

STATE OF NEW HAMPSHIRE

BEFORE THE  
PUBLIC UTILITIES COMMISSION

AQUARION WATER COMPANY OF NEW HAMPSHIRE, INC.  
DOCKET NO. DW 12-085

TOWN OF HAMPTON'S CLOSING ARGUMENT

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NOW COMES Intervenor Town of Hampton in the above entitled matter and sets forth the following by way of its closing argument in this matter:

The Town of Hampton (hereinafter, "Hampton") has opposed the rate increases and revenue requirement being sought herein by Aquarion Water Company of New Hampshire, Inc. (hereinafter, "AWC-NH" or "the Company") on three major grounds: 1) that the increased rates that the Company is seeking herein are excessive and are coming too frequently; 2) that AWC-NH should not be allowed to continue to collect increased revenues to make up for declining consumption of water due to water conservation by consumers; and 3) that the rate of return on equity being sought herein is too great and in fact ought to be reduced in light of economic conditions.

I. **The increased rates sought are too great in amount and frequency.**

The Company brought this case seeking an 18.3% increase in rates with a corresponding revenue requirement increase of just over 1.1 million dollars (\$1,113,981). Following PUC Staff review and audit and rounds of data requests by the PUC Staff, the Office of Consumer Advocate, and the Towns of Hampton and North Hampton, this increase was reduced somewhat to a 17.71% increase, corresponding to a revenue

requirement that still exceeds \$1 million dollars (\$1,077,924). This figure appears in the “Report of Reconciliation of Original, Revised & Settlement Requirement” (Exhibit 18), but that Report assumes a 9.75% return on equity from the settlement of the last rate case in 2009, and the Company is now seeking a higher authorized return on equity of 10.25%.

The context of these increases is important and is demonstrated by Exhibit 21 (copy attached), a history of the rate increases that have been obtained by the Company as derived from the PUC’s dockets. Whereas before 2006 rate increases were being sought 8 and then 6 years apart, now they are being sought much more frequently, on a cycle of only 3 years. See Troy Dixon Testimony, Exhibit 5 a, page 94 of 171 (describing an every 3 year general rate case as the Company’s “practice”) and Exhibit 7, Rebuttal Testimony of Troy Dixon and Carl McMorrان, page 12 (identifying the Company’s filing of rate cases approximately every 3 years as a “previously announced plan”). Mr. Dixon’s response with the post hearing filing of Exhibit 24 by the Company as its “Five Year Plan” assumes that a new rate base case will be filed in 2015.

Not only are recent rate increase petitions coming more frequently, but they are in double digit amounts. An 18.64 % increase was granted in 2006, a 17.44 % increase was granted in 2009, and another 17.71 % increase is now being sought. Significantly, this latest increase comes on the heels of three consecutive years’ worth of increases already having been granted under the category of Water Infrastructure and Conservation Adjustments (WICA). These charges, implemented on a pilot basis, were supposed to extend the time between full rate cases. As testified to by Mark Naylor, Director of the Gas & Water Division of the PUC in Exhibit 9, page 3, this goal has not been achieved.

As Mr. Naylor notes, “The establishment of a WICA program in 2009 has not extended the time between rate cases. Indeed, Aquarion has stated in its filing that it anticipates the need to file for rate relief every three years, regardless of the WICA. The Company is no longer suggesting that extending the time between rate cases is an objective of its WICA.”

From the point of view of the consumer, whose total water usage is declining, and who may be out of work or may be under-employed in this economy or living on a fixed income, the question must be asked, where is the end to this cycle? The answer this time is probably no end, if the Company is allowed to maintain this cycle. If all else remains the same, the Company will be back every year for a WICA increase and every three years for another permanent rate increase with the WICA percentage being re-set to zero each time, which is to occur in this case. See paragraph 10 of the Partial Settlement Agreement (Exhibit 4).

The Company’s Director of Rates and Regulation indicated a fond hope that the next rate of increase sought by AWC-NH might be limited to 10%. The Company’s 5 year plan (Exhibit 24 as produced subsequent to the hearing) provides no real basis to believe that this hope will materialize, because the projected average annual customer bill amounts reflect an assumption that level of usage will remain consistent: as Mr. Dixon states in his response accompanying Exhibit 24, “The average annual customer bill amounts reflected on page 2 of Attachment A reflect the Company’s estimates of what a residential customer will pay over the next five years assuming a consistent level of usage.” (Emphasis added). See also footnote 1 on Attachment A: “1. Annual residential bill assuming consistent usage.” Based upon Mr. Dixon’s own testimony in this case, it is

not reasonable to assume a “consistent level of usage” when predicting what the Company will be seeking by way of percentage rate increase in its next rate case in three years. As noted in the next section of this closing argument, the Company has acknowledged that there has been steady decline in consumption that it expects will continue for the foreseeable future, necessitating the filing of a rate case at least every three years. On that basis, AWC-NH will necessarily be seeking a higher rate of increase from its customers in the next rate case than is reflected in Attachment A to Exhibit 24.

The Company has already been granted and has implemented a temporary rate increase of 8.8% overall, corresponding to a revenue requirement of \$535,709. (Order No. 25,412). In light of the high percentage of the permanent rate increase the Company is seeking that is attributable to declines in consumption due to water conservation, and in light of the reduction in return on equity that should be authorized as explained below, Hampton asks that if any further rate increase is granted by the Commission in this case above the temporary increase that already has been awarded, that the total rate increase granted be less than a double digit increase.

II. The Company should not be rewarded with an increased revenue requirement that makes up in full for the decline in consumption due to water conservation by consumers.

Mr. Dixon has testified in Exhibit 5a that “Were it not for increases in expenses and property taxes, it is likely that the Company would not have had to file a rate case.” (Page 71 of 171). In his rebuttal testimony with Mr. McMorran (Exhibit 7 at the top of

page 13), Mr. Dixon points in particular to “the new, unexpected ROW tax assessed by the Town of Hampton.” Of course, as Hampton Town Manager Welch has testified, the Hampton Board of Selectmen has decided that it will not appeal from the recent Rockingham County Superior Court Orders (Exhibit 22) that will result in a refund to the Company of about \$126,000 plus interest. As Mr. Dixon indicated in his live testimony, this is a “pot of money” to be in Aquarion’s hands that is not accounted for in this case. Future right of way taxes starting in 2013 were found to be valid by the Superior Court and are accounted for by the step adjustment referred to in paragraph 4 of Exhibit 4, the Partial Settlement Agreement.

Of bigger impact than the percentage increase in revenue attributable to taxes is the percentage (19.3%) of the increased revenue requirement associated with the decline in consumption due to consumer water conservation. See pie chart on page 71 of 171 of Exhibit 5a. This percentage represents \$214,000 of the requested permanent rate increase. Company’s response to Hampton data request 1-3, attached as Exhibit 2 to Mr. Welch’s Testimony (Exhibit 15).

Mr. Dixon describes this decline in consumption as steady on page 9 in his rebuttal testimony (Exhibit 7) and is one reason why he states that the Company has been unable to earn its allowed rate of return. He indicates on page 13 of Exhibit 7 in rebuttal testimony that declining consumption is a trend that is likely “to continue for the foreseeable future”, necessitating the filing of “a rate application at least every three years for the foreseeable future.” This decline is quantified in gallons on Staff Data Request 2-25 (Exhibit 20).

The Commission itself drew attention to this problem as early as the July 11, 2012

Prehearing Conference, perceiving that if the Company did not change the way it looked at things, this would only head us down a downward spiral, “and you’ll be back here in a couple of years saying usage has continued to go down even more, so we need to raise our rates even more.” (Transcript on page 19).

The Commission held a Public Statement Hearing on November 28, 2012, and at that Hearing, a number of speakers commented on consumers being penalized with higher water rates as a result of having achieved water conservation.

In response, in its December 17, 2012 letter, the Commission issued a directive to the Company to respond to the question of whether Aquarion has considered tiered block rates that are lower for lower usage and escalate with higher usage.

Despite issuing rebuttal testimony on other matters in March of 2013, the Company chose not to respond to this major issue of declining consumption until the hearing itself. At the hearing, Troy Dixon admitted that the Company has had an inclining block program in effect for several years now in the Massachusetts member of the Aquarion family, and he acknowledged that the tiered break points the Massachusetts affiliate uses were recently upheld in a Massachusetts rate case. He agreed that the Company had actually proposed such a program for New Hampshire in its rate case filing in DW 08-098. See testimony of Troy M. Dixon in that Docket at pages 6-9. He further testified that the Company now had the meter reading and monthly billing capability to create a block for the seasonal water users, whose usage is the major driver for the peak consumption in July for which the Company must plan. He acknowledged that a new major commercial water user (Smuttynose Brewery) was coming to Hampton and that figures as to their consumption in their Portsmouth location had been provided to him but

that these had not been analyzed thoroughly.

The Company has not done a cost of service study since 2005 and agreed to provide one with the next rate case. See paragraph 13 of Exhibit 4. This is the only concrete step that the Company has offered and is no real answer to the problem that the Company itself has identified as a continuing trend. The Town of Hampton submits that this is an insufficient response to the problem and the Commission's directive. Consumers are being penalized in a very tangible, monetary way for having achieved conservation: they are being asked to absorb \$214,000 (or about 20%) of the \$1,077,924 adjusted filing revenue requirement to make Aquarion whole on an ongoing basis. This represents just "same old, same old" business as usual (July 11, 2012 Prehearing Conference at 19) and it is too much for the consumer to bear. The Company was alerted early on in this case that the Commission wanted it to address this problem more proactively, and the Company has failed to do so.

As a consequence, the Town of Hampton requests that the Commission not allow all or a significant portion of the \$214,000 in increased revenue that the Company has asked for to cover the loss of revenue due to declining consumption. The burden of this loss of revenue should not fall upon consumers or the Towns. The Company has the means at hand to address the problem via rate design in a way that promotes conservation, as it had done in Massachusetts, but has failed even to propose inclining blocks again for its New Hampshire operation as it did in the 2008 rate case. To allow the Company to increase its revenue requirement to make up for this decline would be to reward the Company for its lack of response to a well-recognized problem, and to kick the can down the road for another 3 years.

**III. The rate of return on equity should be set at 9.3% and not at the 10.25% requested by the Company.**

The Company's Petition in this matter sought an increase in the authorized rate of return on equity (ROE) from the 9.75% figure arrived at by settlement in the 2008 rate case (DW 08-098, Order No. 25,019 dated September 25, 2009) to 10.25%. It is noteworthy that the Company is requesting an increase in its authorized ROE without either acknowledging or satisfying its burden of proof. It is the Company's burden by statute to justify such an increase. RSA 378:8.

The requested increase in the ROE is significant, as each percentage point of change in return on equity authorized translates to between \$154,000 and \$155,000 in revenue requirement. See Exhibit 18, page 2 of 2 [\$154,214] and Exhibit 10, Attachment JPL-1, page 22 of 127 [\$154,846].

As Troy Dixon testified at the hearing, the Company did not utilize a rate of return expert in developing the 10.25% ROE in its Petition. It simply put forth a survey of ROE's from other water companies in other states (see Attachment TMD-1 on page 97 of 171 in Exhibit 5a) for which the average awarded ROE was less than 10.25%. Half of the companies listed on that survey received an authorized ROE of less than 10%. Ultimately, it appears the Company ignored the survey data and based its 10.25% requested ROE just upon what its Massachusetts affiliate was awarded in a 2011 rate case. See Exhibit 5a on page 88 of 171.

ROE expert David Parcell was engaged by the Towns of Hampton and North Hampton in the fall of 2012. Mr. Parcell testified that he has been engaged in the advising and testifying about return on equity for utilities for over 40 years. (See



Attachment 1 of his January 11, 2013 Direct Testimony, Exhibit 13). He has previously filed testimony and/or testified in about 500 utility proceedings before some 50 regulatory agencies in the United States and Canada, dating back to 1972. He has been involved in a broad range of utilities, from water to gas to electric to transportation. Mr. Parcell has also provided testimony before in New Hampshire for the PUC Staff. He is a founding member of the Certified Rate of Return Analysts, who are certified by the Society of Utility and Regulatory Financial Analysts (SURFA). Mr. Parcell has authored a Practitioner's Guide on the cost of capital for SURFA.

In conjunction with his engagement here, Mr. Parcell has been provided with all data request discovery in this matter and all of the Company's filings; he also performed independent studies. Because the Company is ultimately a subsidiary of Macquarie Utilities, Inc. (MUI), he also evaluated MUI as well as several intermediate MUI subsidiary levels. The corporate structure he utilized was the same as set forth in Hampton 3-4, attached as Exhibit 1 to the direct testimony of Selectman Philip Bean (Exhibit 16).

Based upon three methodologies, Mr. Parcell's findings appear on page 3 of Exhibit 13 as follows:

Methodology	Range
Discounted Cash Flow	9.0-9.6% (9.3% mid-point)
Capital Asset Pricing Model	6.1%
Comparable Earnings	9.0-10.0% (9.5% mid-point)

Mr. Parcell's recommendation is to average all three methods from the DCF, CAPM, and CE models and from doing so he arrives at a recommended 8.3 % ROE. Even though he has not done this averaging of the three methods in some previous cases, his recommendation to average all three here is based upon the low cost of borrowing that has prevailed for a number of years in the depressed economy we have been experiencing since 2008.

This Commission has traditionally utilized the DCF method to determine the allowed ROE, though the Commission has also recognized that other valid measures may be used as a test of reasonableness. See p. 57 of Order No. 24,972 (dated May 29, 2009) in EnergyNorth Natural Gas, Inc., DG 08-009 (hereinafter referred to as the "EnergyNorth Order").

Mr. Parcell's DCF method yielded a range of 9.0% to 9.6% with a mid-point of 9.3%. If the Commission chooses to utilize the DCF method only, then the Town would argue that 9.3 % should be the ROE authorized. Mr. Parcell's DCF percentage range actually focuses on the upper portion of the broad DCF range, as explained on page 19 of Exhibit 13. This is a conservative approach that actually benefits the Company.

Pauline Ahern did not appear as a cost of equity expert in this proceeding until 2013, and filed no testimony until March 6, 2013 (Exhibit 8). She testifies primarily in water utility cases and has not testified in New Hampshire before. She did not advise the Company on what ROE to request in this proceeding. She did not offer testimony specifically as the cost debt, capital structure, or total cost of capital for the Company. She did not perform any analyses of the level of AWC-NH's business risks or financial risks at the current time relative to the level of business risks and financial risks at the

time of the Company's last proceeding.

There is a major disagreement in the approaches between Mr. Parcell and Ms. Ahern in that Ms. Ahern relies exclusively on analyst's forecasts of earnings per share in the DCF context. This disagreement is described in Mr. Parcell's Surrebuttal Testimony on pages 5 to 11 and he explains there why Ms. Ahern's exclusive reliance on analysts' forecasts in the DCF method is inappropriate. By comparing the last sentence on page 60 and the top of page 61 in the EnergyNorth Order, it can be seen that Ms. Ahern is making the same kind of contention on page 17 of her testimony here that EnergyNorth made to this Commission in its last litigated ROE case. On page 62, the Commission in the Order in EnergyNorth found that "The Commission has long relied on measures of growth other than earnings per share in applying the DCF method." It is noteworthy, as Mr. Parcell points out in his Surrebuttal Testimony (Exhibit 14) on page 10 that the Securities and Exchange Commission in a 2010 Investor Alert has warned against exclusive reliance on analysts' recommendations when deciding whether to buy, hold, or sell a stock.

The above debate between the experts on the DCF range has become somewhat academic for this case, with the correction changes to her Exhibit 8 Rebuttal Testimony that Ms. Ahern announced to the Commission at the outset of her live testimony, which now appear in writing as submitted by the Company in revised Exhibit 8. As shown on Attachment PMA-3 to her Testimony, Ms. Ahern opines that her indicated DCF range is now between 9.32% and 9.54%. This range is thus entirely within Mr. Parcell's 9.0% to 9.6% DCF range. Her mid-point of 9.43% and Mr. Parcell's 9.3% mid-point would average out to 9.365%, as pointed out by the OCA.

Ms. Ahern, who testifies primarily on behalf of water utilities, contends nevertheless that the DCF ROE ought to be adjusted upward to account for what she claims to be the greater risk of water companies generally and the Company in particular due to what she characterizes as its “smaller size.” Ms. Ahern’s approaches in this regard belie the realities as to the comparative risk of the water industry in general and the Company in particular. Mr. Parcell’s Surrebuttal Testimony (Exhibit 14) on pages 19 through 22 explains why Ms. Ahern’s adjustments are inappropriate. Moreover, his Schedule 14 (DCP-2) In Exhibit 14 compares the risk factors in 2009 and 2013 for the water proxy group that he and Ms. Ahern have both used, and demonstrates that the risk of water utilities has declined since 2009.

Ms. Ahern’s track record before other Commissions in regard to her recommended ROE testimony appears in Exhibit 26, which is her response to Hampton Data Request 4-1. The chart of this response goes back to the year 2000. Ms. Ahern agrees that in the vast majority of cases, the Commissions’ authorized rates of return resulting in those cases exceed the rates of return she recommended. Indeed, she does not quarrel with the computation chart that appears in Exhibit 27 that provides a comparison between her recommended returns on equity in other commissions’ cases for the period 2000 to the present, and the authorized returns on equity arrived at by those other commissions. On average, her recommended ROE’s exceeded the ultimately authorized ROE’s by an average of 1.44%.

The Commission here should not accept Ms. Ahern’s business risk and financial adjustments that would result in a higher rate of return. This Commission has already rejected, in the EnergyNorth Order on page 67, the kind of leverage adjustment on

account of debt in its capital structure that the Company is now advocating for through Ms. Ahern. It is further noteworthy that the EnergyNorth Order noted above cited a water utility proceeding involving Pennichuck Water Works. The Commission can take notice of its own records that in Pennichuck's last rate proceeding (Docket DW 08-073), a 42.22% common equity ratio was used, about the same as Aquarion's in this case.

The Company introduced Exhibit 32 in an attempt to imply that its actual capital structure of 40.75% common equity and 59.25% debt results in a lower overall cost of capital than a capital structure with more equity, with the implication that Aquarion's lower equity ratio puts the Company in a position of having more financial risk and therefore requiring a higher ROE than the proxy companies. This exercise is incorrect for several reasons. First, the actual capital structure of AWC-NH reflects what its parent(s) want it to be. The record is clear that the Company's New Hampshire capital structure is intertwined with and dependent on its parent(s). In this regard, it is also apparent that no equity infusions have been made into the Company from any of its parent(s) since its acquisition in 2002. Second, the Company did not request a financial risk adjustment in its original application. Third, throughout the discovery process of this proceeding, the Company refused to provide the types of information required to properly assess the actual nature of AWC-NH and its affiliated companies. See, for example, the Company's answers to Hampton data requests 3-4, 3-6, 3-9, 3-12, and 3-13 attached to the Testimony of Selectman Bean (Exhibit 16). Without such an analysis, it is not possible to assess the "true" capital structure of the Company. David Parcell Testimony (Exhibit 13) at pages 13-14.

AWC-NH is obviously not the “stand alone” company that its officials and Ms. Ahern would now like to have the Commission believe. As Troy Dixon testified, borrowings have flowed up from the Company to its parents as well as down from the parent to the Company. As Ms. Ahern herself acknowledged, Aquarion NH’s operating results are already consolidated with Aquarion Water Co. of Connecticut and Aquarion Water Co. of Massachusetts and are reflected in the financial statements of the parent, Aquarion Water Company. The aggressive growth and acquisition strategy being pursued in Connecticut as revealed through the cross examination of Mr. Dixon, as well as the decision not to infuse new equity capital in the New Hampshire affiliate, are purely the result of decisions made by the parent company and higher up the corporate ladder.

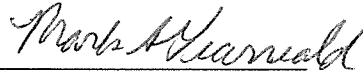
As pointed out by Mr. Parcell on page 21 of his Surrebuttal Testimony (Exhibit 14) and in his live testimony, it would not be appropriate to approve Ms. Ahern’s proposal to assess a greater degree of risk to the AWC-NH based on its own size, as doing so would encourage utilities to split up their operations in order to form even smaller entities in an effort to be awarded higher rates of return. Consumers served by the resulting smaller utilities would thus end up being charged higher rates to enable these companies to earn artificially higher rates of return. This is Mr. Parcell’s reasoning behind rejecting the approach to return on equity that the Company attempted to quantify in Exhibit 32. This inappropriate and artificial end is precisely where the Company seeks to end up, based upon Ms. Ahern’s rebuttal testimony.

For all the above reasons, the Commission should reject this effort, and award no greater than the 9.3% DCF that is the mid-point in Mr. Parcell’s testimony, if not the lower 8.3% ROE that he recommends using all three methodologies.

Dated: June 7, 2013

Respectfully submitted,

Town of Hampton  
By its Town Attorney

A handwritten signature in cursive script, appearing to read "Mark S. Gearreald".

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History of Water Company Rate Increases

<u>Year</u>	<u>Docket No.</u>	<u>Order</u>	<u>Percentages</u>
1992	DR 91-023		
2000	DW 99-057		
2006	DW 05-119	7/18/06 (No. 24,691)	18.64%
2009	DW 08-098	9/25/09 (No. 25,019)	17.44% 9.9% (public fire)
WICA 2011	DW 10-293	12/22/10 (No. 25,186)	1.5715%
WICA 2012	DW 11-238	12/30/11 (No. 25,311)	3.7269%
WICA 2013	DW 12-325	1/17/13 (No. 25,455)	5.273%
2012	DW 12-085		17.71% sought 8.8% temporary