

STATE OF NEW HAMPSHIRE

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PUBLIC UTILITIES COMMISSION

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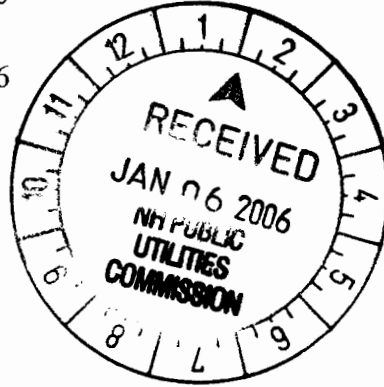
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January 6, 2006

Ms. Debra A. Howland
Executive Director & Secretary
New Hampshire Public Utilities Commission
21 South Fruit Street, Suite 10
Concord, New Hampshire 03301-2429



Re: DW 05-072 Pennichuck East Utilities, Inc.
Permanent Rate Proceeding – Settlement Agreement

Dear Ms. Howland:

Pursuant to the approved procedural schedule, Staff, on behalf of itself and the parties, is filing a Settlement Agreement for the Commission's consideration at the January 12, 2006 hearing. Staff, Pennichuck East Utilities, Inc., and the Office of the Consumer Advocate plan to present the settlement agreement and offer testimony in support of the settlement at that hearing.

If you have any questions, please feel free to call me. Thank you in advance for your assistance in this matter.

Sincerely,

A handwritten signature in cursive script that reads "Marcia A. B. Thunberg".

Marcia A. B. Thunberg
Staff Attorney

Enclosure
cc: Service List

**STATE OF NEW HAMPSHIRE
PUBLIC UTILITIES COMMISSION**

**PENNICHUCK EAST UTILITY, INC.
DW 05-072
PETITION FOR RATE INCREASE**

SETTLEMENT AGREEMENT

I. INTRODUCTION

This Agreement is entered into this 6th day of January, 2006, between Pennichuck East Utility, Inc. (PEU), Office of the Consumer Advocate (OCA), and the Staff (Staff) of the New Hampshire Public Utilities Commission (Commission) with the intent of resolving all of the issues in the above-captioned proceeding.

II. PROCEDURAL BACKGROUND

PEU provides water service to approximately 4,600 customers located in limited areas of the towns of Litchfield, Londonderry, Windham, Pelham, Atkinson, Sandown, Derry, Raymond, Plaistow, Hooksett, Bow, and Lee. On April 8, 2005, PEU filed with the Commission a Notice of Intent to File Rate Schedules.

On May 20, 2005, PEU filed a petition for a permanent increase in its revenues of \$779,027 or 24.99%. Contemporaneously, PEU filed for a temporary rate increase pursuant to RSA 378:27 of \$381,565 or 12.25%. PEU requested that temporary rates be made effective for service rendered on and after June 1, 2005.

On June 16, 2005, the Commission issued Order No. 24,476, which suspended the proposed tariffs, established a procedural schedule for the consideration of temporary rates, and set a prehearing conference for July 6, 2005. Following the prehearing conference, Staff on

behalf of itself and the Parties submitted a procedural schedule for Commission approval. The Commission subsequently approved the procedural schedule on July 8, 2005.

On June 21, 2005, the Office of the Consumer Advocate (OCA) filed a notice of its intent to participate in this docket. The Commission held a hearing on temporary rates on August 9, 2005, at which PEU, OCA and Staff filed an agreement regarding temporary rates. On August 12, 2005, PEU filed with the Commission, Exhibit 4, its response to a record request made at hearing for a schedule depicting PEU's pro forma test year rate of return under the terms of the proposed temporary rate increase.

On September 8, 2005, the Commission, by secretarial letter, granted PEU's request for waiver of Rule Puc 1604.01(a)1 and (25), which was filed on May 20, 2005, by PEU's counsel.

On September 9, 2005, the Commission issued Order No. 24,513, approving the settlement agreement regarding temporary rates.

III. TERMS OF AGREEMENT

As a result of the nearly full completion of the procedural schedule Staff and the parties have reached agreement on all issues as specified below.

A. Revenue Requirement

Staff and the parties agree that PEU's original filing in this docket reflected a revenue requirement increase request of 24.99%, but that request did not include the results of PEU's updated depreciation study completed and submitted subsequent to the filing of this case.

Based on the updated depreciation study, PEU's total revenue requirement increase request in this docket was 29.61%. Staff and the parties agree that PEU should be granted a 24.26% overall increase in revenues based on a test year net operating income requirement of \$761,796. This agreed increase in revenues results in a revenue requirement of \$3,871,953. Staff and the parties stipulate that this net operating income requirement and resulting revenue requirement represent a reasonable compromise of all issues relating to the revenue requirement pending before the Commission in this rate case docket, including allowed overall rate of return, return on equity, *pro forma* adjustments, capital additions to PEU's rate base, operating expenses, and depreciation. As the sums expressed above are the result of compromise and settlement between the Staff and the parties, they are liquidations of all net operating income requirement and revenue requirement issues, and each party to this Agreement may have its own rationale or basis for agreeing to this amount. Staff and the parties agree that the revenue requirement contained in this Agreement results in rates for customers of Pennichuck East Utility, Inc. that are just and reasonable.

Staff and OCA acknowledge that RSA 378:7 states the Commission is under no obligation to investigate any rate matter which it has investigated within a period of two years; and that the Company, because of its ongoing capital requirements and fixed costs such as electricity, property taxes, or others, may seek Commission approval for a rate increase sooner than twenty-four months following the Commission's final order in this rate case. Staff and OCA

agree not to object to any such request on the basis that it has been filed within the two year time period specified in that statute.

B. Consolidation Of Rate Design

The Staff and the parties agree that it is appropriate, just and reasonable to consolidate the three existing rate groups (A, B and L) into two rate groups (A and L). The only remaining rate differential between the 'A' rate (all metered customers other than Litchfield) and 'L' (Litchfield rate) will be the inclusion of a surcharge in the Litchfield rate for municipal fire protection. By way of background, the structure of the three rate groups was established by the Commission in a *Southern New Hampshire Water Company* (Southern) rate case (DR 89-224) in 1991. See SNHWC 76 NHPUC 521. PEU is the successor owner to Southern (later, Consumers New Hampshire Water Company) for all of the water systems formerly owned by Consumers with the exception of customers located in the Town of Hudson. Hudson established a municipal water utility following a Commission order in DR 96-227 and thus no longer was provided water service by Consumers. 82 NHPUC 775. In Docket No. 89-224, the Commission established the current three rate groups as an interim step that moved Southern closer to uniform rate groups for all its customers in all its systems. Consumers filed a rate case in 1995 and requested the differential between the groups be reduced, but the Commission ordered the retention of the existing rate differentials in part because of the effect of further consolidation of rates on the Hudson customers then served under the 'A' rate. The elimination of the Town of Hudson's (approximately 4,000) customers which were originally part of Southern's franchise and the

transfer of the remaining service areas and satellite systems to PEU removed much of the rationale and cost basis for adoption of a more conservative and graduated approach to a consolidated rate for all of the former Southern water systems. Although PEU serves many customers in a number of towns and in a number of satellite systems, these systems for the most part experience similar administrative and operation and maintenance costs.

Subsequent to PEU's acquisition of these systems, it has acquired a significant number of new water systems, and continues to acquire more systems. Currently these systems are assigned to one of the existing three rate groups based on an analysis of their individual cost of service, and in effect this assignment is a consolidated approach to ratemaking.

PEU's original request in this proceeding was for application of its requested rate increase equally to each of the three rate groups. In reviewing the rate design of PEU in this proceeding, the Staff and the parties agree that the original basis for establishment of the three rate groups no longer exists. PEU does not track its expenses by rate group, and there is no basis for maintaining rate differentials. In addition, the departure of Hudson from the 'A' rate group has further eroded the original cost basis for the establishment of three rate groups. At present, the 'A' rate results in an average residential customer paying \$417.80 annually; an average 'B' customer pays \$543.44 annually; and an average 'L' customer pays \$514.20. The 'L' rate, that rate charged to customers in Litchfield, was established originally as the 'A' rate but with additional costs for fire protection that were not billed to the municipality following a Commission order. In re Southern New Hampshire Water Company, 79 NHPUC 14. The Staff

and the parties agree that it remains appropriate for Litchfield customers to pay for the municipal fire protection costs in that municipality, and that the 'L' rate should be maintained for Litchfield.

The parties further agree that a consolidated rate should exist for all of the remaining PEU systems. Thus, Staff and the parties agree that an 'A' rate be established based on all PEU's cost of service except for Litchfield fire protection; those costs (estimated at \$133,193 annually) should be added to customer bills as a fire protection surcharge and that this 'A' rate plus the Litchfield fire protection costs would constitute an 'L' rate for Litchfield customers. The parties agree that the amount of the fire protection surcharge is \$87.05 per customer on an annual basis, based on a count of 1,530 customers in the current 'L' rate group.

With the proposed overall increase of 24.26% to PEU's revenue requirement as recommended in this Agreement, the average residential customer consuming 8,800 cubic feet of water annually will see rate increases as follows: 'A' group, 44.8%; 'B' group, 11.3%; and 'L' group 34.6%. In addition to the lack of any cost basis for retention of the three existing rate groups, Staff and the parties agree that the decision to recommend elimination of the three groups and the resulting increase allocated to each group is based on the level of investment PEU has made in the water systems within each group since assuming ownership in 1998. On a per-customer basis, that level of investment is as follows for each rate group: 'A' group, \$2,208.68; 'B' group, \$858.72; and 'L' group, \$1,182.75. Thus, Staff and the parties agree that although the 'A' group customers will experience the largest percentage increase as a result of this rate case,

there is additional justification for it based on PEU investments made in the 'A' systems since PEU's acquisition of the assets from Consumers.

C. Cost of Service Study

Staff and the parties agree that PEU should prepare a cost of service study to be completed for submission with its next rate filing. PEU agrees to complete such a study prior to its next rate proceeding and file it with the Commission as a part of that proceeding.

D. Depreciation Study

As a part of this rate case, PEU conducted a Depreciation Study. The revenue requirement impacts of the study are contained in the recommended revenue requirement detailed above. Staff and the parties agree that PEU should be entitled to total depreciation expense of \$636,068, amortization of reserve imbalance of \$64,417, amortization of plant acquisition adjustment of \$(238,268), and amortization of CIAC of \$(79,826). Attachment 1 to this Agreement provides details on these amounts as well as the Staff and parties' recommendation for revised depreciation accrual rates for each plant account.

E. Effective Date and Recoupment

Permanent rates shall be effective for service rendered on and after June 16, 2005, consistent with the Commission's Order No. 24,513 on temporary rates in this case. In order to reconcile the difference between temporary rates and permanent rates, Staff and the parties agree that a surcharge amounting to the difference between temporary rates and the level of permanent rates agreed to herein shall be calculated and applied to customer bills over a 12 month period

effective with the implementation of the permanent rates provided for in this Agreement. Staff and the parties agree, and recommend to the Commission that, due to the complexity of reconciling temporary rates by rate group, where the three previous rate groups have been reduced to two in this Agreement, PEU shall calculate a total of dollars to be recovered from customers in each “old” rate group by type of customer (e.g. residential and commercial/industrial), and then recover those dollars on an equal basis from all customers in those classes.

F. Rate Case/Depreciation Study Expense Surcharge

Staff and the parties agree that PEU shall be allowed to recoup its rate case expenses and the costs associated with the depreciation study, as approved by the Commission, through a surcharge applied over the same 12 month period as the rate recoupment surcharge. Rate case expense shall include, but not be limited to, PEU’s legal expenses and administrative expenses such as copying and delivery charges associated with filing the case. The depreciation study expense shall include those expenses incurred associated with the depreciation study conducted by Associated Utility Services, Inc. At the time of this Settlement Agreement, PEU had an estimate of rate case and depreciation study expenses from which to calculate the rate case expense surcharge. PEU agrees to submit its final rate case expense request to Staff and the OCA for review and recommendation to the Commission. The Staff and the OCA agree that the rate case expense submitted by the Company is reasonable and encourage the Company to continue efforts to minimize rate case costs in the future.

Upon receipt of the Commission's final order, Staff and the parties agree PEU shall file a compliance tariff supplement including the approved surcharge relating to recoupment of the difference between the level of temporary rates and permanent rates and recovery of the amount of rate case expenses. Staff and the parties agree PEU shall file an accounting with the Commission of the amount of the rate case expenses recovered at the end of the 12 month period.

IV. NON-WAIVER

By this Agreement, PEU has not waived its right to seek additional revenue by means of a full rate proceeding, or otherwise, and Staff and OCA have not waived the right to seek a reduction in the PEU's rates by means of a show cause proceeding or otherwise.

V. CONDITIONS

The making of this Agreement shall not be deemed in any respect to constitute an admission by any party that any allegation or contention in these proceedings is true or valid.

This Agreement is expressly conditioned upon the Commission's acceptance of all its provisions, without change or condition, and if the Commission does not accept said provisions in their entirety, without change or condition, the Agreement shall at PEU's, the Staff's or OCA's option, exercised within thirty days of such Commission order, be deemed to be null and void and without effect and shall not constitute any part of the record in this proceeding nor be used for any other purpose.

The Commission's acceptance of this Agreement does not constitute continuing approval of, or precedent regarding, any particular principle or issue in this proceeding, but such

acceptance does constitute a determination that (as the parties believe) the adjustments and provisions set forth herein in their totality are just and reasonable and that the revenues contemplated by this Agreement will be just and reasonable under the circumstances.

Staff and the parties acknowledge that the procedural schedule in this proceeding was truncated because the parties reached agreement on a proposed resolution of the issues in this proceeding. Furthermore, the information and testimony previously provided in this proceeding are not expected to be subject to cross-examination by Staff and the parties, which would normally occur in a fully litigated case. Staff and the parties agree that all pre-filed testimony should be admitted as full exhibits for the purpose of consideration of this Agreement. Agreement to admit all pre-filed and rebuttal testimony without challenge does not constitute agreement by the Staff or parties that the content of the pre-filed testimony filed on behalf of the other is accurate or what weight, if any, should be given to the views of any witness. In addition, the identification of the resolution of any specific issue in this Agreement does not indicate Staff's, PEU's or OCA's agreement to such resolution for purposes of any future proceeding, nor does the reference to any other document bind Staff and the parties to the contents of, or recommendations in, such document for purposes of any future proceeding. The Commission's approval of the recommendations in this Agreement shall not constitute a determination or precedent with regard to any specific adjustments, but rather shall constitute only a determination that the income requirement and rates resulting from this Agreement are just and reasonable.

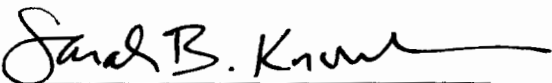
The discussions which have produced this Agreement have been conducted on the explicit understanding that all offers of settlement relating thereto are and shall be confidential, shall be without prejudice to the position of any party or participant representing any such offer or participating in any such discussion, and are not to be used in connection with any future proceeding or otherwise.

IN WITNESS WHEREOF, the parties have caused this Agreement to be duly executed in their respective names by their fully authorized agents.

PENNICHUCK EAST UTILITY, INC.

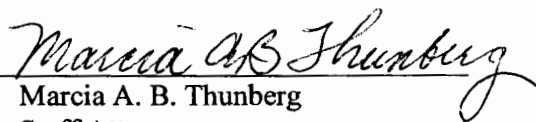
By McLane, Graf, Raulerson & Middleton,
Professional Association

Dated: January 6, 2006

By: 
Sarah B. Knowlton, Esq.

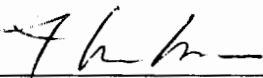
STAFF OF PUBLIC UTILITIES
COMMISSION

Dated: January 6, 2006

By: 
Marcia A. B. Thunberg
Staff Attorney

OFFICE OF THE CONSUMER
ADVOCATE

Dated: January 6, 2006

By: 
F. Anne Ross
Consumer Advocate

Depreciation Accrual Rates in Settlement
Amortization of Depreciation Reserve Imbalance in Settlement

Acct. No.	Account Description	Original Cost 12-31-2004	Avg. Serv. Life	Net Salv. Value	Dep. Accr. Rate	Dep. Expense
DEPRECIABLE PLANT						
Source of Supply						
304.10	Structures & Improvements	\$ 726,266	40.1	-5.0%	2.62%	\$ 19,017
307.10	Wells & Springs	\$ 651,630	29.0	-10.0%	3.79%	\$ 24,717
	TOTAL Source of Supply	\$ 1,377,896			3.17%	\$ 43,734
Pumping Plant						
304.20	Structures & Improvements	\$ 1,601,379	41.9	-5.0%	2.51%	\$ 40,130
311.20	Electric Pumping Equipment	\$ 932,642	20.0	-10.0%	5.50%	\$ 51,295
311.60	Other Power Pumping Equipment	\$ 13,176	30.0	0.0%	3.33%	\$ 439
	TOTAL Pumping Plant	\$ 2,547,197			3.61%	\$ 91,865
	Source and Pumping	\$ 3,925,093			3.45%	\$ 135,598
Water Treatment Plant						
Water Treatment Equipment						
320.00	Purification System Equipment	\$ 305,717	15.0	-10.0%	7.33%	\$ 22,419
320.10	Other Production Equipment	\$ 19,383	20.0	0.0%	5.00%	\$ 969
320.20	Water Treatment Equipment	\$ 1,014	15.0	-10.0%	7.33%	\$ 74
	TOTAL Water Treatment	\$ 326,114			7.19%	\$ 23,463
Transmission & Distribution Plant						
304.50	Distr Reservoir & Standpipe Structures	\$ 7,360	39.0	-5.0%	2.69%	\$ 198
304.55	Booster Station Structure	\$ 338,462	39.0	-5.0%	2.69%	\$ 9,112
330.00	Distribution Reservoirs & Standpipes	\$ 997,414	56.6	-10.0%	1.94%	\$ 19,384
Transmission & Distribution Mains						
331.01	Pavements-Transmission Mains	\$ 877	15.0	0.0%	6.67%	\$ 58
331.02	Pavements-Distribution Mains	\$ 2,764	15.0	0.0%	6.67%	\$ 184
331.04	Pavements	\$ 2,809	15.0	0.0%	6.67%	\$ 187
331.10	Transmission Mains-New	\$ 1,299,945	100.0	-10.0%	1.10%	\$ 14,299
331.15	Transmission Mains-Developer Installed	\$ 215,050	100.0	-10.0%	1.10%	\$ 2,366
331.20	Distribution Mains-New	\$ 13,579,181	75.0	-10.0%	1.47%	\$ 199,161
331.25	Distribution Mains-Gate Valves	\$ 14,520	75.0	-10.0%	1.47%	\$ 213
331.30	Distribution Mains-Developer Installed	\$ 3,486,300	75.0	-10.0%	1.47%	\$ 51,132
	Total Account 331	\$ 18,601,446	77.0		1.44%	\$ 267,602
Services						
333.04	New Services-Pavement	\$ 28,021	15.0	0.0%	6.67%	\$ 1,868
333.10	Services-New	\$ 1,642,949	55.0	-10.0%	2.00%	\$ 32,859
333.20	Services-Renewed	\$ 133,779	55.0	-10.0%	2.00%	\$ 2,676
333.23	Services-Developer Installed (CIAC)	\$ 359,240	55.0	-10.0%	2.00%	\$ 7,185
333.25	Services-Developer Installed (PAID)	\$ 475,900	55.0	-10.0%	2.00%	\$ 9,518
	Total Account 333	\$ 2,639,889	54.6		2.05%	\$ 54,105
Meters & Meter Installs						
334.10	Meters & Meter Installs	\$ 557,574	25.0	-5.0%	4.20%	\$ 23,418
334.11	Meters-Digamatic Readers	\$ 602,589	10.0	0.0%	10.00%	\$ 60,259
	Total Account 334	\$ 1,160,163			7.21%	\$ 83,677
335.00	Hydrants	\$ 327,614	75.0	-10.0%	1.47%	\$ 4,805
335.10	Hydrants-Developer Installed	\$ 313,536	75.0	-10.0%	1.47%	\$ 4,599
	Total Account 335	\$ 641,150	75.0		1.47%	\$ 9,404
339.00	Other Plant & Misc Equip	\$ 71,542	50.0	0.0%	2.00%	\$ 1,431
	TOTAL Transmission & Distribution	\$ 24,457,426			1.82%	\$ 444,913
General Plant						
343.00	Shop Equipment	\$ 83,373	12.0	0.0%	8.33%	\$ 6,948
346.00	Communication Equipment	\$ 185,264	9.0	0.0%	11.11%	\$ 20,585
347.11	Computer Equipment-Hardware/Software	\$ 36,484	8.0	0.0%	12.50%	\$ 4,561
348.00	Miscellaneous General Equipment	\$ -	11.0	0.0%	9.09%	\$ -
	TOTAL General	\$ 305,121			10.52%	\$ 32,093
	Total Depreciation	\$ 29,013,754			2.19%	\$ 636,068
	Amortization of Depreciation Reserve Imbalance					\$ 64,417
	Amortization of Plant Acquisition Adjustment (based on overall composite depreciation accrual rate)					\$ (238,268)
	Amortization of CIAC (based on depreciation accrual rate for Mains, Services and Hydrants)					\$ (79,826)
	Total Depreciation and Amortization					\$ 382,391