the settlement?

MR. HEAD: Yeah.

I want to cross-check one thing. Sorry. Yeah, that's right.

COMMISSIONER BAILEY: So the difference between the number that you settled on and the number that you asked for is the difference between $1,380,060 and $1,304,272.

MR. HEAD: In percentages, it would be, in the original filing, 20.08 percent, and in the settlement, 18.97 percent.

COMMISSIONER BAILEY: Or about

$76,000.

MR. HEAD: Or about $76,000, yes.

COMMISSIONER BAILEY: Okay. Thank you.

CHAIRMAN HONIGBERG: All right. Mr. Head or Ms. Ross, do you have any redirect for the panel?

MR. HEAD: Thank you, Mr. Chairman.

REDIRECT EXAMINATION OF MR. GOODHUE

BY MR. HEAD:

Q. I have one question, I believe, on the issue of 150 percent. When a new rate case comes up -- Mr. Goodhue, can you turn to Page 24 of the settlement.

A. (Goodhue) Yes.

Q. And in that Paragraph C on Page 24 of the settlement, it talks about the target of the combined PEU rate stabilization funds. Do you see that?

A. (Goodhue) I do.

Q. And that the 150 percent is 150 percent of the combined target amount; is that correct?

A. (Goodhue) That is correct.

Q. So, in terms of what that 150 percent reference is, it's the target of the funds most recently established by the Commission. If you look on Page 19, that has the listing of what is the initial funding and the estimated adequate funding. And in that first paragraph below, it says that if PEU determines that the levels of its RSF accounts become inadequate relative to the operating requirements, the Company will submit a financing petition to request approval to issue debt for the purpose of obtaining funds necessary to fully provide for the RSFs. And I just wanted to clarify.

When you said the "150 percent" reference, the 980, the total amount that's in the total RSFs, that could change in the future if the Commission decided that that amount should increase.

A. (Goodhue) That is correct.

Q. Okay. But as of today in the settlement, it would be 980.

A. (Goodhue) Yes.

Q. Thank you.

In terms of PEU and the system, when --

how was it that Pennichuck ultimately took over that system? And what were the issues in that system that are driving some of these current costs?

A. (Goodhue) One of the key differences between PEU and Pennichuck Water Works is Pennichuck Water Works is, I'm going to say, the "historical Pennichuck system," been owned since 1852, and it's grown organically and then has added some community water systems. PEU really came out of a number of activities with the Pennichuck Corporation, really in response to certain requests from the DES, participated in taking over certain troubled water system that began with the acquisition of a number water systems of consumers' water, and then when the DES had certain deficient system in the state, they used to come to us and look to us to were we willing to acquire a system. The three North Country water systems are prime examples of that situation. And the good news is we've provided water to customers for many years there. There bad news is that some of those required really some material capital investments, and continue to do so.

MR. HEAD: Thank you. No other questions.

CHAIRMAN HONIGBERG: Ms. Ross, did you have any other questions?

MS. ROSS: No further direct. Thank you.

CHAIRMAN HONIGBERG: All right, gentlemen. Thank you. You can return to your seats.

There are no other witnesses; correct?

MR. HEAD: That's correct.

CHAIRMAN HONIGBERG: Without objection, we'll strike I.D. in Exhibit 3. We're going to be holding the record open for Exhibit 4, which is a record request that was made.

If there's nothing else, it's time for the parties to sum up and basically tell us what you think we should do.

Mr. Ranaldi, do you understand? It's basically a closing statement. Are you willing to go first, or would you prefer to hear somebody else go before you?

MR. RANALDI: Up to you, sir. I'll go first.

CHAIRMAN HONIGBERG: In the normal course, you would go first.

CLOSING STATEMENTS

MR. RANALDI: Okay. I'm in total agreement with the numbers, per se. Just looking forward, I want to make sure that the operating expenses that seems to be very volatile --

(Court Reporter interrupts.)

MR. RANALDI: I understand that the bond reserves are all fixed. The debt, as far as paying off capital expenditures were all fixed. It's the operating costs, that that could be year over year so that we're not faced with 20 percent increases. That really is a problem here.

My other concern is if you have to borrow money just to help pay this off, that's additional costs to us, especially if you have to pay the principle, the interest, plus the cost of getting the loan from the banks. So, any way that monies can be stretched out so that it helps those who are on fixed income would be appreciated.

As far as the 20 percent, I have heard the numbers going through the tech sessions. They did a great job, as far as I'm concerned. And I wish there was a magical way to have it lowered. But when you can't even depend on how much money you're going to get in revenue, that's why I brought that up also, on year over year -- I remember looking at certain documents where there was a very big drop in the amount of volume, as far as profit was coming in. And to try to stretch that out over three or four years I think is -- we don't have equity anymore. It's very dangerous. So that's all I have to say. Thank you.

CHAIRMAN HONIGBERG: Thank you, Mr. Ranaldi.

Mr. Buckley.

MR. BUCKLEY: Thank you, Mr. Chairman. The Office of Consumer Advocate sees the rates as set forth within the settlement agreement as just and reasonable. We would request the opportunity to also review the record request posed by Commissioner Bailey relative to the various capital additions. We do recommend the Commission's approval of this settlement agreement.

And I would just add that we are sympathetic to the concerns expressed by Mr. Ranaldi regarding the magnitude of this specific rate increase and would very much be willing to explore opportunities to allow for a more frequent way to account for various cost increases that we know are likely to occur. I think in some instances we referred to it as the "operating expense revenue requirement surcharge," or I think I referred to it as a "operating expense cost escalator." But we do believe that a change in ratemaking structure of that magnitude is something that should probably be submitted to the Commission within the original petition in whatever rate case that's filed.

And we would look forward to reviewing such a change, without prejudice, within a future case from this company.

CHAIRMAN HONIGBERG: Thank you, Mr. Buckley.

Ms. Ross.

MS. ROSS: Thank you. As you know, Staff has signed the settlement, supports the settlement, and believes it would be in the public interest for the Commission to approve it. And we note that this is a company that has been operating under Commission regulation for many years, has experienced staff. There have not been significant issues when the books and records of this company have been audited. And Staff believes the new ratemaking mechanism is appropriate and does not create any unusual burdens on Staff. But Staff will be monitoring, both through Audit Staff and through Water Staff, both PWW and PEU, as they move forward under this new ratemaking regime. And if issues begin to emerge, they will certainly make the Commission aware of that. But at this point, Staff believes this is an appropriate arrangement with PEU. Thank you.

CHAIRMAN HONIGBERG: Thank you, Ms. Ross.

Mr. Head.

MR. HEAD: Thank you, Mr. Chairman, members of the Commission. Obviously, we seek approval of the settlement. The methodology that's outlined in the settlement would prevent insolvency, as you heard the testimony of PEU; allow for annual step adjustments through the QCPAC process, which does not exist in any form now with this company, which would avoid rate shock; places PEU in a better position relative to financial covenants in their lending and potentially the overall total borrowing costs associated with the debt; move towards a stronger cash flow model, as the testimony described; and provides RSF accounts as a backstop to PEU's revenue requirements.

The Company certainly recognizes and appreciates the concerns relative to the percentage increase in what is being sought in this case. It is four years of activity in which there's not been any adjustments to the rates over those four years, with significant capital investments that have been occurring as a result of just the quality of the capital needs for this particular system. The Company did describe its own efforts to try to reduce the overall financial impact on its customers, including only applying 50 percent to the five-year averaging, eliminating the four CCF minimum, which was done on the temporary rates. So that was done early on in this process as opposed to waiting for the permanent rates and also the reduction in the North Country capital recovery surcharge. And, again, those were all being done with the goal, ultimately, of reducing the overall impact. But unfortunately in order for the costs to be recovered, we believe that the request is fair and reasonable and in the public interest relative to the needs of this company and would ask that the settlement approval be approved.

We will certainly follow up with the request that was made relative to the capital improvements and have them for the Commission review.

CHAIRMAN HONIGBERG: Thank you, Mr. Head.

We will leave the record open for Exhibit 4. Otherwise, we'll adjourn the hearing and take the matter under advisement and issue an order as quickly as we can.

(Hearing adjourned at 2:24 p.m.)

CERTIFICATE

I, Susan J. Robidas, a Licensed Shorthand Court Reporter and Notary Public of the State of New Hampshire, do hereby certify that the foregoing is a true and accurate transcript of my stenographic notes of these proceedings taken at the place and on the date hereinbefore set forth, to the best of my skill and ability under the conditions present at the time.

I further certify that I am neither attorney or counsel for, nor related to or employed by any of the parties to the action; and further, that I am not a relative or employee of any attorney or counsel employed in this case, nor am I financially interested in this action.

____

Susan J. Robidas, LCR/RPR
Licensed Shorthand Court Reporter
Registered Professional Reporter
N.H. LCR No. 44 (RSA 310-A:173)