

DW 03-107

PITTSFIELD AQUEDUCT COMPANY, INC.

Petition for Increase in Permanent Rates

Order Approving Settlement Agreement

O R D E R N O. 24,261

December 31, 2003

APPEARANCES: McLane, Graf, Raulerson & Middleton, P.A. by Sarah B. Knowlton, Esq. on behalf of Pittsfield Aqueduct Company, Inc. and Marcia A. B. Thunberg, Esq. on behalf of the Staff of the New Hampshire Public Utilities Commission.

I. BACKGROUND AND PROCEDURAL HISTORY

This proceeding involves a request by Pittsfield Aqueduct Company, Inc. (PAC) for approval by the New Hampshire Public Utilities Commission (Commission) of a general rate increase. PAC is a public utility as defined in RSA 362:2 and 362:4 and is a wholly owned subsidiary of Pennichuck Corporation. PAC serves approximately 643 customers in the Town of Pittsfield, New Hampshire.

On May 2, 2003, PAC filed a Notice of Intent to File Rate Schedules. On May 19, 2003, PAC filed a Motion for Waiver of Puc 1604.01(a)(28), regarding the filing of workpapers providing financial "support for figures appearing on written testimony and/or in accompanying exhibits" filed in a rate proceeding. On June 18, 2003, the Commission Staff (Staff) filed a letter stating that it did not object to the waiver request. Staff stated that it anticipated obtaining the supporting documentation during the discovery and audit

process. The Commission granted PAC's request for waiver of Puc 1604.01(a)(28) by a secretarial letter dated June 18, 2003.

On June 19, 2003, the Commission received PAC's tariff filing to increase rates along with revised tariff pages and supporting documentation. PAC proposed an increase in operating revenues of \$67,243 or 16.29 percent on an annual basis over its currently authorized revenues.

On July 18, 2003, pursuant to Order No. 24,192, the Commission suspended the proposed tariff pages and scheduled a Prehearing Conference and technical session for August 27, 2003.

A Prehearing Conference was held on August 27, 2003 and no motions for intervention were filed. Immediately following the Prehearing Conference, PAC and Staff conducted a technical session to develop a proposed procedural schedule, which Staff filed with the Commission. The Commission approved the schedule by a secretarial letter issued on September 5, 2003.

Discovery ensued according to the procedural schedule. On November 21, 2003, PAC and Staff submitted a Settlement Agreement (Agreement) for the Commission's consideration.

On December 2, 2003, the Commission held a duly noticed hearing and heard testimony in support of the Agreement. At the request of PAC and Staff, the Commission deferred consideration of the rate case expenses pending a final submission of these expenses

by PAC as well as a review and recommendation by Staff.

On December 5, 2003 PAC submitted a response to a record request that was made at hearing regarding the average annual residential customer consumption amount used in calculating the impact of the proposed rate increase.

On November 25, 2003 and December 16, 2003, PAC submitted documentation in support of rate case expenses totaling \$6,510.59. On December 18, 2003, Staff submitted a recommendation to the Commission that PAC be allowed to recover \$6,398.68 in rate case expenses through a surcharge of \$0.83 per customer per month over a period of twelve months commencing after January 1, 2004. The Staff recommended that the Commission disallow \$111.91 attributable to items not used during the rate case or audit related expenses which historically have been disallowed by the Commission as rate case expenses.

II. SUMMARY OF SETTLEMENT AGREEMENT

PAC and Staff presented the terms of the Settlement Agreement as follows:

A. Revenue Deficiency

PAC and Staff agreed to a permanent rate increase, based on a 2002 test year, providing PAC with an increase in its annual revenues of \$73,227 or 17.74 percent, for an annual revenue requirement of \$486,019. Staff and PAC agreed to use

the following components in the determination of that revenue requirement:

Stipulated Rate Base:	\$1,586,857
Stipulated Rate of Return:	8.42%
Stipulated Operating Income Requirement:	\$ 133,613
Stipulated Proforma Test Year Operating Income:	\$ 89,391
Stipulated Revenue Deficiency before Taxes:	\$ 44,222
Stipulated Tax Effect (based on a 60.39% factor):	\$ 29,005
Stipulated Revenue Deficiency	\$ 73,227
Stipulated Proforma Test Year Revenue Requirement:	\$ 412,792
Stipulated Revenue Requirement:	\$ 486,019
Stipulated Percent Increase in Revenue Requirement:	17.74%

B. Rate Design

PAC and Staff agreed that PAC would maintain its present rate design and that the revenue increase should apply to all customers.

C. Effective Date and Recoupment

PAC and Staff agreed that the rates contemplated in the Agreement should be effective on a bills-rendered basis on and after January 1, 2004. At hearing, PAC sought a waiver of Puc Rule 1203.05, which requires that rate changes be effective on a service-rendered basis. In support of its request, PAC cited: 1) its inability to earn its allowed rate of return since it acquired the Pittsfield system; 2) that it had foregone the expense of seeking temporary rates; 3) that it is less costly for customers if PAC implements the rate change on a bills-rendered basis; and 4) the avoidance of customer confusion by

placing rates into effect coincident with the new year. Hearing Transcript of December 2, 2003 (12/2/03 Tr.) at 37 lines 18-24 and at 38 lines 1-13. Staff concurred with PAC's waiver request.

PAC and Staff also requested that PAC be allowed to recoup its approved rate case expenses through a surcharge applied over the 12 month period beginning after January 1, 2004. The Agreement states that the rate case expenses shall include PAC's legal expenses as well as mailing and other miscellaneous overhead charges, all subject to Commission review.

PAC and Staff agreed that upon receipt of the Commission's final order, PAC shall file a compliance tariff supplement including the approved surcharge relating to recovery of the amount of rate case expenses. PAC shall also file an accounting with the Commission of the amount of the rate case expenses recovered at the end of the 12 month period.

D. System Maintenance

PAC and Staff agreed that PAC shall flush the water mains in the Pittsfield system during the Spring of 2004, and will conduct any future main flushing maintenance in alternate years, starting in 2006. PAC and Staff also agreed that PAC will conduct additional main flushings in the event of unusual

customer complaints or system emergencies.

E. Sarbanes-Oxley Accounting Costs

PAC and Staff acknowledged that PAC and its two affiliated regulated water utilities, Pennichuck Water Works, Inc. and Pennichuck East Utility, Inc., have incurred and will continue to incur significant accounting costs related to the implementation of and compliance with Section 404 of the Sarbanes-Oxley Act of 2002. These costs, which are allocated by PAC's parent company, Pennichuck Corporation, to all of its subsidiaries, totaled approximately \$2,100 for the Company thus far in 2003. Since these costs have occurred beyond the test year of this docket, recovery of these costs was not embedded in the proposed rates of this docket. Given the significant and extraordinary nature of these costs to PAC, however, PAC and Staff recognized that recovery of these costs through rates in future proceedings would be appropriate, subject to any review or audit adjustments recommended by Staff.

III. COMMISSION ANALYSIS

The Commission is authorized to set rates after notice and hearing pursuant to RSA 378:7. The Commission is obligated to investigate the justness and reasonableness of the proposed rate. *Eastman Sewer Company, Inc.*, 138 N.H. 221, 225 (1994).

We have considered the proposed Settlement Agreement as well as the supporting testimony provided at the hearing.

A. Revenue Deficiency

The Settlement Agreement between PAC and Staff provides for an overall revenue increase of \$73,227 or 17.74 percent. Traditional rate-of-return principles permit a utility to recover prudently incurred operating expenses and 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). The Agreement provides for an 8.42 percent rate of return that incorporates a 10.00 percent return on equity. We note that the 10.00 percent return on equity amount utilized in the determination of the proposed rate of return of 8.42% is also consistent with other cost of equity amounts approved by this Commission in recent rate case proceedings involving water companies. *Pennichuck Water Works, Inc.*, 87 NHPUC 97 (2002).

This Commission's obligations extend to balancing the consumer's interest in paying no higher rate than required against the investors' interests in obtaining a reasonable return on their investment. *Eastman Sewer Company, Inc.*, 138 N.H. 221, 225 (1994). The Court in *Eastman* affirmed this Commission's discretionary actions providing a margin of profit

sufficient to attract capital. Accordingly, we will exercise that discretion and approve the recommended return on equity of 10.00 percent.

We note that PAC originally filed for an increase of \$67,243 or 16.29 percent over its current authorized revenue requirement. However, the Settlement Agreement indicates that PAC and Staff agreed upon a \$73,227 increase in PAC's revenue requirement representing a 17.74% increase. At hearing, PAC and Staff witnesses testified that the revenue increase proposed in the Agreement was greater than that initially requested by PAC due to a correction that was made in the calculation of PAC's rate base. 12/2/03 Tr. at 19 lines 1-5. More specifically, PAC's original filing treated the Amortization Reserve for Contributions in Aid of Construction in the amount of \$95,216 as a reduction in rate base when, in fact, this component should have increased rate base. The resulting correction increased PAC's rate base by an amount of \$190,432. Exh. 2 at 13. Additional pro forma adjustments agreed upon by PAC and Staff were made to other rate base components as well as various operating expenses which, to a great extent, mitigated the impact of this large adjustment to PAC's rate base. The increase in PAC's revenue requirement ultimately agreed upon still remained greater than the amount that PAC originally

requested in its filing. We have reviewed the pro forma adjustments contained in the supporting schedules of the Agreement and find the resulting revenue requirement in this rate proceeding to be just and reasonable.

B. Rate Design And Bill Impact

The Agreement states that PAC will maintain its present rate design and that the proposed revenue increase will apply to all customers. PAC submitted exhibits demonstrating the effect of the proposed rate increase on the average annual bill for residential customers. Based on an average annual usage per residential customer of 8,900 cubic feet, the average annual residential bill will increase from \$354 to \$417. This represents an increase of \$63 per year or approximately \$5 per month. We feel that this is a reasonable rate increase and therefore approve the Agreement's proposal that PAC's present rate design be maintained and that the revenue increase contemplated therein be applied to all customers.

C. Effective Date and Recoupment

The Agreement proposes that the revised rates resulting from this proceeding shall become effective on a bills-rendered basis on and after January 1, 2004. To that end, PAC requested a waiver of Puc Rule 1203.05, which requires that all rate changes, with certain exceptions, be implemented on a

service-rendered basis on or after the effective date of the approved rate change.

We will allow PAC to implement the new rates on a bills-rendered basis and grant the request for waiver of Puc 1203.05. PAC notified customers in July that it was seeking a rate increase but it did not request temporary rates, even though it has not earned its allowed rate of return since it acquired the Pittsfield system in 1998. Filing for temporary rates causes utilities to incur additional expenses; thus many small water companies forego requesting them. In this case, since PAC did not request temporary rates, our approval of new rates on a bills-rendered basis allows PAC to avoid additional costs, and affords PAC a benefit akin to temporary rates for a relatively short period of time at the end of the proceeding.

The Agreement also proposes that PAC will be allowed to recoup its rate case expenses through a customer surcharge applied over a 12 month period beginning after January 1, 2004. Further, PAC will file an accounting with the Commission of the amount of rate case expenses recovered at the end of this 12 month period. PAC submitted a total of \$6,510.19 in proposed rate case expenses for Staff's review and as previously noted, Staff recommends recovery of \$6,398.68. Staff further proposed that recovery of these rate case expenses be applied to the

roughly 643 present customers of PAC over a 12 month period, resulting in a monthly surcharge of \$0.83 per customer. We have reviewed Staff's memorandum and we agree with Staff's proposal for the recovery of \$6,398.68 in rate case expenses. Further, we find recovery through a customer surcharge over a 12 month period at a rate of \$0.83 per customer per month is reasonable and therefore will approve this surcharge.

D. System Maintenance

The Agreement states that PAC shall flush the water mains in the Pittsfield system during the Spring of 2004, and will conduct future main flushing maintenance in alternate years, starting in 2006, but will conduct more frequent flushings in the event of unusual customer complaints or system emergencies. At hearing, PAC's witnesses explained that the Pittsfield system had recently encountered an increased number of water quality issues. 12/2/03 Tr. at 31 and 32 lines 15-1. To that end, PAC determined to embark on a more aggressive main flushing program, such as that outlined in the Agreement, whereby the mains will be flushed at least once every two years. We agree with and approve this provision of the Settlement Agreement in that it will enable PAC to provide safe and reliable drinking water to its customers.

E. Sarbanes-Oxley Accounting Costs

The Agreement proposes that, given the significant and extraordinary nature of certain accounting costs related to the implementation of and compliance with Section 404 of the Sarbanes-Oxley Act of 2002, these costs should be recovered through rates as part of subsequent rate proceedings, subject to Commission audit and review. More specifically, as explained by PAC witnesses, the accounting costs at issue pertain to a provision in the Sarbanes-Oxley Act that requires a system of internal controls for all publicly traded companies to be documented as well as certified that they are in compliance with acceptable standards. PAC has recently initiated this process which requires the review of an accounting firm that is separate from the one with which it normally contracts for services. PAC has incurred approximately \$2,100 in compliance expenses thus far in 2003. These costs are beyond the test year and will not be included in the proposed rates. We recognize that publicly traded companies are experiencing a climate of more stringent regulation and therefore are incurring increased expenses in order to comply with new securities regulations such as the provisions contained in the Sarbanes-Oxley Act of 2002. Given the extraordinary nature and significant expense anticipated for the accounting costs at issue, we will consider in a future rate

proceeding the costs related to compliance with Section 404 of the Sarbanes-Oxley Act of 2002.

Based upon our review of the record and testimony at hearing, we conclude that the Settlement Agreement and the rates established therein are just and reasonable. We find the terms of the Agreement will benefit customers of Pittsfield Aqueduct Company and that the Agreement is in the public interest.

Based upon the foregoing, it is hereby

ORDERED, that the Settlement Agreement reached between Pittsfield Aqueduct Company, Inc. and Staff is APPROVED; and it is

FURTHER ORDERED, that Pittsfield Aqueduct Company, Inc.'s rate case expenses of \$6,398.68 are APPROVED; and it is

FURTHER ORDERED, that Pittsfield Aqueduct Company, Inc. shall submit reports to the Commission as identified in the Settlement Agreement as specified above; and it is

FURTHER ORDERED, that Pittsfield Aqueduct Company, Inc. shall submit a compliance tariff within ten days in conformance with this order.

By order of the Public Utilities Commission of New
Hampshire this thirty-first day of December, 2003.

Thomas B. Getz
Chairman

Susan S. Geiger
Commissioner

Graham J. Morrison
Commissioner

Attested by:

Michelle A. Caraway
Assistant Executive Director