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Via Overnight and Electronic Mail

Debra A. Howland, Executive Director
New Hampshire Public Utilities Commission
21 South Fruit Street, Suite 10
Concord, NH 03301-2429

Re: DW 18 – 056 Lakes Region Water Co., Inc., *Investigation to Determine Rate Effects of Corporate Tax Reductions* – Response to Staff Recommendation

Dear Executive Director Howland:

On July 29, 2019, Staff filed its recommendations based on the findings and conclusions contained in Blue Ridge's original report and follow-up response. Staff recommended that the Commission order Lakes Region Water Company, Inc. ("Lakes Region" or the "Company") to create regulatory liabilities, as of January 2, 2018 to account for the impact of federal and state statutory tax reductions, and to recognize an Excess Deferred Income Tax (EDIT) liability to customers.

The Commission should not accept Staff's recommendations: (1) to record an annual regulatory liability of \$42,707 "to track [alleged] tax savings realized through the effective date of the Company's next approved" rate case; and (2) to "record a separate regulatory liability for EDIT in the amount of \$141,995" which is claims represent "income tax credits to customers [to] be resolved" it Lakes Region's next rate case. Staff's recommendation represents a major departure from the terms of the Settlement Agreement approved in DW 15 – 209 and the laws governing Lakes Region's approved rates. By way of summary:

- As explained herein, Staff's recommendations retroactively and unlawfully adjusts a single component of rates in violation the Settlement Agreement by the Commission in Docket No. DW 15 – 209. The Settlement Agreement does not allow for single component adjustments. Under the terms of the Settlement Agreement, an exogenous event, if one were to occur, requires a new rate proceeding.

- Lakes Region's rates are just and reasonable. There is no evidence to suggest that it earned more than its allowed return at any time.
- RSA 378:7 prohibits adjustments to rates, absent a hearing and a finding that existing rates are unjust and unreasonable. In this case, the reductions in marginal tax rates were offset by other increases. The tax changes allowed Lakes Region to defer seeking a rate increase based on a 2018 test year, which resulting in savings to customers. The Commission cannot adjust rates outside of the statutory process, particularly when there is *no evidence* that existing rates were unjust or unreasonable at any time.
- Staff's proposed retroactive adjustment to rates (or an adjustment its accounts for the same purpose) would result in single issue rate making and a regulatory taking of Lakes Region's investment in its plant and property dedicated to serving the public.

As set forth herein, Lakes Region requests that the Commission reject Staff's recommendations. To the extent that the Commission has any concerns regarding existing rates or the impact of changes to marginal tax rates, Lakes Region recommends that the Commission direct it to file a rate case by July 1, 2020, based on a 2019 test year. This would allow appropriate adjustments to be made based on current *pro forma* income, expenses, capital additions, capital structure, etc., as required by RSA 378:7.

In support of this request, Lakes Region provides the following information for the Commission's consideration:

1. Staff's Recommendations (and Proposed Adjustments) Violate the Settlement Agreement Approved By Order of the Commission.

On November 28, 2016, the Commission approved a Settlement Agreement in Docket No. DW 15 – 209 which set Lakes Region's permanent rates based on 2014 pro forma test year expenses. Attachment #1. The Settlement Agreement reflects significant compromises on every aspect of Lakes Region's rates by all parties after a comprehensive two year review in multiple related proceedings. The Agreement provided that approval by the Commission "constitute[s] a determination that the revenue requirement and rates recommended by the Settlement Agreement are just and reasonable." Attachment #1, Page 12. It was "expressly conditioned upon the Commission's approval of *all its provisions, without change or condition. If such approval is not granted, the Settlement Agreement shall be deemed to be null and void and without effect, and shall not be admissible as evidence or used against any party.*" (emphasis added).

In the July 19, 2019 Blue Ridge Report to Staff, it stated that: "The Company's current utility rates charged to customers reflect the recovery of income tax expense at the federal and state marginal rates of 34% and 8.5%, respectively." It appears that Blue Ridge and Staff assumed that Lakes Region's approved rates¹ under the Settlement Agreement could be unilaterally revised to

¹ Ordering Lakes Region to record a future liability to be credited to customers has the same effect, particularly if such an adjustment is made retroactively. As noted below, Lakes Region was prohibited by the "stay out" provision

reflect future changes in tax rates, without examination of all of the other evidence required by law to be considered when establishing permanent rates. This is incorrect. The Settlement Agreement approved rates based on a 2014 test year subject to a condition that requires acceptance of *all its provisions, without change or condition*. It also provided that it did “not constitute continuing approval of, or precedent regarding, any particular principle or issue”.

Unlike in some rate case settlements,² the Lakes Region Settlement Agreement does not contain a single adjustment mechanism for exogenous events. If an exogenous event were to occur, the remedy would be for Lakes Region to file a rate case, or, request that the Commission commence an investigation under RSA 378:7. The Settlement Agreement does not permit the Commission to re-open and modify approved rates based on changed circumstances. It can only do so by opening a new statutory investigation to determine just and reasonable rates under RSA 378.

Staff’s recommendation, if accepted, would result in a major modification of the rates approved under the Settlement Agreement. The Settlement Agreement is based on a net operating income of \$233,041. Attachment #1, Page 16. Staff’s recommendation that Lakes Region be required a retroactive liability to January 1, 2018 in the amount of \$141,995, plus an annual regulatory liability of \$42,107 (total: \$184,102) represents a major departure from the terms and rates approved. The Settlement Agreement does not permit such an adjustment to be made. Under the terms of the Agreement, the choice is to accept all of the rate components based on a 2014 test year, or to request that the Commission commence a comprehensive statutory investigation to change lawfully approved rates under RSA 378:7.

2. Lakes Region’s Existing Rates Remain Lawful, Just and Reasonable.

Lakes Region did not and has not over-earned based the tax rate changes that came into effect in 2018. The reason is that Lakes Region’s rates are based on a 2014 pro forma costs to provide service. Lakes Region’s expenses and the costs to provide service have increased over the last five years. The benefits from the changes to tax rates have been offset by increases in other expenses over the last five years.

Lakes Region’s Annual Reports confirm that its existing rates continue to be just and reasonable. Each year Lakes Region Annual Report includes a calculation of its actual rate of return which show that it has not earned above its allowed rate of return. For example, in 2017, its net operating income was \$236,984 and it earned an actual rate of return was 6.895% which was below its authorized rate of return of 7.49%. Attachment #2. In 2018, Lakes Region’s net operating income was \$259,801 and its actual rate of return was 7.07%. Attachment #3. There is no evidence or reason to believe that Lakes Region has over-earned or its rates are not just and reasonable.

The Commission should be aware that the benefits of reductions in tax rates directly benefitted customers by allowing Lakes Region to defer filing a rate case based on a 2018 test

of the Settlement Agreement from filing a rate case in 2018 because the changes in tax rates did not qualify as an exogenous event under the Settlement Agreement. Its rates remained within its allowed rate of return.

² See e.g. PSNH, Order No. 26,177 in Docket DE 18-049 (September 27, 2018) which suggests that the settlement agreement allowed Eversource or any other party to certify exogenous events and propose adjustments.

year. It used the small actual tax savings³ to defer rate increases while continuing to make capital improvements and improve service, all within existing rates that are just and reasonable and less than its allowed returns.

Staff recommendations would result in Lakes Region recording liabilities of \$141,995 in 2018 and \$42,707 each year (total: \$184,102). This would fundamentally change Lakes Region's financial condition. The total of \$184,102 represents over 70% of the net operating income in 2018 reported in Attachment #3. Staff's adjustments would appear to require substantial and immediate rate increases to account for tax rate changes that, as discussed below, are more theoretical than actual. The result would harm both Lakes Region and its customers.

3. Lakes Region did not realize any windfall due to the changes in marginal tax rates.

In Staff's recommendation it acknowledges Lakes Region's "2017 Tax Return indicated marginal and effective tax rates of 34% and 26.4%, respectively." Staff Recommendation, Page 4. Despite acknowledging that Lakes Region's actual tax rate to be lower, Staff and Blue Ridge used the 34% marginal rate as the basis for their recommendations. Lakes Region's 2017 Tax Return shows its actual effective tax rate was only 26.4%. Attachment #4. In 2018, Lakes Region adjusted its ADIT using the newly enacted Federal tax rate of 21%. However, Attachment #3 shows that, using the 2018 tax rates, Lakes Region did not over-earn and its rates remain just and reasonable. The small reduction in tax rates simply offset other cost increases and allowed Lakes Region to defer seeking a rate increase, which directly benefitted its customers.

Staff's recommendation to record a liability to customers as of January 1, 2018 would have the effect taking income that Lakes Region lawfully earned in 2018 under rates that were in all respects just and reasonable. Staff provides no mechanism for Lakes Region to recover for the resulting liability which reduces its rates below reasonable levels and below those approved under the Settlement Agreement. Staff's recommendation would result in a regulatory taking of lawfully earned income in 2018.

The Commission should note that, under the provisions of the Settlement Agreement, Lakes Region was prohibited from requesting a rate increase "sooner than 2019 using a 2018 test year".⁴ Lakes Region could not have sought rate relief and it had no reason to do so as its rates under the Settlement Agreement were not below just and reasonable levels. To order a liability to be recorded as proposed represents a unlawful retroactive taking of lawfully earned income under the terms of the approved Settlement Agreement.

³ Lakes Region's actual effective tax rate in 2017 was 26.4%. See Attachment #4. Staff's use of a 34% tax rate to project theoretical savings overstates Lakes Region's actual tax rates and tax savings.

⁴ The Settlement Agreement defined an exogenous event as one that "create[d] an unforeseen financial obligation of the Company that exceeds 7.50% of net plant in service as of the date of the Commission's final order in this rate proceeding." At the time of the Settlement Agreement, Lakes Region's "net plant in service" was \$3,642,958. Attachment #1, Page 20. An exogenous event was therefore one that imposed a financial obligation on Lakes Region greater than \$273,222. However, the lowering of tax rates did not impose any obligation on Lakes Region and it was not an exogenous event.

4. Staff's Recommendation Results in Unlawful Single Issue Ratemaking.

Staff's recommendation departs from traditional utility rate making principles which require that rates be set based on comparison of test year plant in service, income and expenses. It is wholly inappropriate to adjust rates for changes in tax rates in 2019 using expenses from a 2014 test year. The Commission should therefore follow its long-standing rule of disfavoring single-issue rate making. As the Commission explained in *Connecticut Valley Electric Company Inc.*, Docket No. DE 01-224, Order No. 23,887 (2001), Page 18:

"Single-issue rate cases are frowned upon in utility ratemaking because the objective of ratemaking is ... to ensure that the company has a reasonable opportunity to earn a reasonable overall return on investments dedicated to public utility functions. In order to make this ultimate determination, it is necessary to match ordinary and necessary expenses with income from the same period, and determine whether the net income is sufficient to provide a reasonable return on allowable rate base. Single-issue rate cases do not allow for this determination of overall net income. They focus on the change in a single expense (or revenue) item since the last rate case, ignoring completely what changes may have taken place in the other factors of net income."

See also Town of Hampton, Docket No. DW 19-065; Order No. 26,263 (2019); *PNE Energy Supply, LLC D/B/A Power New England*, Order No. 25,603 at 14 (December 13, 2013).

In this proceeding, as in the recent Town of Hampton complaint, "[t]he record is devoid of evidence, furthermore, that [Lakes Region] violated its tariff or charged illegal rates." To order Lakes Region to record a liability and, presumably, issue a refund to customers without any evidence or suggestion that Lakes Region has over-earned would result in a rates that are confiscatory, unreasonable and ultimately a taking of Lakes Region's investment in property dedicated to public service.

5. RSA 378:7 Prohibits Retroactive Application of Tax Rates.

In the absence of evidence that Lakes Region has charged customers an illegal or unreasonable rate, the Commission lacks authority to order Lakes Region to refund lawful rates for service rendered to customers. RSA 378:7 provides:

378:7 Fixing of Rates by Commission. – Whenever the commission shall be of opinion, after a hearing had upon its own motion or upon complaint, that the rates, fares or charges demanded or collected, or proposed to be demanded or collected, by any public utility for service rendered or to be rendered are unjust or unreasonable, or that the regulations or practices of such public utility affecting such rates are unjust or unreasonable, or in any wise in violation of any provision of law, or that the maximum rates, fares or charges chargeable by any such public utility are insufficient, the commission shall determine the just and reasonable or

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lawful rates, fares and charges to be thereafter observed and in force as the maximum to be charged for the service to be performed, and shall fix the same by order to be served upon all public utilities by which such rates, fares and charges are thereafter to be observed. The commission shall be under no obligation to investigate any rate matter which it has investigated within a period of 2 years, but may do so within said period at its discretion.

RSA 378:7 requires that the Commission hold a hearing and make a determination that a rate is "unjust or unreasonable" before ordering it to be changed. Even so, the authority to order a change in rates is limited to the rates "thereafter to be observed." There is simply no legal authority to order a retroactive refund without notice, a hearing and evidence of unreasonable rates under RSA 378:7.

* * *

Lakes Region is confident that, when "match[ing] ordinary and necessary expenses with income from the same period" will confirm that the rates it has charged customers are just and reasonable. However, Lakes Region recognizes that its existing rates are based on a 2014 test year and that significant changes have occurred. To the extent that the Commission wishes to investigate rates, Lakes Region recommends that the Commission direct it to file a rate case by July 1, 2020, based on a 2019 test year. To the extent that the Commission directs Lakes Region to record deferred liabilities related to change in the tax rates and excess deferred taxes, any adjustments to rates should only be made under RSA 378:7 based on pro forma test year income, expenses, capital additions, capital structure, etc.

Lakes Region would like to thank Staff and the Commission for the opportunity to provide these comments and for consideration of the same. If you have any questions, please feel free to contact me.

Very truly yours,



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JCR

Enclosure(s)

Cc: Official Service List