

**STATE OF NEW HAMPSHIRE
PUBLIC UTILITIES COMMISSION**

DW 15-209

LAKES REGION WATER CO., INC.

Petition for Change in Rates and for Related Approvals

Order Approving Settlement Agreement and Change in Rates

ORDER NO. 25,969

November 28, 2016

APPEARANCES: Justin C. Richardson, Esq., Upton & Hatfield, LLP, for Lakes Region Water Co., Inc.; Donald M. Kreis, Esq., Office of the Consumer Advocate, on behalf of residential utility customers; and John S. Clifford, Esq., for Staff of the New Hampshire Public Utilities Commission.

The Commission approves a settlement granting Lakes Region Water Co., Inc. (“Lakes Region” or “the Company”), authority to increase its rates by \$160,999, or 15.43 percent pursuant to RSA 378:28. The Commission also approves the transfer of land owned by an affiliate with the cost of the property to be included in rate base for purposes of determining permanent rates. The Commission approves a stipulated capital structure for the Company, prior vehicle financings, reconciliation of previously approved temporary rates with the permanent rates, and recovery of reasonable rate case expenses pursuant to N.H. Code Admin Rule Puc 1905.02. An average customer using 27.89 hundred cubic feet (ccf) of water per year will have an annual bill of approximately \$722.28 (\$180.57 per quarter) compared to a prior bill of \$628.47 annually (\$157.12 per quarter). This translates to an increase of approximately \$23.45 per quarter or \$7.82 per month. Finally, the Commission grants the Company permission to submit a filing by no later than December 31, 2017, for a subsequent increase in its rates via a

step adjustment estimated to be \$22,903, or an additional 2.20 percent for certain future capital improvements to be completed by the end of 2017, resulting in a total increase of 17.63 percent.

I. PROCEDURAL HISTORY

This order and prior docket filings, other than any information for which confidential treatment is requested of or granted by the Commission, are posted on the Commission's website at <http://www.puc.nh.gov/Regulatory/Docketbk/2015/15-209.html>.

On August 5, 2015, Lakes Region submitted a request to increase the permanent rates charged to its general metered and unmetered customers by \$398,274 or 38.18 percent, pursuant to RSA 378:3. The filing included proposed tariff pages and schedules as required by rule. On August 17, 2015, Lakes Region filed a petition for temporary rates seeking approval for an increase of \$221,487, or 21.23 percent, on a temporary basis while the permanent rate proceeding was pending. On September 4, 2015, the Commission suspended the Company's tariff and scheduled a pre-hearing conference.

On September 30, 2015, the Company submitted a petition requesting approval of long-term financing as well as the transfer of land owned by an affiliate through the Company's proposed acquisition of the so-called "Mt. Roberts Property" from its shareholder. Lakes Region's financing submission was assigned Docket No. DW 15-422 and, for administrative efficiency, the Commission approved a procedural schedule that consolidated the two dockets.

Petitions to Intervene were filed by the Property Owners Association at Suissevale, Inc., Murray D. Movitz for residents on Judges Road in Thornton, William Endres for the Indian Mound Property Owners Association, and Mark Evitts for the Hidden Valley Home Owners Association. The OCA also filed a notice of participation.

On January 29, 2016, the Commission approved a settlement agreement submitted by the parties for an increase in temporary rates effective on a service-rendered basis as of September 14, 2015. The result was an increase in revenues of \$103,694, or 9.94 percent, on a temporary basis for Lakes Region's general metered and unmetered customers. *See* Order No. 25,862 (January 29, 2016).

The parties to this proceeding continued to exchange discovery and participated in a series of technical sessions about the permanent rate increase, the Mt. Roberts Property acquisition, and the proposed step adjustments for future system improvements. On August 3, 2016, Staff submitted written testimony and schedules stating its positions regarding permanent rates, the appropriate cost of capital, the financing and transfer of the Mt. Roberts Property, and future step adjustments.

Subsequently, the parties met and negotiated the terms of a settlement agreement on permanent rates and other issues. On October 7, 2016, Lakes Region, the OCA, and the Commission Staff (the Settling Parties) filed a settlement agreement on permanent rates, which was presented at a final hearing held on October 12, 2016.

At that hearing, each of the Settling Parties testified in support of Commission approval of the settlement agreement. None of the intervenors was present at the final hearing, although the OCA read into the record an e-mail comment submitted by Mr. Movitz. Mr. Movitz's email stated that he opposed payment of the legal fees of Upton Hatfield incurred in representing the Company in this proceeding and opposed the Company's acquisition of the Dockham Shores Estates franchise, which was being considered in a separate proceeding.

On November 7, 2016, Staff filed a letter with the Commission which reported on the findings of an audit performed by the Commission Staff with regard to certain assets and other

costs pertaining to an initial step adjustment which was proposed as part of the settlement agreement. Based on those audit findings, Staff's letter also recommended that certain adjustments be made to the proposed initial step adjustment as well as to the resulting initial customer rates proposed in the settlement agreement.

II. THE SETTLEMENT AGREEMENT

The Settling Parties agreed that Lakes Region should be permitted to charge its general metered and unmetered customers initial rates stemming from this rate proceeding, which are based on a total revenue requirement of \$1,204,645. That revenue requirement represents an increase of \$161,502, or 15.48 percent above test year. The revenue requirement proposed by the Settling Parties has two components.

The first component is a permanent rate increase of \$103,694, or 9.94 percent. The resulting permanent rate revenue requirement of \$1,146,837 would be in effect for the Company on a service rendered basis back to September 14, 2015, per Commission Order No. 25,862, which approved temporary rates in this proceeding. The permanent rate component was derived using a pro forma rate base, weighted average cost of capital, and operating activity amounts, which were agreed to by the Settling Parties for the test year ended December 31, 2014.

Among the items agreed to by the Settling Parties was a pro forma test year capital structure consisting of 64 percent equity and 36 percent debt based on the expectation that Lakes Region will be undertaking certain future capital improvement projects which it intends to finance primarily through debt. Further, the Settling Parties agreed to recommend that the Commission provide after the fact approval, pursuant to RSA 369, for two vehicle financings which were undertaken by the Company in 2010 and 2011 without Commission approval. With regard to the cost of common equity, the Settling Parties agreed to apply a rate of 9.60 percent,

which is the same as the rate recently approved by the Commission for another regulated water utility.¹ Regarding the Mt. Roberts Property, the Settling Parties agreed to the inclusion of a cost of \$262,095 in Lakes Region's pro forma test year rate base because, even though the transfer of this property has not yet formally occurred, the two wells situated on that property were providing service to customers during the test year. Lakes Region also agreed to withdraw its filing in Docket No. DW15-422, because the Company decided to record the transfer of the Mt. Roberts Property as a shareholder equity contribution, rather than finance it through debt.² Finally, the Settling Parties agreed to a depreciation rate of 20 percent (based on a 5-year service life) to be applied to the Company's fleet of cars and light trucks.

The rate of return applied to permanent rates is 7.70 percent. This includes an overall cost of debt of 4.31 percent which, when applied to the 36 percent pro forma debt weighting, results in a weighted average cost of debt of 1.55 percent. The cost of equity was 9.6 percent and, after applying the 64 percent pro forma equity rating, results in a weighted average cost of equity of 6.14 percent. The 7.70 percent rate of return is derived by adding the cost of debt to the cost of equity ($1.55 + 6.14 = 7.70$ ³).

The second component of the overall revenue requirement recommended in this case was in the form of an initial step adjustment in Lakes Region's general rates of \$57,808, or 5.54 percent, which would go into effect on a service-rendered basis as of the date of the Commission's order approving the settlement. The Settling Parties agreed that the initial step adjustment would provide a return, associated depreciation expense, and applicable taxes on improvements made at the Company's Indian Mound system during 2015, as well as a new

¹ See Commission Order No. 25,539 (June 28, 2013) in Docket No. DW 12-085, *Re Aquarion Water Company of New Hampshire, Inc.*

² On October 13, 2016, Lakes Region filed a letter with the Commission withdrawing its request for financing approval in DW 15-422.

³ After rounding.

accounting software system that was placed into full service during 2016. The initial step adjustment was also designed to provide the Company with recovery of costs associated with its employee pension plan as well as the deferred professional fees associated with Commission Docket No. DW 07-105.⁴ The Settling Parties agreed to an applied rate of return for the initial step adjustment of 7.49 percent, which was calculated based on the weighted average cost of capital for the permanent rate revenue requirement with the addition of \$130,000 of debt financing attributable to the Indian Mound improvement project.⁵ Adding the \$130,000 in debt financing with an accompanying 2.43 percent interest rate changed the debt/equity ratio to 38.46/61.54. The result was a reduction in the overall cost of debt to 4.11 percent. The cost of equity remained at 9.6 percent. The weighted average cost of debt was reduced to 1.58 percent and the weighted average cost of equity became 5.91 percent resulting in an overall cost of capital of 7.49 percent ($1.58 + 5.91 = 7.49$).

The settlement agreement proposed initial customer rates based on the combined revenue requirement of \$1,204,645. The Settling Parties also agreed that, prior to the implementation of those rates, the Commission Staff should perform an audit of the assets and other applicable expense items that are included in the determination of the initial step adjustment component of the overall proposed revenue requirement. The Settling Parties further agreed that the Commission's Audit Staff should issue a report on its findings so that, if necessary, modifications could be incorporated and reflected in customer rates prior to Commission approval.

⁴ See Commission Order No. 25,454 (January 17, 2013) in Docket No.'s DW 07-105, DW 10-043, DW 10-141, and DW 11-021, *Re Lakes Region Water Company, Inc.*

⁵ See Commission Order No. 25,753 (January 15, 2015) in Docket No. DW 14-285, *Re Lakes Region Water Company, Inc.*

The Settling Parties agreed that Lakes Region should be permitted to implement a surcharge to collect an amount equal to the difference between the revenues the Company would have collected had the agreed upon level of permanent rates been in effect as of the effective date of September 14, 2015, and the revenues that were actually collected by the Company during the temporary rate period. The Settling Parties also agreed that the revenues associated with the initial step adjustment should not be included in the Company's temporary-permanent rate recoupment calculation. The Settling Parties agreed that Lakes Region would file its calculations as well as a surcharge recommendation no later than 30 days from the date of the order approving the settlement. Staff, the OCA, and other interested parties would have the opportunity to review Lakes Region's submission and submit recommendations prior to Commission approval.

The Settling Parties agreed that Lakes Region may request a second step adjustment to provide a return, associated depreciation expense, and applicable taxes on two pending main and service replacement projects planned for Paradise Drive in Moultonborough and Captain Lovewell Lane in Ossipee. The combined cost of the two projects is currently estimated to be \$401,000, which the Settling Parties agreed should be primarily financed by debt obtained from the Company's primary lender, CoBank ACB. Nonetheless, the Settling Parties acknowledged that some equity financing may be necessary to maintain compliance with other loan requirements to which the Company may be subject as well as other prudent utility considerations. The Settling Parties agreed that Lakes Region would be required to submit its filing for the second step adjustment for Commission review and approval by no later than December 31, 2017. Further, Lakes Region agreed that except for exogenous events that create a

revenue deficiency, it would not seek its next permanent rate increase sooner than 2019 using a 2018 test year.

The Settling Parties agreed that Lakes Region should be permitted to recover its reasonable rate case expenses for this proceeding through a customer surcharge. Lakes Region agreed to file its final rate case expense request, pursuant to Puc 1905.02, by no later than 30 days from the date of the Commission's order approving the settlement. Staff, the OCA, and other interested parties would have the opportunity to review Lakes Region's submission and file recommendations prior to Commission approval. Finally, the Settling Parties agreed that Lakes Region would file tariff pages implementing the approved terms of the settlement agreement by no later than 15 days from the date of an order approving the settlement.

III. AUDIT OF INITIAL STEP ADJUSTMENT AND STAFF RECOMMENDATION

On November 1, 2016, in accordance with the settlement agreement, the Commission's Audit Staff submitted a final report of its review of the assets and other costs associated with the proposed initial step adjustment. The audit report recommended that the cost of the assets associated with the initial step be reduced by a total of \$3,174. On November 7, 2016, Staff filed a letter with the Commission which recommended, based on the audit findings, that the increase resulting from the initial step adjustment should now be \$57,305, or 5.49 percent. As such, Staff also recommended a revised revenue requirement upon which initial rates to general metered and unmetered customers would be based of \$1,204,142, representing an increase of \$160,999, or 15.43 percent, above test year revenues earned from general customers of \$1,043,143.

The resulting initial rates by customer class recommended by Staff are as follows:

<u>Customer Class</u>	<u>Annual</u>	<u>Quarterly</u>
Waterville Valley Gateway Pool	\$1,676.98	\$419.25
Unmetered General Customers	\$722.20	\$180.55
Metered General Customers:		
Customer Charge	\$568.05	\$142.01
Meter Charge (per ccf)	\$5.53	\$5.53

IV. ANALYSIS AND DECISION

Under RSA 541-A:31, V(a), informal disposition may be made of a contested case at any time prior to the entry of a final decision or order, by stipulation, agreed settlement, consent order, or default. We encourage parties to settle issues through negotiation and compromise because it is an opportunity for creative problem solving, allows the parties to reach a result in line with their expectations, and is often a better alternative to litigation. *Granite State Electric Co.*, Order No. 23,966, at 10 (May 8, 2002); *see* RSA 541-A:31 V(a).

The Commission's procedural rules provide for the approval of a settlement "if it determines that the result is just and reasonable and serves the public interest." NH Code Admin. Rules Puc 203.20(b). Thus, the Commission cannot approve a settlement without independently determining that the result comports with applicable standards. *Granite State Electric Co.* at 11. The process leading up to a settlement is one relevant factor in determining whether we should approve the agreement.

A. Initial Rates and Reconciliation of Temporary and Permanent Rates

Pursuant to RSA 378:3, "no change shall be made in any rate, fare, charge, or price, which shall have been filed or published by a public utility ... except after 30 days' notice to the

commission.” RSA 378:28 provides the standards by which the Commission sets permanent rates. Under that statute, the Commission “shall not include in permanent rates any return on any plant, equipment, or capital improvement which has not first been found by the commission to be prudent, used, and useful.” Further, the Commission sets rates after a finding that the rates provide the Company with “a just and reasonable rate of return.” *Id.* Finally, the utility bears the burden of proving the necessity of the increase. RSA 378:8.

In determining whether rates are just and reasonable, the Commission must balance the customers’ interest in paying no higher rates than are required against the investors’ interest in obtaining a reasonable return on their investment. *Eastman Sewer Company, Inc.*, 138 N.H. 221, 225 (1994). In this way, the Commission fulfills its duties as an arbiter between the interests of customers and those of utility’s owners. RSA 363:17-a. The Commission exercises its discretion and judgment in striking this balance. *Appeal of Conservation Law Foundation*, 127 N.H. 606, 634-36 (1986).

The Settling Parties agreed that the revenue requirement, including the initial step adjustment, should be determined after the completion of a Staff audit. The audit resulted in an overall revenue requirement for Lakes Region’s general metered and unmetered customers of \$1,204,142. This revenue requirement is a combination of a permanent rate increase of \$103,694, and an initial step adjustment of \$57,305, above test year water revenues of \$1,043,143. The total increase in revenues being proposed is \$160,999, or 15.43 percent.

The proposed overall revenue requirement is the product of a “meeting of the minds” of the Settling Parties regarding a number of complex issues. The areas of agreement include an appropriate and equitable capital structure, the cost components reflected in the determination of an overall cost of capital, and an appropriate valuation for the Company’s rate base. The

permanent increase is equal to the previously approved temporary rate increase of 9.94 percent and is proposed to be effective on a service-rendered basis as of September 14, 2015, in accordance with Commission Order No. 25,862. In addition, the initial step adjustment is proposed to be effective on a service rendered basis as of the date of this order. In order to reconcile the revenue difference between temporary and permanent rates, the Settling Parties propose that a surcharge be implemented to collect an amount equal to the difference in revenues the Company would have collected had the agreed upon level of permanent rates been in effect for service rendered after September 14, 2015. The Settling Parties also propose that the revenues generated from the initial step adjustment not be included in the reconciliation of temporary and permanent rates. Further, Lakes Region is to submit its surcharge proposal to the Commission by no later than 30 days from the date of this order and the surcharge shall be subject to the review and recommendations of the Commission Staff, and the OCA. The Commission has previously approved negotiated settlements which include step adjustments. *See, e.g. West Swanzey Water Company, Inc.*, Order No. 25,606 (December 19, 2013). The Commission finds the proposed revenue requirements, rates, and effective dates reasonable and approves them.

B. Second Step Adjustment

The Settling Parties propose that Lakes Region be permitted to request a second step adjustment in order to provide a return, and to recover associated depreciation expenses and applicable taxes on two pending capital projects. The total cost of the two projects is anticipated to be \$401,000 resulting in an estimated increase in Lakes Region's revenue requirement of \$22,903, or an additional 2.20 percent.

The Settling Parties agreed that Lakes Region shall use debt financing from CoBank ACB, subject to Commission approval under RSA 369:1 *et seq.* to complete these two projects. The Settling Parties also recognize that the Company may use some additional equity financing to maintain compliance with CoBank loan requirements. Prior to the final procurement of these loans from CoBank ACB, the Company will be filing a petition for Commission approval in accordance with RSA 369. The financing shall be subject to review by Staff, the OCA, and other interested parties. The Settling Parties also propose that Lakes Region shall submit its filing for a second step increase with the Commission by no later than December 31, 2017. Lakes Region agrees that it shall not seek a new permanent rate increase sooner than 2019, using a 2018 test year, except for exogenous events that create a revenue deficiency. The Commission finds that granting Lakes Region permission to file for a second step adjustment under these circumstances is reasonable and approves such.

C. 2010 and 2011 Vehicle Financings

During the course of the proceeding, Staff became aware that two loans associated with the purchases of certain pickup trucks were not submitted to the Commission for approval pursuant to RSA 369:1. The first loan was in 2010 in the amount of \$31,301 from Ford Motor Credit to finance the purchase of a 2011 Ford F350XL pickup truck. The term of that loan was for five years at an interest rate of 7.89 percent. The second loan was in 2011 in the amount of \$32,509 from Ford Motor Credit to finance the purchase of a 2011 Ford F150XL pickup truck. The term of that loan was for five years at an interest rate of 7.89 percent. Staff found that the Company's failure to submit the vehicle financings for Commission approval was an inadvertent oversight, and Staff filed testimony recommending that the Commission waive any penalty for failure to properly seek Commission approval of the vehicle financings.

The Settling Parties agreed that the acquisition of the vehicles and two financings were prudent and used and useful in the Company's operations and that they be included in the determination of permanent rates. The Commission finds those vehicles used and useful in the Company's business and approves their purchase and accordingly waives any penalties, in this instance, for the Company's failure to seek Commission approval under RSA 369.

D. Depreciation Service Lives for Cars and Light Trucks

The Settling Parties propose that a service life of 5 years (20.00 percent annual depreciation rate) should be used by Lakes Region for determining depreciation rates for cars and light trucks acquired by the Company in this and future rate proceedings. The Commission finds that this provision meets applicable accounting standards and approves the depreciation rate agreed to by the parties.

E. Rate Case Expenses

The Settling Parties agreed that Lakes Region shall be allowed to recover its reasonable rate case expenses pursuant to N.H. Code Admin Rule Puc 1905.02 and that it file its request for recovery of those expenses no later than 30 days from the date of the Commission's final order in this proceeding. Staff, the OCA, and other interested parties will have the opportunity to review the rate case expenses and provide recommendations on their approval to the Commission.

V. CONCLUSION

The Commission finds that the proposed settlement is just and reasonable, in the public interest, and in conformance with all applicable legal standards. We therefore approve the settlement agreement as filed.

Based upon the foregoing, it is hereby

ORDERED, that the Settlement Agreement between Lakes Region Water Co., Inc., Staff and the Office of Consumer Advocate is hereby **APPROVED**; and it is

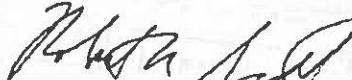
FURTHER ORDERED, that Lakes Region shall submit a proposed form of notice of the approved rate changes to be sent to its customers to Commission Staff for their review and approval prior to any billing changes being implemented. The proposed form of notice shall be submitted to Commission Staff within ten (10) days of the date of this order; and it is

FURTHER ORDERED, that pursuant to RSA 378:1 and N.H. Code Admin Rules Puc 1603, Lakes Region shall submit properly annotated revised tariff pages consistent with the terms of the Settlement Agreement within ten (10) days of the date of this order.

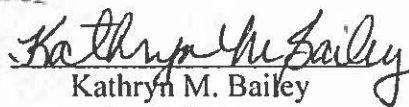
By order of the Public Utilities Commission of New Hampshire this twenty-eighth day of November, 2016.



Martin P. Honigberg
Chairman

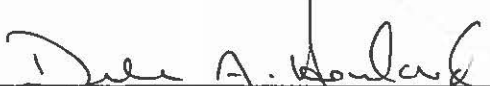


Robert R. Scott
Commissioner



Kathryn M. Bailey
Commissioner

Attested by:



Debra A. Howland
Executive Director

SERVICE LIST - EMAIL ADDRESSES - DOCKET RELATED

Pursuant to N.H. Admin Rule Puc 203.11 (a) (1): Serve an electronic copy on each person identified on the service list.

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FILING INSTRUCTIONS:

- a) Pursuant to N.H. Admin Rule Puc 203.02 (a), with the exception of Discovery, file 7 copies, as well as an electronic copy, of all documents including cover letter with:**
- DEBRA A HOWLAND
EXEC DIRECTOR
NHPUC
21 S. FRUIT ST, SUITE 10
CONCORD NH 03301-2429
- b) Serve an electronic copy with each person identified on the Commission's service list and with the Office of Consumer Advocate.**
- c) Serve a written copy on each person on the service list not able to receive electronic mail.**