STATE OF NEW HAMPSHIRE
PUBLIC UTILITIES COMMISSION

DW 08-160

FOREST EDGE WATER COMPANY

Petition for Temporary and Permanent Rates

Order Granting Permanent Rate Increase

O R D E R N O. 25017

September 23, 2009

APPEARANCES: Stephen P. St. Cyr, for Forest Edge Water Company; Matthew J. Fossum, Esq. for the Staff of the Public Utilities Commission.

I. PROCEDURAL HISTORY

On December 11, 2008, Forest Edge Water Company (Forest Edge or Company), a water utility serving 38 customers in North Conway, filed a notice of its intent to file rate schedules. On February 10, 2009, the Company filed revised tariff pages indicating its intent to increase its annual revenues by $10,852, or about 142.79%. In addition, the Company requested that its current rates be set as temporary rates. The Company also sought approval of financing that it had obtained from its "parent," Kearsarge Building Company (KBC), in 2007.

On March 3, 2009, in Order 24,946, the Commission suspended the Company's proposed tariff revisions pursuant to RSA 378:6 and scheduled a pre-hearing conference for March 25, 2009. On March 20, 2009, a group of homeowners served by the Company petitioned to intervene (the Forest Edge Homeowners). The Commission approved their intervention at the March 25, 2009 pre-hearing conference. No other parties petitioned to intervene in this docket. Following the pre-hearing conference, the Commission approved the parties' proposed procedural schedule, which included a hearing on temporary rates on May 1, 2009.

On April 27, 2009, Commission Staff filed a stipulation on temporary rates to which only the Staff and Company were signatories. Following presentation of the stipulation at the hearing on temporary rates on May 1, 2009, the stipulation was approved by the Commission in Order No. 24,971 (May 22, 2009). The approved stipulation set the Company's current rates as temporary rates for service rendered on and after April 1, 2009.

On August 31, 2009, following discovery, technical sessions and discussions among the parties, Staff and the Company filed a settlement agreement on permanent rates, which was presented at the hearing on September 2, 2009. The settlement agreement noted that, although the Forest Edge Homeowners were not signatories to the agreement, a representative member of the group had indicated that they did not oppose it.

II. POSITIONS OF THE PARTIES AND STAFF

A. Forest Edge and Staff

The positions of the Staff and Company are contained in the settlement agreement, which is described below.

B. The Forest Edge Homeowners

The Forest Edge Homeowners noted that they have had long-standing issues with the water system, in part because of what they characterized as an "unusual setup." Transcript of Sept. 2, 2009 Hearing (Tr.) at 28. The Forest Edge Homeowners stated that the system had gone down often, particularly for those homeowners at the top of the hill. Tr. at 28. The Forest Edge Homeowners, however, also stated that they had appreciated that much work had been done in recent years to improve the system. Tr. at 28-29. They also stated that they appreciated Staff's proposal to continue improving the system and that they looked forward to some "permanent improvements" to the system that would, possibly, result in lowering its operating costs. Tr. at 29.

Regarding the rate increase, the Forest Edge Homeowners noted that they have had relatively low rates from the Company, but they have had to incur additional expenses in procuring water when the system failed. Tr. at 29-30. Thus, they stated that their costs have already been in excess of the approved rates and that they were looking forward to having the system improved. Tr. at 30.

III. TERMS OF SETTLEMENT AGREEMENT

Staff and Forest Edge reached agreement on all issued as specified below.

A. Income Requirement

The settling parties agreed that Forest Edge should be granted an increase of $10,008, or 131.68%, in its adjusted test year water revenues of $7,600 in order to produce a total revenue requirement of $17,608. This amount was calculated using a stipulated rate base amount of $36,774 and an overall rate of return of 7%. The revenue requirement takes into account a reclassification of $92,677 of the Company's long-term debt to equity as well as the establishment of its operating and maintenance (O&M) expenses at a 5-year average.

B. Rate Design and Impact

There are to be no changes to rate design other than the Company's transition from semi-annual to quarterly billing beginning with bills rendered October 1, 2009. This change reduces the cash working capital component of rate base. Moreover, the settling parties agreed that the change will allow customers to better manage the increase in rates. The settlement agreement does not require the Company to install customer meters at this time.

The settling parties agreed that the overall increase in the unmetered rate would go from $200 annually per customer to $463.37 annually per customer, an increase of 131.68%. This increase, coupled with the change in billing practices will result in a quarterly bill of approximately $115.84 per customer.

C. Review of Water System

The settling parties agreed that Forest Edge will retain one or more entities with water system operation/design expertise to assess current and future system needs. The results of this study are to be reported to Staff and the homeowners by December 31, 2009. The study will outline the current status of the system, along with the need for and cost of improvements to the system in the future.

Following submission of the study, the settling parties have agreed to meet in a technical session in the first quarter of 2010 to discuss the study and its findings. The settling parties are to discuss the feasibility and necessity of any improvements to the system, and the timing thereof, as called for in the study. The settling parties agreed that the Company should be entitled to a step adjustment to its rates for the cost of the study, and that they would endeavor to provide a joint recommendation as to that adjustment. In the event one or more of the settling parties disagree on a joint recommendation, each is to provide its own recommendation to the Commission. The settling parties also agreed that if the Company undertakes and completes any capital improvement(s) called for in the study by the end of 2011, it may request an additional step adjustment to its rates to reflect the cost of the capital improvements completed, including associated depreciation expense and property taxes.

D. Financing and Relationship with KBC

The settling parties have recommended that the Commission approve the financing previously obtained by Forest Edge from KBC. This financing totals $37,454, which incorporates borrowing occurring in 2007, as well as prior borrowings from KBC. The settling parties have agreed that this debt will accrue interest at a rate of 7% per annum for a 20 year term. Forest Edge has agreed to submit a copy of an executed note with KBC conforming to these terms within 15 days of the Commission's final order in this proceeding. The settling parties also agreed that Forest Edge must clarify its relationship with KBC by, at least: (1) establishing a defined separate corporate existence for Forest Edge; (2) improving Forest Edge's accounting and financial practices in line with the Staff's audit report; and (3) filing a proper affiliate agreement defining the relations between Forest Edge and KBC.

E. Effective Date for Rate Increase and Recoupment

Forest Edge and Staff recommended that permanent rates shall be effective for service rendered on and after April 1, 2009, consistent with Order No. 24,971 (May 22, 2009) on temporary rates in this case. The Company agreed that for recoupment, it will file its calculation of the temporary rate recoupment within 15 days of the Commission's final order in this proceeding, along with a proposal for recovery. The settling parties also agreed that temporary rate recoupment may be combined with recovery of the Company's rate case expenses, as discussed below.

F. Rate Case Expense Surcharge

The settling parties recommended that Forest Edge be allowed to recoup its reasonable and appropriate rate case expenses associated with this docket. As with recoupment, Forest Edge agreed to submit its final rate cases expense request to Staff for review and recommendation to the Commission within 15 days of the Commission's final order in this proceeding.

IV. COMMISSION ANALYSIS

RSA 378:7 authorizes the Commission to fix rates after a hearing upon determining that the rates, fares, and charges are just and reasonable. In determining whether rates are just and reasonable, the Commission must balance the customers' 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). Additionally, 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. Pursuant to RSA 541-A:31, V(a), informal disposition may be made of any contested case at any time prior to the entry of a final decision or order, by stipulation, agreed settlement, consent order or default. N.H. Code Admin. Rules Puc 203.20 (b) requires the Commission to determine, prior to approving disposition of a contested case by settlement, that the settlement results are just and reasonable and serve the public interest.

A. Revenue Increase

Initially, we note that the Company has not had a rate increase since 1985. Tr. at 8. Since that time the Company has completed various upgrades to the system. Tr. at 15. To meet these needs, the Company has repeatedly borrowed money from KBC in order to finance its operations and to pay for improvements, and in so doing amassed substantial debt, which it has not able to pay. Tr. at 9-11. Given these circumstances, we conclude that the Company is entitled to a rate increase.

Under the terms of the settlement agreement entered into by the Company and Staff, and not opposed by the Forest Edge homeowners, the Company's annual revenues would increase from \$7,600 to \$17,608, or 131.68%, based upon a stipulated rate base of \$36,774 and an overall rate of return of 7%. The bills for each customer will increase from \$200 annually to \$463.37

annually. While the increase is substantial, we nevertheless conclude that the rates produced by the settlement agreement are just and reasonable. Initially, we note that as this is the first increase in rates in more that 20 years, and it must account for substantial changes in routine operating and maintenance expenses over that time. Moreover, as noted by Staff, there have been numerous necessary upgrades to the system in the last few years, Tr. at 15, requiring an increase to the Company's revenues.

We are further persuaded that this agreement will produce just and reasonable rates because, in setting the amount of its revenues, Forest Edge was willing to reclassify some of the debt it owes to KBC as equity. This reclassification eliminates the retained deficit created by operating losses, which necessitated repeated borrowings from KBC. Converting debt to equity causes the Company's remaining debt load to be more manageable. Tr. at 9-11. Moreover, it allows the Company to earn a somewhat lower rate of return than it might otherwise have sought, while still enabling Forest Edge to meet its remaining debt obligations.

In addition, in determining the Company's rates its O&M costs were averaged over a longer period than the Company had originally proposed in order to level out the otherwise large annual disparity in costs. This fluctuation in costs has been occasioned by outages and the resulting maintenance to the system, as well as costs associated with system improvements. Tr. at 13-14. We find this averaging appropriate in that it ensures that the Company's costs are taken into account, without unduly weighting the substantial costs incurred in recent years.

Finally, we note that this settlement agreement was the product of compromise between the Staff and Company, and was not opposed by the Forest Edge homeowners. Tr. at 29. This agreement among diverse interests provides some further assurance that the revenue requirement agreed to in this docket is a reasonable one. For the reasons stated, we conclude that the new rates as established in the settlement agreement are just and reasonable and serve the public interest.

B. Rate Design and Impact

As for the impact of the new rates, the settlement agreement contemplates that the Company will migrate from semi-annual billing to quarterly billing, in arrears, beginning with bills rendered October 1, 2009, but does not include any other changes to the Company's rate design. This change, when coupled with the rate increase as described above, will result in a quarterly bill of approximately $115.84. We find this billing change appropriate. The change will both aid customers in managing the increase in rates by spreading it out over time, and it will enable Forest Edge to have a more stable flow of funds for its operations. Therefore, we approve the change in billing from semi-annual to quarterly as set out in the settlement agreement.

C. Study of the Water System

The settlement agreement calls for a review of the water system to assess its current condition and to determine its future needs. As stated at hearing, there have been some significant improvements to the system recently, including the deepening of a well, and the addition of new pumps, new well meters, and telemetry for the pump stations. Tr. at 15. It is clear from the record, however, that more capital investment will be needed. For example, as noted by Staff, the New Hampshire Department of Environmental Services has determined that the upper pumping station is structurally unsound. Tr. at 15. Thus, the Company must soon determine when and how to deal with its replacement or repair. Other testimony at hearing makes it clear that the Company needs a roadmap in order to focus its efforts going forward. Tr. at 15, lines 20-24 and at 16, lines 1-3.

Consequently, we agree with Forest Edge and Staff that a study ought to be completed by a competent person or group so that the system's immediate and longer term needs can be evaluated. Accordingly, we require that a study of the system be completed by December 31, 2009.

Additionally, the settlement agreement permits the Company to request a step increase to recover the costs of the study. We have previously employed step adjustments to rates as a means of ensuring that a regulated utility retains its ability to earn a reasonable rate of return after implementing large capital projects that increase the utility's rate base after a test year. *See, Eastman Sewer Company, Inc.*, Order No. 24,989 (July 24, 2009) at 7-8. The step adjustment avoids placing a utility in an earnings deficiency immediately after a rate case in which the revenue requirement was based on a historical test year. *See id.* Here, given the need for the study, and the fact that requiring the Company to initiate a new rate case to cover the costs of such a study would be unreasonable, we approve the portion of the settlement agreement permitting the Company to seek a step increase to cover the costs of the study.

The settlement agreement further calls upon Staff and the Company to meet soon after the completion of the study to discuss recommended improvements and plan a timeframe for implementing appropriate improvements. Moreover, the settlement agreement contemplates that in addition to a step increase to recover the costs of the study, for any improvements the Company actually completes in accord with the plan prior to the end of 2011, it may request another step increase. Given the size of Forest Edge, requiring it to return for a rate case in such a short time after completing needed capital projects would not serve the customers well. We conclude that the use of a step increase for any projects completed in accord with the settlement agreement is reasonable. We note that we do not, at this time, approve any costs related to the study or any projects deemed necessary by the study and completed prior to the end of 2011. Instead, we approve only that portion of the settlement agreement permitting the Company to request recovery of those costs.

D. Financing from and Relationship with KBC

As noted previously, as part of this rate case, the Company is reclassifying a portion of the debt owed to KBC as equity. Following this conversion, Forest Edge will still owe KBC $37,454, which incorporates the borrowing in 2007 for which the Company originally sought approval, as well as other, prior borrowing. This remaining debt will be memorialized with a new note bearing an interest rate of 7% per annum and a payment term of 20 years. Tr. at 9-10, 12-13, 26. Given the Company's new capital structure and rates, repayment of this note ought to be manageable for the Company and we therefore approve this financing pursuant to RSA chapter 369. We caution, however, that once the new relationship between Forest Edge and KBC is established as described below, such borrowing requests must be filed with the Commission pursuant to RSA 369:1-7.

Regarding the relationship of Forest Edge and KBC, as noted at the hearing Forest Edge has been referred to as a "subsidiary" of the "parent" KBC, though there is no legal distinction between them. Tr. at 11. They are "really one." Tr. at 11. The informal and incorrect use of formal terms has led to unconventional financing arrangements and has contributed to some lax accounting by the utility. Therefore, the settlement agreement calls for Forest Edge to establish itself as a legally distinct entity, to improve its accounting and financial practices in line with Staff's audit report and to file proper affiliate agreements covering the relations between the newly independent entities pursuant to RSA 366:3. Additionally, though there is no deadline for completing these changes in the agreement, at the hearing on the settlement agreement the

Company committed to completing them by the end of the year. Tr. at 22. We agree that separating the two entities and having the utility function independently is appropriate in that it will allow that entity to focus on its mission of providing safe and adequate water service. Further, improving the now-independent Forest Edge's accounting and financial practices will enable more accurate appraisals of its financial condition in the future, particularly when reviewing the costs of any improvements completed in line with the system study. We, therefore, approve the settlement agreement's requirements for the separation of Forest Edge and KBC.

E. Recoupment and Reconciliation

The settlement agreement addresses the reconciliation of the temporary and permanent rates and the recoupment of rate case expenses in a similar manner. At the outset, we agree that the Company is entitled to recover the reconciled difference between temporary and permanent rates, *see* RSA 378:27-29, as well as its reasonable rate case expenses, *see* RSA 365:38-a. For both, the Company is to submit its calculations for review by Staff within 15 days of the date of this order and final recommendations are to be made for our review thereafter. We note that due to the relatively compressed schedule for this case the reconciliation period will be only three months, or one quarter, and, therefore, will not likely have a profound impact on customers' bills. We approve of the settlement agreement's provisions regarding reconciliation and recoupment and await the filings and recommendations.

F. Conclusion

Having reviewed the record, including the settlement agreement and evidence presented at hearing, we find that the revenue requirement adopted by the signatories is reasonable and will produce just and reasonable rates. We further find that the terms of the settlement agreement represent an appropriate balancing of ratepayer interests and the interests of Forest Edge under current economic circumstances. We find that the investments in Forest Edge's plant used to serve its customers are prudent and that the terms of its financing from KBC are just and reasonable. We therefore adopt and approve the terms of the settlement agreement as consistent with the public interest. We note that the settlement agreement leaves unresolved the amounts of recoupment, the step adjustments and rate case expenses, all of which we will address in future orders.

Based upon the foregoing, it is hereby

ORDERED, the terms of the settlement agreement are hereby adopted and APPROVED as discussed herein; and it is

FURTHER ORDERED, that Forest Edge Water Company is authorized to collect from customers, permanent rates as discussed herein; and it is

FURTHER ORDERED, that Forest Edge Water Company is authorized to file for step increases as authorized in the settlement agreement; and it is

FURTHER ORDERED, that Forest Edge Water Company is authorized to recover from all customers the difference between its temporary and permanent rates, subject to the submission of documentation within fifteen (15) days of this order, and further subject to review and approval; and it is

FURTHER ORDERED, the Forest Edge Water Company shall file an accounting of its rate case expenses for the temporary and permanent phases of this proceeding within fifteen (15) days of this order; and it is

FURTHER ORDERED, that Forest Edge Water Company file with the Commission a compliance tariff within fourteen (14) days of this order.

By order of the Public Utilities Commission of New Hampshire this twenty-third day of September, 2009.

Thomas B. Getz Chairman	Clifton C. Below Commissioner	Amy Ignatius Commissioner

Attested by:

Debra A. Howland
Executive Director & Secretary