

DW 07-032

PENNICHUCK EAST UTILITIES, INC.

Petition for Permanent and Temporary Rate Increases

Order Approving Settlement Agreement

ORDER NO. 24,840

April 4, 2008

APPEARANCES: McLane, Graf, Raulerson & Middleton, P.A. by Sarah B. Knowlton, Esq., for Pennichuck East Utility, Inc.; Office of the Consumer Advocate by Kenneth E. Traum on behalf of residential ratepayers; and Marcia A. B. Thunberg, Esq. for the Staff of the New Hampshire Public Utilities Commission.

I. PROCEDURAL HISTORY AND BACKGROUND

Pennichuck East Utility, Inc. (PEU) provides water service to approximately 5,000 customers in parts of Atkinson, Bow, Chester, Derry, Exeter, Hooksett, Lee, Londonderry, Litchfield, Pelham, Plaistow, Raymond, Sandown, and Windham.

On March 1, 2007, PEU filed a notice of intent to file rate schedules increasing its rates and, on April 20, 2007, PEU filed the proposed schedules with supporting testimony. PEU sought an overall permanent increase in annual revenues in the amount of \$864,285 or 20.92 percent. A full description of PEU's proposal, interventions, and pre-filed testimony in this docket can be found in Order No. 24,784 (August 24, 2007). In that order we approved a temporary 11.99 percent rate increase for PEU, on a service-rendered basis, effective May 29, 2007. We approved the application of the temporary rate increase to all PEU customers equally, pending the outcome of PEU's most recent cost-of-service study.

On December 12, 2007, Staff filed the testimony of analysts James L. Lenihan and Jayson P. Laflamme. Mr. Laflamme provided testimony on Staff's recommended revenue requirement and on a step adjustment to rates for the recently acquired Daniels Lake water

system. Mr. Lenihan provided testimony on Staff's recommendation on PEU's multi-year plan to bring rates and revenues in line with its 2007 Cost of Service Allocations and Rate Design Study.

On December 24, 2007, Windham Town Administrator, David Sullivan, filed a letter expressing the Town's concern regarding PEU's proposal to implement fire protection rates to the Town of Windham for service that not all town residents would receive. On January 8, 2008, State Senator Robert Letourneau filed a letter about this issue, opining that it would be unfair to bill taxpayers for a service they would not receive any benefit from.

On February 26, 2008, Staff and PEU filed a proposed settlement agreement and the Commission held a duly noticed hearing on February 28, 2008.

On March 31, 2008, Staff filed a letter with the Commission recommending PEU be authorized to recover \$47,767.72 in rate case expenses. Staff indicated that PEU requested recovery of \$49,067.63, but that \$1,300 should be disallowed. Staff stated that these expenses are already contained in PEU's revenue requirement. Specifically, Staff identified \$297 in legal costs that PEU had already indicated to Staff were not related to PEU's rate case, \$245 related to a press release, and \$216 related to Staff's audit.

II. POSITIONS OF THE PARTIES AND STAFF

A. PEU and Staff

The positions of Staff and PEU are set forth in the settlement agreement, which is summarized below.

B. City of Nashua

Nashua did not enter into the settlement and did not appear at the hearing. Nashua authorized Staff to represent to the Commission that Nashua took no position on the settlement agreement.

C. Office of the Consumer Advocate

The OCA did not enter into the settlement and took no position on the settlement agreement.

III. SETTLEMENT AGREEMENT

A. Income Requirement

Staff and PEU agreed that PEU should be granted an increase of \$711,656, or 17.19 percent, in its adjusted test year water revenues of \$4,140,829 in order to produce a total revenue requirement of \$4,852,485. This amount was calculated utilizing a stipulated rate base amount of \$12,537,337 and provides for an overall rate of return of 7.60 percent. It includes a stipulated cost of equity of 9.75 percent. Staff and PEU agreed that the revenue requirement recommended to the Commission in the agreement would result in permanent rates for PEU's customers that are just and reasonable.

B. Rate Impact

Based on the recommendations in PEU's cost of service study, Staff and PEU recommend a rate increase for the metered customer class of 13.32 percent. The average residential customer with a 5/8 meter and using approximately 8,900 cubic feet of water per year would thus see an annual bill of \$685.67, which is an increase of approximately \$75.20 per year, or just over \$6.27 per month.

C. Rate Design

PEU prepared a cost-of-service study as required by Commission Order No. 24,591 in PEU's last rate case, Docket No. DW 05-072. PEU recovers its revenues from a general metered class, private fire protection charges, and municipal fire protection service. In addition to the metered rates, customers in Litchfield pay a separate monthly charge for their fire protection charge. A major focus of the cost of service study was to examine the revenue allocations

between the metered customer class and costs associated with the provision of fire service. At hearing, PEU witness Bonalyn Hartley testified that the study found that more revenues needed to be allocated to fire protection customers and less to general metered customers. The study recommended a five-year phase-in of the allocation adjustment. In the settlement agreement, the phase-in period was reduced such that approximately 75 percent of the adjustment would occur when permanent rates become effective in this proceeding. At hearing, Staff characterized the phase-in as being in two parts, the first occurring in this rate case and the next occurring in PEU's next rate case. According to Staff and PEU, this would avoid unnecessary rate shock to customers in the fire protection classes.

With respect to fire protection charges for customers in Bow, Raymond, and Windham, Staff and PEU recommended a surcharge be added to customer bills as is already the practice for PEU customers in Litchfield. As a result of this recommended rate design, PEU's revenue requirement would be collected as follows: \$4,141,073 from the general metered classes; \$148,309 from private fire protection customers; and \$567,005 from municipal fire protection customers. The total of these amounts exceeds the stipulated revenue requirement of \$4,852,485 by approximately \$3,900 due to the process of allocating revenues to each customer class. Staff and PEU assert this amount is so small as to have no effect on the actual customer rates derived from the revenue requirement for each class as shown.

i. Cost-of-Service Update Prior to Next Rate Case

The revenue allocations recommended by Staff and PEU are intended to remain in effect until PEU submits its next rate case along with an update to its cost of service findings. The update to the study would capture future plant additions and will allocate those costs to the appropriate customer classes. When this second phase-in of the allocation adjustment is

implemented it will bring the allocation into full alignment with the results of PEU's cost of service study.

D. Effective Date and Recoupment

Staff and PEU recommend that permanent rates be effective for service rendered on and after May 29, 2007, which is the date specified in the temporary rate order. This affects PEU's general metered customers, private and public fire protection customers, and charges to certain customers in Litchfield for fire protection. As to new fire protection service provided in Bow, Raymond, and Windham, Staff and PEU recommend those charges be implemented as of the date of the Commission's order approving permanent rates.

Staff and PEU recommend that a surcharge amounting to the difference between temporary and permanent rates be calculated and applied to fire protection bills over a 12-month period and to general metered and private fire protection bills as a one-time surcharge, effective with the implementation of the permanent rates.

E. Step Adjustment for Daniels Lake Water Works

PEU acquired Daniels Lake Water Works in Weare last year. In approving the acquisition, the Commission allowed consideration of a step increase for PEU to recover expected capital investments and other expenses associated with Daniels Lake. *Pennichuck East Utility, Inc.* Order No. 24,757 (May 31, 2007). Here, Staff and PEU recommend that PEU be allowed to recover acquisition costs as well as depreciation and taxes resulting from ongoing plant additions. PEU agreed to document these costs, which would then be verified by the Commission's Audit Staff. Staff and PEU recommend that PEU be allowed to recover the costs from customers through a future step adjustment with an effective date to be set in a Commission order approving the audited step adjustment.

F. Rate Case Expense Surcharge

Staff and PEU recommend that PEU recover its rate case expenses and the costs associated with this docket, including PEU's legal and administrative expenses, and copying and delivery charges. PEU agreed to submit to Staff its final rate case expense request from which to calculate the rate case expense surcharge for review and recommendation to the Commission. Staff and PEU further recommend that the rate case expense surcharge be implemented with the temporary-permanent rate recoupment surcharge, where applicable, so as to simplify collection from customers. As noted earlier, PEU has filed documentation of its rate case expenses and Staff has filed its recommendation for approval.

IV. COMMISSION ANALYSIS

RSA 378:7 authorizes the Commission to fix rates pursuant to an order after a hearing. In determining just and reasonable rates, the Commission must balance the consumers' interest in paying no higher rates than are required with the investors' interest in obtaining a reasonable return on their investment. *Eastman Sewer Co.*, 138 N.H. 221, 225 (1994). 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.

A. Revenue Requirement

We first consider the revenue requirement proposed by Staff and PEU. They agreed on an increase of \$711,656 in order to produce a total revenue requirement of \$4,852,485. This represents a 17.19 percent increase over PEU's test year revenues ending December 31, 2006. The revenue requirement represents a settlement between Staff and PEU of all issues related to the revenue requirement, including allowed overall rate of return, return on equity, capital structure, *pro forma* adjustments, capital additions to rate base, operating expenses, and depreciation. At hearing, Staff and PEU testified the increase was necessary due to recent capital

improvements at several of PEU's water systems. Staff and PEU stipulated to a cost of equity capital of 9.75 percent, which is the same cost rate approved in recent water rate proceedings. *Pennichuck Water Works, Inc.*, Order No. 24,751 (May 25, 2007); *Hanover Water Works*, Order No. 24,759 (June 7, 2007).

Our review of PEU's petition, prefiled testimony, and the testimony and other evidence provided at hearing, satisfy us that the revenue requirement called for in Staff and PEU's agreement will result in permanent rates for PEU's customers that are just and reasonable. We further find based on our review of the record that the plant, equipment, and capital additions placed in PEU's rate base are prudent, used, and useful in accordance with RSA 378:28.

B. Rate Design and Cost of Service Study

We next consider the impact the revenue requirement will have on rates. When we approved PEU's temporary 11.99 percent rate increase, we ordered the increase be applied equally to all customer classes, pending review of PEU's most recent cost of service study. The settlement agreement presented by Staff and PEU adopts the recommendations of the cost of service study that more of the revenue requirement be allocated more to the public fire protection classes, and less to general metered customers. Staff and PEU acknowledge that public fire protection revenues are being recovered for the first time from the towns of Bow, Raymond, and Windham. Although the study recommended that the adjustment in the revenue allocation be accomplished over a five year period in order to avoid rate shock, Staff and PEU recommend approximately 75 percent of that allocation take effect at this time.

As a result of this allocation adjustment, the effective increase for general metered customers would average 13.32 percent. An average residential customer with a 5/8 meter and using approximately 8,900 cubic feet of water per year would see an annual bill of \$685.67. This is a \$75.20 increase over the present average residential bill. Private fire protection customers

would see a 2.32 percent increase in rates. The public fire protection/hydrant rate, which affects customers in Pelham and Londonderry, would see an increase of 45.52 percent. The Litchfield fire protection rate would see the largest increase of any customer class, with revenues rising by 69.48 percent. As explained at hearing, however, the effective increase for Litchfield fire protection rates is actually 41.23 percent, since the Litchfield rates were separately identified on customer bills for only 10 months of the test year.

We have reviewed the record and Staff and PEU's recommendations as to rate design and accept them. We believe that Staff and PEU have taken appropriate steps to implement the cost of service study's recommendations for revenue allocation while being mindful of potential rate shock to customers. The objective of gradualism is an established ratemaking principle, but it is countered in this case by the need to reduce and eliminate cross subsidies among rate classes. We agree the proposed allocation adjustment represents an appropriate balance of these principles and we approve the cost allocations as presented.

Staff and PEU have proposed that the new charges for public fire protection in the towns of Bow, Raymond, and Windham be collected through surcharges to bills for customers residing in those towns. At hearing we inquired as to this proposal and understand that in each of these towns there is a small base of customers in PEU's community water systems and that the fire protection benefit therein does not extend throughout the community. PEU reports that the communities are reluctant to pay these costs since the benefit is not town-wide. In light of these factors, Staff and PEU recommend that surcharges for fire protection service be added to the bills of the customers who benefit from that service. We note that the surcharge method of billing for fire protection is not new. In the Town of Litchfield, the town had invested in fire protection and only a portion of the town received fire protection service from the utility. In those circumstances, we found it reasonable that the customers who benefited from the fire protection

service pay for the service through a surcharge added to their water bill. *See Southern New Hampshire Water Co.*, 78 NH PUC 243 (1993). The circumstances in Bow, Raymond, and Windham are similar to Litchfield and the surcharge mechanism for recovery of these costs is reasonable for fire protection customers in these towns. We approve this cost recovery as a part of our approval of the settlement agreement.

C. Daniels Lake Water Works

Staff and PEU have adopted the provisions of Order No. 24,757 in Docket No. DW 06-172, which provides that PEU be permitted to file for a step adjustment in its rates to recover capital improvements and other expenses associated with its acquisition and repair of this community water system. PEU will file for a step adjustment to recover acquisition and organization costs, and capital improvements, which PEU has indicated are already under way. As we have previously approved a step adjustment for improvements at Daniels Lake, we agree with Staff and PEU that this treatment is appropriate as part of our consideration and approval of the settlement agreement.

D. Recoupment of Temporary and Permanent Rates

In Order No. 24,784, we set May 29, 2007 as the effective date of PEU's rate change. Pursuant to RSA 378:29, PEU is entitled to recover the difference between temporary and permanent rates and Staff and PEU have proposed various surcharges to effectuate that recoupment. Staff and PEU recommend a surcharge be applied to public fire protection bills over a 12-month period and that a one-time surcharge be applied to general metered customers and private fire protection customers. These surcharges would be effective as of the date of our order approving permanent rates.

We understand that public fire protection customers will experience a 45.52 percent and 41.23 percent rate increase in permanent rates and thus the need exists to mitigate rate shock as

much as possible. We agree that spreading recoupment over 12 months for these classes of customers is reasonable and thus we approve the surcharge. As to PEU's general metered customers, who will experience a 13.31 percent rate increase, and who are already paying an 11.99 percent increase in temporary rates, we conclude that applying a one-time surcharge to customers is reasonable. Since fire protection rates have not been set for the towns of Bow, Windham, and Raymond and temporary rates did not apply to these customers, no recoupment will occur and no surcharge will be imposed.

Our approval of these surcharges is contingent upon PEU filing its calculation of the recoupments, per customer class, for our review. Since the actual surcharges are not yet known, our approval today is thus only to allow PEU to calculate the surcharge. We will grant our final authorization to PEU to collect the recoupment at a later date when there is sufficient evidence to support a finding that the actual surcharge amounts are reasonable.

E. Rate Case Expenses

Lastly, we consider the recovery of rate case expenses through a surcharge as proposed by Staff and PEU. PEU indicates that its rate case expenses associated with this docket are primarily legal expenses and consulting expense related to the cost of service study. The settlement agreement provides that these expenses should be recovered through a surcharge applied over a 12 month period. Since the hearing, PEU has filed documentation of its rate case expenses and Staff has filed its recommendation that most of PEU's expenses be allowed. We have reviewed Staff's recommendation and agree that all but \$1,300 of PEU's requested expenses are appropriate for recovery. With respect to the audit-related expenses, the Commission has consistently excluded these expenses from recovery as rate case expenses since cooperation with auditing efforts is a continuing obligation under RSA 374:18 and is recognized in calculating permanent rates in RSA 378:28. To include them again as rate case expenses

would amount to double recovery from customers. See, *Pennichuck East Utility, Inc.*, 91 NH PUC 62 (2006). We find the same reasoning applies to PEU's press release expense; it is not an expense unique to the rate case and, furthermore, it would be recognized in calculating permanent rates. With respect to the \$297 in legal costs, it appears PEU agrees that these costs are not related to its rate case. Thus, we agree with Staff that \$1,300 ought to be disallowed. We will approve recovery of \$47,767.72 in rate case expenses and authorize PEU to recover the expenses as a surcharge to customer bills over a 12 month period.

To simplify collection of the rate case expense surcharge and temporary-permanent rate recoupment surcharge Staff and PEU recommend the surcharges be combined, once the recoupment information becomes available. We agree this will be less confusing to customers and approve it on that basis.

F. Conclusion

Having reviewed the record in this proceeding, including the settlement agreement and the supporting testimony presented at the February 28, 2008 hearing, we find the terms of the settlement agreement to be reasonable and for the public good. We find that the terms will result in just and reasonable rates and that they represent an appropriate balancing of ratepayer interests and the interests of PEU's investors. Accordingly, we approve the settlement agreement.

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 Pennichuck East Utility, Inc. is authorized to collect from customers permanent rates, as discussed herein; and it is

FURTHER ORDERED, that Pennichuck East Utility, Inc. shall calculate the temporary rate reconciliation appropriate for each of its customer classes, as discussed herein, and file it with the Commission for review; and it is

FURTHER ORDERED, that Pennichuck East Utility, Inc. is authorized to recover rate case expenses in the form of a surcharge to customer bills over 12 months as specified above; and it is

FURTHER ORDERED, that Pennichuck East Utility, Inc. shall file with the Commission a final accounting of its temporary rate recoupment and rate case expenses recovered at the end of the 12-month period; and it is

FURTHER ORDERED, that Pennichuck East Utility, Inc. file with the Commission a compliance tariff within fourteen days of the date of this order.

By order of the Public Utilities Commission of New Hampshire this fourth day of April, 2008.

Thomas B. Getz
Chairman

Graham J. Morrison
Commissioner

Clifton Below
Commissioner

Attested by:

Debra A. Howland
Executive Director & Secretary