

**STATE OF NEW HAMPSHIRE
PUBLIC UTILITIES COMMISSION**

**DW 12-170
Temporary and Permanent Rate Case**

**DW 06-104
DW 07-133
DW 10-111
DW 11-193
Request for Financing Approval**

HAMPSTEAD AREA WATER COMPANY, INC.

**Order Approving Settlement Agreement on Permanent Rates and
Modifications to Financings**

ORDER NO. 25,519

June 7, 2013

APPEARANCES: Hampstead Area Water Company, Inc., by Robert C. Levine, Esq.; and Staff of the New Hampshire Public Utilities Commission by Marcia A. Brown, Esq.

I. PROCEDURAL HISTORY

Hampstead Area Water Company, Inc. (HAWC) is a regulated public utility and provides water service to approximately 3,100 customers in southern and southeastern New Hampshire. On June 14, 2012, HAWC filed a notice of intent to file rate schedules and on July 27, 2012, HAWC filed its rate schedules and supporting testimony. HAWC requested an increase in permanent rates of 6.99%, and also requested temporary rates at the level of its currently approved tariff rates. On August 21, 2012, the Commission issued Order No. 25,401, suspending HAWC's proposed tariff pages and scheduling a prehearing conference for September 18, 2012. The Commission received no requests for intervention. On September 24, 2012, the Commission approved a proposed procedural schedule submitted by Staff and HAWC. On October 12, 2012, HAWC filed a Management/Service/Rental Agreement between itself and

Lewis Builders Development, Inc. (Lewis), which reflected a \$10,000 increase in costs not included in HAWC's rate case filing. On October 17, 2012, Staff and HAWC filed a settlement agreement on temporary rates, which was heard by the Commission on October 19, 2012. The Commission issued Order No. 25,437 on November 8, 2012, approving the settlement agreement and establishing HAWC's current rates as temporary rates, effective for service on and after September 1, 2012.

On December 28, 2012, HAWC filed a motion to amend its rate filing, to include a step increase for a newly hired employee and additions to rate base for the Black Rocks and Fairfield systems. On January 7, 2013, Staff filed an objection to HAWC's motion. On February 8, 2013, pursuant to Order No. 25,463, the Commission granted HAWC's motion, but provided for an additional round of discovery for Staff to explore the issues raised. On April 12, 2013, Staff and HAWC filed a settlement agreement resolving all outstanding issues in the proceeding. The Commission held a hearing on the settlement agreement on April 18, 2013. On May 7, 2013, Staff filed a letter with the Commission regarding audit work completed with respect to the proposed first step adjustment. Staff's letter, which attached a copy of the audit report, indicated that the assets related to the proposed step adjustment were in service, used and useful, and that review of the final costs of those assets did not result in any material change in the rates proposed in the settlement agreement.

II. SUMMARY OF SETTLEMENT AGREEMENT TERMS

A. Permanent Rate Revenue Requirement

Staff and HAWC recommend the Commission approve an overall revenue requirement of \$1,595,961 based on a 2011 test year. This is an increase of \$29,895, or about 2%, over pro

forma test year water revenues of \$1,498,187. It is based on a rate base of \$4,997,601 and an overall rate of return of 4.89%. The rate of return is based on a cost of debt of 4.00%, a cost of equity of 9.75%, and a capital structure of 85% debt and 15% equity. The settling parties agree that the plant in service in rate base is used and useful in the provision of service to HAWC's customers.

B. Affiliate Agreement

Staff and HAWC recommend the Commission approve an affiliate agreement and notes that the proposed revenue requirement contains costs arising from an affiliate agreement between HAWC and Lewis that is dated July 1, 2012. The agreement was previously filed with the Commission on October 12, 2012. Staff and HAWC agree that the costs arising from the affiliate agreement are just and reasonable pursuant to RSA 366.

C. Step Adjustments

Staff and HAWC agree and recommend that the Commission approve two step adjustments to HAWC's rates. The first, proposed for effect as of the date of the Commission's order in this proceeding, is intended to recover certain capital improvements made during 2012 including \$142,445 for service line replacements; \$15,242 for improvements to a water storage facility; meter replacements of \$39,900; filter replacements of \$46,818; service and main improvements totaling \$9,531; and a service vehicle of \$34,479. The first step adjustment also permits HAWC to recover the costs of well exploration at West Side Drive in Atkinson. While this well did not prove to be a reliable source of additional water, Staff and HAWC agree that the investment in exploration was prudent and the step adjustment begins the amortization of the costs totaling \$20,473 over 20 years. Total capital improvements to be recovered through the

first step adjustment amount to \$288,415. The rate of return applied to this investment is 3.78%, based on the underlying sources of financing for the improvements. The first step adjustment, proposed to be effective for service rendered on and after the date of the Commission order approving the settlement agreement, results in an additional increase in rates of 1.81%.

Revenues from this first step adjustment are not to be reconciled for purposes of temporary rates.

The second step adjustment is to allow HAWC to file on or after November 1, 2013 for certain improvements undertaken during 2013. It is capped at \$142,555 and is for additional service line replacement work which is expected to be funded through State Revolving Loan Funds (SRF) and for a new well in HAWC's Eastwood Place system which is expected to cost up to \$30,000. The rate of return to be applied in the calculation of this second step adjustment is currently projected to be 3.32% but will be determined at the time of the filing according to the final interest rate on the SRF financing(s). This step adjustment is subject to an analysis of HAWC's earnings for the 12 months ended September 30, 2013. If that earnings analysis yields a rate of return that is equal to or higher than the weighted average cost of capital approved in this docket, then HAWC will not seek this second step adjustment. If that earnings analysis shows an achieved rate of return lower than the finally approved cost of capital in this proceeding, then HAWC may file the second step adjustment request to seek new revenues that are the lesser of: 1) HAWC's revenue deficiency as calculated at September 30, 2013; or 2) the total revenues produced by applying the applicable rate of return to the sum of the service line replacements and well costs, less a half year depreciation, and adding depreciation expense, property taxes, and income taxes thereon. Based on current estimates of the cost of the capital

improvements and the cost of capital to be applied to those improvements, this second step adjustment would represent additional revenues of 0.73%.

D. Customer Rate Impact

The rate impact of the recommended revenue requirement resulting from the proposed permanent rates and the first step adjustment, both proposed to go into effect as of the date of the Commission's order in this proceeding, represents a total increase in revenues of 3.80%. HAWC agrees to reconcile only the permanent rates portion of the revenue requirement with temporary rates; the step increases will not be subject to reconciliation. Staff and HAWC propose the 3.80% increase be recovered solely through an increase in HAWC's consumption rate, from \$4.74 per 100 cubic feet to \$5.02 per 100 cubic feet. Staff and HAWC propose no change to the per customer fixed charges. For an average residential customer using 74.08 hundred cubic feet of water annually, the average annual bill will increase from \$471.14 to \$491.88, an increase of \$1.73 per month.

E. Rate Case Expenses

Staff and HAWC agree that, within 15 days of the final order in this docket, HAWC will file documentation of its rate case expenses as well as a proposed surcharge for the Commission's consideration.

F. Temporary Rate Recoupment

Within 15 days of the final order in this docket, HAWC agrees to file its calculation of the reconciliation of temporary and permanent rates pursuant to RSA 378:29, as well as a proposed surcharge.

G. Financings

The capital structure proposed by Staff and HAWC contains certain financings that were previously approved by the Commission in four different dockets and were subsequently modified by HAWC. The Commission approved two financing requests from HAWC in Docket Nos. DW 06-104 and DW 10-111, however, HAWC ultimately financed two vehicles with different lenders since it was able to acquire financing on more favorable terms. In Docket No. DW 07-133, HAWC sought approval for a loan with an unrelated developer in order to acquire the Coopers Grove water system. Subsequently, HAWC renegotiated the loan, resulting in a change of terms, reducing both the principal balance of the loan as well as the interest rate. In Docket No. DW 11-193, HAWC sought and received approval for a loan from Lewis for various capital improvements, but subsequently financed these improvements through internal cash flow and did not utilize the financing offered. To the extent the Commission deems re-approval to be necessary, Staff and HAWC recommend the Commission provide approval for the changes to these prior financings.

III. COMMISSION ANALYSIS

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 the consumers' interest in paying rates no higher 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. 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. N.H. Code Admin. Rules Puc 203.20 (b) requires the Commission to determine, prior to approving the disposition of a contested case by settlement, that the settlement results are just and reasonable and serve the public interest.

Staff and HAWC propose a revenue requirement of \$1,595,961 based on a 2011 test year, a rate base of \$4,997,601 and a rate of return of 4.89%. This represents an increase of 2.0% over HAWC's 2011 test year revenues. A 13-month average of test year rate base components was used for calculation of the rate base, except for two capital projects completed in the test year which the settling parties agreed to place in rate base at year-end value. Staff testified that these assets, considered non-revenue producing, meet the criteria the Commission has established in previous dockets for year-end value. Staff and HAWC also provided adjustments to reduce rate base value for what was described as excess capacity, where water systems were serving fewer customers in residential developments than the water systems were designed to serve. Finally, Staff and HAWC agreed to certain adjustments to depreciation lives, and to the value of certain deferred items. We find these treatments and adjustments to be reasonable. HAWC's books are sufficiently detailed so as to provide more accurate 13-month calculations, and the downturn in the housing market means that developments will be fully built out over a longer period of time than originally expected. As a result, we approve the revenue requirement and find the resulting rates just and reasonable.

Staff and HAWC also recommend two step adjustments to HAWC's revenue requirement. The first is for capital improvements undertaken during 2012, primarily in the area of service line replacements. This work relates to HAWC's leak detection program that is

required by the N.H. Department of Environmental Services (DES) to reduce lost water. The step adjustment also provides recovery of water storage facility improvements, meter installations, filter replacements, other service and main improvements, and a service vehicle. In addition, this step adjustment permits HAWC to commence recovery of the costs of well exploration, which, while ultimately not fruitful, are considered by Staff and HAWC to be prudently incurred. These capital additions total \$288,415 and, based on a cost of capital of 3.78%, would yield additional revenues of \$27,050, an additional increase in rates of 1.81%. The second proposed step adjustment relates primarily to additional service line replacement, leveraging the company's access to SRF funds at low interest rates, and also includes well costs. It is capped at \$142,555 as described above. In order to avail itself of this second step adjustment, HAWC can file its request and supporting documentation on or after November 1, 2013 and the revenues sought in this second step must be the lesser of either: 1) HAWC's revenue deficiency as calculated at September 30, 2013; or 2) the total revenues produced by applying the applicable rate of return to the sum of the service line replacements and well costs, less a half year depreciation, and adding depreciation expense, property taxes, and income taxes thereon.

Step adjustments to rates are employed as a means of ensuring that a regulated utility retains its ability to earn a reasonable rate of return after implementing large capital projects, and to avoid placing a utility in an earnings deficiency immediately after a rate case in which a revenue requirement was based on a historical test year, which in this case was 2011. We find that the capital improvements recommended in the first step increase are used and useful and should be included in rate base. Traditional rate-of-return principles permit a utility 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).

Having reviewed the record and testimony presented at hearing, we approve the proposed step increase, effective as of the date of this order on a service rendered basis, to cover the costs and expenses identified above. This step increase shall not be considered part of permanent rates and shall not be subject to reconciliation pursuant to RSA 378:29.

With respect to the proposed second step increase, we find the associated conditions to be reasonable since they protect customers from HAWC being in an over-earning situation as a result of the step increase. We will determine whether HAWC satisfies these conditions when it submits its filing for this second step, and we will render our decision at a future date. With respect to the overall revenue requirement, we find that the plant included in the proposal is prudent, used, and useful and that the revenue requirement is appropriate and will produce just and reasonable rates.

According to the proposal offered by the settling parties, the increase in HAWC’s revenue requirement will raise HAWC’s volumetric rate per customer per 100 cubic feet to \$5.02, up from \$4.74. Staff and HAWC estimate that an average residential customer using a 5/8-inch meter and consuming 74.08 ccf of water per year will pay approximately \$491.88 annually; an increase of \$20.74. Having considered the impact on rates, we find that the rates are just and reasonable pursuant to RSA 378:7.

Pursuant to RSA 366:3, a regulated utility must file with the Commission all contracts it enters into with an affiliate with a value exceeding \$500. HAWC has a relationship with its affiliate, Lewis Builders Development, Inc. (Lewis) whereby Lewis rents to HAWC office,

storage, and warehouse space at a per square foot charge that includes all real estate taxes, utilities, telephone, and use of copying and related office equipment. The affiliate agreement also covers the use by HAWC of Lewis' attorney, accountant, legal secretary, and management, among other things. Staff and HAWC testified that the rates charged for such services were just and reasonable and have included costs relating to the affiliate agreement in the proposed revenue requirement. Having reviewed the terms of the affiliate agreement as well as the charges, we find the terms of the affiliate agreement to be just and reasonable and for the public good, and we approve the inclusion of agreement-related costs in HAWC's revenue requirements.

Pursuant to the provisions of RSA 369:1, public utilities engaged in business in this State may issue evidence of indebtedness payable more than 12 months after the date thereof only if the Commission finds the proposed issuance to be "consistent with the public good." Analysis of the public good consideration involves looking beyond actual terms of the proposed financing to the use of the proceeds and the effect on rates to insure that the public good is protected. *See Appeal of Easton*, 125 N.H. 205, 211 (1984). As we have previously noted, "certain financing related circumstances are routine, calling for more limited Commission review of the purposes and impacts of the financing, while other requests may be at the opposite end of the spectrum, calling for vastly greater exploration of the intended uses and impacts of the proposed financing. *Public Service Company of New Hampshire*, Order No. 25,050, 94 NH PUC 691, 699 (2009). The Commission previously approved the four financings brought to the Commission's attention at hearing in Docket Nos. DW 06-104; DW 07-133; DW 10-111; and DW 11-193. The Commission approved the financings noting that if the terms of the proposed financings varied

significantly, HAWC would need to seek additional Commission approval. HAWC did not seek subsequent approval following the change in terms of these loans but instead filed, on April 2, 2013, a notice with the Commission that certain terms had changed.

We do not condone amending the terms of financings regulated by RSA 369:1 after the fact. RSA 369:1 requires prior approval of financing terms. We caution HAWC that if terms of financings change in the future that it should file for prior approval of such term changes.

Having reviewed the record regarding the term changes regarding the four financings, we find the terms to be in the public interest. HAWC was able to secure terms that were more favorable than originally approved, which benefits both HAWC and its customers. Accordingly, we approve the changes to the terms of the financings previously approved in those dockets. We also approve inclusion of these loans in the calculation of HAWC's revenue requirement.

Having reviewed the record in this proceeding, including the stipulation and supporting testimony presented at hearing, we find the terms of the stipulation 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 HAWC's investors under current economic circumstances. Accordingly, we approve the stipulation.

Based upon the foregoing, it is hereby

ORDERED, that the stipulation entered into among Staff and Hampstead Area Water Company, Inc. is adopted and approved as discussed herein; and it is

FURTHER ORDERED, that Hampstead Area Water Company, Inc.'s request to increase its revenue requirement by \$29,895, or 2.00%, to an overall revenue requirement of \$1,595,961 is hereby approved, for service rendered on or after the date of this order, and

Hampstead Area Water Company, Inc. is authorized to collect from customers the rates described herein to recover this revenue requirement; and it is

FURTHER ORDERED, that Hampstead Area Water Company, Inc.'s request for a step increase in its revenue requirement to recover a total of \$288,415 in capital improvements and for effect as of the date of the Commission's order in this proceeding is hereby approved; and it is

FURTHER ORDERED, that the step increase to recover \$228,415 in capital improvements is not to be reconcilable with temporary rates; and it is

FURTHER ORDERED, that Hampstead Area Water Company, Inc.'s loans in Docket Nos. DW 06-104; DW 07-133; DW 10-111; and DW 11-193 are re-approved pursuant to RSA 365:28; and it is

FURTHER ORDERED, that Hampstead Area Water Company, Inc. file within fifteen days from the date of this order documentation of its calculation of the difference between temporary and permanent rates as well as a proposed surcharge for recovering the difference from customers; and it is

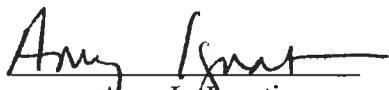
FURTHER ORDERED, that Hampstead Area Water Company, Inc. file documentation of its rate case expenses as well as a proposed surcharge for recovery of these expenses within fifteen days from the date of this order; and it is

FURTHER ORDERED, that Hampstead Area Water Company file a compliance tariff within ten days of the date of this order; and it is

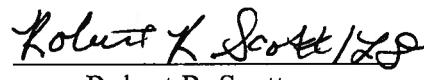
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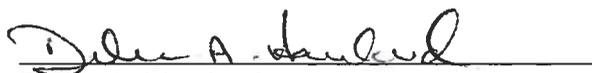
By order of the Public Utilities Commission of New Hampshire this seventh day of June
2013.


Amy L. Ignatius
Chairman


Michael D. Harrington
Commissioner


Robert R. Scott
Commissioner

Attested by:


Debra A. Howland
Executive Director