STATE OF NEW HAMPSHIRE

BEFORE THE

NEW HAMPSHIRE PUBLIC UTILITIES COMMISSION

IR 18-001

Investigation to Determine Rate Effects of Federal and State Corporate Tax Reductions

Consolidated Response of Pennichuck Water Works, Inc., Pennichuck East Utility, Inc. and Pittsfield Aqueduct Company And Request for Exemption From Further Participation

Pennichuck Water Works, Inc. ("PWW"), Pennichuck East Utility, Inc. ("PEU") and Pittsfield Aqueduct Company, Inc. ("PAC") (collectively PWW, PEU and PAC are referred to as the "Companies"), each of which are corporations duly organized and existing under the laws of the State of New Hampshire and operating therein as public utilities subject to the jurisdiction of the New Hampshire Public Utilities Commission (the "Commission"), hereby responds to The Office of Consumer Advocate's January 2, 2018 Petition and the Commission's Order of January 3, 2018, No. 26,096, as follows:

BACKGROUND

1. In Order No. 26,096, the Commission ordered that

> Each utility shall file a proposal with the Commission no later than April 1, 2018, to address the effects of the changes in tax laws, including financial information that is sufficient to establish a revenue requirement that reflects prospectively the impacts of those changes. The filing shall include a calculation of any deferred liability accrued by report date and any liability projected to be accrued until the time when final rates are next issued in accordance with a general rate case. It shall also include a plan for providing periodic reports on the accrual and extinguishment of the deferred liability, including an outline of the financial information the utility would expect to file that would be sufficient to establish a revenue requirement that reflects the impact of the tax law changes.

Order No. 26,096 at 2-3.

2. As is described in more detail in Mr. Goodhue's testimony attached to this Response, the Companies request to be exempted from further participation in this Docket. This request for exemption is based on the unique circumstances resulting from the City of Nashua's ("City") acquisition of Pennichuck Corporation ("Penn Corp") (the parent corporation of PWW, PEU and PAC) in January 2012 pursuant to this Commission's Order No. 25,292 (November 23, 2011, DW 11-026) (Approving Acquisition and Settlement Agreement). As a result of this unique structure, the Companies do not currently collect money from ratepayers for federal income tax, and the state tax liability is immaterial. Therefore, the decrease in the federal income tax rate will have no impact on the Companies' rates.

3. PEU and PAC are both currently subject to the rate methodology described in Order No. 25,292 (the "11-026 Rate Methodology"). PWW is subject to the ratemaking structure set forth in the recent ratemaking Settlement Agreement approved by Commission Order No. 26,070 in Docket No. DW 16-806 (the "16-806 Rate Methodology"). The 16-806 Rate Methodology currently applies only to PWW, although in PEU's open Docket No. DW 17-128, PEU is asking that the 16-806 Rate Methodology also apply to it.

Effect of the City's Acquisition of Penn Corp

4. The change in the ultimate ownership of Penn Corp from a publicly-traded investor-owned company to a City-owned company has had important consequences for the operation of the Companies. One of the most important consequences is that the Companies no longer have access to private equity markets as a method of financing their capital needs. As such, and as contemplated during the Commission's proceeding to approve the City's acquisition of Penn Corp in DW 11-026, the Companies have financed their on-going capital needs entirely

through the issuance of debt. This alone has benefited ratepayers as the Companies no longer seek rates that incorporate a rate of return demanded by equity investors.

5. Since the acquisition of Penn Corp by the City, the Companies have transitioned their rate methodologies from the traditional ratemaking methodology to what is now much more akin to a cash flow municipal-type ratemaking methodology. The first step toward a municipal utility-like rate model was accomplished with the 11-026 Rate Methodology, which, among other things, eliminated a traditional approach to recovery of revenues for federal income tax liabilities. Instead, the 11-026 Rate Methodology limited the Companies' recovery from ratepayers generally to *actual* cash expenses. In 2017, when the Commission authorized PWW to implement the 16-806 Rate Methodology, the rate methodology transitioned even more completely to a cash flow-based methodology analogous to that used by municipal utilities.

6. Unlike other investor-held utilities, the Companies' most recently approved rates do not include a federal tax liability component and the state BPT and BET are immaterial to the current rates. Thus, the Companies are unlike the other utilities that are subject to this Docket and as such, should be exempt from further participation in this proceeding.

7. Furthermore, although only PWW is subject to the 16-806 Rate Methodology, PEU has an open docket (DW 17-128) in which it is requesting that the 16-806 Methodology also apply to it. To the extent the Commission has any questions regarding the impact of recent changes in tax law, those questions can best be addressed in PEU's docket.

The 11-026 Rate Methodology

8. The 11-026 Rate Methodology has two primary components of the allowed revenue calculation. The first component is the fixed revenue component tied to the City Bond Fixed Revenue Requirement (CBFRR), and the second component is based upon a blended

Return on Rate Base (or Return on Investment; ROI) and Return on Equity (ROE) component. However, DW 11-026 includes significant differences from the traditional treatment of the blending of the ROR and ROE components of allowed revenue.

9. Under DW 11-026, Companies have a Debt/Equity ratio that is in the range of 95/5, and the ROE is stipulated to be at a fixed factor tied to the 12-month average treasury rate without any adjustment for tax costs or factors. Also, under DW 11-026, because all of the cash tied to the CBFRR is paid to Penn Corp annually as a dividend (comprised of all the weekly and monthly cash transfers for the CBFRR), this small ROE factor applies only to the net income (after deducting the CBFRR dividend) earned in the test year leading up to the company's most recent rate case.

10. Because the Companies no longer have an effective ROE component to their 11-026 Rate Methodology, and because, as described above (and unlike the traditional way ROE is determined), that ROE component is determined without any adjustment for tax costs or factors, there is no impact from federal income taxes, and the impact from state BPT taxes is immaterial. Although a reduction in the federal (and state) income tax rates would normally be a benefit to rate payers in this manner, in the case of PEU and PAC, the benefit associated with favorable tax rates has already been granted to customers because the weighted average cost of capital included in the 11-026 Rate Methodology is primarily a debt-based weighted average cost of capital, which has already benefited customers in a lower cost of capital applied to the factors included in the allowed revenue calculations.

The 16-806 Rate Methodology

11. The 16-806 Rate Methodology represents a further divergence from traditional Rate Methodology and is much more in line with a municipal utility-like rate model. In this rate

methodology, an ROI calculation is no longer a component of the allowed revenue calculation. This was requested, and approved under Commission Order No. 26,070, to allow the revenue structure of PWW to reflect the cash flow needs and requirements tied to the service of debt payment obligations of a company that is nearly 100% funded by debt for its operations. The new methodology has three primary "buckets" of fixed revenue requirements: the CBFRR; the Material Operating Expense Revenue Requirement ("MOERR"); and the Debt Service Revenue Requirement ("DSRR") – plus a Non-Material Operating Expense Revenue Requirement ("NOERR"). The NOERR component for PWW is currently very small (1.87% of the overall allowed revenue requirement) and allows only for the recovery certain enumerated costs as approved in Commission Order No. 26,070, which approved costs do not include any federal or state tax costs.

12. Federal taxes are accounted for under the 16-806 Rate Methodology as described in Mr. Goodhue's testimony. Importantly, however, because there is no ROI component under the 16-806 Rate Methodology (which would account for any deferred tax liabilities) and because tax costs are not included in either the MOERR or NOERR component, the 16-806 Rate Methodology does not include any costs or factors for federal taxes.

State BET and BPT

13. The treatment of BPT is largely identical to the treatment of federal income taxes. The BET, however, is essentially a minimum tax calculation for state taxes in New Hampshire, based upon amounts incurred each year for payroll, interest and dividends. This tax calculates a minimum tax liability in the state for corporations, based upon these factors, but also creates a BET credit to offset BPT liability in a year. If the BET credit is not fully used in a year, it can be carried forward (up to 15 years) to offset future BPT liability. As a result, all calculations of the

tax provision on a GAAP basis for inclusion in each company's income statements and balance sheets is done using the statutory rate for BPT, as the BET rate is simply in place to provide for a minimum level of actual tax payments by corporations in each calendar year. Because there is no ROI component under the 16-806 Rate Methodology (which would account for any deferred tax liabilities) and because tax costs are not included in either the MOERR or NOERR component, the 16-806 Rate Methodology does not include any costs or factors for state taxes.

Overall Effect of Tax Legislation on the Companies

14. To the extent the Tax Act has any material impact on the Companies, it may ultimately result in an increased tax liability, not a decrease in tax liability as might be expected. There is a section of the IRS code that stipulates that the interest expense deduction limitation does not apply to regulated utilities, but it is silent as to how that is to be interpreted for consolidated groups of companies, filing consolidated tax returns, including non-regulated subsidiaries and a non-regulated parent. The Company is working with its tax consultants and legal representatives in following developments on the interpretation of this provision in the Code, as the first time it would truly be impactful would be when the 2018 corporate income tax return is due to be filed with the IRS in late 2019. Thus, it is premature to evaluate the full impacts of the Tax Act on the Companies.

Request for Exemption From IR 18-001

15. Given the Companies' unique corporate structure, lack of equity funding and reliance entirely on debt funding, it is much differently situated than the other public utilities that were identified in The Office of Consumer Advocate's Petition that led to Order No. 26,096. As is described in Mr. Goodhue's testimony, the 2017 Tax Act will, at best, have an immaterial or neutral impact on the three subsidiaries' ratepayers, and may ultimately result in an increased tax

burden. Thus, the regulated subsidiaries' involvement in this docket will not be an efficient use of the Commission's time as the Companies are not similarly situated to the other companies involved in this docket.

16. In addition, PEU currently has an open rate case docket, DW 17-128. Because PEU is currently under the 11-026 Rate Methodology and is requesting application of the 16-806 Rate Methodology going forward, there is an existing vehicle for Staff, the OCA and the Commission to explore the issues raised by the 2017 Tax Act and changes in state tax law and how those changes may impact the three companies under both rate methodologies. Continued participation in this Docket will only result in duplication of efforts.

17. Because of these unique differences and the pending rate docket, the Companies are requesting to be exempt from participating in IR 18-001 and avoid the costs that may be associated with participating in that docket. Instead, to the extent the Commission, Staff or the OCA have questions, all of these issues can be addressed in DW 17-128.

Conclusion

WHEREFORE, by this petition, PWW, PEU and PAC respectfully requests that the Commission:

(a) Exempt the Companies from further participation in this Docket; and

(b) Take such further action and make such other findings and orders as in its judgment may be just, reasonable, and in the public good.

Respectfully submitted,

PENNICHUCK WATER WORKS, INC.
PENNICHUCK EAST UTILITY, INC.
PITTSFIELD AQUEDUCT COMPANY, INC.

By Its Attorneys

RATH, YOUNG AND PIGNATELLI, P.C.

Dated: March 29, 2018 By: ______________________

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Certificate of Service

I hereby certify that a copy of this response has been distributed to the parties identified in the service list for this docket.

Dated: March 29, 2018 ______________________

Richard W. Head