

Before the New Hampshire Public Utilities Commission

**DW 07-105 Investigation into Quality of Service
DW 10-043 Affiliate Agreement with LRW Water Services, Inc.
DW 10-141 Petition for a Change in Rate Schedules
DW 11-021 Petition to Approve Long Term Debt**

Lakes Region Water Company

Office of the Consumer Advocate's Closing Statement

The OCA is very concerned about Lakes Region Water Company's ("LRWC" or "Company") financial circumstances and managerial abilities as well as its ability to provide safe and adequate service to its customers. How to address the Company's current and future cash flows and management issues is the question before the Commission. The OCA recommends the Commission, in making its determinations in these consolidated proceedings, consider two general goals: 1) getting the Company the financial and managerial resources it needs to function in a safe and adequate manner; and 2) achieving some reasonable confidence that the Company employs these increased resources for the benefit of customers while maintaining regulatory compliance.

This is not a typical case at the Commission. This is a rate case consolidated with several other open dockets: a receivership docket opened in 2007; a docket to consider the Company's request for after-the-fact approval of significant amounts of unauthorized long-term debt; and a docket involving a proposed affiliate agreement between entities that are controlled by the same person and which agreement has contract terms that appear to be unreasonable for the utility. This case involves a utility with a history of regulatory non-compliance and consistently marginal management practices, and which is also in serious financial trouble. As Mr. Naylor testified on behalf of Advocate Staff, the Company is in "very dire" financial circumstances, Transcript Day 4 AM page 23 line 21 through page 24 line 1, and has been for some time. The

“cornerstone” of utility operations – as Mr. Naylor described access to capital to make investments in its systems – is missing for LRWC. Transcript Day 4 AM page 105 line 22 through page 106 line 4. Customers are at risk unless changes are made and demonstrable improvements become evident.

The current financial circumstances of the Company have been long in the making and are the result of different factors, many of which were within the Company’s control. Some of the Company’s current challenges – aging or deficient infrastructure, and the increasingly complex and technical regulation of drinking water – are common to many small water utilities in New Hampshire. However, other small regulated water utilities face these types of challenges without experiencing the type of long-standing and pervasive financial difficulties faced by the Company.

During the hearing, the Company explored the last Pittsfield Aqueduct Company (PAC) rate case (DW 08-052) which involved consideration and approval of double and triple-digit percentage rate increases. However, as the Company’s witness, Mr. St. Cyr, testified PAC is not comparable to LRWC. See Transcript Day 1 page 109 lines 5-8 and 14-16 (describing as “unfair” a comparison of LRWC to any of the Pennichuck utilities). Consideration of the circumstances in that PAC rate case support that conclusion.

Prior to DW 08-052, PAC invested approximately \$4 million, using both commercial funds and state revolving loan funds (SRF), to rehabilitate three small, long-neglected, developer-built water systems which serve, in total, approximately 1,100 customers. Without difficulty, PAC secured the financial capital it needed to fund this investment, and the Commission approved the substantial rate increases because it was satisfied that the capital investment was prudent, necessary to provide safe and adequate service, as well as used and

useful in the service to PAC's customers. Unlike this LRWC rate case, the Commission did not have any concerns about PAC's financial circumstances or managerial abilities.

In this case, to quote Staff Advocate Naylor, the Company is not "bankable." See Transcript Day 4 AM page 119 lines 20-21. The Commission heard testimony about the Company's consistent lack of planning, the ever-expanding delinquent accounts payable balance, a significant amount of unauthorized long-term debt that has accumulated in recent years, and the failure of the Company to secure – despite Commission approval - low-cost SRF funding for much-needed capital improvements. The Commission also received evidence that the Company faces between \$1 million and \$2.5 million in near-future capital investments and that, without some special utility ratemaking methodology, the Company may not be able to secure commercial debt to finance these capital investments.

Also, a deadline to resolve supply issues related to the Paradise Shores and Suissevale communities looms on the horizon and with it the potential for significant capital investment, additional environmental compliance issues, as well as the potential for the loss of consumption of, and associated revenues from, Suissevale customers. The Company keeps sliding further into financial distress, and the OCA posits that one of the chief causes of the Company's continual financial decline is a lack of adequate management, including financial expertise and planning specific to the regulatory environment in which the Company operates.

Unlike the aforementioned PAC case, in this case the Commission must consider whether to grant rate relief while also considering whether the Company has the ability to manage its operations in a manner that is consistent with the law, requiring safe and adequate service at just and reasonable rates. Unfortunately, the OCA's experience during the pending dockets causes it

to be less than confident that the Company – as it is currently structured and managed – will be able to operate lawfully.

One issue in particular that we draw to the Commission’s attention relates to our concern about Tom Mason’s conflicted – or at least apparently conflicted – role as head of both LRWC and its affiliate, LRW Water Services company, as well as Mr. Mason’s apparent lack of compliance with the requirement for fair dealings between LRWC and LRW Water Services company.. This, coupled with what appears to be the absence of any other actively-involved, or even a neutral non-family member of the utility’s Board or management, contributes to the OCA’s concerns for the Company’s residential customers.

As the Commission heard, Mr. Mason’s parents, who are two of the four directors of the Company’s board, are no longer involved, and Mr. Mason’s sisters, who serve as the other two members of the board, are very minimally involved. See Transcript Day 2 AM pages 62-63 and Day 2 PM Transcript pages 51-52. In light of these circumstances, we believe that at least part of the solution to LRWC’s serious problems includes affirmatively addressing Lakes Region’s governance and management structure. Granting a rate increase without some requirement that the Company improve its management and governance seems ill advised given the history of this Company. At the very least, it appears to the OCA that Lakes Region needs some new managerial and financial leadership with utility experience if it is to work to reduce its cash flow problems as well as to begin to proactively manage the utility operations. This recommendation is consistent with past recommendations of Advocate Staff and is not inconsistent with the Advocate Staff’s present recommendation that the Company be sold, at least in the interim period before such a sale can occur. See Transcript Day 4 AM page 31 line 21 through page 32 line 8.

In addition, the OCA is concerned about the future relationship between the Company and its wholesale customer Suissevale. The issues concerning the Company's supply to Suissevale and the adjacent community, Paradise Shores, have existed for several years and, once again, the Company will invest some of its limited financial resources erecting a temporary solution to this supply problem just to make it through the summer season of 2012. See LRW Exhibit 14 ("Revised Mount Roberts Schedule Proposal" to NH DES). At the same time, the Suissevale community is exploring new sources of supply, which, to the extent that these efforts are successful, may enable it to decrease (or possibly discontinue) use of the LRWC's supply in the near future. With such a decline in Suissevale consumption, the Company's other customers could be negatively impacted.

In particular, the OCA is concerned that the Company will make permanent investments to serve Suissevale and, thereafter, unreasonably shift the costs of these investments onto its other customers if Suissevale significantly curtails – or stops - its use of the Company's supply. As long as the terms of the relationship between the Company and its Suissevale customer remain in flux – especially in terms of whether Suissevale will contribute to the costs of the permanent solution to the existing supply issues – the retail, residential customers of the utility are in limbo and at financial risk. Consequently, before LRWC makes any significant investment to meet Suissevale's future supply needs, the Commission should require LRWC to secure a commitment from Suissevale to pay its share of the so-called "Mount Roberts" investment – either through a revised special contract or otherwise.

On the issue of the affiliate agreement contract proposed by the utility, it is the OCA's position the Company has failed to meet its burden of proving the terms of this agreement – particularly the pricing terms - are just and reasonable, as required by RSA 366:5. As Mr.

Eckberg discussed in his testimony, the standard typically used by the Commission in evaluating the pricing terms of affiliate contracts is whether the price paid by the utility is the lesser of the actual cost of the affiliate's services or market cost, and whether the price paid by the affiliate is the greater of the actual cost of the utility's services or market cost. Based upon the record of these proceedings, the rates charged by LRWC and its affiliate do not comply with this standard.

For example, the affiliate agreement includes the affiliate's use of LRWC's "Personnel including a pick-up (vehicle)" for \$19.00 per hour. LRW Exhibit 10, Appendix A. This rate includes "employee's hourly rate, payroll taxes, employee benefits, vehicle costs including fuel, maintenance, insurance and depreciation," *Id.*, and is based upon a calculation of the actual costs for this service, which are now "more in the \$25 range." Transcript Day 2 AM page 109 line 19 through page 110 line 6. Similarly, the affiliate agreement includes LRWC's use of the affiliate's "Personnel including a pick-up (vehicle)" for \$50.00 per hour, a cost which includes the same components as those included in LRWC's "personnel" rate: "employee's hourly rate, payroll taxes, employee benefits, vehicle costs including fuel, maintenance, insurance and depreciation." LRW Exhibit 10, Appendix B. Unlike the rate paid by LRWC for the affiliate's personnel services, however, the affiliate's much higher hourly rate is a discounted market-based rate. Transcript Day 2 AM page 113 line 22 through page 114 line 5.

As the affiliate agreement is proposed, for identically-defined personnel services, the affiliate would pay LRWC a cost-based rate that is approximately half of the discounted market-based rate that LRWC would pay the affiliate. This result, however, is exactly the opposite of what the Commission's affiliate-agreement standard requires. LRWC should charge its affiliate the market-based rate because it is greater than the actual costs of the personnel services, and the affiliate should charge LRWC actual cost for the personnel services because it is less than the

market-based rate. Without changes to these rates to comply with the Commission's standard, the OCA agrees with Staff Advocate Naylor; the Commission should reject the proposed affiliate agreement. See Transcript Day 4 PM page 25 Lines 5–8.

As the Commission is aware, RSA 366:7 allows the Commission to disallow payments by a utility to an affiliate if the utility fails to establish that the terms of the agreement are reasonable. The Commission may disallow these amounts on its own initiative.

On the issue of installing meters in several of the Company's unmetered systems, which Staff Advocate Naylor mentioned during testimony, the OCA recommends that the Commission reaffirm its directive (Order 24,692) to the Company to install meters in certain systems in order to comply with PUC 603.03(a) or to make a filing, by a date certain, detailing why the Company believes such investment is not in the best interest of its customers. There was testimony presented during the hearing on the subject of "lost water" as well as prefiled testimony, which expressed a concern about water revenues and volumes sold in the Company's Indian Mound system – one of the Company's unmetered systems which it received approval to acquire in Order No. 24,374 in DW 04-090. Installing meters would bring the Company into compliance with PUC regulations and has the potential to provide additional data which would be useful to company management and regulators in setting rates.

On the issue of access to reasonably priced capital the Company's President, Mr. Mason testified that conventional ratemaking methodologies create a mismatch between the term of a loan and the period of time over which the Company must recover the costs of the financed investments from ratepayers. It is his position that this "mismatch" is a barrier to borrowing money at reasonable rates. As Mr. Mason testified, "I'd borrow money in a heartbeat, as long as I can pay it back." See Transcript Day 2 PM page 48 lines 18-19. While the OCA understands

the Company's argument, we are not persuaded that modifying conventional ratemaking principles will provide the solution that LRWC needs. Even if the incoming revenue stream that the Company can collect from its ratepayers for a particular loan matches the required payment stream for that particular loan, there is no specific guarantee to the debtor that LRWC will pay that loan. Rates collected from customers do not arrive at the Company's doorstep in dedicated funding streams which will ensure that any particular loan amount is paid. The Company's managers must decide weekly and monthly what bills to pay and this Company has over \$500,000 in accounts payable which it must also currently manage. As Mr. Mason appropriately stated when discussing longer loan terms, "It might help and it might not work." Transcript Day 2 PM page 49 lines 1-2. That is, longer loan terms are no guarantee that the Company will borrow money from the SRF at rates more favorable to customers than the current inappropriately high rates it now applies to borrowings from the stockholders.

On the issue of the Company's management capabilities, the OCA is very concerned about the information provided by the Company in Record Request 6 (provided electronically by email on March 30, 2012). The information in Record Request 6 shows that the Company has already incurred a judgment in Carroll County Superior Court related to the outstanding unpaid balance to one of its service providers. This judgment has required the Company to pay \$1,000 per month since January 2011. It also appears that the Company is liable to pay 18% annual interest on this outstanding debt. Further, the Company appears to have several tax liens against property which is presumably used in the provision of service to customers, and information provided in the record request indicates that additional tax liens may occur in the very near future if the Company is unable to make necessary payments. The OCA believes that these facts provide support to Mr. Naylor's position that there exists an imminent threat to the Company's

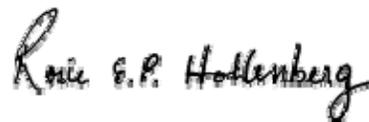
ability to continue to provide safe and adequate service. See Transcript Day 4 AM page 42 lines 16-23.

On the issue of the Company's revenue requirement, the OCA does not oppose the Staff's recommended revenue requirement. Although this presumably includes revenues and expenses associated with the affiliate transactions between the Company and LRW Water Services, the OCA's position should not be construed as supporting the affiliate agreement. In addition, the OCA's position should not be construed as supporting any of the individual components of, or adjustments included in, Staff's recommended revenue requirement except to the extent that the OCA advocated for the same or similar adjustments in its testimony (e.g., Income Tax Adjustment). Rather, the OCA does not object to the total amount of the revenue requirement recommended by Staff. In addition, the OCA strongly recommends that the Commission require the Company to conduct a cost of service study – to some extent – in its next rate case.

Finally, the OCA is concerned about the level of rate case expenses that the Company may seek to recover. We respectfully request that the Commission make it clear in its order that the Company must file its rate case expense recovery request as a docketed filing in the consolidated dockets. Also, at this time, the OCA reserves our right to respond to any filing by the Company to recover the difference between temporary and permanent rates, once determined, as well as to recover rate case expenses.

In closing, the OCA thanks the Commission for this opportunity to be heard in these matters.

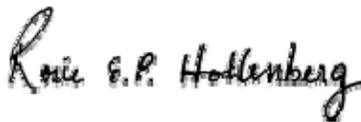
Respectfully submitted,
Office of the Consumer Advocate



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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing closing statement was forwarded this day to the parties in the four consolidated dockets by electronic mail.



April 9, 2012

Rorie E. P. Hollenberg