

DW 05-119

AQUARION WATER COMPANY OF NEW HAMPSHIRE

Petition for Rate Increase

Order Approving Settlement Agreement on Permanent Rates

ORDER NO. 24,648

July 18, 2006

APPEARANCES: McLane, Graf, Raulerson & Middleton, P.A. by Steven V. Camerino, Esq. for Aquarion Water Company of New Hampshire; Mark S. Gearreald, Esq. for the Town of Hampton; Robert Landman, Commissioner, on behalf of the North Hampton Water Commission; 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

This docket concerns rate increases proposed by Aquarion Water Company of New Hampshire (Aquarion) and the New Hampshire Public Utilities Commission's (Commission) investigation of those proposed rates. The case began on July 5, 2005, with the filing by Aquarion of a notice of intent to file new rate schedules, followed by the submission of the rate schedules on August 5, 2005. Included with the August 2005 filing was a request for a temporary rate increase of 10.99 percent pursuant to RSA 378:27, which the Commission approved in part, following a hearing, by Order No. 24,546 (November 18, 2005) (authorizing an overall temporary rate increase of 10 percent, effective for service rendered on or after November 1, 2005).

Pursuant to the procedural schedule approved by the Commission upon recommendation of the parties and Commission Staff, attention then turned to Aquarion's request for permanent rates. Discovery on issues related to the permanent rates ensued, in advance of a hearing scheduled for either June 6, 2006 or July 18, 2006, depending on whether Aquarion would be

able to reach a settlement with Staff and the Office of Consumer Advocate (OCA) prior to the submission of prefiled direct testimony by Staff and OCA witnesses. The June 6, 2006 hearing date was premised on the submission of a settlement agreement by May 25, 2006. Such an agreement, entered into among Aquarion, OCA and Staff, was filed on that date.

While the settlement agreement was still being finalized, the Town of Hampton filed a letter on May 3, 2006, expressing concerns regarding the magnitude of the proposed rate increases for the various rate classes and the timing of the implementation of the increases. The Town indicated that it did not concur with the settlement agreement then under discussion. Similarly, the North Hampton Water Commission (Water Commission) filed a letter, on May 5, 2006, objecting to the proposed settlement agreement and the rate increase proposed therein. Both the municipality and the Water Commission stated an intent to press their concerns at hearing. On May 26, 2006, the Board of Selectmen for the Town of North Hampton filed a letter with the Commission requesting to be heard at the June 6, 2006 hearing.

The hearing took place as scheduled, with the Commission receiving testimony in support of the settlement agreement by witnesses for Aquarion, OCA and Staff. The Commission also heard testimony by witnesses for the Water Commission. The Water Commission submitted certain additional documents for inclusion in the record on June 13, 2006. On June 28, 2006, the Town of North Hampton filed a request for clarification of the hydrant maintenance procedures to be implemented by Aquarion pursuant to the terms of the settlement agreement.

II. POSITIONS OF THE PARTIES

A. Aquarion Water Company of New Hampshire, Staff and Office of the Consumer Advocate

The positions of Aquarion, Staff and OCA are embodied in the settlement agreement as follows:

1. Revenue Requirement

Aquarion, Staff, and OCA recommend Aquarion be granted an overall increase in revenues of 18.6 percent yielding a revenue requirement of \$4,954,372. According to the signatories, this revenue requirement represents a reasonable compromise on all issues relating to the request for an increase in rates pending before the Commission in this docket, including allowed overall rate of return, return on equity, capital structure, pro forma adjustments, capital additions to Aquarion's rate base and operating expenses. Aquarion, Staff and OCA state the revenue requirement is a liquidation of all net operating income requirement and revenue requirement issues and each party may have its own rationale or basis for agreeing to this amount.

Aquarion agreed to adjust its booking rates for depreciation for two plant accounts to reflect Commission-approved depreciation accrual rates. Specifically, Aquarion would change the booking rate for plant account 304-T&D Structures and Improvements to 2.04 percent and change the booking rate for plant account 304-General Structures to 2.71 percent.

2. Rate Design

Aquarion, Staff and OCA recommend the Commission apply the increased revenue requirement in accordance with Aquarion's most recent Cost of Service Study as set forth in Appendix A to the Settlement Agreement.

3. Rate Base

Aquarion, Staff and OCA agreed that all plant additions added to rate base since Aquarion's last general rate case in DW 99-057, as listed in Appendix B to the agreement, are in service and are prudent and used and useful in accordance with RSA 378:28 and recommend the Commission find the same.

4. Step Adjustment

Aquarion, Staff and OCA recommend the Commission allow Aquarion to file for a step increase in rates to account for capital expenditures made for distribution mains and related facilities in the Hampton Beach area. The Hampton Beach project is expected to be complete later this year and Aquarion's filing to the Commission is expected shortly thereafter. Aquarion, agreed to file supporting information setting forth the amount of the additions to rate base

relating to the Hampton Beach project, the increase in property taxes and depreciation resulting therefrom, and calculate the pro forma increase to its revenue requirement resulting from the project. Aquarion agreed to provide a copy of the step adjustment filing to all parties in this docket and agreed to be subject to audit by the Staff prior to final approval by the Commission. Aquarion, Staff and OCA recommend the additional revenues resulting from the step adjustment be allocated in accordance with the cost of service study submitted in this docket. The Staff and Aquarion believe that any adjustment for additional revenues from the Hampton Beach investment would be inconsistent with the concept of reflecting only known and measurable changes during a historical period, and therefore agree that an adjustment for alleged revenue changes at the time of the step adjustment should not be made. The OCA reserved the right to seek such an adjustment for increased customer revenues if it determines it to be appropriate to do so at the time Aquarion seeks the step adjustment.

5. Temporary Rate Recoupment and Rate Case Expenses

The Commission approved temporary rates, effective for service rendered on and after November 1, 2005, in Order No. 24,546 (November 18, 2005). Aquarion, Staff and OCA recommend the Commission allow Aquarion to impose a surcharge to recover the difference between temporary and permanent rates, exclusive of the step adjustment. They further recommend the surcharge be calculated and applied to customer bills over a 12 month period, effective with the implementation of the permanent rates.

Aquarion, Staff and OCA recommend the Commission allow Aquarion to recoup its rate case expenses, as approved by the Commission, through a surcharge applied over the same 12 month period as the rate recoupment surcharge. They recommend rate case expenses include, but not be limited to, Aquarion's cost of service expert, legal expenses, mailing and notification expenses and miscellaneous labor and overhead charges.

6. Reports

Aquarion agreed to conduct an engineering review of the overall physical adequacy of Aquarion's existing hydrants, including compatibility and interchangeability issues, wet versus dry hydrants, the need to replace or upgrade older styles, nozzle types, and nozzle and valve opening sizes and provide recommendations within nine months. Aquarion agreed to conduct an engineering review of the current hydrant inspection and maintenance program and provide recommendations within nine months.

Aquarion agreed to provide Staff with a copy, when completed, of Aquarion's: Integrated Resource Plan; Feasibility Study - Mill Road Treatment Center; and Source of Supply Study.

Aquarion agreed to file the following with the Commission: Form E-17, Annual Report of Hydrant Inspection; Form E-22, Report of Proposed Expenditures for Additions, Extensions and Capital Improvements to Fixed Capital; 2007/8 Capital Improvements Plan, when completed; Five year Capital Improvements Plan, when completed; and Summary of Lost Water (water produced, water billed, non-revenue usage and lost water) by quarter, to be filed annually in conjunction with Annual Report.

B. Town of North Hampton Board of Selectmen

The Board of Selectmen, through Selectman LaGassa, made a public statement at hearing objecting to the proposed rate increase. The Board of Selectmen took the position that, because Aquarion's hydrant rates are higher than most in the state, the Commission should disallow any hydrants that do not meet 90 percent of the ISO recommended flow for fire protection. The Board of Selectmen contend that Aquarion has become lax in its hydrant service and in keeping maintenance records, and that the case of *Libby v. Hampton Water Works, Inc.*, 118 NH 500 (1978), has caused Aquarion to diminish its fire protection service. The Board of Selectmen requested that the proposed step increase to cover capital improvements at Hampton Beach be offset by anticipated future revenues. Selectman LaGassa stated that real estate development has recently accelerated in the Town of Hampton. 06/06/06 Tr. at 165 line 13. The Board of Selectmen urged the Commission to consider other ways of allowing Aquarion to collect revenues and suggested, in particular, that Aquarion be allowed to charge access fees to real estate developers, similar to those currently being applied in Salisbury Beach, or be allowed to charge peak load pricing. Tr. 6/6/06 at 166 lines 3-12. The Board of Selectmen urged the Commission to condition implementation of any rate increase on adoption of creative rate designs that shift the burden of new development to the beneficiaries thereof. Tr. 6/6/06 at 166 lines 16-19.

C. North Hampton Water Commission

The Water Commission sponsored three witnesses: Commissioner Harold Mailhot, Commissioner Richard Bettcher and Commissioner Henry Fuller. Mr. Mailhot testified that he had spoken to neighbors who reported boilers failing and plumbing having to be flushed with acid. Residents also reported water staining, according to Mr. Mailhot. Mr. Bettcher testified

that he had reviewed hydrant charges from around the state and found Aquarion's hydrant charge to be three times the state average. 06/06/06 Tr. at 173 line 13. Mr. Bettcher also testified that he made 60 calls to customers in North Hampton and Hampton and found that most customers do not drink the water. 06/06/06 Tr. at 174 line 24 and at 175 lines 1-7. Mr. Fuller testified at length about Aquarion's lack of record keeping concerning maintenance records of Aquarion's hydrants and the Water Commission's desire to have corroboration that Aquarion is performing the maintenance the company states it is performing. Mr. Fuller said the lack of corroboration of maintenance has led the Water Commission to question whether the fire hydrants actually work. 06/06/06 Tr. at 192 line 14. The Water Commission stated that six different sizes of hydrants exist in the Town of North Hampton and suggested that the hydrants were undersized for Hampton Beach. 06/06/06 Tr. at 194 lines 12-21.

D. Town of Hampton

The Town of Hampton did not join in the settlement agreement. The Town of Hampton contended the rate increase would constitute rate shock to seasonal users and that the rate increase would deter growth in the Hampton Beach area. 06/06/06 Tr. at 224 lines 4-24 and at 225 lines 1-16. The Town stated that tourism is important to its economy and it recommended that the Commission phase in the permanent rate increase and proposed step increase in order to dampen rate shock.

E. Executive Councilor Ruth Griffin

Councilor Griffin offered a public statement at hearing expressing her concern that her constituents receive the fire protection service they are paying for. She reported that, according to her constituents, questions exist as to whether Aquarion is inspecting, opening, and flushing

fire hydrants. She urged the Commission to assure that her constituents receive adequate fire protection.

III. COMMISSION ANALYSIS

RSA 378:7 authorizes the Commission to fix rates pursuant to an order after a hearing, provided that such rates are just, reasonable and lawful. In determining just and reasonable rates, the Commission 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). The utility bears the burden of proving the necessity of an increase pursuant to RSA 378:8.

Aquarion, Staff and OCA propose an overall revenue requirement of \$4,954,372. This amount represents an increase of 18.6 percent over Aquarion's test year revenues of \$4,166,569 and compares to the revenue requirement for temporary rate purposes of \$4,583,039, approved last year in Order No. 24,546. In its initial filing, Aquarion had sought a revenue requirement of \$5,052,174. Although the settlement agreement does not specifically state an agreed upon rate of return, return on equity, capital structure, or *pro forma* adjustments, we find that the revenue requirement falls within the realm of reasonableness. At hearing, it was evident that Staff and the parties had conducted a thorough review of Aquarion's filing and that the revenue requirement represents a compromise among Aquarion, Staff and OCA of all issues related to the revenue requirement. In light of the documented rate base described below, we conclude that the stipulation provides for just and reasonable rates.

With respect to the rate base, Aquarion, Staff and OCA produced a list of plant additions they assert were in service, prudent, and used and useful pursuant to RSA 378:28. Exh. 5 at 12. The plant additions total \$6,940,923. At hearing, Staff testified that the Commission's Audit

Staff had conducted a thorough examination of Aquarion's books and records and had issued a Final Audit Report on February 9, 2006. 06/06/06 Tr. at 105 lines 10-13. 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 settlement agreement are prudent, used, and useful in accordance with RSA 378:28.

At hearing, Aquarion testified how the rate increase would impact the average single family residential customer, based on consumption of 63,300 gallons per year. Under the proposed permanent rates, Aquarion estimates the average single family residential customer would pay \$382.92 annually or \$57.36 more for water service on an annual basis. 06/06/06 Tr. at 24 lines 7-12. The Report of Proposed Rate Changes attached to the settlement agreement allocates the proposed 18.64 percent overall rate increase among customer classes according to Aquarion's August 2005 Cost of Service Study.¹ Exh. 5 at 11. Residential customers would actually see an effective 17.51 percent rate increase. The remaining classes will see an effective rate increase ranging from a high of 22.76 percent to a low of 16.89 percent. We find that in light of Aquarion's updated Cost of Service Study, and Staff and the parties' discovery thereon, that the allocation of the rate increase among Aquarion's rate classes and the rates themselves are just and reasonable.

Aquarion, Staff and OCA recommend the Commission allow Aquarion to file for a step adjustment to its rates after its construction project at Hampton Beach involving distribution mains and related facilities is complete. The settlement agreement provides for a mechanism for review and audit of costs associated with the requested step adjustment. It does not request specific Commission approval of an amount certain at this time. The settlement agreement

¹ Aquarion's Cost of Service Study was submitted with the direct testimony of Mr. John F. Guastella, and according to discovery responses submitted at hearing, the study was thoroughly evaluated by Staff and the parties.

further states that OCA reserves the right to seek an offset for increased customer revenues if it deems it appropriate to do so at the time Aquarion seeks the step adjustment. The Hampton Beach project involves replacement of approximately 6,600 feet of water main, enlargement of 8 and 12-inch mains to 12 or 16 inches, and installation of new services and hydrants. 06/06/06 Tr. at 25 lines 11-24 and at 26 lines 1-6. Aquarion testified that it anticipated filing for the step adjustment within the next two months. Aquarion did not provide a cost estimate for the Hampton Beach project; however, Staff witness Mark Naylor testified that Staff anticipated the step adjustment to be just above five percent. 06/06/06 Tr. at 103 lines 23-24 and at 104 line 1. Staff believed the permanent rate increase and step adjustment combined would raise customer rates by a total of 23 to 24 percent. Staff further stated that it believed this total rate increase was generally reasonable in light of the fact that Aquarion's last rate case was seven years ago. 06/06/06/ Tr. at 104 lines 2-5.

The Town of Hampton supported the concept of a step adjustment for the Hampton Beach project but requested that the rate increase and step adjustment be phased in to minimize rate shock on its seasonal customers and to mitigate adverse impacts to its economic growth. 06/06/06 Tr. at 226 lines 3-5. We note that according to Aquarion's petition for temporary rates, Aquarion's rate of return, as of December 31, 2004, was 4 percent, or 481 basis points below its authorized rate of return of 8.81 percent. Customers have been paying a 10 percent overall temporary rate increase, which will be credited toward the permanent rate. It will be a few months before Aquarion files for the proposed step adjustment. The implementation of temporary rates and the timing of the proposed step adjustment sufficiently address the concern over rate shock. Additional measures to phase in the rate would do little more than increase

carrying costs and therefore the overall rate obligation of customers. Accordingly, we find that the proposed step adjustment mechanism is reasonable.

With respect to the effective date and reconciliation of temporary rates and permanent rates, we specified in Order No. 24,546 that Aquarion could implement temporary rates by an average of 10 percent, effective for service rendered on or after November 1, 2005. In addition we determined, consistent with the settlement agreement on temporary rates, that the temporary increase be allocated to the various customer classes in accordance with the Cost of Service Study as filed with this rate case. For permanent rates, Aquarion, Staff and OCA propose a final permanent rate that represents an average of 18.6 percent increase from existing rates. Exh. 5 at 11. RSA 378:29 requires that the utility be allowed, at the conclusion of a rate proceeding, to amortize and recover the difference between the temporary and permanent rates. In this case, the difference for the period of time temporary rates were in effect is between 10 percent and 18.6 percent. At hearing, Aquarion testified that it intends to calculate the difference between the temporary rate and permanent rate and bill the customers the difference in an equal amount over twelve months. 6/6/06 Tr. at 27 lines 4-10. We will make permanent rates effective as of the date of this order and thus will allow Aquarion to recoup the difference from November 1, 2005, through the date of this order, over twelve months as called for in the settlement agreement.

With respect to recovery of rate case expenses, Staff testified that it had made an inquiry as to the anticipated level of rate case expenses and concluded that at that level the recovery over twelve months would not be burdensome to customers. In addition, Staff indicated that Aquarion was obligated under the terms of the settlement agreement to provide a filing detailing its rate case expense request. 6/6/06 Tr. at 111 lines 5-11. Given the uncertainty as to the level of expense recovery at this time, we will defer our consideration of whether the proposed

surcharge and proposed twelve-month recovery period are just and reasonable until after Staff submits its recommendation on rate case expenses following Aquarion's submission.

As stated earlier, the Water Commission raised numerous issues at hearing concerning the maintenance and costs of hydrants. Among other things, Mr. Fuller described a particular hydrant that he asserted was out of service for an extended time in February 2006. 06/06/06 Tr. at 187 line 6 through at 190 line 5. Mr. Fuller also pointed to maintenance records that were incomplete. Aquarion acknowledged that its hydrant record keeping needed to be improved but it denied any implication of wrongdoing. In fact, Aquarion testified that it was presently undertaking a process of computerizing its hydrant maintenance records to facilitate accurate recording of maintenance work by field staff. 06/06/06 Tr. at 83 lines 18-24 and at 84 lines 1-6. Based on the record before us, we find no basis for concluding that Aquarion acted improperly in maintaining its hydrant records but we do find that an improved method of record keeping and reporting is appropriate as further discussed below.

The Water Commission was also critical of Aquarion's rates for public fire protection. The Water Commission produced an exhibit which depicted comparative municipal fire protection rates around the state and averred that some of the rates were significantly lower than Aquarion's fire protection rates. Exh. 22. Upon questioning, however, the Water Commission could not explain the derivation of the rates shown on Exh. 22. 06/06/06 Tr. at 179 line 10. For instance, it was unclear whether the rates shown were inch-foot charges or otherwise. Aquarion testified that the rates could be based on a per-foot charge, a hydrant charge, or charges could be recovered in another portion of the budget. 06/06/06 Tr. at 55 lines 19-24. We note that Aquarion's proposed rates, fire protection rates included, were based on a recently completed Cost of Service Study that Aquarion provided with their initial filing. That study was subject to

thorough discovery by Staff and the parties and they are in agreement with the study's allocation of costs among customer classes. In light of the unidentified elements of the rates shown on Exhibit 22, and thorough discovery by the parties and Staff, we find no basis to conclude that Aquarion's proposed fire protection rates are unjust or unreasonable.

Lastly, the settlement agreement requires Aquarion to provide certain reports. As stated earlier, the Board of Selectmen and Water Commission for the Town of North Hampton raised concerns about Aquarion's hydrant maintenance. The agreed upon reports will contain an engineering review of the overall physical adequacy of Aquarion's existing hydrants, including compatibility and interchangeability issues, wet versus dry hydrants, the need to replace or upgrade older styles, nozzle types, and nozzle and valve opening sizes. A separate report will require Aquarion to conduct an engineering review of the current hydrant inspection and maintenance program. Aquarion commits to producing these reports to the Commission and parties to this docket within nine months. We have considered the concerns raised by the Board of Selectmen and Water Commission for the Town of North Hampton and conclude that the reports required by the settlement agreement are adequate to address the Board of Selectmen and Water Commission's concerns. At hearing, Mr. Fuller of the Water Commission was asked by Staff if the reporting requirements addressed the selectmen's concerns. Mr. Fuller replied in the affirmative but added that he wished to see Aquarion adopt a barcode reader scan. 06/06/06 Tr. at 216 lines 8-17. We will not rule on the appropriateness of barcodes, rather, we believe it is reasonable to await the recommendations of qualified engineers on this subject before requiring specific changes to Aquarion's hydrant system or hydrant maintenance practices. For the above reasons, we find the reports as recommended by the settlement agreement to be reasonable.

Having reviewed the record in this proceeding, including the settlement agreement and supporting testimony presented at the June 6, 2006 hearing, we find the terms of the settlement agreement to be reasonable and in the public interest. We find that the terms will result in just and reasonable rates and represent an appropriate balancing of ratepayer interests and the interests of Aquarion's investors under current economic circumstances. Accordingly, we will approve the settlement agreement.

Based upon the foregoing, it is hereby

ORDERED, the Settlement Agreement is **APPROVED** as discussed herein; and it is **FURTHER ORDERED**, that Aquarion Water Company of New Hampshire 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 eighteenth day of July 2006.

Thomas B. Getz
Chairman

Graham J. Morrison
Commissioner

Clifton C. Below
Commissioner

Attested by:

Debra A. Howland
Executive Director & Secretary