

DW 04-056

PENNICHUCK WATER WORKS, INC.

Petition For Rate Increase

Order Approving Settlement Agreement

ORDER NO. 24,465

April 29, 2005

APPEARANCES: McLane, Graf, Raulerson & Middleton, P.A., Sarah B. Knowlton for Pennichuck Water Works, Inc.; Upton & Hatfield, Robert Upton II, Esquire for the City of Nashua; Office of the Consumer Advocate by F. Anne Ross, Esq. on behalf of residential ratepayers; and Marcia A.B. Thunberg, Esq. for the Staff of the New Hampshire Public Utilities Commission.

I. PROCEDURAL HISTORY

On March 3, 2004, Pennichuck Water Works, Inc. (Pennichuck) filed a Notice of Intent to File Rate Schedule as well as a motion for waiver of Puc 1604.01(a). On April 8, 2004, Staff recommended the Commission grant waiver of Puc 1604.01(a) as Pennichuck believed the financial information requested by this rule was duplicative of materials already filed with the Commission. The Commission granted the waiver by secretarial letter on April 15, 2004.

On April 5, 2004, Mr. William Mahoney from Whitegate Condominium Association filed comments pertaining to proposed rate increases by Pennichuck. On April 6, 2004, the Office of the Consumer Advocate (OCA) filed its notice of its intent to participate in this docket. During the initial phase of the proceeding, the Commission received intervention requests from the following parties: Anheiser-Busch, Inc.; Ms. Barbara Pressly; City of Nashua; and the Towns of Amherst, Bedford, and Raymond.

On May 28, 2004, Pennichuck filed revised tariff pages designed to increase its revenues by \$2,414,183 or 16.39% on an annual basis over its current authorized level of rates. The proposed

tariffs were to be effective on July 1, 2004. On the same day, Pennichuck also filed a petition for a temporary rate increase, pursuant to New Hampshire RSA 378:27, in the amount of \$1,668,132, or 11.32% over current rates.

On June 18, 2004, by Order No. 24,338, the Commission suspended the proposed revisions to Pennichuck's permanent rate tariffs, pursuant to RSA 378:6, pending investigation and decision thereon; scheduled a hearing for July 27, 2004, to address procedural matters regarding the proposed temporary and permanent rate increases; and ordered that Pennichuck publish notice of the hearing. Pennichuck duly noticed the hearing through the publication of a display ad concerning the temporary rates hearing.

On July 23, 2004, the City of Nashua filed a motion to suspend consideration of permanent increase in rates until conclusion of Nashua's attempted acquisition of Pennichuck Water Works, Inc., Pennichuck East Utility, Inc., and Pittsfield Aqueduct Company, Inc. through its eminent domain action. Pennichuck filed an objection on July 27, 2004.

On July 27, 2004, the Commission conducted a prehearing conference at which it heard oral arguments on Nashua's motion to suspend and established a schedule for briefing the issue. Staff and the Parties held a technical session subsequent to the hearing and agreed upon a proposed procedural schedule for submission to the Commission. The proposed procedural schedule also included deadlines for briefing whether the City of Nashua's eminent domain proceeding under RSA 38 impacted review schedules contained in RSA 378:6.

On August 3, 2004, the Commission approved the procedural schedule by way of Secretarial Letter and, on August 9, 2004, parties submitted briefs on the interplay of RSA 38 and RSA 378:6. Staff and the Parties submitted testimony, pursuant to the procedural schedule, and on August 24, 2004, the Commission held a hearing on temporary rates.

On September 17, 2004, the Commission issued Order No. 24,371 and denied Nashua's motion to suspend, and granted the interventions of Ms. Barbara Pressly, City of Nashua, Anheuser-Busch, Inc., and the Towns of Amherst, Bedford, and Raymond. On September 30, 2004, the Commission issued Order No. 24,377 and granted Pennichuck's request for temporary rates on a service-rendered basis, effective June 1, 2004.

On January 10, 2005, Staff filed testimony of Jason P. Laflamme, Utility Analyst III, with a revenue requirement recommendation, and Maureen L. Sirois, Utility Analyst III, with respect to return on equity and allowed overall rate of return. Staff and the Parties met on February 16, 2005, to discuss the Staff's testimony as well as the potential for settlement. On February 23, 2005, Pennichuck filed rebuttal testimony of Bonalyn J. Hartley, Donald L. Correll, Henry G. Mulle, and William D. Patterson.

On March 2, 2005, Staff and the Parties requested the March 3, 2005 hearing be postponed so that a settlement document could be written. The Commission subsequently rescheduled the hearing for April 5, 2005. On March 18, 2005, Staff and Pennichuck filed a Settlement Agreement (Agreement) with the Commission and the Commission held a hearing on the Settlement Agreement on April 5, 2005. Finally, on April 8, 2005, Pennichuck filed Record Request, Exhibit 26, with the Commission which provided a summary of expenses Pennichuck Corporation has incurred in defending against the City of Nashua's eminent domain proceeding.

II. POSITIONS OF THE PARTIES AND STAFF

A. Pennichuck Water Works, Inc.

Staff and Pennichuck's positions are set forth in the Settlement Agreement which is summarized below.

B. City of Nashua

Nashua did not enter into the Settlement Agreement. At hearing, Nashua stated that it neither supported nor opposed the Agreement. Nashua took issue with a provision of the Settlement Agreement that would permit the creation of the deferral account for Pennichuck's eminent domain expenses arising from Nashua's filing in DW 04-048. Nashua did not want the creation of such an account to create any future presumption that PWW would be entitled to recover the expenses in the deferred account. Hearing Transcript of April 5, 2005 (4/5/05 Tr.) at 73 lines 22-24 and at 74 lines 1-13. Nashua expressed concern that if the deferred account took on the status of a "regulatory asset," then that would imply recovery. Nashua stated that some of the expenses Pennichuck seeks to place in the deferred account are costs related to Pennichuck's public relations campaign against Nashua's effort to municipalize the water system. Nashua asked that, if the Commission allows Pennichuck to establish the account, that it restrict Pennichuck from including in the account expenses related to the public relations campaign. Nashua also expressed concern as to who the costs may be recovered from at a future time.

C. Office of Consumer Advocate

The OCA did not enter into the Settlement Agreement. Like Nashua, OCA expressed its concern that creation of the deferred account would represent bad policy. 4/5/05 Tr. at 76 lines 16-24. OCA averred that, with Pennichuck unable to quantify the level of

expenses to be incurred in the next year, the deferred account is akin to a blank check. OCA suggested that Pennichuck could have included its eminent domain expenses from its 2003 test year in this rate case filing so that a determination could be made whether those expenses benefited Pennichuck and its ratepayers or just its stockholders. OCA requested that the Commission refuse to allow the proposed accounting treatment for the deferred account. 4/5/05 Tr. at 77 lines 2-5.

D. Staff

Staff and Pennichuck's positions are set forth in the Settlement Agreement which is summarized below.

III. SETTLEMENT AGREEMENT

A. Income Requirement

Pennichuck and Staff agree that Pennichuck should be granted an 11.8% overall increase in revenues based on a net operating income requirement of \$3,574,734. This results in a revenue requirement of \$16,469,258. Pennichuck and Staff stipulate that this net operating income requirement and resulting revenue requirement represent a reasonable compromise of all issues relating to the revenue requirement pending before the Commission in this rate case docket, including allowed overall rate of return, return on equity, capital structure, *pro forma* adjustments, capital additions to Pennichuck's rate base, operating expenses, and temporary rates.

B. Rate Design

Pennichuck and Staff agree to maintain Pennichuck's present rate design and recover the revenue increase from all customers except private and public fire protection customers. Pennichuck's most recent Cost of Service and Rate Design Study, dated July 2001,

indicated that fire protection revenues were sufficient to earn an adequate rate of return and that no change in rate design was needed.

C. Rate Base

Pennichuck and Staff agree that all plant additions added to rate base since Pennichuck's last general rate case in Docket No. DW 01-081 are in service and are prudent, and used and useful in accordance with RSA 378:28.

D. Depreciation

Pennichuck agrees to conduct a depreciation study before filing its next general rate case.

E. Effective Date and Recoupment

Pennichuck and Staff agree that the rate increase shall be effective for service rendered on and after June 1, 2004, consistent with Commission Order No. 24,377. Pennichuck and Staff agree that a surcharge amounting to the difference between temporary rates and the level of permanent rates agreed to herein shall be calculated and applied to customer bills over a 12-month period effective with the implementation of the permanent rates.

Pennichuck and Staff agree that Pennichuck shall be allowed to recoup its rate case expenses, as approved by the Commission, through a surcharge applied over the same 12 month period as the temporary rate recoupment surcharge. At hearing, Pennichuck testified that rate case expenses totaled somewhere between \$123,000 and \$135,000 but Pennichuck was unable to provide a per-customer estimate of the surcharge at that time. 4/5/05 Tr. at 68 lines 11-18.

Upon receipt of the Commission's final order, Pennichuck and Staff agree that Pennichuck shall file a compliance tariff supplement including the approved surcharge relating to

recoupment of the difference between the level of temporary rates and permanent rates and recovery of the amount of rate case expenses. Pennichuck and Staff agree that Pennichuck shall file an accounting with the Commission of the amount of the rate case expenses recovered at the end of the 12-month period.

F. Deferred Asset Account

Pennichuck and Staff agree that Pennichuck shall be authorized to create a deferred asset account in which it may book costs associated with its defense of the City of Nashua's eminent domain efforts. After the conclusion of Docket 04-048, or at such sooner time as the Commission may determine to be appropriate, the Commission shall determine the extent to which, if any, costs deferred by Pennichuck may be recovered through rates.

IV. COMMISSION ANALYSIS

New Hampshire RSA 378:7 authorizes the Commission to fix rates pursuant to an order after a hearing. In determining just and reasonable rates, the PUC must balance the consumers' interest in paying no higher rates than are required with the investors' interest in obtaining a reasonable return on their investment. *Eastman Sewer Company, Inc.*, 138 N.H. 221, 225 (1994). In circumstances where a utility wishes to increase rates, the utility bears the burden of proving the necessity of the increase pursuant to RSA 378:8.

Staff and Pennichuck propose a net operating income requirement of \$3,574,734 and a revenue requirement of \$16,469,258. This is an increase of 11.8 percent over Pennichuck's test year revenues and compares to the revenue requirement for temporary rate purposes of \$16,047,313, approved by Commission Order No. 24,377, (September 30, 2004). In its initial filing, Pennichuck had sought a net operating income of \$3,873,665 and revenue requirement of \$17,145,212 while Staff proposed a net operating income of \$3,342,956 and a

revenue requirement of \$15,688,461. Exh. 12 at 35. Although the Agreement does not specifically state an agreed upon rate of return, we believe the revenue requirement falls within the realm of reasonableness. We accept that the revenue requirement represents a compromise between Staff and Pennichuck of all issues related to the revenue requirement, including allowed overall rate of return, return on equity, capital structure, *pro forma* adjustments, capital additions to rate base, operating expenses, and temporary rates. In light of the scope of the revenue sought, compromise obtained, and documented rate base described below, we conclude that this is a reasonable outcome and find the revenue requirement just and reasonable.

At hearing, Pennichuck testified how the rate increase would impact the average single family residential customer, based on a consumption of 11,140 cubic feet per year. Exh. 25. Prior to temporary rates, the average single family residential customer paid \$289.88 annually. Under temporary rates, that average increased to \$310.41. Under permanent rates, Pennichuck estimates the average single family residential customer will pay \$330.90 annually or \$41.07 more for water service on an annual basis. Exh. 25. We find these rates to be just and reasonable.

Staff and Pennichuck do not propose any change in rate design in this docket. Staff and Pennichuck propose that the rate increase be applied to all customers except private and public fire protection customers. Staff and Pennichuck cite to Pennichuck's last Cost of Service and Rate Design Study, dated July 2001. We note that we relied upon that cost of service study in concluding in Docket No. DW 01-081 that no change in rate design was warranted. We accepted the recommendations of the cost of service study that no increase to fire protection rates be made. *Pennichuck Water Works, Inc.*, 87 NH PUC 97, 101 (2002). Staff and Pennichuck represent that the revenues from fire protection are still sufficient to earn an adequate

rate of return for that customer class. 4/5/05 Tr. at 27 and 28 lines 24-1. Since no party has identified any reason to depart from this conclusion, we will accept Staff and Pennichuck's recommendation that the rate increase be applied to all customers except private and public fire protection.

With respect to the rate base, Staff and Pennichuck agreed and aver that the \$17,571,961 in rate base additions since Pennichuck's last rate case, Docket No. DW 01-081, should be deemed prudent, used, and useful in accordance with RSA 378:28. Exh. 10 at 15, 27, and 39. The attachment to the Agreement contains an extensive list of fixed asset additions for years 2001, 2002, and 2003. At hearing, Pennichuck witness Bonalyn Hartley testified that the Commission's audit staff conducted an audit of the additions. 4/5/05 Tr. at 19 line 16. In light of the fact that the fixed asset additions have been subject to audit, and there being no objection, we find that the fixed asset additions identified in the Agreement are prudent, used, and useful in accordance with RSA 378:28.

With respect to depreciation, Staff testified at hearing that Audit Staff identified that there may have been some over-accruals for depreciation in some of Pennichuck's plant accounts. 4/5/05 Tr. at 29 lines 19-24. In light of that, Staff in its testimony recommended Pennichuck make certain adjustments to depreciation expense and conduct a full depreciation study. 4/5/05 Tr. at 30 line 12. Pennichuck testified that it planned to conduct a full depreciation study in the very near future. 4/5/05 Tr. at 33 lines 8-9. Pennichuck's last depreciation study was conducted in 1996, based on 1995 information. Staff recommended depreciation studies be conducted about every five years and, thus, the present information is ten years old. 4/5/05 Tr. at 30 lines 21-22. We agree that an updated depreciation study will be necessary before Pennichuck's next rate case to minimize differences between booked and theoretical depreciation

reserves. For this reason, we find this provision of the Agreement reasonable and in the public good.

With respect to the effective date and recoupment of the permanent rate increase, we specified in Order No. 24,377 that Pennichuck could raise General Metered customer rates by 10.6 percent, effective for service rendered on or after June 1, 2004. Staff and Pennichuck proposed a final permanent rate that represents a 13.99 percent increase from existing rates. Exh. 23. RSA 378:29 requires that at the conclusion of the rate proceeding, the utility be allowed to amortize and recover the difference between the temporary rate and permanent rate, in this case, the difference between 10.6 percent and 13.99 percent, for the period of time temporary rates were in effect. At hearing, Pennichuck testified that they intend to calculate the difference between the temporary rate and permanent rate and bill the customers the difference in an equal amount over twelve months. 4/5/05 Tr. at 23 lines 14-21. We will make permanent rates effective as of the date of this order and thus will allow Pennichuck to recoup the difference from June 1, 2004 through the date of this order. We will not, however, approve the recovery of the temporary rate recoupment over twelve months at this time. Prior to approving a temporary rate surcharge, we usually have an estimate of the per-customer surcharge before us. That is not the case here and we will defer approving a recoupment time period until after we have reviewed the proposed per-customer charge to ensure recovery over twelve months is not onerous on customers.

With respect to recovery of rate case expenses, Pennichuck testified that rate case expenses totaled somewhere between \$123,000 and \$135,000. Pennichuck was unable to provide a per-customer estimate of the surcharge at the time of the hearing. 4/5/05 Tr. at 68 lines 11-18. Also at the time of hearing, Staff had not yet reviewed and formed a recommendation as

to the rate case expenses Pennichuck seeks to recover. Consequently, we will defer our consideration of whether the proposed surcharge and proposed twelve month recovery period are just and reasonable until after Staff and Pennichuck submit an accounting of the rate case expenses and a suggested surcharge amount.

The only contested issue in this case involves Staff and Pennichuck's proposal to create a deferred asset account for expenses Pennichuck is incurring related to its defense of Nashua's eminent domain efforts.¹ At hearing, Nashua and the OCA expressed concern with respect to the establishment of the deferred asset account. Nashua was particularly concerned with the characterization of the account as a "regulatory asset", which Nashua avers implies recovery. The Uniform System of Accounts for Water, Account 186, is for "items the proper final disposition of which is uncertain." We stress that, in contrast to regulatory assets established under Financial Accounting Standard 71, deferred debits do not carry any assurance of recovery. It is clear from the language of the Agreement that the Staff and Pennichuck also understand that recovery is not assured. Our approval of the creation of the deferred account is based on the distinction between Financial Accounting Standard 71 and Account 186 under the Uniform System of Accounts for Water. For this reason, we do not consider establishment of the deferred account for costs relating to Pennichuck's defense of its eminent domain case with Nashua as binding the Commission in any way to recovery of costs booked to that account.

With respect to the appropriate starting point for recording expenses to be included in the account, the Agreement does not expressly address the issue but simply states that the Company "shall be authorized to create a deferred asset account in which it may book costs associated with its defense of the City of Nashua's eminent domain efforts." In *Consumers*

¹ In response to a record request made at hearing, Pennichuck supplied Hearing Exhibit 26 which showed expense totals for year 2003 as \$235,198; 2004 as \$1,201,325; and through March 2005 as \$291,546.

New Hampshire Water Company, 81 NHPUC 1026 (1996), concerning the Town of Hudson's eminent domain proceeding to acquire Consumer's property, the Commission found premature a request to defer legal expenses associated with that proceeding. Instead, the Commission stated that "consistent with [its] traditional treatment of rate case expenses" it would determine the appropriate level of recovery at the end of the proceeding. *Id.* At 1027.

The *Consumers* case raises issues concerning the propriety of a deferral account, the appropriate starting point for possible recovery, and the preferred procedural vehicle for making such a request. Addressing the issues in reverse order, the procedural issue relates to the proceeding in which the deferral request was made. There are at least three plausible vehicles available, namely: the rate case, which was employed here; the eminent domain proceeding, as was employed by Consumers; and, a separate request for an accounting order, as was employed by *Unitil Energy Systems, Inc.* in Docket No. DE 04-231. *See, Unitil Energy Systems, Inc.* Order No. 24,449 (April 7, 2005). We recognize that reasonable grounds may exist for employing each of the procedural devices. With respect to Pennichuck's request, we find that it was fairly made, noticed and considered in Docket No. DW 04-056. As to the second issue, the *Consumers* case suggests that the eminent domain proceeding, in this instance Docket No. DW 04-048, provides the appropriate measuring stick for determining the starting point for recording expenses that may be subject to recovery. The *Consumers* case likens the costs of defending an eminent domain proceeding to rate case expenses, which are linked to the eminent domain proceeding itself. Accordingly, we find that Pennichuck may seek recovery of expenses incurred after March 25, 2004, the date on which the valuation petition was filed. The final issue goes to the creation of the deferral account itself. Consumers filed a very specific Motion for Order Re: Accounting Treatment and Method for Recovery of CNH Case Expense which is distinguishable

from the generalized request here to create a deferred asset account to book costs for subsequent Commission review. We find, based on the earlier discussion distinguishing between FAS 71 and Account 186, and the practical need to track the costs in any event, that it is reasonable to approve the requested deferral account mechanism, which will be subject to further review as described below.

At the conclusion of Docket No. 04-048, Pennichuck shall submit all expenses booked in the deferred account to the Commission for audit and review. At that time, we will then consider, among other things, the types of expenses that may be recovered, whether particular expenses were reasonably and prudently incurred, the appropriate allocation of expenses among the parent and its subsidiaries and the mechanism for recovery. For the foregoing reasons, we find creation of the deferred account reasonable and we will approve this accounting treatment of Pennichuck's expenses related to its defense against Nashua's eminent domain proceeding in Docket No. DW 04-048.

Having reviewed the record in this proceeding, including the Settlement Agreement and supporting testimony presented at the April 5, 2005 hearing, we find the terms of the Settlement Agreement to be reasonable and in the public good. We find that the terms will result in just and reasonable rates and represent an appropriate balancing of ratepayer interests and the interests of Pennichuck's investors under current economic circumstances. Accordingly, we will approve the Agreement as augmented above.

Based upon the foregoing, it is hereby

ORDERED, the Settlement Agreement is **APPROVED** as discussed herein; and
it is

FURTHER ORDERED, that Pennichuck Water Works, Inc. file with the Commission a compliance tariff within ten days of the date of this order.

By order of the Public Utilities Commission of New Hampshire this twenty-ninth day of April, 2005.

Thomas B. Getz
Chairman

Graham J. Morrison
Commissioner

Michael D. Harrington
Commissioner

Attested by:

Debra A. Howland
Executive Director & Secretary