

1. Staff Advocate's position on Lakes Region Water Company, Inc.'s (LRWC) affiliate agreement in Docket No. DA 10-043 is that the agreement ought not to be approved. Hearing Transcript of March 27, 2012 (3/27/12 Tr.) PM at 25.
2. Staff Advocate's position on the requested financing is that the Commission approve, *nunc pro tunc*, the loans totaling \$216,547 from the years 2004, 2006, 2007, 2008, 2009, and 2010 as shown on page 39 of Mr. Laflamme's testimony, Exh. Staff 1. Mr. Laflamme included the financings in his revenue requirement because the equipment is used and useful and Staff Advocate believes the proceeds of the loans were used for equipment that is in the public good.
3. With respect to the revenue requirement for Docket No. DW 10-141, Staff Advocate supports Mr. Laflamme's recommendation. Temporary rates are in place and Mr. Laflamme's recommended permanent rate revenue requirement, although close to the temporary revenue requirement, will require reconciliation pursuant to RSA 378:29. LRWC should file its reconciliation calculation and suggested surcharge as soon as is practicable so that it can recover the difference from customers. LRWC characterized Mr. Laflamme's recommended revenue requirement as being half of what the company requested, however, this characterization is inaccurate as explained in 3/27/12 Tr. PM at 105. Regarding the 1.18%% step adjustment recommended by Mr. Laflamme, it would not be eligible for reconciliation under RSA 378:29 and, importantly, an audit of the 2010 plant additions must be done prior to Commission approval of the step. See Exh. Staff 1 at 34. Lastly, Staff Advocate recommends the Commission consider approving permanent rates in a separate order so that rate relief can be obtained quickly and be free of any delay due to Docket No. DW 07-105.
4. Staff Advocate is most concerned with Docket DW 07-105 and Mr. Mark Naylor has offered his opinion that LRWC ought to sell its assets and relinquish its franchise. Mr. Naylor's

recommendation was not made lightly and Staff Advocate believes a sale is a more preferable means of obtaining an orderly ownership transition than receivership under RSA 374:47-a.

As the Commission is aware, utilities seeking to exercise any right or privilege under any franchise must first obtain Commission approval pursuant to RSA 374:22. The test for whether a franchise is for the public good under RSA 374:26 is whether the utility possesses the requisite managerial, technical, financial, and legal expertise to operate a utility. LRWC's managerial capabilities were called into question in DW 07-105. LRWC has improved its managerial capabilities but LRWC's financial capabilities are in crisis, its financial outlook is bleak, and it is in such a financial hole that it cannot overcome its financial crisis under traditional ratemaking. Even efforts to bend the rules so-to-speak at the Commission and at DES, will not remedy LRWC's bleak financial picture.

A persistent problem is with LRWC's lack of ability to manage its finances. Staff Advocate acknowledges LRWC has increased its plant in service by over \$1 million, or 33% since 2006 to address compliance issues but LRWC has a serious cash flow problem. In its Final Audit Report, (Exh. Staff Adv. 4), Audit Staff found LRWC's Accounts Payable as of the end of the 2009 test year was in excess of \$350,000 and 69% of that balance was over 90 days past due. According to the 2010 Annual Report, the accounts payable was in excess of \$471,000. As of March 9, 2012, the Accounts Payable was up to \$506,815. Payables aged over 90 days had increased to 78.46% and this was during the time when the rate increases from DW 08-070 and temporary rates in DW 10-141 were in effect. The Final Audit Report also noted that LRWC has received shut-off notices and Record Request 2 shows the company is in peril of more shut-off notices given that its utility bills are over 90 days past due. At hearing, LRWC attempted to portray the accounts payable as less than \$506,815; however, not all of the \$184,700.09 it claims as "Rate Case Vendors" qualifies as recoverable rate case expenses.

This financial hole did not arise over-night; it is a result of LRWC's inability to manage spending on capital improvements and revenue increases. Mr. Mason's testimony on whether it plans when it needs to seek rate relief was that it does it when it "feels the need to do it" and that "hopefully, when we get rate relief on this case, we'll look at it...as a group." 3/15/12 AM Tr. at 79-80. LRWC simply has not done proactive rate case planning. 3/15/12 AM Tr. at 45.

In its Reply Testimony, LRWC blames its financial condition on the Commission's regulations. This is misplaced. Regulated utilities, not the Commission, manage a utility's finances. LRWC has provided water service to the public since the 1970's and has expanded through acquisition of smaller systems. LRWC ought to be well aware of the Commission's regulations and how to earn a return on its investment under traditional rate of return regulation. The record shows that LRWC has not been earning its allowed rate of return and has even had a negative return. See Record Request 1. LRWC's last rate case prior to DW 10-141 was in 2005. Part of possessing the requisite managerial expertise to hold a franchise is to seek appropriate, timely rate relief. Mr. Mason testified that the 2007 4.12% ROR did not cause LRWC to seek rate relief because it thought the step increase would be sufficient. 3/15/12 AM Tr. at 96. Staff Advocate notes that the step increase to rates was only to reflect the added plant, it was not a full rate case where LRWC could have adjusted its revenue requirement to cover increases in other expenses. LRWC's 2008 rate of return was negative 4.71% and it attempted to file a rate case in 2009, but the record in that docket (DW 09-184) shows that: on February 17, 2010, Staff urged the Commission to reject the filing because LRWC had not closed its books on 2009 assets it sought to include in its 2008 test year; that, importantly, LRWC had failed to complete its 2008 Annual Report; and that the filing did not comply with Puc Chapter 1600. In short, LRWC was not competent to manage a rate case filing. In the instant case, Mr. Mason testified that "we're not attractive to anybody to give us money...we're just on the edge all the time." "We're barely

getting enough money to pay our bills.” 3/15/12 AM Tr. at 98. No regulated utility should be in such disarray and financial crisis.

The record shows that LRWC recently consulted financial experts to assist it. Mr. Montville testified that when he looked for savings but found none. 3/8/12 Tr. at 48-49. When asked, other than large rate increases, what can LRWC do to get itself out of the financial crisis, Mr. Montville testified not much. 3/8/12 Tr. at 75. Mr. Mason also testified that permanent rates are not the answer to LRWC’s cash crunch. 3/15/12 AM Tr. at 41. 3/15/12 PM Tr. at 35. Mr. Montville testified that LRWC was operating on a tight cash flow (3/8/12 Tr. at 62) and that capital asset acquisition was driving the cash flow problem. 3/8/12 Tr. at 63, lines 1-6, Mr. Montville agreed that LRWC would need frequent rate relief.

Mr. Montville, Mr. St Cyr, and Mr. Eckberg, all testified that it is unlikely that LRWC will get out of the cash flow problem under traditional ratemaking. The dire nature of LRWC’s financial condition was also described by LRWC’s other consultant, Mr. Stephen P. St. Cyr. He testified that the \$207,674 net operating loss for the 2009 test year (p. 54 of Exh. LRW 3) is a drain on LRWC (3/8/12 Tr. at 136-137) and that LRWC will need over \$200,000 in additional revenue in order to earn its authorized rate of return coming out of the rate case. Even tinkering with the year-end vs. 13-month average rate base isn’t going to get LRWC sufficient funds to get out of the financial hole.

Record Request 2 shows that accounts payable are insurmountably high. Mr. Montville testified that LRWC can’t afford to pay outside vendors and thus cannot go out to bid; LRW Water Services, Inc. is LRWC’s bank. 3/8/12 Tr. at 78-79. Mr. Mason also testified LRWC is “leery” about going out to bid because the contractors want to be paid but if LRWC uses LRW, it can float the bill at no charge to LRWC. 3/15/12 PM Tr. at 34. When asked how long the accounts payable is sustainable, Mr. Montville testified that LRWC is at the mercy of its

vendors. 3/8/12 Tr. at 80. LRWC has been robbing Peter to pay Paul for a long time. Id. at 81. Mr. Mason testified how LRWC determines which accounts payable to pay: "I sit down with the payables guy and we go through and select what is available for money on at least a weekly basis and try to figure out who we need to pay." The professionals, lawyers, accountants, finance people have not been paid but the suppliers have. 3/15/12 AM Tr. at 130. LRWC assesses who it can pay and who it can put off. 3/15/12 PM Tr. at 66. Mr. Mason testified LRW Water Services, Inc. and LRWC swap off money between the companies. 3/15/12 PM Tr. at 69.<sup>1</sup>

When asked if LRWC pays LRW Water Services, Inc. over other vendors (LRWC presently owes LRW \$3,500), Mr. Mason disagreed that LRW has been paid unfairly ahead of other vendors. 3/15/12 PM Tr. at 68.<sup>2</sup>

When asked if the financial crisis had resulted in LRWC being shut off from professional services, Mr. Mason replied no. 3/15/12 PM Tr. at 88. The record shows otherwise. Shaheen & Gordon, P.A. filed a withdrawal of representation with the Commission on October 14, 2011 and Record Request 2 shows LRWC is 90-days past due to the firm: \$60,384.31 and \$2,204.14. This firm no longer provides work to LRWC. Mr. Mason testified that LRWC still uses engineering firms to do work even though LRWC owes them money. Again, Record Request 2 shows Lewis Engineering, owed \$30,837.50 at 90-days overdue and that LRWC is not incurring any more payables with it. LRWC owes HydroSource \$10,780.47 and this amount is consistent with payments required under the court judgment in Record Request 6 but Record Request 2 only

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<sup>1</sup> LRW Water Services, Inc. floating LRWC raises other concerns. Mr. Mason testified that the money owed to LRW by LRWC just sits there, interest-free, until LRWC can pay it. "[W]e've been kind of doing the same thing for years." 3/15/12 AM Tr. at 46. Mr. Mason does not consider it a loan that would need financing and the Final Audit Report lists the failure of LRWC to seek financing for loan arrangements as a repeat find. This is not how a competent regulated utility should be managing its loans.

<sup>2</sup> It is of interest to note that although Mr. Mason testified that LRWC makes up about 5% of LRW's work (3/15/12 AM Tr. at 107), the 2008 Annual Report shows LRWC paid LRW \$337,255. In LRW Exhibit 8, this amount was \$86,223 in 2010.

shows HydroSource as providing \$176.71 worth of work, which is 31 days past due.<sup>3</sup> \$176.71 worth of work is not consistent with the testimony that LRWC still has access to engineering firms. This begs the question of whether Lewis has shut LRWC off and whether LRWC truly has engineering services available to it as Mr. Mason testified. 3/15/12 PM Tr. at 88.

LRWC's financial crisis is made even more dire by the fact that the shareholders are not willing to further invest in LRWC. 3/15/12 Tr. AM at 65. Mr. Mason testified that there was no way for LRWC to pay back shareholder loans so they were converted to equity. 3/15/12 PM Tr. at 37. See also Mr. St. Cyr testimony at 3/8/12 Tr. at 160.

LRWC faces large capital investment needs in the coming years. Mt. Roberts is described in Exh. LRW 14 and Exh. LRW 6, Exhibit E lists others. Access to capital was an issue in DW 07-105 and remains a serious problem. In DW 07-105, LRWC was supposed to obtain SRF financing yet LRWC declined the loan on November 12, 2010 in DW 09-098. Mr. Mason testified LRWC recently reapplied for SRF funds and at hearing he disclosed that DES offered to extend the SRF loans, should LRWC qualify, to 30 years. Mr. Mason testified that this would help, but it would not solve the problem unless LRWC can get the entire present loan payment from present customers. 3/15/12 PM Tr. at 40. Even if the loan is extended to 30 years to resolve the mismatches to the composite asset lives, the lack of a personal guarantee would still inhibit obtaining a loan. Mr. Mason testified: "I don't think anybody would sign, personally guarantee a note that they knew they couldn't pay." 3/15/12 PM Tr. at 41. Mr. Mason acknowledged that LRWC's shareholders, Tom and Barbara Mason, signed personal guarantees in the past (3/15/12 AM Tr. at 50) but Tom Mason (Jr.) doesn't believe it makes sense. See also, 3/15/12 PM Tr. at 41. Loan length and personal guarantee aside, even with the debt forgiveness,

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<sup>3</sup> Mr. Mason testified that his parents paid for all the Mt. Roberts work (3/15/12 PM Tr. at 12) but Record Request 2 shows the HydroSource bill as unpaid.

Mr. Montville testified that LRWC “wouldn’t have been able to meet their debt payments.” 3/8/12 Tr. at 73-74. St. Cyr concurred: 3/8/12 Tr. at 140. It is important to note that while LRWC avers that it can’t obtain financing, other smaller water companies regulated by this Commission are able to obtain SRF financing. E.g., Lakeland Management Company, Inc.; Tioga River Water Company; West Swanzey Water Company.

When questioned about whether LRWC would have sufficient water supply this summer, Mr. Mason replied yes, with the temporary use of the Mt. Roberts property. 3/15/12 PM Tr. at 11. This assurance is not supportable. DES does not want to issue any more temporary permits for LRWC’s use of Mt. Roberts and thus, through an LOD, is requiring LRWC to pursue a small community well permitting process. Exh. LRW 14. Mr. Mason testified, however, that he does not know how LRWC will pay for the project. 3/15/12 AM Tr. at 43-44. The Mt. Roberts project is not in rates and operating the wells and pumps (owned by Tom and Barbara Mason personally) is not in the proposed revenue requirement (3/15/12 PM Tr. at 20-21) and will be operated at a loss. Id. Mt. Roberts is not the only project LRWC can’t pay for. Mr. Mason testified that after Mt. Roberts (assuming Suissevale stays as a customer), the next project is Far Echo Harbor then Indian Mound. Far Echo Harbor will involve purchasing land and moving a well from the beach and estimates that project will cost \$300,000. He estimated Indian Mound, a pump and well replacement project, to cost \$150,000. at 3/15/12 PM Tr. at 65-66. Mr. Mason admitted that Far Echo was listed as a number 2 priority on Exh. LRW 6, Exhibit E and explained that some of the projects on Exhibit E had been started and that he was just guessing on the costs. 3/15/12 PM Tr. at 79, 82. Mr. Mason testified that he does not use any project tracking software but he defended that LRWC is always updating the capital improvement plan. 3/15/12 PM Tr. at 84. Again, Mr. Montville and Mr. St. Cyr testified LRWC cannot fund these.

Additionally, LRWC has testified that it does not know how it will fund the Capital Improvement Plan. LRWC's shareholders are not in a position to fund improvements unless they sell property in Massachusetts (3/15/12 AM Tr. at 65) and a bank will only lend to it if it sees cash flow to cover the loan payments. Mr. Mason testified that about half of the 2011 projects have yet to be done (3/15/12 PM Tr. at 25-26) and none of the ARRA projects are presently being done (3/15/12 AM Tr. at 51). Mr. Mason testified that Staff's proposed permanent rate increase is not enough to enable LRWC to fund the proposed capital improvements. 3/15/12 AM Tr. at 90. Also, Mr. Montville testified that LRWC is not in a financial position to pay an additional \$100,000 fine, should it be assessed for the Tamworth convictions; the money would have to come from the stockholders. 3/8/12 Tr. at 61 and 68. If LRWC cannot pay a \$100,000 fine, then it certainly cannot pay \$300,000 for a project at Far Echo. Mr. St Cyr testified that LRWC, even coming out of the rate case, would not be able to fund capital investments. 3/8/12 Tr. at 145.

LRWC's inability to pay for Mt. Roberts is indicative of how past capital planning has been conducted: Mr. Mason testified that projects are a moving target and that "most of the time we just react to them because they're -- I don't know how you budget for them." 3/15/12 PM Tr. at 91. This haphazard nature of planning improvements and managing system needs feeds and compounds LRWC's financial crisis.

The harm to customers from LRWC's financial management is illustrated by the Tamworth conviction. The Tamworth conviction had a damaging ripple effect on LRWC's financial ability and damaged the company at a time when it could least afford it. Tom Mason (Sr.) relinquished his certified operator's license (3/15/12 AM Tr. at 95) and LRWC had to find another certified operator. LRWC pays \$3,300 per month out of general funds toward the criminal fine (3/15/12 AM Tr. at 125) and this robs from funds otherwise available for capital



improvements or loan payments. The ripple effects are seen in higher costs of capital and lack of access to capital. LRWC has not resolved the water quantity issue in Tamworth and its financial crisis will likely inhibit resolution. Mr. Mason testified that LRWC is presently “figuring out whether it financially makes sense to move forward or is it better to go find another piece of property” and the cost of running a treatment system could be “pretty expensive.” 3/15/12 PM Tr. at 53. The Commission has an obligation to protect customers from any impact whatsoever resulting from the criminal and civil complications resulting from the Tamworth conviction. Increasing LRWC’s ROE, shortening asset lives, raising rates outside of traditional ratemaking principles will shift the company’s responsibility for the Tamworth situation on to customers.

On the subject of compliance with DW 07-105, LRWC was supposed to provide a construction budget but this has not occurred; all that exists is Exhibit E to Mr. Mason’s testimony and Mr. Mason testified that LRWC has no funding plan for the improvements. The Technical Session Notes from September 23, 2008 and December 16, 2008 state: “LRWC has no construction budget yet” and “LRW has not yet prepared a 2008-2010 construction budget and the related source and use of funds statement.” Mr. Mason testified that it was discussed but that one was not formally “put together.” 3/15/12 PM Tr. 24-25. Also, LRWC was supposed to rework Mr. Roberge’s time so that Mr. Roberge would oversee planning of rate relief; this has not occurred.

Continued violations remain an issue. As the hearings demonstrated, LRWC does not have a complete grasp of its compliance status. In Reply Testimony (page 5) Mr. Mason stated that LRWC had resolved its non-compliance with the exception of the Mt. Roberts compliance issue; but at hearing, he testified that there “was a whole bunch of administrative orders” that were resolved (3/15/12 AM Tr. at 81 line 13) and that he did not know which administrative order was the one he cited on page 5 of his testimony. Id. at 83 line 9. Mr. Mason testified that

there are no other outstanding NOV's or violations other than the Mt Roberts LOD. 3/15/12 PM Tr. at 50, but Exh. Staff Advocate 10 noted NOV's existed and this resulted in the Commission requesting a list of any and all violations. See, Record Request 5. Whether noncompliance with DES and Commission regulations exists is not only a matter of truthfulness and demonstration of competent management, but also implicates how LRWC would pay an additional \$100,000 in criminal fines. Mr. Montville testified LRWC is unable to pay such a fine. 3/8/12 Tr. at 61.

It is clear from the record that LRWC lacks the ability to manage its finances. LRWC has no access to capital either from its shareholders or from loan programs such as DES's SRF program. It is only a matter of time before LRWC fails "to provide adequate and reasonable service to its customers", and until such failure becomes "a serious and imminent threat to the health and welfare of the customers of the utility." RSA 374:74-a. Staff Advocate is not asking for receivership, however, LRWC's failure to maintain fifteen of its Permits to Operate in 2009 is prima facie evidence that LRWC's operation of its systems presents a serious and imminent threat to the health and welfare of its customers. Staff Advocate, instead, is asking that LRWC's franchise be revoked and that LRWC proceed with an orderly ownership transition because it no longer possesses the requisite financial expertise to hold a franchise. Advocate Staff believes the best course of action is for LRWC to seek a qualified buyer, one with access to reasonably-priced capital, and ensure that customers will continue to receive safe and adequate service at just and reasonable rates into the future.