

**BEFORE THE STATE OF NEW HAMPSHIRE**

**PUBLIC UTILITIES COMMISSION**

**In the matter of:  
Lake Region Water Company  
Authority to Finance and to Increase Rates**

)  
) **DW 08-070**  
)

**Direct Prefiled Joint Testimony**

**of**

**Kenneth E. Traum  
Assistant Consumer Advocate**

**and**

**Stephen R. Eckberg  
Utility Analyst**



*Dated: September 4, 2008*

NHPUC SEP04/08 PM 3:17

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**OFFICE OF CONSUMER ADVOCATE JOINT TESTIMONY  
DW 08-070 Lakes Region Water Company**

1 **Q. Please state your name, business address and position.**

2 A. My name is Kenneth E. Traum. I am the Assistant Consumer Advocate for the Office of  
3 Consumer Advocate (OCA), which is located at 21 S. Fruit Street, Suite 18, Concord,  
4 New Hampshire 03301. I have been employed by the OCA for approximately 19 years.  
5 I include my resumé as Attachment 1.

6 A. My name is Stephen R. Eckberg. I am a Utility Analyst for the OCA, where I have been  
7 employed for 1 year. I include my resumé in Attachment 2.

8  
9 **Q. Mr. Traum, have you previously testified before the New Hampshire Public Utilities  
10 Commission?**

11 A. Yes. I have testified before the Commission in numerous dockets on behalf of the OCA,  
12 as well as testifying on behalf of Commission Staff when I worked for the Commission's  
13 Finance Department.

14  
15 **Q. Mr. Eckberg, have you previously testified before the Commission?**

16  
17 A. Yes. I have testified previously before the Commission on behalf of the Belknap-  
18 Merrimack Community Action Agency when I served as Administrator of the Statewide  
19 Electric Assistance Program, and I have also testified on behalf of the OCA in my current  
20 position.

21  
22 **Q. Please summarize the Company's original requests in this docket.**

23 A. In this docket the Company is seeking approval to finance approximately \$780,000.00 at  
24 an interest rate of 9.75% to complete and finance a number of capital projects. The  
25 Company has also requested three (3) Step Increases in order to recover the costs of these

1 capital projects as well as increases in property and income taxes, operation and  
2 maintenance, and depreciation.

3  
4 **Q. Is it your understanding that the Company may be changing that request?**

5 A. Yes. We believe that the Company is changing its proposal based on a data response  
6 from Stephen St. Cyr received on Friday, August 22, 2008. Mr. St. Cyr stated in  
7 response to Staff 2-1, that “the Company’s owners have recently decided to contribute the  
8 entire amount as additional paid in capital rather than loan the funds as a shareholder  
9 loan.” See Attachment 3. However, in response to OCA 3-1, Mr. St. Cyr states that “the  
10 Company does not plan to revise its petition.” See Attachment 4.

11  
12 **Q. Would this change, if filed with the Commission as a revision of the Company’s  
13 Petition in this case, change your positions discussed in this testimony?**

14 A. In part, yes. It is our understanding that equity infusions do not require Commission  
15 approval. Therefore, our positions related to the financing itself would not apply to a  
16 proposal for new equity only. However, the Company would still need approval for any  
17 Step Increases that they seek, and our concerns discussed below related to this proposal  
18 would remain.

19  
20 **Q: Please provide a brief overview of your testimony.**

21 A: Generally, we oppose the terms of proposed financing for a variety of reasons discussed  
22 below. We also oppose Step Increases done in isolation for items not fully vetted in a  
23 general rate case. Lastly, we continue to have concerns about this Company’s  
24 managerial, technical and operational abilities which raise concerns about increasing the

1 Company's rate of return without commensurate changes in how the Company is  
2 managed.

3  
4 **Q. Has the OCA previously raised its objection to the proposed Step Adjustments?**

5 A. Yes. The OCA stated at the July 1, 2008 Prehearing Conference in this Docket that the  
6 proposed Step Adjustments, which are not the result of prior rate proceedings, amount to  
7 inappropriate single issue ratemaking. See DW 08-070 Prehearing Conference  
8 Transcript, page 18. We also raised our concerns about single issue ratemaking in the  
9 Hearing on Settlement in DW 07-105, the Commission's investigation about whether to  
10 place the Company in receivership. See DW 07-105 Final Hearing Transcript, May 8,  
11 2008, at page 57-58 and at page 82.

12  
13 **Q. Is the OCA's position in this matter consistent with recent Commission decisions on  
14 this issue?**

15 A. Yes. In Order No. 24,891 dated August 29, 2008 in Docket DW 07-032, the Commission  
16 approved a step adjustment for Pennichuck East Utilities, Inc. (PEU). In the  
17 Commission's Analysis on page 3 the Commission states: "PEU's request moreover, is  
18 consistent with the settlement agreement approved in Order No. 24,840, in which the  
19 Commission specifically found it appropriate to consider a step adjustment for PEU's  
20 capital improvements and expenses related to Daniel's Lake." This makes clear that the  
21 Step Increase was approved because it was consistent with a prior rate case. This is  
22 consistent with the OCA's view that Step Adjustments generally should not be approved  
23 unless they relate to specific projects that have been reviewed and approved in a rate  
24 case.

1 **Q. If the OCA had a fundamental objection with the Company's filing, why did the**  
2 **OCA agree to proceed with discovery and discussions with the Staff and Parties?**

3 A. Despite our position, the OCA agreed at the Prehearing Conference to conduct discovery  
4 and participate with Staff and the Parties in discussions on this docket to explore whether  
5 we could reach a settlement.

6 After conducting discovery, our conclusion is that there remain too many unknowns in  
7 this proceeding. It is our view that we would have the opportunity to seek the additional  
8 information we require in a full rate case proceeding, and that it would be more  
9 appropriate, as discussed above, to consider Step Increases in the context of a full rate  
10 case. We also do not believe that the Company necessarily needs all the revenues from  
11 the three Step Adjustments included in its Petition in order to have an opportunity to earn  
12 a reasonable return based on prudent decisions and actions. In addition, the OCA  
13 remains concerned about the Company's continued lack of compliance with Commission  
14 Rules and Orders. The Company has not met commitments – both regulatory and self-  
15 imposed – on significant issues such as formal filing of Affiliate Agreements, which have  
16 a major impact on the utility's costs and revenues.

17  
18 **Q. Please discuss your concerns about the proposed financing in more detail.**

19 A. The proposed terms of the Company's original financing request were for a twenty (20)  
20 year loan for \$780,000 at what we consider to be a high interest rate, by Commission  
21 standards, of 9.75%. This loan would be made to the Company by Thomas Mason Sr.  
22 and Barbara Mason, the sole owners and shareholders of Lakes Region Water Company.  
23 The OCA believes that a more prudent approach, from the ratepayer perspective, is for  
24 the Company to make every reasonable effort to avail itself of financing from the State

1 Revolving Fund (SRF) administered by the Department of Environmental Services  
2 (DES), Interconnection Grants, and Community Development Block Grants rather than  
3 relying on the proposed debt issuance at 9.75% annual interest by the Company's owners.  
4 We believe this to be true even under the Company's most recent proposal to raise the  
5 funds through an equity infusion instead of through a loan. The OCA understands that  
6 SRF funds are available at interest rates generally in the 3.5% to 4.0% range. This lower  
7 interest rate would be considerably better for LRWC ratepayers, and is a more prudent  
8 approach to managing the finances of a water utility. In its response to Staff 1-7, LRWC  
9 indicated that financing from conventional banking institutions at interest rates lower  
10 than 9.75% is not available to the Company, and that this in turn makes the 9.75% rate  
11 reasonable. See Attachment 5. The OCA asserts that this is circular logic and does not  
12 constitute a sufficient basis to permit the Company to incur long term debt from its  
13 principals at such high interest rates. In addition, we continue to ask what steps are being  
14 taken to make necessary changes in the management and operation of the Company so  
15 that it can attract financing at competitive rates. That is an important question that simply  
16 must be addressed before approval is given to increase rates.

17  
18 **Q. What does the OCA recommend with respect to the financing portion of this filing?**

19 A. The OCA recommends that any debt financing be considered *only* as short-term bridge  
20 financing to be in place for a maximum period of three (3) years, or until the Company  
21 replaces the debt with lower interest SRF loans or other financing secured on more  
22 reasonable terms. The OCA does not recommend that such bridge financing include  
23 consideration of a Step Increase in rates outside of a full rate case. If the Company  
24 prefers the equity infusion option, that decision is left to the shareholders of the utility but

1 should be considered in a rate case in the context of the appropriate debt to equity ratio  
2 and overall rate of return.

3  
4 **Q. Do you consider this to be an appropriate time for the Company to submit a rate  
5 case filing?**

6 A. Yes, the OCA feels this would be appropriate for several reasons. First, the Company  
7 contends, in its May 30, 2008 cover letter from Mr. St. Cyr to Debra Howland in DW 07-  
8 105, that it is not earning its authorized rate of return. See Attachment 6.. The OCA  
9 believes that the essential purpose of a rate case is to provide a regulated utility with rate  
10 relief if, in an environment of sound fiscal management and prudent decision making, it  
11 is not earning their authorized rate of return. Secondly, the Company filed a rate case in  
12 2002 (DW 02-156), using a 2001 test year. This was followed by a rate case in 2005  
13 (DW 05-137), using a 2004 test year. It seems reasonable, following this historical  
14 pattern of three year intervals, and in light of the many investments that the Company has  
15 undertaken in recent years, that the Company should file a rate case in 2008 with a  
16 current test year.

17  
18 **Q. Recognizing that the OCA does not agree with the *concept* of a Step Adjustment in  
19 this instance, do you have specific comments on the Company's filing regarding the  
20 *level* of requested Step Adjustments?**

21 A. Yes, we have quite a few comments:  
22 1) With regard to the various Plant Additions, it is the OCA's understanding that the  
23 Company's request for multiple Step Increases is due to the addition of large non-  
24 revenue producing additions. The OCA believes that the improvements to both

1 water supply reliability and quality may lead to additional usage which would  
2 result in increased revenue. This should be recognized as an offset to any revenue  
3 needed from proposed Step Increases.

4 2) The proposed Step Increases assume approval of a 20 year loan to the Company's  
5 owners at an annual interest rate of 9.75%. This request must first pass the test of  
6 prudence. Under the alternative of an equity infusion, the Company is seeking a  
7 similar proposed revenue requirement. However, the OCA does not believe that  
8 the Company has met its burden of proof to demonstrate that this is the most  
9 prudent approach for its ratepayers.

10 3) The depreciation rates proposed in the filing need to be carefully reviewed. The  
11 comparable depreciation rates for similar assets of at least one other water utility  
12 located in the same general area of the state, Pittsfield Aqueduct Company, reflect  
13 significantly longer service lives.

14 4) The proposed Step Increase filing includes a gross-up for income taxes, but based  
15 on the Company's responses in technical sessions and discovery, and deferred  
16 Federal Income Tax (FIT) balances shown on the Company's 2007 Annual  
17 Report to the Commission, the Company does not expect to pay any FIT through  
18 at least 2008. See Attachment 7. The OCA believes that the relevant accounting  
19 methodology for this warrants further investigation.

20 5) The filing calls for ratepayers to pay higher rates though Step Increases under the  
21 assumption that the Company will have to pay higher property taxes immediately  
22 for the plant additions, and does not recognize the likely lag prior to increased  
23 payments of these taxes.

24 6) The filing also mistakenly assumed property taxes would be imposed on assets

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- such as vehicles.
- 7) The filing does not include additional revenue that the Company will realize by placing its customers in the Gunstock Glen service territory onto the Consolidated Tariff Rate as proposed in the filing. (See Attachment 8, Company responses to Staff 1-8 and OCA 1-15)
  - 8) The filing does not include additional revenue that the Company will realize through rate increases to be put into place via its Special Contract with the Property Owners Association of Suissevale, Inc (POASI). (See Attachment 9, Company response to OCA 2-19)
  - 9) A significant amount of the Plant Additions included in the proposed Step Increases relates to work performed by an affiliate, Lakes Region Water Services (LRWS), which is owned by the Company's Vice President, Thomas Mason, Jr. At the time this work was performed and billed, there was not a current Affiliate Agreement on file with the Commission governing that relationship. The OCA is extremely concerned that allowing this inadequately documented relationship to continue, a relationship which yielded 2007 billings in excess of \$250,000, is an unacceptable situation. This issue was identified by PUC Staff as Audit Issue #1 in the PUC Audit Staff's Final Audit Report dated May 22, 2006 (see Attachment 10). In that Audit Report, the Company's comment was "the Company is updating its agreements and will submit same for PUC review. The Company and affected parties of the agreements intend to review such agreements on an annual basis." To the OCA's knowledge, these required Affiliate Agreements have not yet been filed since the issue was raised two years ago by Audit Staff.

1 **Q. In the Company’s response to OCA 2-5, the Company provided “affiliate**  
2 **agreement”(see Attachment 11) and also responded to OCA data requests 3-3 and 3-**  
3 **4 regarding these agreements. Does this adequately address the OCA’s concerns on**  
4 **this issue?**

5 A. No. The OCA does not consider the submittal of Affiliate Agreement through data  
6 responses as a formal filing. In addition, the responses to OCA 3-3 (see Attachment 12)  
7 and 3-4 (see Attachment 13) do not demonstrate compliance with the applicable PUC  
8 Standards that rates for services provided to the affiliate by the utility must be at the  
9 greater of market value or actual cost, nor do they demonstrate that costs for services  
10 provided by the affiliate to the utility must be at the lesser of market value or actual cost.

11  
12 **Q. What is the OCA’s overall assessment of the Company’s filing?**

13 A. The OCA recognizes that the Commission’s Rules allow for expedited and simplified  
14 procedures for small water utilities. However, PUC Rule 602.12 defines a “small water  
15 system” as “any water distribution system serving fewer than 600 customers.” LRWC  
16 serves approximately 1,600 customers, nearly three times that number.

17 In spite of that, the OCA recognizes that LRWC is a relatively small, family-owned and  
18 operated utility that does not have an especially strong set of financial statements. Their  
19 ratepayers, however, are entitled to the same regulatory protections as those of larger  
20 utilities.

21 If those larger utilities were to seek Step Increases and single-issue ratemaking as in this  
22 case, the OCA would object and insist upon a full rate case. The OCA seeks the same  
23 treatment for LRWC’s ratepayers as it would for customers of any other utility.

24

1 **Q. In conclusion, what are the OCA's recommendations in this docket?**

2 A. The OCA recommends that the Commission should:

- 3 1) Deny the Step Increases at this time;
- 4 2) Remind the Company that it is welcome to file a rate case if it feels that it is not  
5 earning its authorized rate of return; and
- 6 3) Allow the Company to enter into a bridge financing agreement with the Mason's  
7 at a market based rate for a period not to exceed 3 years, and require agreement  
8 from the company that it will:
- 9 a. Take all necessary steps to address problems with the management of the  
10 utility that make it difficult for it to attract lower cost financing; and
- 11 b. Take all necessary steps to seek lower cost financing.

12

13 **Q. Is it the OCA's understanding that the Commission's Audit Staff is conducting an  
14 audit of this filing?**

15 A. Yes, but because the results of that audit were not available to the OCA at the time this  
16 testimony was compiled, we reserve our rights relating to the audit and its findings.

17

18 **Q. Does this complete your Joint Testimony?**

19 A. Yes.

20

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