STATE OF NEW HAMPSHIRE

PUBLIC UTILITIES COMMISSION

DW 10-090

<u>In the Matter of:</u>
<u>Pittsfield Aqueduct Company, Inc.</u>
<u>Petition for Permanent Rates and Step Increase</u>

Direct Testimony

of

Jayson P. Laflamme
Staff Utility Analyst, Gas and Water Division

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Direct Testimony of Jayson P. Laflamme

I. INTRODUCTION

Q. Please state your full name.

A. My name is Jayson P. Laflamme.

Q. By whom are you employed and what is your business address?

A. I am employed by the New Hampshire Public Utilities Commission (NHPUC) and my business address is 21 South Fruit Street, Suite 10, Concord, New Hampshire.

Q. What is your position at the NHPUC?

A. I am a Utility Analyst in the Gas and Water Division.

Q. Please describe your duties at the NHPUC.

A. I am responsible for the evaluation of rate and financing filings, including the recommendation of changes in revenue levels that conform to regulatory methodologies. I represent Staff in meetings with company officials, outside attorneys and accountants relative to rate case and financing matters as well as the Commission's rules, policies and procedures.

Q. Would you please describe your educational background?

A. I received a Bachelor of Science Degree in Accounting from Lyndon State College in 1989. In 1998, I attended the NARUC Annual Regulatory Studies Program at Michigan

State University. In 2002, I attended the 22nd Annual Western Utility Rate School in San Diego, California.

Q. Would you please describe your work experience?

A. In 1989, I was hired as a Staff Accountant by Driscoll & Company, a CPA firm located in Littleton, New Hampshire. I performed audits, reviews and compilations as well as prepared tax returns for a variety of entities. I was eventually promoted to the position of Manager. In 1997, I was hired as a Utility Examiner in the Audit Division of the NHPUC. In that position, I participated in field audits of the books and records of regulated utilities in the electric, telecommunications, water, sewer and gas industries. I examined reports and filings submitted to the Commission by regulated utilities and performed rate of return analyses. In 2001, I was promoted to my current position as a Utility Analyst in the Commission's Gas and Water Division.

Q. What is the purpose of your testimony?

A. My testimony will provide Staff's recommendation with regard to a permanent rate revenue requirement for Pittsfield Aqueduct Company, Inc. (PAC or the Company). My testimony will also provide Staff's recommendation regarding the Company's request for a step increase in this proceeding.

Q. Before discussing the specifics of Staff's recommended revenue requirement, are there any general comments that you would like to make?

A. Yes. I would like to thank the Commission's Audit Staff for their excellent work in this case. The Audit Staff was quite thorough in its examination of the Company's test year and identified several issues which were included in its Final Audit Report dated

November 23, 2010 (Final Audit Report) that have been incorporated into Staff's recommended revenue requirement.

II. STAFF RECOMMENDATION FOR PERMANENT RATES

Q. Please provide a brief summary of PAC's request for permanent rates in this proceeding.

A. On May 6, 2010, PAC filed a petition, including testimony and supporting schedules, requesting approval of a permanent rate increase in order to generate additional revenues of $121,328, representing a 19.98% increase in annual operating water revenues. The Company utilized 2009 as its test year in making its determinations.

Q. Did the Company subsequently modify the revenue increase that it is seeking in this rate proceeding?

A. Yes. In its discovery response to OCA Data Request 3-1, PAC provided revised schedules showing the impact of several adjustments resulting from its responses to Staff and OCA discovery as well as from the Final Audit Report. As a result, the increase in water revenues now being sought by PAC is $107,686, or 17.73%. A copy of PAC's response to OCA 3-1 is attached to my testimony as Attachment JPL-1.

Q. Does Staff agree with the adjustments reflected in the Company's response to OCA 3-1?

A. For the most part. However, Staff is proposing modifications to two adjustments proposed by PAC in its response to OCA 3-1. Also, additional pro-forma adjustments to rate base and operating expenses are being proposed by Staff in order to derive its recommendation for a permanent rate revenue requirement in this case. All of Staff's proposed adjustments will be discussed in detail later in my testimony.

Q. Are temporary rates currently in effect in this docket?

A. Yes. On October 8, 2010, the Commission issued Order No. 25,154 authorizing a temporary revenue increase of $60,713, or 10.00%, to be implemented on a service rendered basis, effective June 16, 2010.

Q. Please summarize Staff's recommendation regarding a permanent rate revenue requirement for PAC in this case.

A. As indicated on Schedule 1 of Attachment JPL-2, Staff is recommending a revenue requirement totaling $713,242. This represents an increase of $105,983, or 17.45%, over the Company's pro-formed test year operating water revenues of $607,259. Staff's recommended revenue requirement is calculated utilizing a total rate base of $1,900,499 which is computed on Schedule 2 of Attachment JPL-2 and provides for an overall rate of return of 7.60%. This level rate of return is that proposed by PAC in its original filing. The revenue deficiency before tax effect is $64,003. A combined federal and state tax effect of $41,980 is added to this revenue deficiency resulting in an overall increase in the Company's revenue requirement of $105,983.

Q. What was used for a Federal and State tax rate?

A. As indicated on Schedule 1A of Attachment JPL-2, an overall effective tax rate of 39.61% was computed. This is the same effective tax rate proposed by the Company in its filing.

III. RATE BASE

Q. Please discuss the rate base amount calculated by Staff on Schedule 2 of Attachment JPL-2.

A. Columns (1) through (3) summarize the Company's derivation of its pro-forma thirteen-month average rate base of $1,962,038 as proposed in its initial filing. Columns (4) and (5) show the subsequent adjustments made by the Company which are contained in its response to OCA 3-1 (Attachment JPL-1) and result in a modified rate base amount of $1,900,913. Columns (6) through (8) show the impact of Staff's one adjustment to rate base which results in its recommendation of $1,900,499 for pro-forma rate base in this case.

Q. Please explain Staff Adjustment # 1 to reduce Cash Working Capital by an amount of $414.

A. There are actually two elements to this adjustment. The first relates to the $1,602 overall decrease in Operation & Maintenance (O&M) Expenses indicated by PAC in its response to OCA 3-1 (see Column 4 of Schedule 3 of Attachment JPL-2). This amount has been included as part of Staff's adjustment because the Company, in its response to OCA 3-1, did not include an adjustment to the cash working capital component of rate base relative to this decrease in O&M Expenses. The second element relates to Staff's proposed decrease in O&M Expenses of $1,753 in its revenue requirement recommendation as indicated in Column 6 of Schedule 3 of Attachment JPL-2. The combined decrease in O&M Expenses, or $3,355, when multiplied by the 12.33% working capital rate, results in a $414 decrease in the cash working capital component of rate base from $50,629 to $50,215 (see Column 8 of Schedule 2 of Attachment JPL-2).

IV. NET OPERATING INCOME

Q. Please discuss the Operating Income Statement for PAC presented on Schedule 3 of Attachment JPL-2.

A. Columns (1) through (3) present PAC's derivation of its pro-forma net operating income as proposed in its original filing in the amount of $75,752. Columns (4) and (5) summarize the Company's subsequent adjustments to net operating income as presented in its response to OCA Data Request 3-1 (Attachment JPL-1). PAC increased its original net operating income proposal by $3,595 to an amount of $79,347. Columns (6) through (10) summarize my testimony in support of Staff's proposed revenue requirement of $713,242. Specifically, in Columns (6) through (8), a total of four pro-forma adjustments are shown which increase the Company's net operating income by a tax adjusted amount of $998 to $80,345. These adjustments are further detailed on Schedule 3A of Attachment JPL-2 as well as discussed later in my testimony. Columns (9) and (10) summarize the revenue requirement calculation from Schedule 1 of Attachment JPL-2, showing a proposed increase in PAC's revenue requirement of $105,983 to $713,242, ultimately resulting in a net operating income requirement of $144,348.

Q. Please explain Staff Adjustment # 2 which decreases PAC's Production Expenses by $660.

A. This pro-forma adjustment stems from the Final Audit Report which stated that the Company's test year included a charge of $660 for work performed at one of its former North Country systems. According to Counsel, the North Country systems were transferred from PAC to Pennichuck East Utility, Inc. (PEU) effective January 1, 2010 as part of the Settlement Agreement in dockets DW 08-052 and DW 09-051 which was approved by Commission Order No. 25,051 issued on December 11, 2009. Therefore, this $660 charge relating to the former North Country systems should be removed from PAC's pro-forma test year as it is a non-recurring expense.

Q. Please explain Staff Adjustment # 3 reducing Transmission and Distribution Expenses by $1,148.

A. In its response to Staff Data Request 2-11, PAC indicated that its share of a pro-forma increase in union wages resulting from a contract with the United Steelworkers Union should be reduced. In its original filing, the Company included a pro-forma adjustment to increase wages by $3,433 and increase benefits by $2,329 ($3,433 x 67.85%) for a combined amount of $5,762. However, in its response to Staff 2-11, PAC recalculated the wage increase so as to remove wages allocated to affiliates with the result being only a $2,749 wage increase. Combined with a revised benefits component of $1,865 ($2,749 x 67.85%), the resulting revised pro-forma increase in union wages and benefits is $4,614 which is $1,148 less than PAC's original pro-forma entry included in its filing.

Q. Please explain Staff Adjustment # 4 which increases the Inter-Division Management Fee by $55.

A. This adjustment stems from the elimination of a Customer Service Representative position; the cost for which, including salary and benefits, was allocated to PAC in its original filing. The Company's response to OCA Data Request 3-1 included a reversal of the allocated salary and benefits cost of this position. However, the benefits percentage used by the Company relative to the reversing entry in OCA 3-1 of 52.30% is greater than the benefits percentage of 42.92% included in the Company's original filing. Staff

Adjustment # 4, in effect, reduces the Company's reversing entry by $55 in order to properly match the original benefits percentage used by the Company in its filing.

Q. Please discuss Staff Adjustment # 5 which increases Property Tax Expense by $100.

A. In its response to OCA 3-1, the Company adjusted its pro-forma property tax expense to $77,212. However, this amount is $100 less than the combined state and municipal property taxes incurred by the Company for the tax year 2010 of $77,312 as indicated in its response to Staff Data Request 3-4. Staff Adjustment # 5, therefore increases the Company's pro-forma property tax expense by $100 in order to match the known and measurable property tax expense incurred by PAC during 2010.

V. <u>TAX EFFECT OF OPERATING EXPENSE ADJUSTMENTS</u>

Q. Please briefly explain Schedule 3B of Attachment JPL-2.

A. This schedule calculates the income tax effect of the above described expense adjustments. The combined impact of Staff Adjustments # 2 through # 5 results in a net increase in the Company's pro-forma net operating income of $1,653. This increase in net operating income leads to a marginal increase in PAC's New Hampshire Business Profits Tax (NHBPT) of $140 calculated at a rate of 8.50% as well as a marginal increase in its Federal Income Tax of $514 calculated at a rate of 34.0%. Therefore, after tax effect, the net pro-forma increase in PAC's operating income resulting from Staff's adjustments is $998.

VI. STAFF RECOMMENDATION FOR STEP INCREASE

Q. Please provide a brief summary of PAC's request for a step increase in this proceeding.

A. In addition to its request for an increase in permanent rates, the Company's original filing also contained a request for a step increase in its operating revenues in order to recover the cost of certain mandatory upgrades made to its Berry Pond Dam. PAC has been working with the New Hampshire Department of Environmental Services (NHDES) since 2000 to upgrade the dam to State standards. However, in December 2008, NHDES issued a letter of deficiency listing specific areas of improvement relative to the Berry Pond Dam. These upgrades were subsequently undertaken by the Company during 2010 and were completed in November 2010. PAC's original filing, submitted in May 2010, included an estimate of the revenue impact of the Berry Pond Dam upgrades. At that time, the cost of the project was estimated at $183,000 resulting in an additional proposed revenue increase of $32,230, or 5.31%. However, in its response to Staff Data Request 4-1, PAC provided updated schedules which reflect the actual cost of the Berry Pond Dam upgrades completed in November 2010. The actual cost of the Berry Pond Dam upgrades was $114,940 resulting in a revised proposed step increase in revenues of $20,233, or 3.33%. A copy of the Company's response to Staff 4-1 is attached to my testimony as Attachment JPL-3.

Q. What is Staff's recommendation with regard to PAC's request for a step increase in rates relative to the Berry Pond Dam upgrades?

A. Consistent with the testimony of Mark Naylor, Director of the Gas & Water Division, Staff supports the Company's request for a step increase in revenues in order to recover the costs it incurred in order to bring the Berry Pond Dam into compliance with State standards. PAC has worked closely with NHDES with regard to upgrading the Berry Pond Dam and has made a substantial investment in these upgrades which were mandated by NHDES in the December 2008 letter of deficiency. Staff feels that if the Company were not allowed to immediately recover the cost of these upgrades through rates, it would have a detrimental impact on PAC's ability to earn its allowed rate of return upon the conclusion of this case. Further, Staff believes that the upgrades made to the Berry Pond Dam were reasonably necessary and consistent with the public good.

Q. What is the amount of the step increase that Staff is proposing relative to the improvements made at the Berry Pond Dam?

A. Staff is proposing a step increase in revenues of $19,339, or 3.18%, in order for PAC to recover its investment and associated expenses relative to the improvements made to the Berry Pond Dam. I have included Attachment JPL-4 to my testimony which shows how Staff derived its recommendation for a step increase.

Q. Has Staff reviewed the actual costs associated with the upgrades made to PAC's Berry Pond Dam?

A. No. However, it is anticipated that the NHPUC Audit Staff will be reviewing the actual costs of construction pertaining to the Berry Pond Dam upgrades relatively soon. Upon completion of that review, a report containing the NHPUC Audit Staff's findings concerning these upgrades will be issued. After which, a final proposal relative to the exact amount of the step increase should be submitted to the Commission for its approval. In the mean time, and for purposes of my testimony, I utilized the amounts provided by the Company in its response to Staff 4-1 (Attachment JPL-3). As such, it is possible that certain amounts reflected in my schedules may be subject to change depending on the outcome of the NHPUC Audit Staff's review.

VII. STEP INCREASE SCHEDULES

Q. Please provide a brief narrative which explains Staff's computations for the Step Increase in Attachment JPL-4.

A. As illustrated on Schedule 1 of Attachment JPL-4, Staff is proposing a net increase in rate base relative to the Berry Pond Dam improvements of $112,883. The 7.60% rate of return is consistent with that utilized in the determination of permanent rates on Schedule 1 of Attachment JPL-2. Applying that percentage to the net increase in rate base results in an addition to the Company's net operating income requirement of $8,574. From Schedule 3 of Attachment JPL-4, additional operating expenses totaling $3,105 consisting of depreciation and property taxes will be incurred as a result of the upgrades. These additional expenses added to the calculated net operating income requirement results in a revenue deficiency before taxes of $11,679. A combined federal and state income tax effect of $7,660 was calculated relative to the step increase which, when added to the revenue deficiency, results in an overall increase in PAC's revenue requirement of $19,339. This is equivalent to a 3.18% increase over the Company's adjusted test year water revenues of $607,259. At the bottom of Schedule 1 of Attachment JPL-4, I have included the combined impact on revenues for both the permanent rate increase as well as the step increase. Overall, Staff is recommending a total revenue increase in this case of $125,322 and a total revenue requirement of

$732,581. This represents a combined increase of 20.64% in PAC's adjusted test year water revenues.

Q. It appears that Staff is only making one adjustment to the Company's adjusted step increase proposal. Please briefly explain Staff's adjustment to reduce property tax expense relative to the Berry Pond Dam upgrades by $893?

A. The Company determined additional property taxes resulting from the Berry Pond Dam upgrades by multiplying the gross book cost of the upgrades ($114,940) by the municipal and state mill rates of $.02801 and $.00660, respectively, ($0.03461 combined) to derive an additional annual property tax expense of $3,978 ($114,940 x $0.03461). However, Staff believes that this approach is not consistent with the actual determination of property taxes for utilities within the State of New Hampshire. As illustrated by the computation on Schedule 3A of Attachment JPL-4, Staff has determined that the present actual property tax valuation for 2010 employed by both the Town of Pittsfield as well as the New Hampshire Department of Revenue Administration (NHDRA) of $2,233,800 is equivalent to 78.97% of the net book value of the total taxable plant owned by the Company. This analysis is based upon Staff's review of the 2010 valuation prepared by NHDRA and provided by the Company in its response to Staff Data Request 3-4. Staff applied this percentage to the net book value of the new plant associated with the Berry Pond Dam upgrades ($112,883) to derive an estimated tax valuation of $89,147. Using that amount, Staff calculates an estimated property tax expense of $3,085 ($89,147 x $0.03461) which is $893 less than the amount proposed by the Company in its response to Staff 4-1 (Attachment JPL-3). Tax effected, Staff's net expense adjustment becomes $539 as calculated on Schedule 3B of Attachment JPL-4.

Q. Does this conclude your direct testimony?

A. Yes.