

LAKES REGION WATER COMPANY

Petition for Approval of Permanent and Temporary Rates

Order Approving Stipulation Agreement on Permanent Rates

ORDER NO. 24,692

October 31, 2006

I. BACKGROUND

On December 19, 2005, Lakes Region Water Company (Lakes Region) filed with the New Hampshire Public Utilities Commission (Commission) proposed tariff pages and supporting documentation increasing its permanent rates for customers in the following divisions (collectively, the Consolidated Tariff System): Far Echo Harbor, Paradise Shores, West Point, Waterville Valley Gateway, Hidden Valley, Wentworth Cove, Pendleton Cove, Deer Run, Woodland Grove, Echo Lake Woods, Brake Hill Estates, and Tamworth. Lakes Region requested, among other things, Commission approval to incorporate the following other divisions into the Consolidated Tariff System: 175 Estates, Deer Cove, Lake Ossipee Village (LOV), and Indian Mound. Lakes Region also filed a request for waiver certain filing requirements under Puc 1604.01(a) except for (a)(4), (11), and (20), with which Staff concurred.

On January 6, 2006, the Commission issued Order No. 24,576 suspending the proposed tariff revisions and scheduling a prehearing conference and Technical Session for January 26, 2006. On January 25, 2006, the Office of Consumer Advocate (OCA) filed notice of its intent to participate on behalf of residential utility consumers pursuant to RSA 363:28.

On February 3, 2006, Lakes Region filed a petition requesting temporary rates for the remainder of the Commission's investigation. On February 21, 2006, Lakes Region amended both its temporary and permanent rate requests. On February 23, 2006, the Commission issued a

supplemental Order of Notice and scheduled a temporary rate hearing for March 21, 2006. Due to notice delays, the hearing was rescheduled for April 21, 2006.

Staff and the parties conducted discovery according to a Commission-approved procedural schedule. On April 17, 2006, the Property Owners Association at Suissevale, Inc. (Suissevale) filed a motion to intervene, which was granted at the temporary rate hearing held on April 21, 2006. The Commission approved temporary rates for Lakes Region by Order No. 24,624 (May 15, 2006).

On July 26, 2006, Staff filed the testimony of utility analyst James L. Lenihan. Mr. Lenihan stated that Staff was unable to recommend a revenue requirement because Lakes Region had not yet reached agreement with its largest customer, Suissevale, as to a rate. Mr. Lenihan said he anticipated that Lakes Region would enter into a special contract with Suissevale soon but that absent confirmation of what revenue Lakes Region would realize under the special contract, Staff could not calculate and recommend a revenue requirement.

On September 26, 2006, Staff filed a settlement agreement with the Commission. The agreement was signed by Staff, OCA, and Lakes Region. Staff and the parties presented the agreement to the Commission at a duly noticed hearing held on September 28, 2006.

II. STIPULATED TERMS OF THE AGREEMENT

Staff, OCA, and Lakes Region presented the following stipulated terms:

A. CONSOLIDATED RATE

1. Revenue Requirement and Rate Base

Staff, the OCA, and Lakes Region agreed to an overall consolidated revenue requirement of \$643,729. The signatories endorsed a revenue requirement consisting of: (1) a permanent rate component in the amount of \$615,230, which was established according to the rate base, operating revenue and operating expenses as adjusted for the test year 2004, and (2) a step increase component in the amount of \$28,499, which was established based upon certain plant additions. The permanent rate and the step adjustment would be applicable to all of Lakes

Region's water systems with the exception of Gunstock Glen, for which permanent rates were not requested in this docket.

2. Rate of Return

Staff, the OCA, and Lakes Region agreed on an overall rate of return for Lakes Region's rate base of 8.23 percent. This includes a return component of 9.75 percent on equity.

3. Consolidated Customer Rate

Staff, the OCA, and Lakes Region agreed upon a system-wide consolidated rate. They recommend a base charge of \$77.62 per quarter and a consumption charge of \$3.35 per 100 cubic feet. For those systems not metered, including LOV, Deer Cove, Indian Mound, Tamworth, and 175 Estates, the signatories recommend a fixed water rate of \$421.48 annually, or \$105.37 per quarter, which is calculated by dividing the revenue requirement for all general customers (less the revenue from the Waterville Valley Gateway Community Pool) by the total number of customers subject to the consolidated rate. Once customers in Deer Cove, LOV, and Indian Mound are supplied with water meters as detailed below, the signatories recommend these customers be thereafter charged at the consolidated rate consisting of a base charge and a consumption charge. The annual rate that would be charged to the Waterville Valley Gateway Community Pool is \$970.26.

4. Step Adjustment for Meter Installation

Lakes Region agreed to install water meters at Deer Cove, Indian Mound, and LOV during 2007. Staff, the OCA, and Lakes Region recommend a step adjustment in rates to recover a return on this capital investment as well as depreciation expense and direct incremental increases in expense related to providing metered service to those three systems on an ongoing basis. Lakes Region agreed to petition the Commission for this step increase no later than November 1, 2007, with supporting documentation.

B. EFFECTIVE DATE AND TEMPORARY RATE RECONCILIATION

The settlement agreement calls for Commission approval of a reconciliation of the permanent rate component of the consolidated rate with the temporary rates charged from April 5, 2006, forward, which is the effective date for temporary rates approved by the Commission.

Temporary rates were approved as follows:

Revenue Requirement

<u>System</u>	<u>Test Year</u>	<u>Proposed</u>	<u>% Increase</u>
Consolidated Tariff Systems	\$432,081	\$436,955	1.13%
175 Estates	\$ 18,291	\$ 18,291	0.00%
Deer Cove	\$ 11,883	\$ 15,406	29.65%
Lake Ossipee Village	\$ 30,115	\$ 65,853	118.67%
Indian Mound	\$ 22,785	\$ 34,993	53.58%
Total	\$515,115	\$571,498	10.94%

Temporary Customer Rates

<u>Unmetered Customers</u>	<u>Annual Charge</u>	<u>Quarterly Rate</u>
Consolidated Tariff Systems:		
Waterville Valley Gateway – Pool	\$ 789.81	\$ -
Tamworth Water Works	\$ 392.94	\$ 98.24
175 Estates	\$ 397.65	\$ 99.41
Deer Cove	\$ 302.08	\$ 75.52
Lake Ossipee Village	\$ 302.08	\$ 75.52
Indian Mound	\$ 397.65	\$ 99.41

Metered Customers

Consolidated Tariff Systems:		
Minimum Charge per Customer per Quarter	\$	71.64
Or Annual Flat Rate	\$	286.56
Minimum Rate per 100 cubic feet Consumed	\$	3.19

The signatories recommend that Lakes Region recover the difference between temporary and permanent rates through a surcharge added to customer bills in those systems that were subject to a temporary rate. Lakes Region agreed to submit a proposal for a temporary rate recoupment for Staff and the OCA's review and recommendations. Staff, the OCA, and Lakes Region agreed that any recoupment of temporary rates should be combined with recovery of rate case expenses, so that a single customer surcharge results.

C. RATE CASE EXPENDITURE

Lakes Region agreed to submit documentation of its rate case expenditures and propose a temporary rate recoupment surcharge to Staff and the OCA for their review and recommendations.

III. COMMISSION ANALYSIS

RSA 378:7 authorizes the Commission to establish just and reasonable rates for a utility after conducting a hearing. In determining just and reasonable rates, the Commission must balance the consumers' interest in paying rates no higher than are required with the investors' interest in obtaining a reasonable return on investment. *Eastman Sewer Co.*, 138 N.H. 221, 225 (1994). In circumstances where a utility seeks to increase rates, the utility bears the burden of proving the necessity of the increase pursuant to RSA 378:8.

We first consider the revenue requirement proposed by Staff and the parties. They adopted an overall consolidated revenue requirement of \$643,729. Exh. 11 at 50. This includes a permanent rate component in the amount of \$615,230, which was established based upon the rate base, operating revenue, and operating expenses, as adjusted for the test year 2004, and a step increase component in the amount of \$28,499 for certain post-test-year plant additions. At hearing, Staff witness Jayson P. Laflamme testified that although Lakes Region's initial proposal included 2004 and 2005 plant additions in the test year, for settlement purposes the 2004 and 2005 plant additions were accounted for separately as a step adjustment to be implemented at the end of the rate case. Hearing Transcript of September 28, 2006 (9/28/06 Tr.) at 31, lines 4-16. The effect of this treatment is to remove these plant additions from the temporary rate reconciliation allowed under RSA 378:29. The remainder of the rate base consists of plant in service, inventory, materials and supplies, prepaid expenses, cash working capital, deferred taxes, and deferred purchased water. 9/28/06 Tr. at 34, lines 3-11. Staff explained that purchased water related to an incident at Lakes Region's Hidden Valley water system that necessitated Lakes Region trucking water into the system due to insufficient well capacity. 9/28/06 Tr. at 29, lines 21-24 and at 30, lines 1-5.

The proposed operating revenue component of the proposed revenue requirement includes revenues from Lakes Region's sale of water, through a master meter, to Suissevale. We are considering a joint petition for approval of a special contract filed by Lakes Region and Suissevale in a separate docket, DW 06-133. We recognize the revenues derived from the special contract between Lakes Region and Suissevale are consistent with the public interest pursuant to RSA 378:18 pursuant to our findings in Docket No. DW 06-133 made this day in a companion order.

Concerning the step adjustment for the 2004 and 2005 plant additions, we generally employ step adjustments as a means of ensuring that a regulated utility retains its opportunity to earn a reasonable rate of return even after implementing large capital projects. Its purpose is to avoid placing a utility in an earnings deficiency immediately after a rate case in which a revenue requirement was based on an historical test year. Lakes Region has invested capital in a well and pump house in its Hidden Valley system at \$68,000, upgrades to 175 Estates totaling \$8,080, and pumps and water treatment systems in Deer Cove, LOV, and Indian Mound. Exh. 1 at 9, and 9/28/06 Tr. at 20, lines 1-2. We accept Staff and the parties' assertions that the capital improvements are presently used and useful and are in service to customers. We find that it is reasonable to include them in rate base since traditional rate-of-return principles permit a utility to have "the opportunity to make a profit on its investment, in an amount equal to its rate base multiplied by a specified rate of return." *Appeal of Conservation Law Foundation*, 127 N.H. 606, 634 (1986). Accordingly, we find it just and reasonable to approve the proposed revenue requirement and inclusive step adjustment for 2004 and 2005 plant additions, effective as of the date of this order on a service rendered basis. We also find reasonable the recommendation that the 2004 and 2005 plant additions not be considered part of permanent rates subject to reconciliation pursuant to RSA 378:29.¹

We next consider the proposed rate of return on rate base of 8.23 percent and return on equity of 9.75 percent. In 2003, we approved a 9.58 percent rate of return and 10 percent return on equity for Lakes Region and required Lakes Region to replace its existing relatively high cost

¹ RSA 378:29 provides in relevant part:

If, upon final disposition of the issues involved in such proceeding, the rates as finally determined are in excess of the rates prescribed in such temporary order, then such public utility shall be permitted to amortize and recover, by means of a temporary increase over and above the rates finally determined, such sum as shall represent the difference between the gross income obtained from the rates prescribed in such temporary order and the gross income which would have been obtained under the rates finally determined if applied during the period such temporary order was in effect.

debt with lower cost financing. *Lakes Region Water Co.*, 88 NH PUC 382, 388 (2003). In compliance with this order, Lakes Region refinanced its debt and the Commission approved the refinancing on December 19, 2003. *Lakes Region Water Company, Inc.*, 88 NH PUC 653 (2003). The lower rate of return and cost of equity proposed here demonstrates that Lakes Region has indeed reduced its cost of doing business. This reduction in cost will be a benefit to customers and we find the proposed rate of return and return on equity to be just and reasonable.

We next consider the proposal to include 175 Estates, Lake Ossipee Village, Deer Cove, and Indian Mound in the utility's consolidated tariff. Lakes Region presently has consolidated rates for 11 of its 16 water systems. 9/28/06 Tr. at 22, lines 1-2. The decision to consolidate rates is a matter of policy and must also meet the statutory requirements that rates be just and reasonable and that we act in the public interest. See RSA 374:2 and RSA 378:28. We have considered the issue of single tariff pricing for water utilities in the past. See, *Pennichuck Water Works, Inc.*, 83 NH PUC 197 (1998) and *Lakes Region Water Co.*, 84 NH PUC 125 (1999). In those cases, we balanced the benefits to customers of water systems remaining on a per-system cost based methodology against the benefits to customers of adopting a single tariff pricing methodology where costs are determined on a company-wide basis.

In the 1999 *Lakes Region* decision, the Commission observed that "an overriding consideration that favors rate consolidation is the wide disparity in rates among customers of the individual systems that would result from denying [the] request." *Lakes Region*, 84 NH PUC at 128. In the instant case, stand-alone rates for 175 Estates, Deer Cove, LOV, and Indian Mound would range from \$356 to \$569. Exh. 11 at 56. Under a consolidated tariff, customers of these same systems would pay \$421.48 annually. As to the benefits of per-system rate setting, per-system rates would tend to minimize the potential for cross-subsidization between individual systems and arguably reflect better the cost of service by lessening the number of customers over

which cost averaging is performed. At the same time, cost-of-service ratemaking always involves at least some degree of cost-averaging because the cost of serving any given customer is never identical to the cost of serving another customer within that water system and it is administratively inefficient to calculate a cost of service on an individual customer basis.

As to the benefits of consolidation, Staff testified at hearing that in the case of water utilities with multiple individual systems, consolidation helps to insulate individual systems from rate shock when significant investments are made to comply with environmental mandates or for other reasons. 9/28/06 Tr. at 17, lines 2-16. This protection helps ensure that each system can continue to provide safe and adequate water service pursuant to RSA 374:1. The Commission concluded in Lakes Region's last request for consolidated rates that eliminating disparities among individual systems was consistent with the long-term best interests of Lakes Region's customers and we do not see any reason in the record here to find otherwise. The newly acquired systems' rates will be moderated by consolidation. Consolidation will minimize rate shock to customers when Lakes Region invests in additional capital improvements to meet federal and state environmental water quality regulations. Additionally, Lakes Region operates its water systems on a company-wide basis, not on an individual basis, to benefit from shared resources and shared management. 9/28/06 tr. at 22, lines 10-16. These management efficiencies benefit customers. For the above reasons, we find that consolidating 175 Estates, LOV, Deer Cove, and Indian Mound into Lakes Region's consolidated tariff is just and reasonable.

We next address metering. In Order No. 24,376 (September 30, 2004), the Commission directed Lakes Region to install meters at Deer Cove and LOV. In Order No. 24,374 (September 23, 2004) the Commission directed Lakes Region to install meters at Indian Mound. These metering requirements were meant to bring these systems into compliance with N.H. Code

Admin. Rules Puc 603.03(a) which requires that “[a]ll water sold by a utility shall be billed on the basis of metered volume sales unless a waiver is granted” by the Commission. We understand that Lakes Region has needed to address other more pressing capital improvements. At hearing, Staff witness Lenihan testified that these systems had not had rate increases for considerable periods of time and that consequently their physical conditions had somewhat deteriorated prior to their acquisition by Lakes Region. Mr. Lenihan further indicated that Lakes Region was bringing necessary capital to these systems. 9/28/06 tr. at 19, lines 1-12. Lakes Region’s witness St. Cyr also testified as to numerous capital improvements Lakes Region has made and plans to undertake in these three systems, in addition to other capital improvements within all its franchises including a \$550,000 water storage tank at the Paradise Shores system. We understand, given Lakes Region’s recent and planned capital improvement projects, that Lakes Region may not have the financial resources at this time to install meters at these systems without a step increase. We find it reasonable to allow Lakes Region to avail themselves of the step adjustment mechanism in order to effectuate our intent that Lakes Region’s systems be metered in accordance with Puc 603.03(a). Accordingly, we will allow Lakes Region to submit a request for a step adjustment, consistent with the stipulation agreement, to the Commission for consideration of its meter installation costs for the Deer Cove, LOV, and Indian Mound systems.

With respect to temporary rate reconciliation pursuant to RSA 378:29, Staff, OCA, and Lakes Region intend to submit to the Commission at a later date an accounting and surcharge recommendation. In addition, Lakes Region plans to file an accounting and surcharge recommendation pertaining to recovery of its rate case expenses. We defer consideration of temporary rate reconciliation and recovery of rate case expenses until the Commission receives proper accounting documentation and a recommendation from Staff, OCA, and Lakes Region regarding customer surcharges. Since Lakes Region’s calculation of its temporary rate

recoupment is dependent upon an effective date for permanent rates, we will make our approval of the stipulation agreement effective December 1, 2006.

In conclusion, having reviewed the record in this proceeding, including the stipulation and supporting testimony presented at the September 28, 2006 hearing, we find the terms of the stipulation to be reasonable and consistent with the public good. We find the terms will result in just and reasonable rates and we approve the stipulation.

Based upon the foregoing, it is hereby

ORDERED, that the stipulation presented by Commission Staff, Office of the Consumer Advocate, and Lakes Region Water Company, Inc. concerning permanent rates is hereby **APPROVED**; and it is

FURTHER ORDERED that permanent rates proposed in the stipulation are hereby **APPROVED** and shall be effective on a service rendered basis for service rendered on or after December 1, 2006; and it is

FURTHER ORDERED, that Lakes Region Water Company, Inc. shall submit tariff pages in compliance with this order within 15 days of the date of this order.

By order of the Public Utilities Commission of New Hampshire this thirty-first day of October, 2006.

Thomas B. Getz
Chairman

Graham J. Morrison
Commissioner

Clifton C. Below
Commissioner

Attested by:

ChristiAne G. Mason
Assistant Executive Director and Secretary