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NHPLUC 25MAR'19PM3:08

March 25, 2019

Debra A. Howland, Executive Director  
New Hampshire Public Utilities Commission  
21 South Fruit Street, Suite 10  
Concord, NH 03301

Re: DW 18-189 Pennichuck Water Works, Inc., Pennichuck East Utility, Inc., and Pittsfield Aqueduct Company, Inc. - 2018 CIAC Tariff Amendments  
Staff Recommendation for Approval

Dear Ms. Howland:

On December 19, 2018, Pennichuck Water Works, Inc. (PWW), Pennichuck East Utility, Inc. (PEU), and Pittsfield Aqueduct Company, Inc. (PAC) (collectively, the Companies), filed multiple tariff revisions to recover the tax liabilities associated with the receipt of contributions in the aid of construction (CIAC), both in the forms of both property and cash payments. In this letter, Staff recommends the Commission approve these tariff revisions as amended by Staff.

The Companies' submissions were supported by direct testimony and a technical statement from Larry D. Goodhue, CEO, CFO and Treasurer of the respective Companies. Mr. Goodhue stated that changes in federal tax law enacted as part of the 2017 Tax Cuts and Jobs Act (TCJA) have adversely impacted the Companies relative to their receipt of CIAC. Specifically, Congress amended Section 118 of the Internal Revenue Code (IRC), removing the tax exclusion of CIAC received by regulated water utilities. These changes became effective beginning 2018.

As a result, CIAC received by the Companies, in the form of either property or cash towards the cost of construction, are no longer adequate to cover the true cost to the Companies. Additional funds are now necessary in order to cover the tax liability triggered by the receipt of CIAC. Therefore, the Companies submitted revised tariff pages, establishing a "gross up" mechanism, equal to the value of the CIAC and the addition of further funds necessary to cover the new tax liability. The "gross-up" formulas proposed by the Companies' are based on their applicable statutory tax rates rather than their effective tax rates.

The Companies, Pillsbury Realty Development, LLC (Pillsbury), the sole intervenor, the Office of the Consumer Advocate (OCA), and the Staff of the Public Utilities Commission (Staff), met in a Technical Session at the Commission on February 6, 2019. Subsequently, Staff and Pillsbury propounded discovery to the Companies, which Staff has attached to this recommendation. The

Companies provided responses to Staff's Data Requests but filed an Objection to several of Pillsbury's requests. Pillsbury subsequently filed a Motion to Compel upon the Companies on February 26, 2019, to which the Companies objected to on March 7. At this time, Staff takes no position on Pillsbury's motion to compel, but Staff asserts it does not require any of Pillsbury's requests to be answered as a basis for its recommendation. After two technical sessions, and review of the filings and discovery, Staff concludes the tariff revisions, as amended by Staff, are just and reasonable.

Specifically, Staff notes the Companies' response to Staff 1-11(a), whereby the Companies explained that, in the absence of a return on equity (ROE), the Companies' no longer have a financial incentive to expand their water service. In addition, as stated in the last sentence of the Companies' response in Staff 1-1(b), the Companies' current rate structures, devoid of an ROE, neither generate the excess cash to pay the tax liability associated with the receipt of CIAC, nor provide the route whereby shareholders of a traditional regulated utility would be able to provide liquidity through capital markets.

Further, as evidenced in the Companies' response to Staff 1-7, the Companies already incur significant annual expenses relative to new customers added with the receipt of CIAC. In Staff 1-13, the Companies again stated that, in light of the taxation on CIAC, there is inadequate revenue and profitability related to the additional customers, thereby solidifying the Companies' motivations not to expand or add new customers by receiving CIAC. Lastly, the Companies explained in Staff 1-9, that additional customers brought on by receiving CIAC creates additional burdens to the existing system and ratepayers. For the reasons stated above, Staff believes it is appropriate to allow the Companies to "gross-up" the amount or value of CIAC received.

In addition, Staff reviewed the Companies' responses relative to the use of Net Operating Losses (NOL) to offset tax liabilities from the receipt of CIAC. As Mr. Goodhue explained in his testimony on page 7, lines 8-14, all of the Companies' current NOL's were previously generated to the benefit of current ratepayers. Therefore, to use these NOL's to offset CIAC tax obligations would allow the relatively new CIAC contributors to use a tax benefit that should benefit existing ratepayers. Such a decision would prevent the existing ratepayers from realizing these benefits to their full extent in current and future tax years. For the reasons stated above and further explained in the testimony of Mr. Goodhue, starting on line 1, page 5, and Staff 1-8, Staff agrees that in the absence of NOL's, the cost to the Companies from the receipt of CIAC should be the current statutory tax rates. Therefore, the most appropriate rates in the "gross-up" formulas should be the statutory tax rate.

Staff, however, recommends that the Commission approve the tariff amendments with the following additions:

- 1) In addition to the formulas the Companies propose to add to their respective "Miscellaneous Utility Service Fees" Tariff Pages, the Companies shall include examples of the "gross-up" formula similar to that found in the Testimony of Mr. Goodhue on page 4, lines 16-23. Such examples shall use the statutory federal and state tax rates for 2019, and shall be based upon \$1,000 of CIAC property and \$1,000 of CIAC cash, with the resulting tax obligation due to the Companies.

- 2) The Companies shall highlight that the above examples use tax rates effective as of 1/1/2019 and that these tax rates are subject to change in the future;
- 3) As the tax rates are subject to change, the Companies shall include links to the appropriate taxing agencies, i.e. the Internal Revenue Service (IRS) and the NH Department of Revenue Administration (DRA), where customers can periodically visit and obtain the most current tax rates in effect. This will provide assurance that anyone may calculate the CIAC tax implication using the most up to date tax rates. The inclusion of these links also obviate the need for the Companies to refile tariffs to update the formula examples every time tax rates change.

Staff concludes, based upon all the information presented, the proposed tariffs with Staff's amendments result in just and reasonable charges, pursuant to RSA 378:7. Staff further believes, given the unique facts presented in this Docket, this outcome best matches the costs associated with the expansion of public water service to the customers who are to receive the benefits of that service.

Prior to the filing of this recommendation, Staff provided a copy to the Companies, Pillsbury, and the OCA. The Companies indicated they are on board with Staff's position and Staff's additions to the Companies' proposed tariff amendments. The OCA did not respond and Pillsbury indicated that, "at this time, Pillsbury takes no position on staff's recommendation in light of its discussions with PEU concerning cost allocations involving the special contract in Docket No. 18-101".

Thank you for your attention, and if you should have any questions regarding this matter, please contact me.

Sincerely,



Anthony J. Leone  
Utility Analyst, Gas & Water Division

Discovery  
cc: Service list

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