

**STATE OF NEW HAMPSHIRE
BEFORE THE
PUBLIC UTILITIES COMMISSION**

DW 13-126

PENNICHUCK EAST UTILITY, INC.

Permanent Rate Proceeding

SETTLEMENT AGREEMENT

I. PROCEDURAL BACKGROUND

The Settlement Agreement approved by the New Hampshire Public Utilities Commission (Commission) by Order No. 25,292 (November 23, 2011) in Docket No. DW 11-026, Re *City of Nashua*, required that Pennichuck Water Works, Inc. (PWW), Pennichuck East Utility, Inc. (PEU), and Pittsfield Aqueduct Company, Inc. (PAC) (jointly, the Companies) file with the Commission full rate cases simultaneously by June 1, 2013. On May 31, 2013, the Companies filed the required rate cases.

The Commission issued Order No. 25,523 on June 20, 2013 in this docket and suspended PEU's proposed tariff and scheduled a prehearing conference on July 19, 2013 immediately followed by a technical session. The Office of Consumer Advocate (OCA) had previously filed a letter of participation in this docket on May 9, 2013 and the Town of Litchfield (Litchfield) filed a petition to intervene in this proceeding on July 9, 2013. The prehearing conference and technical session were held as scheduled, at which time the Commission approved Litchfield's petition to intervene. On July 19, 2013, the Commission Staff (Staff) filed on behalf of the parties in the case a proposed procedural schedule. On July 22, 2013, the Commission approved the proposed procedural schedule which, among other things, provided for three rounds of discovery followed by a technical session and settlement conference.

II. RATE CASE FILING

PEU requested a permanent rate increase of \$591,485, or 9.97%, in its gross operating revenues, effective July 1, 2013, based on the test year ending December 31, 2012. PEU also requested a step increase of \$133,431, or 2.25%, for capital improvements used and useful by December 31, 2013. Combined, PEU requested an overall increase in rates of 12.21%. PEU requested a temporary rate increase of 7% effective for service rendered on or after July 1, 2013. The Commission approved PEU's temporary rate request by Order No. 25,602 dated November 27, 2013. PEU also filed a Cost of Service Study which contained recommended changes to the allocation of costs to PEU's various customer classes.

III. TERMS OF AGREEMENT

PEU, Staff, and the OCA met on February 25, 2014 to discuss terms of settlement in this rate proceeding. During that meeting, PEU, Staff, and the OCA reached agreement on the following issues. Litchfield did not participate in the settlement discussions.

A. Permanent Rate and Step Increase

PEU, Staff, and the OCA (the Settling Parties) agree to a permanent rate increase of \$587,890, or 9.91%, and a step increase of \$95,977, or 1.62%, over test year general water revenues of \$5,934,818. The total revenue increase is \$683,867, or 11.52%. The calculations of the permanent rate increase and the step increase are more fully described in Attachments A and B to this Settlement Agreement, respectively. The resulting new revenue requirement for PEU, including annual revenues of \$294,576 it earns through the North Country Capital Recovery

Surcharge¹, is \$6,913,261. The components of PEU's total proposed revenue requirement are summarized on Attachment C. The Settling Parties agree that this represents a reasonable compromise of all issues relating to the revenue requirement pending before the Commission for purposes of permanent rates and the step increase, including, but not limited to, allowed overall rate of return, return on equity, capital structure, *pro forma* adjustments, capital additions to rate base, and operating expenses. As the sums expressed above are the result of compromise and settlement, they are liquidations of all adjusted net operating income requirement and revenue requirement issues and do not constitute precedent regarding any particular principle or issue. The Settling Parties agree that the revenue requirement recommended to the Commission results in rates for PEU's customers that are just and reasonable.

B. Effective Date for Permanent Rate and Step Increase

The Settling Parties agree that the permanent rate increase of \$587,890, or 9.91%, as indicated above, shall be effective for service rendered on or after July 1, 2013, in accordance with Order No. 25,602. In order to reconcile the difference between temporary rates and permanent rates, the Settling Parties agree that PEU should be authorized to implement a surcharge designed to collect, over a twelve-month period, an amount equal to the difference between the revenues PEU would have collected had the agreed upon level of permanent rates been in effect for service rendered on and after July 1, 2013, and the actual revenues collected at the temporary rate level actually in effect.

Upon the issuance of a final order in this proceeding, PEU agrees to file, within thirty (30) days of the date of the final order in this proceeding, its calculations of the temporary-

¹ See Section III, 1 for an explanation of the North Country Capital Recovery Surcharge. The rate increase recommended in this agreement does not apply to this surcharge paid by North Country water system customers.

permanent rate recoupment and surcharge recommendation for Commission review. PEU shall also provide a copy of its calculations to the OCA. The equal monthly surcharges shall be calculated based on each customer's actual usage and reflected as a separate item on all customer bills. Upon receipt of the Commission's final order, PEU agrees to file a compliance tariff supplement including the approved surcharge relating to the total recoupment of the difference between the level of temporary rates and permanent rates as well as the average monthly surcharge for each customer class based on customers' individual usage.

The Settling Parties agree that the step increase indicated above shall be effective as of the date of the Commission order approving this Agreement. The Settling Parties also agree that the step increase shall not be reconcilable for the period during which temporary rates were in effect.

C. Clarification of Certain Ambiguities Contained within the DW 11-026 Settlement Agreement

During the course of discovery, certain ambiguities contained within the DW 11-026 Settlement Agreement relative to the rate making process became apparent for which the parties had differing interpretations. For the sake of this as well as future rate proceedings, the Settling Parties have sought to reach a common understanding with regard to clarifying these ambiguities, as follows:

1. Valuation of "Equity-Related Items"

The DW 11-026 Settlement Agreement at Section III, B, 1, c (pg. 9) states:

"Under the proposed Ratemaking Structure . . . the value of each utility's equity at the closing of the Merger shall be removed from its rate base and the related portion of net operating income (the "Equity-Related Items") shall also be removed from the traditional computation of revenue deficiency . . ."

The Settling Parties agree and propose that in this as well as future rate proceedings the value of the “Equity-Related Items” shall be inclusive of the value of common stock at the time of the merger, which for PEU was \$100.

2. **Determination of Return on Equity:** The DW 11-026 Settlement Agreement at Section III, B, 1, e (pg. 10) states:

“ . . . If there is any equity reflected on a utility’s financial statements at the time of a future rate case . . . the Ratemaking Structure would apply a formula cost of equity based on the average of the interest rates on 30-year Treasury bonds for the most recent 12 months ending prior to the filing of the rate case, plus 3.0 percentage points.”

However, Exhibit B to the DW 11-026 Settlement Agreement, with specific reference to PEU (Page 7 of 7), contains the following footnote:

“The component cost rate (allowed ROE) with respect to any Common Equity in any future rate case shall be equal to (i) the most recent 12-month average of thirty-year United States Treasury bond interest rates as derived from the Federal Reserve Statistical Release, H.15(519). “Selected Interest Rates”, or a successor or equivalent publication, including the interest rate published on, or as close as possible after, a date four months following the proposed effective date of proposed changes in the utility’s rates as set forth in the rate filing, plus (ii) 3.0% . . .”

The Settling Parties agree and propose that in future rate proceedings Return on Equity shall be equal to:

- 1) the average of the most recent 12-months of thirty-year United States Treasury Bond interest rates available at the time of the filing of the rate case, plus
- 2) 3.0%.

D. Treatment of Non-Revenue Producing Assets

“Non-revenue Producing Assets” are defined as plant assets that have been placed into service during the test year and receive special rate-making treatment in that they are reflected in rate base at their year-end value rather than at the 13-month test year average value. In order to

be eligible for such treatment, such assets must meet certain qualifying criteria. During the course of this proceeding, it became apparent that there existed a diversity of understanding amongst the parties relative to the specific qualifying criteria required in determining whether an asset(s) qualified as “non-revenue producing”. Therefore, the Settling Parties have devoted their efforts to clarifying the qualifying criteria of non-revenue producing assets on a prospective basis. As a consequence, the Settling Parties agree that in future rate cases, non-revenue producing assets shall be recognized in rate base at year-end value when:

1. The underlying project which establishes the acquired or installed asset(s) is in response to a regulatory mandate. Such mandates shall include but not be limited to: NH Department of Environmental Services (DES) rules or enforcement actions, i.e., Letters of Deficiency (LOD’s); Environmental Protection Agency (EPA) directives; or Safe Drinking Water Act (SDWA) requirements. Projects which emanate from a municipality’s ongoing sewer and drain construction projects shall also constitute a regulatory mandate.
2. The underlying purpose of the project shall not be to increase the Company’s revenues through either increasing its customer base or service capacity. Any increase in annual revenues resulting from the project should be both incidental and negligible. For PEU, incidental and negligible annual revenues shall be defined as that which results in an increase in annual revenues of less than 1% of a project’s expended cost during the test year. Further, when incidental revenues do result from a non-revenue producing asset(s), these should be *pro formed* into test year revenues.
3. The expended cost during the test year on the project must be significant, i.e., the resulting asset(s) placed into service shall have a book value greater than 1.5 times

the reportable amount for filing a Form E-22 set forth in Puc 609.12 (d). Currently for PEU, the expended cost must exceed \$45,000 (\$30,000 x 1.5).

4. The asset(s) shall be used and useful by the end of the test year.

If the asset(s) in question meet the above criteria, the Settling Parties agree and recommend that the year-end value rather than the 13-month average value associated with the asset(s) shall be recognized in rate base. Such rate base valuation treatment shall extend to the Plant in Service, Accumulated Depreciation, Contributions in Aid of Construction (CIAC) and Amortization of CIAC associated with the asset(s) in question.

E. Eminent Domain Costs

Pursuant to the Settlement Agreement approved in Docket No. DW 11-026 regarding the City of Nashua's acquisition of Pennichuck Corporation, the City was permitted to recover, from PWW, PEU, and PAC earnings and profits, up to \$5 million in costs that the City incurred from January 1, 2002 until August 2009, subject to Commission audit. See Settlement Agreement Section III, D, 4 at p. 16.² On October 1, 2013, the Commission Audit Staff issued its Final Audit Report, concluding that \$540,344 in costs should be disallowed and that the recoverable eminent domain amount from PWW, PEU and PAC was \$4,507,978. See Attachment D. As noted in the Final Audit Report, Pennichuck Corporation did not agree at the time with certain of

² "The Settling Parties agree and recommend that the Commission require PWW, PEU, and PAC to not pay or distribute funds in any fiscal year with respect to their common stock, through dividends or other distributions to Pennichuck, in excess of an amount equal to the sum of;

- (i) the amount of the utility's then applicable CBFRR, and
- (ii) an amount from current earnings and profits with respect to such fiscal year to provide funds to allow the City to reimburse itself for costs incurred by the City relating to its efforts to pursue the eminent domain proceeding from January 1, 2002 until August 2009 (the 'Eminent Domain Amount'), provided, however, that the distribution in respect of such Eminent Domain Amount with respect to any fiscal year shall not exceed \$500,000, and, provided further, that the aggregate of all distributions in respect of such Eminent Domain Amount shall not exceed \$5,000,000."

the Audit Staff's recommended disallowances. For purposes of settlement in this proceeding, the Companies do not oppose the Audit Staff's recommended recoverable amount.

F. Municipal Acquisition Regulatory Asset (MARA)

The Settlement Agreement approved in Docket No. DW 11-026 authorized the MARA and provided that the final actual amount of the MARA, as well as the actual acquisition costs, would be subject to Commission audit in the first rate cases filed by the Companies. The Commission Audit Staff issued its Final Audit Report on November 19, 2013. The Audit Staff verified the components of the MARA as of January 25, 2012, with no exceptions. See Attachment E.

G. Rate Design

The Settling Parties agree to adopt PEU's cost of service study submitted in this docket. For purposes of allocating the recommended rate increase set forth above, including the step increase, the Settling Parties propose that the increase be applied *pro rata* based on the cost of service study. The Cost of Service Study recommends that the percentage of the Company's revenue be collected from the primary customer classes as follows:

| | Cost of Service Studies | |
|-----------------|-------------------------|--------------|
| | <u>Current</u> | <u>Prior</u> |
| GM | 86.40% | 85.27% |
| Fire Protection | 13.60% | 14.73% |

H. Rate Impacts

The Settling Parties recommend a permanent rate increase of 9.91%. For the average residential customer with a 5/8 meter and based on average annual usage of 77 ccf, the annual bill will be \$676.83, an increase of approximately \$46.98 per year, or \$3.92 per month, over the previously approved permanent rates.³ The step adjustment will result in an additional increase of \$9.93 per year, or \$0.83 per month.⁴ The results of the revenue increases by customer class are set forth in the Reports of Proposed Rate Changes. See Attachment F.

I. North Country Capital Recovery Surcharge (NCCRS)

On December 11, 2009, the Commission issued Order No. 25,051 in Docket No.'s DW 08-052, Re Pittsfield Aqueduct Company, Inc., and DW 09-051, Re Pennichuck East Utility, Inc., approving a Settlement Agreement which, among other things, established a Capital Recovery Surcharge to be charged to the customers of certain so-called "North Country" water systems: Birch Hill in North Conway, Sunrise Lake Estates in Middleton, and Locke Lake Colony in Barnstead (collectively, the North Country Systems). Concerning the approved surcharge, the approved Settlement Agreement states, ". . . *The Capital Recovery Surcharge shall be recalculated in each general rate case for PEU to reflect changes in the number of customers in each [North Country] System . . .*" As a result, the Settling Parties agree and propose that, effective for service rendered on July 1, 2013, the following adjustments should be made to the monthly Capital Recovery Surcharges assessed to the respective customers of each North Country System: Birch Hill – from \$46.94 to \$46.05 (-1.90%); Sunrise Lake Estates – from \$11.01 to \$10.74 (-2.45%); Locke Lake Colony – from \$17.00 to \$16.36 (-3.76%).

³ Based on a monthly customer charge of \$16.94 and a consumption rate of \$6.15 per 100 cubic feet.

⁴ Based on a monthly customer charge of \$17.19 and a consumption rate of \$6.24 per 100 cubic feet.

J. Rate Case Expense Surcharge

The Settling Parties agree that PEU should be allowed to recover its reasonable rate case expenses for this proceeding through a surcharge. PEU's rate case expenses may include, but are not limited to, its legal and consultant expenses, as well as its incremental administrative expenses such as copying and delivery charges. PEU agrees to file its final rate case expense request, pursuant to Puc 1905.02, no later than thirty (30) days from the date of the final order in this docket. Staff and the parties will have an opportunity to review the rate case expenses and provide recommendations to the Commission for approval. The Settling Parties agree and recommend the surcharge be combined with the temporary-permanent rate recoupment.

IV. CONDITIONS

The Settling Parties expressly condition their support of this Agreement upon the Commission's acceptance of all its provisions, without change or condition. If the Commission does not accept the provisions in their entirety, without change or condition, any party hereto, at its sole option exercised within thirty (30) days of such Commission order, may withdraw from this Agreement, in which case it shall be deemed to be null and void and without effect, and shall not be relied upon by Staff or any party to this proceeding or by the Commission for any 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, other than the prospective application to PEU of the Settling Parties' agreements indicated under Section III(C) regarding clarification of certain ambiguities contained in the DW 11-026 Settlement Agreement and Section III(D) regarding the rate base treatment of non-revenue producing assets, but such acceptance does constitute a determination that the adjustments and provisions set forth herein in

their totality are just and reasonable and that the revenues contemplated will be just and reasonable under the circumstances.

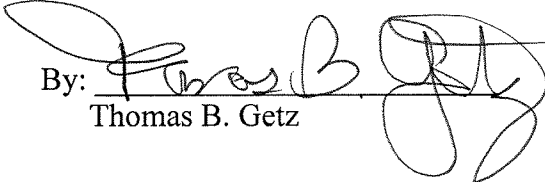
The Commission's approval of the recommendations in this Agreement shall not constitute a determination or precedent with regard to any specific adjustments, but rather shall constitute only a determination that the income requirement, rates, rate base, rate of return, and other provisions of this Agreement, when considered as a whole, are just and reasonable except the Settling Parties' recommendations applicable to PEU in:

- 1) Section III(C) regarding certain clarifications;
- 2) Section III(D) regarding treatment of non-revenue producing assets;
- 3) Section III(E) regarding recoverable eminent domain costs; and
- 4) Section III(F) regarding the MARA.

The discussion that produced this Agreement was 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 Settling Parties have caused this Agreement to be duly executed in their respective names by their fully authorized agents.

Pennichuck East Utility, Inc.
By its attorneys,
Devine, Millimet & Branch

By: 
Thomas B. Getz

Staff of the New Hampshire
Public Utilities Commission

By: _____
Marcia A. Brown
Staff Attorney

Office of the Consumer Advocate

By: _____
Rorie E.P. Hollenberg
Staff Attorney

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

Pennichuck East Utility, Inc.
By its attorneys,
Devine, Millimet & Branch

Dated: May _____, 2014

By: _____
Thomas B. Getz

Staff of the New Hampshire
Public Utilities Commission

Dated: May 14, 2014

By: Marcia A. Brown
Marcia A. Brown
Staff Attorney

Office of the Consumer Advocate

Dated: May 14, 2014

By: Rorie E.P. Hollenberg
Rorie E.P. Hollenberg
Staff Attorney