STATE OF NEW HAMPSHIRE

PUBLIC UTILITIES COMMISSION

DW 12-085

In the Matter of:
Aquarion Water Company of New Hampshire, Inc.
Petition for Permanent Rates and Step Increase

Direct Testimony

of

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

January 11, 2013

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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 Aquarion Water Company of New Hampshire, Inc. (Aquarion 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 October

31, 2012 (Final Audit Report) which have been incorporated into Staff's recommended revenue requirement.

II. STAFF RECOMMENDATION FOR PERMANENT RATES

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

A. On May 14, 2012, Aquarion filed a petition, including testimony and supporting schedules, requesting approval of a permanent rate increase in order to generate additional revenues of $1,113,931, representing an 18.30% increase in annual operating revenues. The Company utilized 2011 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 Staff Data Request 3-11, Aquarion provided revised schedules showing the impact of several adjustments resulting from its responses to discovery as well as from the Final Audit Report. As a result, the increase in water revenues now being sought by Aquarion is $1,077,924, or 17.71%. A copy of Aquarion's response to Staff 3-11 is attached to my testimony as Attachment JPL-1.

Q. Does Staff agree with the adjustments reflected in the Company's response to Staff 3-11?

A. Yes. However, in addition to the modifications to the proposed revenue requirement made by the Company in its response to Staff 3-11, Staff is proposing further adjustments to rate of return, rate base and operating expenses in order to derive Staff's recommendation for a permanent rate revenue requirement in this case. My testimony will discuss these proposed additional adjustments.

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

A. Yes. On September 18, 2012, the Commission issued Order No. 25,412 authorizing temporary rates sufficient to increase Aquarion's annual revenues by $535,709, or 8.80%, to be implemented on a service rendered basis, effective July 1, 2012.

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

A. As indicated on Schedule 1 of Attachment JPL-2, Staff is recommending an annual operating revenue requirement of $6,944,483. This represents an increase of $857,810, or 14.09%, over the Company's pro-formed test year annual operating revenues of $6,086,673. Staff's recommended revenue requirement is calculated utilizing a total rate base of $22,507,605 which is computed on Schedule 2 of Attachment JPL-2 and provides for an overall rate of return of 7.31% which is calculated on Schedule 1B of Attachment JPL-2. The revenue deficiency before tax effect is $510,183. A combined federal and state tax effect of $347,627 has been added to this revenue deficiency resulting in the proposed overall increase in the Company's revenue requirement of $857,810.

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 59.48% was computed. This is consistent with the effective tax rate proposed by the Company in its filing.

III. RATE OF RETURN

Q. Please discuss the 7.31% Rate of Return being proposed by Staff in this case which is calculated on Schedule 1B of Attachment JPL-2.

A. Staff calculated an overall capital structure for Aquarion in the amount of $22,965,299. The Company's capital structure is comprised of three components. The first is Long-term Debt in the amount $13.9 million, or 60.53% of the overall capital structure. The Company's filing indicated a balance for Long-term Debt in the amount of $12.9 million. However, Staff increased this amount by an additional $1 million. An in-depth explanation for this adjustment is contained in the Direct Testimony of Mark A. Naylor, Director of the Gas-Water Division of the NHPUC. Staff calculated a weighted average cost for Long-term Debt of 3.66%. The next component is Preferred Stock in the amount of $2,300, or 0.01% of the overall capital structure. Staff calculated a weighted average cost for Preferred Stock of 0.00%. The last component of Aquarion's capital structure is Common Equity totaling $9,062,999, or 39.48% of the Company's total capitalization. The Company's filing proposed a cost of equity rate of 10.25%. However, for reasons also discussed in the Direct Testimony of Mark A. Naylor, Staff is proposing that a 9.25% cost of equity rate be applied to the common equity component resulting in a weighted average cost of equity of 3.65%. As illustrated on Schedule 1B of Attachment JPL-2, the combination of the weighted average costs of the three components described above result in Staff's recommended rate of return of 7.31% to be applied to Aquarion's rate base.

IV. 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 calculation of the Company's proposed average rate base of $22,319,760 as contained in its initial filing. Columns (4) and (5) show the subsequent adjustments to rate base made by the Company during the course of this proceeding which are summarized in its response to Staff 3-11 (Attachment JPL-1) resulting in a modified rate base amount of $22,320,608. Columns (6) through (8) show the impact of three adjustments to rate base proposed by Staff resulting in a total recommended rate base of $22,507,605.

Q. Please explain Staff Adjustments # 1 and # 2 which result in a combined increase in Aquarion's proposed rate base of $173,506.

A. Aquarion's initial filing contained two rate base adjustments in order to reflect the entirety of the net plant in service component of rate base at year-end value rather than at a 13-month average. The Company increased Plant in Service by $975,222 as well as increased Accumulated Depreciation by $420,533. The net effect was a $554,689 increase in Aquarion's net plant in service and overall rate base. The Direct Testimony of Troy M. Dixon on page 86 of 171, lines 9 through 13 explained the purpose of these adjustments as follows: "The Company believes that, consistent with evolving practice at the Commission, it is critical that a year-end rate base balance be used in order to give the Company a reasonable opportunity to achieve its authorized return. The Company is experiencing a steady decline in consumption by its customers and its rate base additions are almost exclusively non-growth in nature." However, Staff believes that this explanation presents an overly broad characterization of past Commission rulings relative to rate base valuation. Current NHPUC rules require that with regard to rate cases filed with the Commission, a test year average presentation must be made relative to rate base including plant in service and accumulated depreciation. See Puc 1604.07(s)(1). Further, according to the advice of Counsel, the Commission affirmed the use of a thirteen-month average rate base in rate cases in *EnergyNorth Natural Gas, Inc.,* Order No. 20,776, 78 NH PUC 120 (1993). However, in recognition of the financial pressures that small water utilities are under especially when attempting to meet stringent regulatory requirements to provide safe and adequate water service to customers, the Commission has developed a modified rate base treatment for certain so-called "Non-revenue Producing Assets." Specifically, Non-revenue Producing Assets may be reflected in rate base at year-end, or full, cost rather than at a test-year average. However, utility plant that is recognized for Non-revenue Producing Asset treatment must meet certain criteria. First, the acquisition or installation of the utility plant in question must be the result of some regulatory mandate. Second, the acquisition or installation of such plant must not result in a direct increase in revenues to the utility such as through an increase in its customer base. Third, the cost of the specific plant projects under consideration must be in and of themselves substantive in nature. According to the advice of Counsel, these concepts relative to Non-revenue Producing Assets have been developed in previous Commission orders including *Pennichuck Water Works, Inc.*, Order No. 21,026, 78 NH PUC 626 (1993), *Re Pennichuck Water Works, Inc.*, Order No. 22,883, 83 NH PUC 200 (1998) and *Re Pennichuck Water Works, Inc.*, Order No. 23,923, 87 NH PUC 102 (2002). In Staff Data Request 2-3, the Company was asked to provide information in support of the Non-

Revenue Producing Asset treatment that it was essentially requesting for all test year asset acquisitions and disposals. A copy of Aquarion's response to Staff 2-3 is attached to my testimony as Attachment JPL-3. Upon review of the Company's response, Staff identified seven plant additions which it felt properly met the criteria established by the Commission for Non-revenue Producing Asset Treatment. Staff subsequently communicated its conclusions to the Company during discovery. These projects are identified as "Grouping 1" in Aquarion's response to Staff Data Request Tech 2-1 which is included in my testimony as Attachment JPL-4. In addition to the Non-revenue Producing Assets identified by Staff in this case which it is proposing should be valued at year-end value rather than at a thirteen-month average, Staff is also proposing that certain plant additions and disposals that occurred during the test year as a result of the Company's Water Infrastructure and Conservation Adjustment (WICA) pilot program should receive similar treatment. These plant additions and disposals are identified as "Grouping 2" in the Company's response to Staff Tech 2-1 (Attachment JPL-4). These assets were reflected at year-end value in the WICA Surcharge approved in Commission Order No. 25,311 on December 30, 2011 in Docket DW 11-238 which is currently included in customer rates. As such, Staff believes that it is appropriate that the full value of the test year WICA asset additions and disposals should be reflected in rate base at year-end value for purposes of the instant rate case. I have included a calculation in my testimony, identified as Attachment JPL-5, which shows how the Company's two pro-forma adjustments to net plant in service contained in its filing should be modified in order to properly reflect just those assets identified as either Non-revenue Producing (Grouping 1) or WICA Projects (Grouping 2) at full year-end value but reflecting the remainder of the Company's net plant in service at a thirteen-month average. Specifically, Staff is proposing that Plant in Service should be reduced by $249,044 (Staff Adjustment # 1) and Accumulated Depreciation should be reduced by $422,550 (Staff Adjustment # 2). The net result is an increase in net plant in service and rate base of $173,506.

Q. Please explain Staff Adjustment # 3 to increase Cash Working Capital by an amount of $13,491.

A. Aquarion's original filing included a Cash Working Capital component for rate base in the amount of $201,405. As a result of the adjustments reflected in its response to Staff 3-11 (Attachment JPL-1) the Company increased this amount by $808 to $202,213. The Company determined its cash working capital component based solely on the Operation and Maintenance (O & M) Expense activity that it experienced during the test year. Thus, the Cash Working Capital component proposed by Aquarion does not reflect either the Company's or Staff's pro-forma adjustments affecting test year O & M Expenses. Therefore, based on the adjusted test year total pro-forma O & M Expenses in the amount of $3,158,181 indicated on Schedule 3, Column (8) of Attachment JPL-2, Staff determined an adjusted Cash Working Capital component of $215,704 which is $13,491 more than that proposed by the Company in its response to Staff 3-11 (Attachment JPL-1).

V. <u>NET OPERATING INCOME</u>

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

A. Columns (1) through (3) present Aquarion's pro-forma net operating income as proposed in its original filing in the amount of $1,094,054 (Column (3)). Columns (4) and (5) summarize the Company's subsequent adjustments to net operating income as presented in its response to Staff Data Request 3-11 (Attachment JPL-1). Aquarion increased its original proposed net operating income by $17,017 (Column (4)) to a revised amount of $1,111,071 (Column (5)). Columns (6) through (10) summarize my testimony in support of Staff's proposed revenue requirement of $6,944,483. Specifically, in Columns (6) through (8), two pro-forma adjustments are indicated which further increase the Company's net operating income by a tax adjusted amount of $24,378 (Column (6)) to $1,135,449 (Column (8)). 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 Aquarion's revenue requirement of $857,810 (Column (9)) to $6,944,483 (Column (10)), which ultimately results in a proposed net operating income requirement by Staff of $1,645,632 (Column (10)).

Q. Please explain Staff Adjustment # 4 which decreases Aquarion's Administrative & General Expenses by $26,464.

A. In 2011, the Town of Hampton began assessing a new right-of-way tax to Aquarion. This tax is over and above the regular property taxes assessed the Company by the Town of Hampton and are based on the extent to which Aquarion requires use of the town's public rights of way. During 2011, the total right-of-way assessment by the Town of Hampton to Aquarion was $63,512. Because this represents a significant and unexpected expense to Aquarion, the Company proposed recording a deferred asset in the amount of

$79,391, which represents the first 15 months (April 2011 through June 2012) of this assessment ($63,512 x 15/12 = $79,391). The Company further proposed that this deferred asset should be recovered in customer rates by way of a three-year amortization of the deferred asset resulting in an annual amortization expense of $26,464 ($79,391 ÷ 3 = $26,464). Additionally, Aquarion has also proposed to recover this right-of-way tax assessment on a going-forward basis through its pro-forma property taxes included in operating expenses. Staff disagrees with the Company's proposed deferral and amortization of its previously assessed right-of-way tax. Staff views such treatment as a form of retroactive rate making which is not allowed by the Commission.[1] Further, the creation of a deferred asset usually occurs when previous costs incurred by a utility result in some future benefit that will be recognized by both the utility and its customers. The deferred asset is thus amortized over the future period over which those benefits will be realized. However, in this case, Staff sees no future benefit that will be derived by either the Company or its customers that would justify such deferred asset treatment. Therefore, Staff has reversed the Company's expense pro-forma in the amount of $26,464.

Q. Please discuss Staff Adjustment # 5 which decreases pro-forma Property Tax Expense by $14,525.

A. The Company's original filing proposes a pro-forma property tax expense of $602,806. In its response to Staff Data Request Tech 2-3, Aquarion provided copies of its 2012 municipal property tax assessments including the right-of-way tax assessment from the Town of Hampton. The Company's response to Staff Tech 2-3 is included in my testimony as Attachment JPL-6. Additionally, Staff obtained directly from the New

[1]Retroactive ratemaking is defined as setting future rates to allow a utility to recover past losses.

Hampshire Department of Revenue (NHDRA) the Company's State Utility Tax assessment for 2012. The 2012 property tax assessments to Aquarion summarized on Attachment JPL-7 total $588,281 which is $14,525 less than the pro-forma property tax expense proposed by Aquarion in its filing.

VI. TAX EFFECT OF OPERATING EXPENSE ADJUSTMENTS

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 # 4 and # 5 results in a net increase in the Company's pro-forma net operating income of $40,989. This increase in net operating income results in a marginal increase in Aquarion's New Hampshire Business Profits Tax (NHBPT) of $3,484 calculated at a rate of 8.50% as well as a marginal increase in its Federal Income Tax of $13,127 calculated at a rate of 35.00%. Therefore, after tax effect, the net pro-forma increase in Aquarion's operating income resulting from Staff's adjustments is $24,378.

VII. STAFF RECOMMENDATION FOR STEP INCREASE

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

A. In Aquarion's previous rate proceeding, DW 08-098, the Commission approved the WICA as a pilot program in Order No. 25,019 (September 25, 2009). In November of 2009, Aquarion filed its first proposed list of capital projects for 2010 through 2012 in Docket No. DW 09-211. By Order No. 25,065 (January 15, 2010), the Commission approved Aquarion's WICA budget for 2010 and, on a preliminary basis, Aquarion's schedule of proposed 2011 projects. In each of the two following years, Aquarion submitted filings for recovery of its completed annual WICA projects, and its proposals for capital projects for the subsequent three years. As a result of WICA projects completed in 2010, a surcharge of 1.5715% was approved for application to customer bills, for service rendered on and after January 1, 2011, in Order No. 25,186 (December 22, 2010) in Docket No. DW 10-293. A surcharge of 3.7269% was approved in Order No. 25,311 (December 30, 2011) in Docket No. DW 11-238, combining the previously approved surcharge with an additional surcharge of 2.1554% for recovery of the Company's WICA projects completed during 2011. The Company's filing for permanent rates in the instant docket reflect the WICA projects approved and completed in 2010 and 2011 as well as the revenues authorized as a result of those projects. On October 31, 2012, Aquarion filed its petition for approval of its 2013 WICA surcharge in Docket No. DW 12-325. Aquarion's filing reflected $834,663 in WICA asset additions as well as $34,371 in corresponding retirements during the period January 1 through September 30, 2012. A Staff recommendation concerning the Company's filing was submitted on December 21, 2012. If approved, the resulting additional annual revenues for Aquarion from the 2013 WICA surcharge will be $115,978. With regard to the instant rate proceeding, Aquarion proposes and Staff concurs that the approved WICA surcharges for 2011, 2012 and 2013 be incorporated into the newly approved rates at the conclusion of this case and that the WICA surcharge should be reset to zero. As previously stated, the WICA projects and surcharge revenues for 2011 and 2012 have already been factored into the permanent revenue increase discussed in my testimony. However, with regard to the 2012 WICA assets resulting in the pending 2013 WICA surcharge, Aquarion proposes and Staff concurs that a Step Increase should also be approved at the conclusion of this rate proceeding. This step increase would be based on the 2012 net WICA additions including return (based on the approved rate of return in the instant proceeding), depreciation and property taxes. Staff proposes that this Step Increase should be effective on or after the date of the Commission's final order in this proceeding and that the revenues resulting from such should not be included in the calculation of the of the difference in revenues between temporary and permanent rates to be recovered from customers at the conclusion of this case.

Q. Has Aquarion submitted a proposal relative to the level of the proposed Step Increase?

A. Yes. In its response to Staff Data Request Tech 2-4, Aquarion submitted schedules indicating that the Step Increase would result in increased revenues for the Company of $122,087. Aquarion's response to Staff Tech 2-4 is included in my testimony as Attachment JPL-8.

Q. Does Staff agree with the level of the Step Increase calculated by the Company?

A. No. Based on calculations included in my testimony as Attachment JPL-9, Staff proposes that the level of the proposed Step Increase should be $113,865, or an additional revenue increase of 1.87%. There are two overriding differences between the Company's calculations and Staff's calculations. First, the rate of return utilized by the Company in its calculations is that which it proposed in its rate filing of 7.85%. As discussed previously, Staff proposes the application of a 7.31% rate of return in this case and has reflected such in its calculations contained in Attachment JPL-9. Second, Aquarion did not factor in any accumulated depreciation component into its Step Increase calculations. Consistent with previous Step Increases approved by the Commission, Staff has reflected a half-year of accumulated depreciation on the 2012 asset additions for purposes of its step increase calculations. Staff also made an estimate (based on 75% of the total useful life) of the accumulated depreciation on the 2012 asset retirements in order to determine the marginal property tax expense indicated on Schedule 3 of Attachment JPL-9.

VIII. CONCLUSION

Q. Please summarize Staff's revenue requirement recommendations as discussed in your testimony.

A. Relative to permanent rates, Staff is recommending an annual operating revenue requirement of $6,944,483. This represents an increase of $857,810, or 14.09%, over the Company's pro-formed test year annual operating revenues of $6,086,673. The calculations in support of Staff's permanent rate increase are contained in Attachment JPL-2. Staff is also proposing an additional Step Increase in revenues of $113,865 for a 1.87% increase over the Company's pro-formed test year annual operating revenues. Staff's calculations in support of its proposed Step Increase are contained in Attachment JPL-9. Schedule 1 of Attachment JPL-9 shows Staff's combined recommended permanent and step increases of $971,675, or 15.96%, resulting in a proposed total revenue requirement for Aquarion of $7,058,348.

Q. Does this conclude your direct testimony?

A. Yes.