

**STATE OF NEW HAMPSHIRE
PUBLIC UTILITIES COMMISSION**

DW 13-130

PENNICHUCK WATER WORKS, INC.

Notice of Intent to File Rate Schedules

Order Approving Permanent Rates and Settlement Agreement

ORDER NO. 25,693

July 15, 2014

APPEARANCES: Devine, Millimet & Branch, PA, by Thomas B. Getz, Esq., for Pennichuck Water Works, Inc.; Office of the Consumer Advocate on behalf of residential ratepayers, by Rorie E.P. Hollenberg, Esq.; and Marcia A. Brown, Esq., for the Staff of the Public Utilities Commission.

In this order, the Commission approves a 0% rate increase for PWW. PWW's existing customer rates remain unchanged. The Commission also approves clarifications pertaining to Order No. 25,292 and the City of Nashua's acquisition of PWW's parent, Pennichuck Corporation in Docket No. DW 11-026.

I. PROCEDURAL HISTORY

Pennichuck Water Works, Inc., (PWW) provides water service through its core system to approximately 24,600 customers in the City of Nashua and in the Towns of Amherst, Hollis, Merrimack, and Milford. PWW also serves approximately 2,150 customers in the Towns of Bedford, Derry, Epping, Plaistow, Newmarket, and Salem. PWW is a subsidiary of Pennichuck Corporation which is wholly owned by the City of Nashua.

In Docket No. DW 11-026 (the Acquisition Docket), the Commission approved the City of Nashua's acquisition of Pennichuck Corporation and required PWW and its affiliates, Pennichuck East Utility, Inc. (PEU), and Pittsfield Aqueduct Company, Inc. (PAC), to

simultaneously file full rate cases no later than June 1, 2013. *See generally City of Nashua*, Order No. 25,292 (Nov. 23, 2011).

On May 1, 2013, PWW filed a notice of intent to increase customer rates 0.12%. PEU and PAC also filed rate cases and the Commission separately docketed those filings. In Order No. 25,598 (Nov. 22, 2013), the Commission approved PWW's current rates as temporary rates, effective July 1, 2013. On May 14, 2014, Staff filed a settlement agreement (Settlement Agreement) on permanent rates. PWW, the Office of the Consumer Advocate, and Staff (Settling Parties) agreed to a 0% rate increase. The Settling Parties agreed to other terms, including interpretations of provisions in the settlement agreement from the Acquisition Docket. Those terms are more fully described below.

The Commission held a hearing on May 20, 2014. During the hearing, the Commission took administrative notice of testimony in Docket No. DW 13-126, PEU's rate case. N.H. Code Admin. Rules Puc 203.27 and RSA 541-A:33, V. Specifically, the Commission took administrative notice of testimony on Sections C, D, E, and F of the settlement agreement in Docket No. 13-126. Section C pertained to *Clarification of Certain Ambiguities Contained within the DW 11-026 Settlement Agreement*. Section D pertained to *Treatment of Non-Revenue Producing Assets*. Section E pertained to *Eminent Domain Costs*. Section F pertained to the *Municipal Acquisition Regulatory Asset (MARA)*. The PEU rate case involved the same parties and the same issues concerning interpretations of the settlement in the Acquisition Docket.

II. SUMMARY OF SETTLEMENT AGREEMENT

A. Revenue Requirement

The Settling Parties recommend no changes to PWW's revenue requirement.

B. Clarification of Issues from Acquisition - Docket No. DW 11-026

The Settling Parties recommend that in future rate proceedings, the value of the “Equity-Related Items,” as described in the Settlement Agreement in Docket No. DW 11-026 at Section III.B.1.c be inclusive of the value of common stock at the time of the merger, which for PWW was \$30,000.

The Settling Parties recommend that in future rate proceedings, PWW’s “Return on Equity” be equal to the average of the most recent 12-months of thirty-year United States Treasury Bond interest rates available at the time of the filing of the rate case, plus 3.0%.

The Settling Parties agree and propose that in future rate proceedings, the Rate Stabilization Fund (RSF) should be reflected in rate base at its actual 13-month average valuation and the Deferred Debit/Credit to the RSF should be reflected in rate base at its *pro forma* prospective 13-month average valuation.

C. Treatment of Non-Revenue Producing Assets

The Settling Parties agree that in future rate cases, non-revenue producing assets should be recognized in rate base at year-end value when:

1. The underlying project that establishes the acquired or installed asset(s) is in response to a regulatory mandates, such as a state agency’s regulations or enforcement actions or a municipality’s construction projects.

2. The underlying purpose of the project is not to increase PWW’s revenues through either increasing its customer base or service capacity. Any increase in annual revenues resulting from the project should be both incidental and negligible. For PWW, the Settling Parties define incidental and negligible annual revenues as that which results in an increase in annual revenues of less than 1% of a project’s expended cost during the test year. When

incidental revenues do result from a non-revenue producing asset(s), such as the increased revenue under a municipal fire tariff after a main has been upsized, they should be reflected in test year revenues to the benefit of customers.

3. The expended cost during the test year on the project must be significant, i.e., the resulting asset(s) placed into service has a book value greater than 1.5 times the reportable amount for filing a Form E-22 set forth in Puc 609.12 (d). For PWW, the expended cost must exceed \$150,000 ($\$100,000 \times 1.5$).

4. The asset(s) are used and useful by the end of the test year.

If the asset(s) in question meet the above criteria, the Settling Parties recommend that the value of the assets in rate base be recognized at year-end value rather than the 13-month average value. The Settling Parties recommend this treatment extend to the Plant in Service, Accumulated Depreciation, Contributions in Aid of Construction (CIAC) as well as any Accumulated Amortization of the CIAC.

D. Rate Stabilization Fund (RSF)

The Settling Parties recommend converting the \$5 million in the RSF from debt to equity. For calculating allocations of monthly water revenues to the City Bond Fixed Revenue Requirement, the Settling Parties agree PWW will use a revenue requirement of \$27,689,214 for this calculation.

E. Eminent Domain Costs

The Commission previously authorized the City of Nashua to recover from PWW and its affiliates, PEU and PAC, up to \$5 million in costs incurred January 2002 through August 2009 in the eminent domain proceeding. *See, City of Nashua*, Order No. 25,292 (Nov. 23, 2011). On October 1, 2013, the Commission's Audit Staff recommended the Commission allow the City of

Nashua to recover \$4,458,232. Exh. 3 at 7. Audit Staff recommended disallowance of \$490,090. *Id.*

F. Municipal Acquisition Regulatory Asset (MARA)

This regulatory asset was authorized in Order No. 25,292. The Commission ordered that the MARA be subject to an audit at PWW, PEU, and PAC's next full rate cases. On November 19, 2013, the Commission's Audit Staff issued its report and found no exceptions concerning the MARA accounts of PWW, PEU, and PAC.

G. PWW WICA Pilot

The Settling Parties agree that PWW's WICA has not operated long enough to evaluate and recommend the Commission authorize the pilot to continue.

III. COMMISSION ANALYSIS

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. Notwithstanding a settlement among the parties, the Commission must independently determine whether the settlement results comport with applicable standards. N.H. Code Admin. Rules Puc 203.20(b) requires the Commission to determine whether the settlement results are just and reasonable and serve the public interest. 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 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). Applying those standards, we approve the Settlement Agreement.

A. Revenue Requirement

As noted above, the Commission required PWW along with its affiliates, PEU and PAC, to file full rate cases no later than June 1, 2013. In its initial rate filing, PWW sought to increase its revenue requirement by only \$34,016, or 0.12%. Exh. 3 at 2. PWW based this increase on a test year ending December 31, 2012. *Id.* The Settling Parties recommend a 0% rate increase.

Id. The Commission finds this recommendation just and reasonable and will approve it. PWW is not in need of rate relief so soon after its 2011 rate case. The City of Nashua anticipated savings would inure to PWW and its affiliates after the City of Nashua acquired PWW's parent. The requirement that PWW and its affiliates file rate cases was an effort to pass those savings on to customers. Staff testified that there were a number of savings. In particular, PWW realized a substantial decrease in costs associated with executive salaries. Hearing Transcript of May 20, 2014 (5/20/14 Tr.), at 19. Because PWW's parent is no longer a publicly traded company, costs associated with Securities and Exchange Commission reporting requirements were eliminated.

Id. Staff testified that PWW continues to make capital improvements to its system notwithstanding no revenue increase. *Id.* at 20. This is evidence that PWW's current rates generate sufficient revenues for it to provide safe and adequate service. The benefits envisioned by the City of Nashua in the acquisition docket can now be quantified. Those benefits have resulted in no rate increase.

Earlier in this proceeding, pursuant to RSA 378:27, The Commission approved PWW's current rates as temporary rates. *Pennichuck Water Works, Inc.*, Order No. 25,598 (Nov. 22, 2014). Pursuant to RSA 378:29, if the permanent rates approved by the Commission are higher than temporary rates, then the utility is entitled to recover the difference. Here, PWW's permanent rates are the same as its temporary rates. Accordingly, there will be no recoupment,

and PWW's temporary rates will expire as of the date of this order. PWW's existing rates will remain its permanent rates until changed by a future rate case or other adjustment. We therefore direct PWW to file replacement tariff pages reflecting that the existing rates are now its permanent rates.

B. Clarifications to Settlement Agreement in Docket No. DW 11-026

The Settling Parties recommend three clarifications to the settlement agreement approved in the Acquisition Docket. Two involve treatment of PWW's equity. First, the Settling Parties recommend that in future rate proceedings, the value of the "Equity-Related Items" be inclusive of the value of common stock at the time the City of Nashua closed on its acquisition of Pennichuck Corporation, which for PWW, was \$30,000. Exh. 3 at 3. The Settling Parties also recommend this amount be removed from the computation of the revenue deficiency. *Id.*; 5/20/14 Tr. in Docket No. DW 13-126 at 43 – 44. Second, the Settling Parties recommend that in future rate proceedings PWW's "Return on Equity" be equal to the average of the most recent 12-months of thirty-year United States Treasury Bond interest rates available at the time of the filing of the rate case, plus 3.0%. The Commission accepts these clarifications and approves them. These provisions were associated with the establishment of a unique ratemaking structure. The Commission reserved this rate case and PWW's affiliates' rate cases to test these mechanisms and make modifications, if necessary. We find it reasonable to set the value of PWW's Equity-Related Items at the value of its common stock at the time the City of Nashua closed on the acquisition. Given that PWW's capital structure is 100% debt and is funded by bonds, we find it reasonable to derive the return on equity from interest rates on Treasury Bonds, plus an adder. This is a common method of determining interest rates for financing and is an analogous measure of equity under the circumstances.

The Settling Parties recommend that the RSF be reflected in rate base at its actual 13-month average valuation and that the Deferred Debit/Credit to the RSF be reflected in rate base at its *pro forma* prospective 13-month average valuation. The Commission agrees that this is reasonable. Staff testified that the intent in the acquisition docket was to allow PWW to earn a return on the RSF; but the parties never set a rate base value for it. 5/20/14 Tr. at 21. The Settling Parties agree that the value should be based on the 13-month average method. Exh. 3 at 4. In rate cases, the Commission's rules require utilities to file rate base schedules showing test year rate base using methods that include the 13-month average. N.H. Code Admin. Rules Puc 1604.07 (s). Therefore, the Settling Parties' recommendation is consistent with methods prescribed by the Commission's rules. The Commission finds that the recommendation is a reasonable clarification of how to value the RSF in rate base, and the Commission approves the recommendation.

C. Treatment of Non-Revenue Producing Assets

The Settling Parties next recommend year-end value in rate base for assets that meet certain criteria of non-revenue producing assets. The Settling Parties recommend non-revenue producing assets be recognized in rate base at year-end value when they meet the following criteria: (1) the project is in response to a regulatory mandate, (2) the project is not intended to increase revenues, (3) the costs of the project are significant, and (4) the assets of the project are used and useful by the end of the test year. Exh. 3 at 5-6. The Settling Parties also recommend the year-end valuation extend to: Plant in Service, Accumulated Depreciation, CIAC, and any Accumulated Amortization of the CIAC. *Id.* The Commission finds these criteria to be reasonable and approves them. The criteria are not new. The Commission has approved in other rate cases year-end valuation of assets in rate base when they meet similar criteria. *See Lakes*

Region Water Company, Inc., Order No. 25,391 (July 13, 2012). Accordingly, we approve this term of the Settlement Agreement.

D. Rate Stabilization Fund

The Settling Parties recommend the conversion of \$5 million on PWW's books from debt to equity. The Commission finds this reasonable and approves it. The RSF was created in the Acquisition Docket to provide the City of Nashua's bond holders with reasonable assurance that the City would be able to pay debt service on those bonds. Exh. 3 at 6. Pennichuck Corporation contributed \$5 million into the RSF on behalf of PWW. Staff testified that it supported this settlement term because there is no debt instrument evidencing the \$5 million as debt. 5/20/14 Tr. at 23. The amount is simply reflected on PWW's books as debt. Staff testified that there will be no adverse impact on PWW's future customer rates as a result of recording this debt as equity. *Id.* at 24. Given the unique nature of the contribution to the RSF and given that there is no adverse impact on rates, there is no harm in changing the character of this debt to equity because there is no practical effect to this accounting change. For these reasons, the Commission finds that the change is reasonable and approves this term of the Settlement Agreement.

E. Eminent Domain Costs

As stated above, the Commission authorized the City of Nashua to recover from PWW and its affiliates, PEU and PAC, up to \$5 million in costs associated with the City's eminent domain proceeding in Docket No. DW 04-048. *See City of Nashua*, Order No. 25,292 (Nov. 23, 2011). The Settling Parties recommend that the Commission authorize the City of Nashua to recover \$4,458,232. Exh. 3 at 7. This amount is not recovered through customer rates. Only costs incurred by the City of Nashua from January 2002 through August 2009 qualify for recovery. *Id.* Our review is thus to determine whether the costs submitted by the

City of Nashua relate to Docket No. DW 04-048, are within the time frame specified, and are reasonable.

The Commission's Audit Staff reviewed the City of Nashua's documentation and recommended that the Commission allow the City of Nashua to recover \$4,458,232 in eminent domain costs. 5/20/14 Tr. at 6. The Audit Staff recommended that the Commission disallow \$490,090. *Id.* The disallowed amounts pertain to attorney fees and report expenses relating to Docket No. DW 02-126, mathematical errors, and expenses that exceeded contract caps. Exh. 3 at 14-22. The Settling Parties, including PWW, recommend that we accept this recovery amount. The Commission finds that the \$4,458,232 is reasonable, that the costs relate to Docket No. DW 04-048, and that the costs were incurred within the requisite time frame. The Commission approves recovery of \$4,458,232 from PWW, PEU, and PAC.

F. MARA

The MARA is another unique accounting mechanism authorized by the Commission in the Acquisition Docket. *See City of Nashua*, Order No. 25,292 (Nov. 23, 2011). As PWW testified, the MARA entry on PWW's books is PWW's *pro rata* share of the acquisition premium resulting from the City of Nashua's acquisition of Pennichuck Corporation. 5/20/14 Tr. in Docket No. DW 13-126 at 49. Per Order No. 25,292, the Commission's Audit Staff reviewed the components of the MARA. Audit Staff found no exceptions. Exh. 3 at 23-30. The Commission accepts Audit Staff's report and finds that the City of Nashua and PWW have complied with the terms of Order No. 25,292.

G. WICA Pilot

The Settling Parties recommend that the Commission authorize the pilot to continue. The Commission approves that recommendation. The WICA pilot is on a three-year cycle.

Generally, in Year 1, the utility provides its construction schedule for Commission approval. Year 2 projects are provided to the Commission for preliminary review. Year 3 construction projects are provided for advisory purposes. Once Year 1 projects are completed, the utility files for recovery of its costs. Only those WICA-eligible projects that are used and useful in accordance with RSA 378:28 are included in a WICA surcharge. PWW filed its 2013 Year 1 WICA construction budget in December 2012. 5/20/14 Tr. at 16. It filed a proposed budget for its 2014 construction in December 2013. *Id.* PWW has completed construction of its 2013 projects, but PWW has yet to implement its first surcharge associated with those projects. *Id.* The Commission finds that it would be premature to evaluate the pilot when it has yet to complete a full cycle. There is insufficient data and experience to evaluate whether the pilot is achieving its stated goals. The Commission therefore finds it reasonable to extend the pilot. We will evaluate the pilot at the time of PWW's next rate case.

H. Rate Case Expenses

Pursuant to the Settlement Agreement, PWW agrees to file documentation of its rate case expenses no later than thirty days from the date of the final order in this proceeding. The Commission's administrative rules authorize utilities to file for rate case expenses. *See* N.H. Code Admin. Rules Chapter Puc 1900. A utility seeking recovery of rate case expenses shall file its request for recovery along with all supporting documentation no later than thirty days after the Commission's final order. N.H. Code Admin. Rules Puc 1905.02. Accordingly, PWW shall file its rate case documentation within thirty days from the date of this order. The Commission will defer ruling on the recovery of rate case expenses until after PWW makes its filing.

I. Conclusion

The Commission approves the Settlement Agreement and incorporates its terms and conditions into this order. The Commission finds that the revenue requirement proposed by the Settling Parties is reasonable and that the existing rates are just and reasonable. The Commission finds that the terms of the Settlement Agreement represent an appropriate balancing of ratepayer interests and the interests of PWW's investor under current economic circumstances, are just and reasonable, and serve the public interest.

To facilitate the efficient administration of the Settlement Agreement, we authorize PWW, Staff, and the OCA to modify the Settlement Agreement so long as any modification is mutually agreed upon and non-substantive, such as a clerical or ministerial amendment that involves timing or scheduling. The Settling Parties shall file any such modification with the Commission and provide a copy to all parties on the service list. The Commission will approve the requested modification, if appropriate, via a secretarial letter but will not require notice or hearing.

Based upon the foregoing, it is hereby

ORDERED, that the terms of the Settlement Agreement are hereby adopted and APPROVED as discussed herein; and it is

FURTHER ORDERED, that PWW shall file with the Commission within fifteen days of this order a compliance tariff, in accordance with N.H. Code Admin. Rules Puc 1603.02(c) that indicates the temporary rates are now permanent rates; and it is

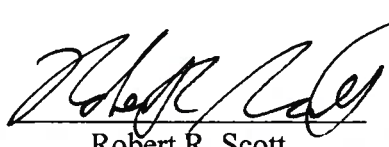
FURTHER ORDERED, that PWW's WICA pilot is authorized to continue and will automatically terminate at the time of a final order in PWW's next general rate case, unless the Commission extends the program in that final order or in an order prior to such order; and it is

FURTHER ORDERED, that PWW shall file with the Commission its rate case expense request no later than thirty (30) days from the date of this order, consistent with N.H. Code Admin. Rules Puc 1905.02.

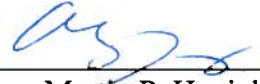
By order of the Public Utilities Commission of New Hampshire this fifteenth day of July, 2014.



Amy L. Ignatius
Chairman

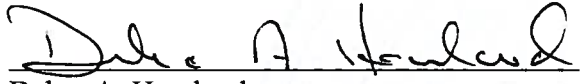


Robert R. Scott
Commissioner



Martin P. Honigberg
Commissioner

Attested by:



Debra A. Howland
Executive Director