

STATE OF NEW HAMPSHIRE
PUBLIC UTILITIES COMMISSION

DW 10-090

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

Direct Testimony

of

Mark A. Naylor
Director, Gas and Water Division

March 4, 2011

1 New Hampshire Public Utilities Commission

2 Pittsfield Aqueduct Company, Inc.

3 DW 10-090

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6

7 **Q. Please state your name, occupation, and business address.**

8 A. My name is Mark A. Naylor. I am Director of the Gas & Water Division at the New Hampshire
9 Public Utilities Commission. My business address is 21 South Fruit Street, Suite 10, Concord,
10 New Hampshire. My experience and qualifications are attached to this testimony as Attachment
11 MAN-1.

12 **Q. What is the purpose of your testimony?**

13 A. The purpose of my testimony is to provide the recommendations of Commission Staff (Staff)
14 with respect to the request of Pittsfield Aqueduct Company (PAC) for a Water Infrastructure and
15 Conservation Adjustment (WICA) mechanism, and for a step adjustment to its rates for a post-
16 test year capital project. I would also like to offer comments on the recently filed joint petition of
17 the City of Nashua (Nashua) and Pennichuck Corporation (Pennichuck) in Docket No. DW 11-
18 026 as to its potential impact on PAC and PAC rates.

19 **Q. Please describe what a WICA mechanism is.**

20 A. A WICA mechanism allows a water utility to seek regular recovery of certain non-revenue
21 producing, pre-approved capital improvements between general rate cases. It is intended as a
22 way of incenting more rapid replacement of aging infrastructure, and is not a replacement for
23 general rate proceedings. The infrastructure to be replaced under a WICA is generally restricted

1 to mains, valves, services, hydrants and meters. A budget for these capital investments is
2 approved by the regulator prior to any construction. Each year the utility makes a filing seeking a
3 WICA surcharge to be added to customer bills to begin recovery of the projects completed that
4 year. The total WICA surcharge added to customer bills at any one time is generally limited to a
5 certain percentage of the utility's total revenues before the utility must seek a new general rate
6 case. At the conclusion of the rate case, the surcharge revenues are incorporated into the total
7 revenue requirement, new tariff rates are established, and the surcharge is re-set to zero. The
8 Commission approved a WICA mechanism for Aquarion Water Company of New Hampshire,
9 Inc. (Aquarion) in that company's last general rate case, DW 08-098. Order No. 25,019,
10 September 25, 2009

11 **Q. Please describe PAC's proposed WICA.**

12 A. PAC proposes that it undertake WICA projects every other year. In the testimony of Donald
13 Ware, President of PAC, he states that PAC believes that because of the company's small size, it
14 will be more beneficial to undertake WICA projects on an every other year basis. This will
15 attract better project pricing based on more water main work, and will minimize fixed project
16 costs such as bonding, mobilization and demobilization that are the same regardless of project
17 size. PAC's requested approval of a WICA would concentrate on water main replacement. This
18 request is based on planned replacement or rehabilitation of 13,650 linear feet of existing
19 distribution main over a 20 year time frame. PAC will also incorporate replacement of services,
20 meters, and hydrants into its proposed WICA. The company indicates that it will prioritize its
21 replacement efforts based on the proximity of the cast iron water main to the source of water
22 supply, and intends to work progressively outward in the distribution system. PAC indicates it
23 will coordinate with the Town of Pittsfield in the event the Town is planning street paving or
24 rehabilitation. PAC proposes that its WICA surcharge be limited to 5% in any one year with a
25 maximum of 7.5% between full rate cases.

1 **Q. What are the asserted benefits of a WICA?**

2 A. A WICA mechanism permits a water utility to begin to recover by a surcharge the costs of capital
3 improvements intended to address issues of aging infrastructure. By commencing recovery of
4 these replacements between general rate cases, the utility's cash flows are enhanced and the
5 WICA may therefore help to speed up replacement of such aging plant. And because a small
6 surcharge is placed on customer bills between rate cases, it may also lengthen the time between
7 full rate cases, thus saving rate case expense. WICA programs also may help in reducing rate
8 shock by virtue of a more gradual increase in customer bills as infrastructure is replaced. And if a
9 WICA program does incent a utility to speed the rate of infrastructure replacement, then it stands
10 to reason the distribution system will ultimately be more reliable.

11 **Q. What is Staff's recommendation regarding a WICA for PAC?**

12 A. Staff supports the establishment of a WICA program for PAC. Although the WICA program has
13 been in place for Aquarion for only a short time, Staff believes that the process has worked well
14 thus far¹. Staff would support structuring a WICA for PAC that is very similar to the one in place
15 for Aquarion. The Aquarion WICA is in place as a pilot program, to be re-evaluated at the time
16 the company files its next rate case. Staff believes this is a good model to follow for PAC as
17 well. Since PAC proposes to undertake WICA replacement projects on an every other year basis,
18 and if it were to begin the program in the construction season of 2012, then the company's first
19 filing in late 2011 or early 2012 would illustrate the planned projects for 2012, 2014, and 2016.

¹ Following issuance of the Commission order in September of 2009 in DW 08-098, Aquarion's rate case, which approved the establishment of a WICA, the company made its initial filing on November 1 of that year. That filing provided Aquarion's first three year budget of infrastructure replacement for 2010, 2011, and 2012. Staff and the parties to DW 08-098 reviewed the budget and provided a joint recommendation to the Commission. A budget was approved by Commission order in January of 2010. On November 1, 2010, Aquarion filed its three year budget for 2011, 2012, and 2013, as well as its request to add a surcharge to customer bills for the completed 2010 projects. Following review and recommendation, the Commission approved the new budget and a surcharge in December of 2010.

1 The first filing which would include a request for a surcharge to customer bills would be made in
2 late 2012 or early 2013.

3 **Q. Does Staff have a recommendation for how the surcharge for completed WICA projects**
4 **should be calculated?**

5 A. Yes. Rather than changing the actual tariff rates charged to customers, Staff recommends the use
6 of a percentage surcharge that would be separately identified on bills and applied to a customer's
7 total bill. This ensures that the WICA surcharge is applied equally to all customer classes. At
8 this time Staff would recommend that the surcharge be calculated in the same way as it has been
9 done with Aquarion. The total revenues to be recovered from completed projects would include
10 return on plant (at the weighted average cost of capital approved in this rate case), depreciation
11 expense, property tax, and associated income tax. That total of revenues should be divided by the
12 total revenue requirement approved in this rate case to calculate the surcharge².

13

14 **Q. Are there any other recommendations with respect to WICA that Staff would like to make?**

15 A. Yes. Staff recommends that because Commission review of WICA filings are by necessity more
16 brief than review of full rate cases, PAC be responsible for providing notice to its customers and
17 to the Town of Pittsfield at least 30 days in advance of its WICA filings. In addition, the
18 company's WICA filings should be accompanied by the following: 1) all the documentation
19 necessary for Staff and the parties to verify the costs of the completed projects; 2) proposed tariff
20 page(s); and 3) testimony that summarizes the WICA budgets and the calculation of the surcharge
21 requested.

² PAC has also requested a step adjustment in this rate case, for needed repairs to its Berry Pond Dam, which Staff is supporting. Therefore Staff recommends that the total revenue requirement that would form the denominator in the surcharge calculation should include the step adjustment revenues if approved by the Commission.

1 **Q. In your testimony in the referenced Aquarion docket, DW 08-098, you testified that you**
2 **believe a WICA mechanism shifts risk away from the utility and onto its customers. Do you**
3 **still take this position?**

4 A. Yes. As I stated in my Aquarion testimony, a WICA mechanism reduces regulatory lag, speeds
5 up cash flows, and mitigates litigation risk for the utility. In this way a WICA mechanism is very
6 similar to step adjustments, which are typically granted for large post-test year capital projects
7 which, if not recognized in rates immediately following a rate case, put the utility in a position of
8 under-earning right away. This Commission has adopted the use of step adjustments for a
9 number of years now, particularly for water utilities. One way to address the issue of the shifting
10 of risk that results from the implementation of a WICA mechanism is to eliminate the granting of
11 step adjustments, or restrict them only to very large capital projects directly affecting the quality
12 of service to customers.

13 **Q. PAC has requested a step adjustment in this docket, relating to mandatory upgrades of its**
14 **Berry Pond Dam. Do you believe this is a project that should qualify for a step adjustment**
15 **even with the implementation of a WICA?**

16 A. Yes. As indicated in the testimony of Staff witness Jayson Laflamme, PAC has received a Letter
17 of Deficiency from the New Hampshire Department of Environmental Services (NHDES) with
18 respect to improvements needed at the Berry Pond Dam. The total capital invested in the needed
19 improvements is fairly significant (\$114,940 in capital investment) relative to PAC's total rate
20 base as recommended by Staff (\$1,900,499), representing about a 6% increase, and the capital
21 investment took place in 2010, the year immediately subsequent to the test year. Therefore I
22 believe a step adjustment is appropriate.

1 Q. Earlier you referenced the joint petition of Nashua and Pennichuck in Docket No. DW 11-
2 026. What are your comments regarding this joint petition as it may affect PAC and PAC
3 rates?

4 A. Nashua and Pennichuck have filed a petition with the Commission for approval of the acquisition
5 by the City of all of the outstanding stock of Pennichuck. A prehearing conference was held
6 February 24, 2011 and the petition is expected to be ruled upon before the end of 2011. As there
7 are certain costs that are passed down to PAC from Pennichuck, and there are certain costs
8 allocated to PAC from Pennichuck Water Works, Inc., those costs should be expected to change
9 under new, municipal ownership. Staff's positions on PAC's revenue requirement, rate design,
10 and all other recommendations as advanced in the testimony of the three Staff witnesses filed
11 today are based solely on the current ownership and cost structure as they exist today.

12 Q. Does this conclude your testimony?

13 A. Yes it does.