STATE OF NEW HAMPSHIRE

PUBLIC UTILITIES COMMISSION

March 7, 2013 - 9:04 a.m. **DAY 2**
Concord, New Hampshire

RE: **DW 13-041**
LAKES REGION WATER COMPANY, INC.:
Petition for Emergency Rates.

PRESENT: Chairman Amy L. Ignatius, Presiding
Commissioner Robert R. Scott
Commissioner Michael D. Harrington

Sandy Deno, Clerk

APPEARANCES: **Reptg. Lakes Region Water Company, Inc.:**
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Robyn Descoteau, Gas & Water Division

Court Reporter: Steven E. Patnaude, LCR No. 52

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JAYSON P. LAFLAMME

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P R O C E E D I N G

CHAIRMAN IGNATIUS: We are resuming the hearing in Docket DW 13-041, Lakes Region Water Company, Petition for Emergency Rate Increase. Yesterday afternoon, we finished everything up with the panel that was on from the Company. And, today, as I understand it, we move to a panel of Staff witnesses.

But, before we do that, are there any administrative matters to take care of? Mr. Richardson.

MR. RICHARDSON: Thank you. Briefly, I have just given to Staff and OCA, and I have for the Commission as well, if you'd like it, the financial schedules that are in the Staff responses. This is Exhibit 4. The pages were missing. I went back to the office -- well, the page numbers, excuse me, were missing. I went back to the office last night, I looked at the original, and it must have just been an error in how it printed. I have those schedules, you know, it is essentially -- well, it is an identical copy of what's in those, with the page numbers. I thought it might be helpful to have that as a reference. I don't think we need a new exhibit or anything.

CHAIRMAN IGNATIUS: All right.

MR. RICHARDSON: But I'm willing to

provide that, if you'd like?

CHAIRMAN IGNATIUS: Okay. Yes. I think, why not distributed those. And, then, at least on my copy, half of the numbers, the top half shows, so I can usually guess what the bottom half is. But there may be --

MR. RICHARDSON: Yes. This will show both, so --

CHAIRMAN IGNATIUS: Right. And, if anybody got one that doesn't even have that much, it will be helpful.

(Atty. Richardson distributing documents.)

CHAIRMAN IGNATIUS: Thank you.

MR. RICHARDSON: The last thing I wanted to address before we -- before we start, is just a concern I have. Because yesterday, you know, at 2:30, when we came back, you know, we got into a very new issue, which was the -- apparently, what appears to be an error in the calculation of the Company's net operating loss carry-forwards. And, I had discussed, you know, what Staff's position was going to be in the case on Tuesday morning with Staff. And, I understood from that discussion that they weren't intending to offer testimony, and that the issues were going to be, you know, whether the Company was actually earning its allowed rate of return and whether an emergency existed.

Obviously, an error in the calculation is a very serious concern. But I think that, if it's -- I want to avoid, as much as we can, trial by surprise, especially given the expedited nature of this case. And, I'd just like to hear what the reasons for or if there's an offer of proof for Staff's testimony, before we jump into hearing entirely new information at this point.

CHAIRMAN IGNATIUS: Well, because of the expedited nature of the hearing, I think that goes towards less opportunity for preparing on everyone's part. You asked for an emergency hearing, and we granted you that. And, part of that means that there's -- some of this is unfolding for everyone on the stand. So, it isn't the normal process, with everyone knowing in advance what the positions are.

So, I'm -- we're going to have to see where questions go and where the information goes. But I don't think there's any understanding of a limit of what Staff can get into, other than relevance to the Petition that you filed.

MR. RICHARDSON: Absolutely. And, I'm

just -- what I'm trying to say is is that I think it would have been more efficient to have known about the error before, you know, we commenced. And, I would have at least appreciated a head's up and an opportunity to review that, rather than having to recess in the middle of the hearing. I think, you know, we -- and Mr. St. Cyr recognized that, you know, Staff appears to have the correct outcome. But I just don't want to have to, you know, to discover things at the last minute.

I mean, obviously, we're in an expedited proceeding. I'm not suggesting that Staff can't testify. I'd just like to know, if there's going to be other kind of material issues, you know, that we'd be, you know, alerted to them as possible.

CHAIRMAN IGNATIUS: Well, I think you'll hear it when they testify, won't you? I mean, you want them to pre-testify right now and tell you what they're going to say, and then get on the stand and say it again? I mean, I don't know what they're going to say either. But I guess I don't get what the efficiency of that is?

MR. RICHARDSON: I was just hoping that we'd understand, you know, is there another major change in the scope of this? Because I understood, coming into the hearing yesterday, that Staff wasn't going to be testifying. And, now, they are. I think they have covered the issues that they had to cover. I'm just curious, is there something new or are we just essentially affirming the topics that were covered on cross already?

CHAIRMAN IGNATIUS: All right. Well, let's break that down into a couple of questions. The Staff evaluated numbers that you presented in your filing, seems to be completely appropriate. And, the fact that you may not have known before it happened, given how expedited this is, you know, that may be unfortunate, but they're numbers you put in. So, I don't know if that's -- if anyone's -- I don't find that to be a very persuasive concern on your part. They're numbers that you presented, and Staff combed through them, and apparently checked the numbers more carefully than your own people did.

As to whether there was ever a commitment on the part of Staff to testify or not testify, Ms. Brown?

MS. BROWN: I'm sorry. I was consulting with -- what was the question?

CHAIRMAN IGNATIUS: Was there a commitment or an expectation conveyed whether Staff would testify or would not testify at this proceeding?

MS. BROWN: No. And, I'd like to

correct that, because Staff did have a conversation with Attorney Richardson. At the time, it was either Monday morning -- yes, Monday morning, Staff had not made a determination on whether we would be calling witnesses or not at that point, and conveyed that to Mr. Richardson. At the time, it looked like we could get all of the information that we were concerned about through cross-examination, and then a closing.

But, in light of the new developments, we -- Staff specifically kept the option open of calling witnesses, but never made a commitment that we would never call them.

As far as the subject matter of today, Staff is not going into any new areas. We're just commenting on the information that was discussed yesterday. So, in answer to the concern of whether Staff is expanding the scope? No.

CHAIRMAN IGNATIUS: And, last night, when it was made clear that Staff did intend to testify, did Mr. Richardson ask you for any explanation of the areas to be going into today?

MS. BROWN: No. And, in fact, late yesterday Staff had offered to just do its -- put its position in through a closing or a written closing, and offered that, in lieu of that, we could put the panel up, so that there would be an opportunity for cross-examination and questions from the Bench, rather than just dump it at the end of a closing, which I thought offered a better due process for the Company.

CHAIRMAN IGNATIUS: Well, I think it was the Commissioners wanted to hear Staff directly. So, that was -- that's our doing, I suppose.

MS. BROWN: Yes.

MR. RICHARDSON: That's fine. And, that really addresses my concern. I just wanted to, you know, if there was going to be some major shift in the nature of the case, I was just hoping that we could avoid surprise as much as possible. You know, I agree that there wasn't a commitment at the conversation that we had on Tuesday, I believe, was just, you know, a statement that it didn't appear that they intended to call witnesses. And, I was just hoping to avoid, you know, some major change or figure out how we would proceed. So, that's fine. Thank you very much.

CHAIRMAN IGNATIUS: All right. Thank you. So, are we ready then for the Staff witnesses to take the stand?

MS. BROWN: Staff would like to call

Mr. Naylor and Mr. Laflamme as witnesses.

(Whereupon ***Mark A. Naylor*** and ***Jayson P. Laflamme*** were duly sworn by the Court Reporter.)

MARK A. NAYLOR, SWORN

JAYSON P. LAFLAMME, SWORN

DIRECT EXAMINATION

BY MS. BROWN:

Q. Mr. Naylor, could you please state your name and position with the Commission for the record.

A. (Naylor) Yes. My name is Mark Naylor. And, I am the Director of the Gas and Water Division here at the New Hampshire Public Utilities Commission.

Q. What is your area of expertise?

A. (Naylor) I have an Accounting degree, and have worked in accounting and finance for pushing 30 years now.

Q. Please describe your involvement with this docket.

A. (Naylor) I have reviewed the Company's emergency rate request filing; reviewed the discovery responses that the Company provided; and have come to the hearing prepared to offer some comments on the Company's filing.

Q. And, would those comments be within your area of expertise?

A. (Naylor) Yes.
Q. Mr. Laflamme, could you please state your name and position for the record.
A. (Laflamme) Jayson Laflamme. Utility Analyst with the Public Utilities Commission.
Q. Mr. Laflamme, what is your area of expertise?
A. (Laflamme) Accounting and finance.
Q. And, can you please describe your involvement with this docket?
A. (Laflamme) I reviewed the Company's Petition for Emergency Rates; I participated in the issuance of discovery, I reviewed the discovery responses; and I'm here to offer my opinion on the Company's request for emergency rates.
Q. And, will your opinion be within your area of expertise?
A. (Laflamme) Yes.
Q. Have you reviewed the exhibits that have been --
A. (Laflamme) Yes.
Q. -- that have been marked in this proceeding?
A. (Laflamme) Yes.
Q. Mr. Laflamme, I'd like to stay with you please. You're familiar with Exhibit 4, which are the discovery responses to Staff?

A. (Laflamme) Yes. Yes.

Q. In particular, I'd like to draw your attention to Staff -- or, responses to Staff 1-3.

A. (Laflamme) Yes.

Q. And, in 1-3, did the Company provide rate of return calculations for the periods 2007 through 2011?

A. (Laflamme) The rate of return calculations for 2007 to through '11 were attachments to Mr. Mason's testimony. And, in the discovery from Staff, Staff requested the rate of return calculation for 2012.

Q. Yes. Thank you for that correction. Do you have any opinion on the schedules provided in Mr. Mason's testimony and the rate of return calculation provided in 1-3?

A. (Laflamme) From the review of the attachments to Mr. Mason's testimony, it would appear that, for the years 2007 through 2010, the Company did not appear to be earning its allowed rate of return. However, for the years 2011 and 2012, the Company indicated in those calculations that it was exceeding its allowed rate of return authorized in DW 10-141 of 8.425 percent.

Q. Mr. Laflamme, when a utility is earning its authorized or it's allowed rate of return, what does that mean to you?

A. (Laflamme) That means, to me, that the Company is earning enough revenues to meet its current obligations, in the form of operating expenses and debt service. And, also, is -- and, also, its earnings are sufficient to earn the allowed rate of return for an owner -- owner's equity for the owners.

Q. Do you have an opinion as to whether this Company ought to -- or, whether the Commission ought to approve emergency rates for the Company?

A. (Laflamme) Based on my review of the record and the data requests, I believe that the Company's request for emergency rates should be rejected.

Q. Mr. Laflamme, knowing what the Company's rate of return was for 2012, do you know what kind of bump the emergency rates would give to the rate of return, if the Commission authorized them?

A. (Laflamme) Yes. Based on the information provided by Mr. St. Cyr, in his updated schedules in response to Staff Data Request 1-5, Staff calculated a rate of return, based on a pro forma year of 2012. If the Company's request for emergency rates was approved, the Company's actual rate of return would be 12.528 percent. When -- and compared to the Company's allowed rate of return from DW 10-141, the Company would exceed its allowed net operating income by better than $100,000.

Q. Mr. Laflamme, given your opinion on the adequacy of the rates, do you have an opinion on -- as to why Lakes Region cannot meet its 2012 income tax liability? And, I say -- and, also, I ask you, if I'm restating Mr. St. Cyr's testimony incorrectly, please feel free to correct me. Because I'm basing it off of Mr. St. Cyr's testimony yesterday that, when I asked him about "whether the rates would allow payment of the taxes?" The answer was "no" was my understanding. So, do you have an opinion on the crisis that the Company is facing right now?

A. (Laflamme) Yes. My opinion is that the Company, it's not a problem of inadequate rates for the Company. I think the record shows the Company's earnings are sufficient to earn its allowed rate of return. Rather, I believe that the crisis is -- has to do with cash flow. The utility rates that the Company is charging are designed to -- with the objective of meeting the Company's current obligations, operating expenses, paying its current debt service, and enabling the Company to earn a sufficient rate of return. However, the rates are not designed with the expectation of paying past accounts payables. They are not designed with the expectation of financing the necessary capital improvements for the Company. These areas need to be -- the funding for these areas need to come from either equity injections from ownership or the acquisition of new debt.

However, in the record from yesterday, it appears that the Company either has an inability or does not desire to access these two other key sources. Hence, all the Company is left with is customer rates. But, unfortunately, customer rates are not designed to finance all areas of the Company's operations.

Q. Thank you for that opinion, Mr. Laflamme. I'm looking at Exhibit 4, data response to Staff 1-4, which is the cash flow statement?

A. (Laflamme) Yes.

Q. Of your opinion that you just gave, are there any numbers here that support that?

A. (Laflamme) I believe that the cash flow statement that was provided by Mr. St. Cyr supports the real crisis with this Company. If you look at the top portion, cash activity from operating expenses, during the year 2012, the Company received $408,616 from operating activities. From -- and, that is primarily customer rates and current operating -- current operating expenses. And, so -- and, the amount that was received by the Company through operating activities was substantially more than what it had received for operating activities in both 2011 and 2010. However, with regards to the investing activities, and that's primarily investment in new plant, and financing activities, which is payment -- debt service payments and monies going back and forth from ownership, you see a -- you see a net outflow of cash in those areas.

What, ideally, for a company that's operating as it should, under the financing activities, there should be monies coming in from new debt, there should be monies -- or monies coming in from ownership. In fact, as was pointed out yesterday, it appears that the ownership is actually withdrawing monies from the Company, which is further exacerbating the Company's cash flow crisis.

Q. I just would like to have you, Mr. Laflamme, comment on, when you said that you don't see funds coming in through new debt, where would that show up on this?

A. (Laflamme) That would show up under "Financing Activities".

Q. Okay.

A. (Laflamme) To finance the -- finance the investments that are made by the Company.
Q. And, the same question regarding ownership contributions, where would those appear?
A. (Laflamme) Those would be under "Financing Activities" as well.
Q. Okay. All right.

CHAIRMAN IGNATIUS: And, this is all on Page 164, correct?

MS. BROWN: Yes.

WITNESS LAFLAMME: I don't have a page number.

MS. HOLLENBERG: Yes.

MS. BROWN: But, yes. The answer is "yes". This is Page 164 of Exhibit 4.

MR. RICHARDSON: I'd be happy to provide the numbered pages to the witnesses. I think that would probably help us all.

MS. BROWN: Thank you.

(Atty. Richardson distributing documents to the Witnesses.)

BY MS. BROWN:
Q. Mr. Laflamme, prior to the amended tax returns, do you have an opinion on whether the Company had a tax

liability?
A. (Laflamme) Prior to its amended returns?
Q. Yes.
A. (Laflamme) The Company was showing a net operating loss carry-forwards for both federal and state.
Q. And, yesterday, did you receive a copy of Exhibit 12, which was IRS Publication 538, and Exhibit 13, which was Publication 542? Did you have a chance to receive and review those?
A. (Laflamme) Yes.
Q. And, I believe these publications were offered in support as to why the Company amended its tax returns?
A. (Laflamme) Yes.
Q. Do you have an opinion as to whether these publications support that position?
A. (Laflamme) I believe that these publications, and the -- and the sections within those publications that were pointed out by Mr. Richardson, do not address that issue. These, the particular sections that were pointed out by Mr. Richardson, have to do with accounting methods. And, specifically, whether a company should record the transactions on its books either under the cash method, the accrual method, or some hybrid that's been authorized by the Internal

Revenue Service, I do not believe that these sections address the reasons or the specific citings for why it is -- why it was appropriate for the Company to amend its tax returns.

Q. Could you remind us why the Company thought it needed to amend its tax returns?

A. (Laflamme) That was based from the prior rate proceeding. And, in that proceeding, Staff and the OCA became aware of payments being made to the shareholders for pension and health insurance. Staff opposed the inclusion of pension and health insurance payments to the shareholders, opposed their reflection in customer rates. So, eventually, the Company agreed with Staff's position, and felt that -- and went further and felt it needed to amend the returns, not only for the test year, 2009, but prior to that, 2007 and '08 as well.

I would also like to point out the fact that, in addition to the pension and health insurance corrections that the Company made to its tax returns, the Company also eliminated interest expense on the debt that the -- the debt from the shareholders, which I don't believe that that issue was even addressed by Staff in its testimony during that case.

Q. Okay. I just want to summarize here. So, are you saying that, with respect to the changes in the rate case, regarding shareholder payments as pension and health insurance, and also elimination of interest expense, that Publications 542 and 538 do not require the Company to amend tax returns if it changes those items, the items being pension and health insurance?

A. (Laflamme) I don't believe that that issue was even addressed in the sections that were pointed out by Mr. Richardson.

Q. Okay. Thank you. Mr. Naylor, have you had a chance to review Exhibits 12 and 13?

A. (Naylor) Yes.

Q. And, do you have an opinion as to whether they support the Company's position that it was required to amend its tax returns?

A. (Naylor) I do. And, I agree with Mr. Laflamme. I don't believe these publications provide the reasoning or the evidence that the Company was required to amend its tax returns, and thus exhaust its operating loss carry-forwards.

Q. From the evidence that you've heard and reviewed, do you have an opinion as to whether emergency rates are warranted in this proceeding?

A. (Naylor) I do.

Q. And, what is that opinion?

A. (Naylor) Well, by law, the Commission is obligated to make decisions that represent an appropriate balancing of the interests between shareholders and customers. By that measure, Staff does not believe that this request should be approved. There are several reasons for that opinion.

First, as I just mentioned, the Company has the burden of proof in this request. But it has not provided any evidence that it was required by law to amend its tax returns, and therefore cause the reduction or exhaustion of its significant operating loss carry-forwards. This is a critical part of the analysis, because it appears the Company deliberately accelerated the exhaustion of those carry-forwards, in order to advance its argument in the last rate case that it was entitled to receive income taxes in its customer rates. Without the proof that the Company was required by law to amend its tax returns, the Company has failed to meet its burden of proof, and its request should be denied on this point alone.

Secondly, the Company has issued what is essentially a dividend to its shareholder, at a time when the Company is in deep financial trouble, and cannot or will not access the capital markets for the financing that it has desperately needed. Whether termed a "dividend" or a "return of capital", such a distribution is imprudent and highly inappropriate. Corporations with this kind of cash flow problem simply cannot issue dividends or other distributions. Such an action looks even worse in the light of fines the Company paid in the Tamworth criminal case, which also served to deplete its cash flow.

MR. RICHARDSON: I'm going to --

BY THE WITNESS:

A. (Naylor) Thirdly, --

CHAIRMAN IGNATIUS: Well, hold on please. Mr. Richardson.

MR. RICHARDSON: You know, the fines are not, I don't think, a material issue. And, I just don't want to have to go back and, you know, go over an issue that relates to, you know, the Tamworth case in 2000. And, it's -- I just think it's, you know, we're now going into an area that is, I think, beyond what's already, you know, in the areas that were suggested that Staff's testimony would cover.

CHAIRMAN IGNATIUS: Well, let me ask this. Is your reference to the Tamworth situation because of them being fined in a criminal matter or because of a cash flow issue?

WITNESS NAYLOR: It's a cash flow issue.

CHAIRMAN IGNATIUS: All right. Then, let's just -- why don't we talk about cash flow of whatever sort, wherever it comes from, without any of us being concerned about what the underlying circumstances are.

MR. RICHARDSON: Yes. And, if I could just explain, I mean, it's my understanding, and I wasn't involved in the case, but, you know, effectively, the issue was that the Company connected a well in Tamworth --

CHAIRMAN IGNATIUS: Mr. Richardson, you're going where you just said you didn't want to go.

MR. RICHARDSON: Okay. Well, I just feel --

CHAIRMAN IGNATIUS: My request to everyone is, if there's issues of cash flow, whether they have to do with paying penalties, paying past accounts payable, operating expenses, debt service, whatever they are, let's focus on the cash flow. And, you know, how we got to that point is -- maybe not be that material. But I think if it's -- what I took from your comment was, in the context of a company strapped for cash, any distributions make it more difficult, and that was one circumstance why the Company was strapped for cash. Now, is that fair? I mean, I don't care about the prior case. It's over and done with. It's not important to me.

MR. RICHARDSON: That's fine. And, we understand that's the issue. I just -- and I'll continue to object, to the extent we, you know, we go into this. Because, you know, I would then want to bring a witness on to explain, you know, that this was, you know, not a serious criminal issue.

CHAIRMAN IGNATIUS: I don't think -- but, Mr. Richardson, are you disputing that there was an obligation to pay fines?

MR. RICHARDSON: No. No.

CHAIRMAN IGNATIUS: And, the Company has succeeded in paying those fines? Right?

MR. RICHARDSON: That's correct.

CHAIRMAN IGNATIUS: So, I don't -- Mr. Naylor, if your intent is to make us think ill of the Company because of that prior case, don't go there, because that's over and done with, and it's really not relevant. And, it's only as it relates to cash demands. And, I think that's what I took your testimony to be. If anyone needs to be reminded of that, we're not concerned about that old case. It's over and done with, except that it creates a financial -- it created a financial pressure on the Company into 2012, 2011, when it was finally paid off. When was it?

WITNESS NAYLOR: We heard testimony yesterday that the Company, within the last few months, had completed the payment of that fine. I believe the fine was payable over a three-year period. It was in excess of $100,000. It is a very significant issue. Because, if you look back at the Page 164 of the Exhibit 4, the cash flow statement, and just below the midpoint of the page, "Investing Activities, Purchase of Plant and Equipment", you see that, for three years, the numbers are a little over 132,000 for 2012, 118,000 for 2011, 107,000 for 2010. For a three-year period, the Company invested just over $300,000 in new plant. That's why $110,000 to pay a fine is a very significant part of the cash flow puzzle.

So, my comments are not to further disparage the Company with respect to that matter. But, to point out, it is a very significant issue, as is the distribution to the shareholder. It's huge, a huge issue.

BY THE WITNESS:

A. (Naylor) The third point that I was making with respect to Staff's recommendation that the filing be rejected is cash flow problems that this Company is experiencing are simply not appropriately solved by asking for a ratepayer bailout. It is the shareholders of a utility who must adequately capitalize the utility. This Company earned a very solid rate of return in both 2011 and 2012, which, as Mr. Laflamme just indicated, is clear evidence that the current customer rates are adequate and appropriate. That the Company is cash-starved is not a burden to be placed on customers. The Company's returns indicate that the customers are already paying appropriate compensatory rates.

If the shareholder is unwilling or unable to adequately capitalize this utility, the utility's assets need to be transferred to owners who have the ability and the willingness to do so.

Further, the Company's request in this proceeding raise the question "well, when is the next emergency requiring a ratepayer bailout?" If the arguments about "impairment of the Company's ability to provide service without this emergency relief" are accepted, what other contingencies may arise that that would also lead to this request, a similar request in the future? Especially in light of the Company's inability or unwillingness to access capital, as all utilities must do. This cycle may never end until this utility is adequately capitalized.

To that end, I would provide a quote from the Commission's order in Lakes Region Docket DW 07-105. It's from Order 24,877, issued on July 25th of 2008. On Page 8 of the order, the Commission said "We consider the ability to raise capital on reasonable terms in order to implement capital improvements to be a cornerstone of any evaluation of a public utility's capabilities."

BY MS. BROWN:

Q. And, Mr. Naylor, is that the extent of your opinion on emergency rates?

A. (Naylor) Yes, it is.

MS. BROWN: Staff has no further questions on direct.

CHAIRMAN IGNATIUS: All right. Mr. Richardson.

MR. RICHARDSON: I would prefer to follow OCA's cross, if that's okay, because I assume that would be a friendly cross?

CHAIRMAN IGNATIUS: All right. That's fair. Ms. Hollenberg?

MS. HOLLENBERG: Sure. Thank you. I don't think I have many questions.

CROSS-EXAMINATION

BY MS. HOLLENBERG:

Q. I'd like to ask a question about the fine, but, again, not going to the behavior underlying the fine. And, only, if I may, and I'll ask the question and I'll give counsel an opportunity to say whether or not he would object to it. But my question is, Mr. Naylor, is the point of your reference to the fine to illustrate that the Company is making certain choices about how it's using its cash flow?

A. (Naylor) Well, I guess that's a -- I think that's sort of an outgrowth of the facts. But, really, the point I'm making is that this is an under-capitalized utility. It's cash flow has been severely constrained by other issues that are not related to operations, in terms of the day-to-day operation of the utility. Payment of a fine, a distribution to shareholder, those are significant events that have put the Company into this situation that it's in, such that it's seeking emergency rate relief. So, it's that aspect of it that I raise the issue.

MS. HOLLENBERG: May I just have a

moment please?

CHAIRMAN IGNATIUS: That's fine.

BY MS. HOLLENBERG:

Q. Mr. Naylor or Mr. Laflamme, you were here yesterday and during the testimony of the Company's witnesses. Would you agree that there -- you heard testimony about the Company's -- what the Company describes as an "inability to obtain financing". Do you recall discussion about that?

A. (Naylor) I do.

Q. And, I mean, I think one of the things the Company said that struck me, and I wonder if I could get your sense about it, was the fact that obtaining financing at this point is too risky for the Company to engage in. Is that -- do you recall Mr. Mason making a statement to the effect that, you know, "I'm not going" -- there were a couple of reasons why he wouldn't obtain financing, and one was because the repayment from customers isn't the same as the repayment he's required to make to the lender. And, then, the other reason being that he would have to get -- make personal surety with his home. What's your response to statements like that?

A. (Naylor) Well, it goes to the heart of the issue, I think, with respect to capitalization. Utilities across the board must be adequately capitalized. They must have access to outside capital. They must access capital on a regular basis to support their capital improvements. That is for a number of reasons, not the least of which is, the capital structure and the rate base should be in close balance. So, it goes to the heart of the issue here.

That the Company has funded almost entirely its capital improvements over the last several years out of its current cash flow, out of its revenues from customers. And, that's not a healthy situation. They must have access to outside capital to survive.

Q. Thank you. How about, the other issue that I just wanted to ask you about is, there was talk yesterday, there was a lot of reference to the position that "a company cannot pay an expense unless that expense is a line item in the calculation of its revenue requirement." And, I believe it was that -- the Company's position that "we can't pay this, one of the reasons we can't pay this tax expense is because the Commission didn't allow us to have this as a line item in the calculation of our revenue requirement in the last rate case." What is your response to that?

A. (Naylor) Well, the Commission did deny their request for recovery of state and federal income taxes in the rate case. That doesn't mean that, under normal circumstances, meaning the Company has access to outside capital and is funding its Capital Improvements Program primarily with outside capital, and perhaps making different decisions about shareholder distributions and so forth, that it would not have the ability to react to something like an expense that was unexpected, an expense that was not specifically included in the revenue requirement in its last rate case. Things happen all the time. Costs change, costs go up, emergencies, you know, system failures, well failures, all kinds of things happen. A utility has to be able to respond to these and have the financial strength to respond to them. So, that's really the essence of that issue.

And, the calculation of the Company's 2012 rate of return shows that, on a pro forma basis, under normal circumstances, it would be able to pay the income taxes, if the carry-forwards had not been exhausted or virtually exhausted.

Q. And, would you agree that, just because an item or an expense isn't included as an express line item in the calculation of a revenue requirement that the utility is prevented from making payments out of its cash flow or otherwise out of its revenue?

A. (Naylor) I agree. And, I think Mr. Laflamme wanted to add something to the previous question.

A. (Laflamme) Yeah. I would just like to point out that the Company's rate of return calculation, in its response to Staff 1-3, the net operating income reflected in that schedule was after state and federal income taxes. So, even after recognizing the state and federal income tax expense, the Company was still earning an adequate rate of return.

MS. HOLLENBERG: Thank you. One moment please.

(Atty. Hollenberg conferring with Mr. Eckberg and/or Ms. McFarland.)

MS. HOLLENBERG: I don't have any other questions. Thank you.

CHAIRMAN IGNATIUS: Thank you. Mr. Richardson.

BY MR. RICHARDSON:

Q. I want to address, before I forget --

MR. RICHARDSON: Can you hear me in the microphone?

CHAIRMAN IGNATIUS: Yes.

MR. RICHARDSON: Okay.

BY MR. RICHARDSON:

Q. Mr. Naylor and Mr. Laflamme, you both testified, and let me see if I -- I have here on my notes from you, Mr. Laflamme, you said "the Company has an inability or", and what I've got in my notes here in quotes, "does not desire to acquire new debt." And, I hope I have that correct. Does that sound about like what you said?

A. (Laflamme) Yes.

Q. Did you hear Mr. Mason say yesterday or anyone say yesterday that "the Company doesn't desire new debt"?

A. (Laflamme) What I took from his testimony was that he does not, with regards to the terms that have been offered to the Company, he does -- he refuses to access debt under the terms that have been offered to him.

Q. Okay. But my question was "did Mr. Mason say that or you inferred that?"

A. (Laflamme) I inferred that from his -- from his testimony.

Q. Now, with respect to terms of debt, I mean, you agree that every company has to evaluate whether or not it can repay a note, right?

A. (Laflamme) Yes.
Q. And, you also heard Mr. Mason say that he's had ongoing discussions with TD BankNorth?
A. (Laflamme) Yes.
Q. And, that was to acquire new debt?
A. (Laflamme) Yes.
Q. And, also with, I'm not familiar with them, but CoBank was another banking institution, is that right?
A. (Laflamme) I don't remember that, but --
Q. Okay. But you recall Mr. Mason saying that he was having discussions trying to acquire new debt?
A. (Laflamme) Yes.
Q. So, then, it really comes down to whether or not the debt's affordable and can be repaid?
A. (Laflamme) Yes. But it appears that the Company has a recent history of turning down debt that has a favorable -- favorable loan terms, especially that offered through the State Revolving Fund through DES.
Q. Right. But that wasn't my question. I mean, the question was whether or not the Company had somehow stated that they didn't desire new debt? And, I think the evidence was that they were seeking it?
A. (Laflamme) Yes.
Q. And, there was just a disagreement about whether the

terms were favorable or not?
A. (Laflamme) Yes.
MS. HOLLENBERG: Can I have a moment to ask counsel a question please?
CHAIRMAN IGNATIUS: All right.
MS. HOLLENBERG: I know that's a little awkward.
CHAIRMAN IGNATIUS: No, that's okay.
MS. HOLLENBERG: May I ask you a question, just to --
MR. RICHARDSON: Sure.
(Atty. Hollenberg and Atty. Richardson conferring.)
MS. HOLLENBERG: Okay. Thank you.
BY MR. RICHARDSON:
Q. Is it unreasonable for a water company to want to ensure that it has the ability to repay whatever debt it acquires?
A. (Laflamme) Yes.
Q. It is unreasonable?
A. (Laflamme) Oh, I'm sorry. Could you restate the question.
Q. Is it unreasonable for a Company to want to ensure that it has the ability to repay debt on the terms of the

note?

A. (Laflamme) Is it unreasonable?

Q. That's right.

A. (Laflamme) No.

Q. Okay. Thank you. Mr. Naylor, do you disagree with Mr. Laflamme's responses to those questions?

A. (Naylor) Well, I recall the testimony perhaps a little bit differently. And, the transcript ultimately will show what was said yesterday. But I recall Mr. Mason saying something along the lines of "it isn't happening", meaning that he found the terms of potential loans to be unacceptable. And, I believe he was referring specifically to the mismatch that can often happen with respect to the term of the loan and the composite lives of the underlying assets that that loan ultimately pays for. That can be an issue with smaller companies, it is a bit of a cash flow mismatch. However, many other companies deal with that quite effectively.

Q. But isn't that a distinction between whether the Company is able to acquire debt on terms it can repay, versus whether or not it is willing to acquire new debt?

A. (Naylor) Well, --

Q. Let me rephrase the question.

A. (Naylor) No, I understand your question. I don't agree with the premise of your question. It's a bit off the mark. Yes. The Company clearly has to obtain financing at a price that is reasonable, both for its repayment terms and for its impact on customers. That's part of the analysis the Commission would go through when evaluating the Company's request for financing.

Q. Uh-huh.

A. (Naylor) The issue is, the Company -- we've been talking about a financing with this Company for the last five or six years. And, it's simply not -- the Company is unbankable at this point with its balance sheet the way it is. So, I mean, we can debate the specifics of, you know, how -- what loans are acceptable, what terms are acceptable. The fact is, the Company has simply not, for a number of years now, had access or availed itself of access to capital. And, that's a significant problem, and it's a very large factor in this emergency rate request.

Q. Do you disagree that the Company is trying to acquire new debt?

A. (Naylor) We can only go by what the Company has

testified yesterday.
Q. And, do you disagree with that?
A. (Naylor) I have no knowledge one way or the other. I can only go by what the Company said on the witness stand yesterday.
Q. Okay.
A. (Naylor) I don't know. We've heard that the Company was acquiring ARRA loans in the 2009 ARRA Program. The Company ultimately turned down the opportunity for that money. It turned down the opportunity for State Revolving Loan funds. So, --
Q. But I thought I heard you say that "the Company wasn't willing to acquire debt", and it really comes down to the terms, doesn't it?
A. (Naylor) I said "unwilling or unable".
Q. Okay. But, as far as we know, the Company is unable -- is willing, excuse me, if it can get terms that it can repay?
A. (Naylor) We can only go by what the testimony of the Company's witnesses was yesterday. I can't possibly have an opinion, I'm not -- I don't know. I have no knowledge of -- specific knowledge of who the Company has talked to, how extensive the Company's efforts has been to acquire debt.

Q. Okay.
A. (Naylor) I only can go by what the Company said yesterday on the witness stand.
Q. Okay. So, then, you don't have a basis for concluding whether or not the Company is really "unwilling"? You don't --
A. (Naylor) I absolutely do have a basis. I heard what Mr. Mason said on this witness stand yesterday. He said "it's not happening." He doesn't want to put his house -- put his house up for collateral. He's unwilling to accept the loan terms that apparently have been offered at various times. He said "it wasn't happening", Mr. Richardson. I heard him say it.
Q. You agree with the general proposition that's in Mr. Mason and Mr. Dawson's testimony, that there's 1,643 customers divided over 17 water systems?
A. (Naylor) I know that to be a fact, yes.
Q. Okay. And, so, that's fewer than a 100 per system, on average?
A. (Naylor) Yes.
Q. Each one having its own source of supply, right?
A. (Naylor) Correct.
Q. Pumping? Treatment?
A. (Naylor) Correct.

Q. So, that's a pretty challenging environment to operate in financially, isn't it?

A. (Naylor) We've been talking about this issue for a number of years now, going back to '06 and '07, when a number of issues began to arise. And, here we are, in early 2013, and we're still talking about the same things. You know, how long can the Commission go with accepting that "Oh, it's difficult to run this Company, these systems." I mean, it's just -- it's no longer a reason. And, it's certainly not a reason to ask customers to pay more than the compensatory rates they're already paying.

Q. Let's get to that. But let me go back to the question that I was trying to get at. It's very challenging. And, I think, if you recall, in the 10-141 case, I showed you a document, you know, "The Small Water System Dilemma", and I can pull it out. But do you remember what that document was?

A. (Naylor) I do.

Q. And, I believe you agreed that all of the challenges facing small water systems were present in the Company's system?

A. (Naylor) I agree that there are many challenges in companies operating small systems. The Commission over many years has recognized that there are many challenges in operating small systems. That is why the Commission has made a number of changes in the way it regulates small companies, through the use of step adjustments, allowing for some year-end treatment of rate base with respect to non-revenue producing assets. A number of different things the Commission has done --

Q. So, --

A. (Naylor) -- to help companies address the problems of the challenges of running small companies.

Q. So, let me cut to the chase. Those limited revenue opportunities or those challenges, however you would like to characterize them, those are all things that Mr. Mason has to take into account when deciding whether or not he can get financing?

A. (Naylor) Well, I'm sure it's something that he has to take into account, but it ultimately cannot be an impediment to the acquisition of reasonably priced capital.

Q. Thank you. Mr. Laflamme, do you agree that the Company is liable for income taxes in 2012?

A. (Laflamme) Yes.

Q. And, going forward in 2013 as well?

A. (Laflamme) 2013 hasn't been completed. We don't know

what the -- what the tax liability will be for 2013.
Q. Uh-huh. But, all other things being equal, that's likely, if it exists in 2012, there's a good chance it will exist going forward?
A. (Laflamme) If operations and revenues remain as they were in 2011 and 2012, then, yes.
Q. Uh-huh. Okay.
A. (Laflamme) But 2013 hasn't been -- we're only in March.
Q. Well, let me ask you this then. You would agree that, wouldn't you, I assume, that, in 2012, the Company can't claim a net operating loss deduction for a pension expense that no longer exists on its books, right?
A. (Laflamme) In 2012?
Q. Yes.
A. (Laflamme) If the Company isn't reflecting a pension expense on its books, then, no, it can't claim it as a deduction.
Q. Okay. And, let me show you, do you have, I don't know if it's --

MR. RICHARDSON: Is Publication 542, is that Exhibit 12 or 13?

CHAIRMAN IGNATIUS: That's 13.

BY MR. RICHARDSON:

Q. Do you have that in front of you?
A. (Laflamme) Yes.
Q. Do you see on Page 8, in the first paragraph under "Accounting Methods", it says "Taxable income should be determined by using the method of accounting regularly used in the keeping of the corporation's books and records"?
A. (Laflamme) Yes.
Q. Have I read that correctly?
A. (Laflamme) Yes.
Q. So, to me, that suggests that, once the Company has reduced the operating loss on its books, as a result of the pension, it can no longer claim it in 2012 as a reduction against its taxes?
A. (Laflamme) In the context of the subject matter, it does -- it does not speak, what you wanted out, does not speak to that issue. The subject matter on Page 8 has to do with accounting method, whether a company uses the cash method of accounting, the accrual method of accounting, or another method of accounting authorized by the Internal Revenue Service. It does not speak to whether it is appropriate to deduct one expense or another.
Q. But the Company is going to get itself into some

trouble, I would assume, if it tries to claim a net operating loss for an item that isn't properly considered an expense, right?

A. (Laflamme) Are we still speaking in the context of Page 8 of Publication 542?

Q. Well, I think Staff has focused, and in your testimony you stated on direct, that none of these provisions required the Company to amend its prior returns. Did I --

A. (Laflamme) I'm just not sure what context you're speaking with regards to. Are you speaking with regards to accounting method or -- I'm not certain of what the context of the question is.

Q. Okay. Let's try to get to the context. You stated on direct that none of these publications that we've referred to required the Company to amend it's prior returns, right?

A. (Laflamme) You pointed out --

Q. No, no, no. This is a "yes" or "no" question. Is that what you testified to on direct? That none of these provisions required the Company to amend its prior returns?

A. (Laflamme) With regards to the subject matter, no.

Q. So, that wasn't what you testified?

A. (Laflamme) Could you restate the question.
Q. Okay. I'm trying to remember --

CHAIRMAN IGNATIUS: Can I? I think the difference is, that you're -- he's referring to the section on Page 8, and you're referring to none of the publications.

MR. RICHARDSON: Okay.

CHAIRMAN IGNATIUS: The totality of the documents, versus the page you highlighted.

MR. RICHARDSON: All right. Okay. I understand now.

BY MR. RICHARDSON:

Q. But, Mr. Laflamme, it's your position that none of these publications state that the Company was required to go back and amend its returns?
A. (Laflamme) I only reviewed the sections of the publications that we were directed to review.
Q. But the issue I'm trying to get at is is, if the Company has, as you had suggested, eliminated an expense from its books, isn't it true that it can no longer claim a loss based on that expense?
A. (Laflamme) If the expense was eliminated from its books, then the Company would not -- should not claim that deduction on its tax returns.

Q. Okay. So, regardless of whether the tax returns were amended or not, you know, the Company has a tax issue in 2012?

A. (Laflamme) Yes.

Q. Thank you. Mr. Naylor or Mr. Laflamme, is it your understanding that it's typical for a company to approach the IRS after it's determined what it's tax liability is? In other words, you can't work out a payment plan until you tell the IRS "here's what our liability is"?

A. (Laflamme) I think my opinion is that the -- the Company can approach the IRS at any time that it becomes aware that it is facing a liability that it cannot meet.

Q. Uh-huh. But the IRS is likely to say "well, why don't you tell us what your liability is, and then we'll address how to pay for it", right?

A. (Laflamme) In most circumstances, yes.

Q. Okay. And, what is your experience? And, I ask this because I don't know, honestly. How much work have you done in this area?

A. (Laflamme) I'm familiar with dealing with the IRS from a prior employment with a public accounting firm.

Q. Okay. And, that was? I'm just curious what the firm was?

A. (Laflamme) Driscoll & Company.

Q. Okay.

A. (Laflamme) Littleton, New Hampshire.

Q. Okay. All right. Well, and I thank you for that clarification, because I think that's really, you know, the most critical piece in talking to the IRS is understanding what the liability is. Right?

A. (Laflamme) Yes.

Q. And, the IRS wouldn't agree to anything or you wouldn't expect them to without a return in their hands?

A. (Laflamme) Probably not.

Q. Okay.

A. (Laflamme) But I don't think that would bar communication with the IRS either, initiated by the Company.

Q. Uh-huh. Have you had a chance to talk with Mr. Roberge about whether he has approached the IRS?

A. (Laflamme) There were two data requests from Staff asking if there had been communication with either the IRS or the State of New Hampshire.

Q. Uh-huh.

A. (Laflamme) And, the responses to each of those was a flat "no".

Q. Yes. Okay.

MR. RICHARDSON: I'm going to have to, I just realized, based on this response, you know, subsequent to the response to the data requests, Mr. Roberge, I believe, contacted the IRS as a follow-up. And, it hadn't occurred to me until now, but I believe there's a duty under the Commission's rules to update data responses, you know, until the close of the record at least. And, maybe the easiest thing for me to do is is to just inform the Commission that, you know, a contact has been made. There hasn't been any agreement or anything of that sort. I don't think it's a -- I don't think it's a material change to the response, just a subsequent event. And, you know, as of, obviously, as of the date of the response, there have been no communication.

CHAIRMAN IGNATIUS: So, when was the communication made?

MR. RICHARDSON: Last week.

CHAIRMAN IGNATIUS: What day?

MR. MASON: I'll have to find out. I'm not sure.

CHAIRMAN IGNATIUS: And, who made the communication?

MR. RICHARDSON: Mr. Roberge did.

CHAIRMAN IGNATIUS: And, who did he speak to?

MR. RICHARDSON: He told me that he spoke with an agent at the IRS who he knew. And, it was primarily asking about amending the returns and the tax liability. I only, you know, I only stumbled on to this, obviously, just now, and realizing that there was a data response out there.

CHAIRMAN IGNATIUS: All right. But it wasn't -- what you just said it was about, amending returns and tax liability, was it about -- did it also involve how one might enter into an arrangement to make some payments and be in good standing?

MR. MASON: I don't know.

MR. RICHARDSON: I don't know either.

CHAIRMAN IGNATIUS: Well, why don't you get, if you're going to update it, let's get some real information.

MR. RICHARDSON: Okay. All right. That's fine.

MS. HOLLENBERG: I'd like to just make a comment right now. Because I know, when I asked several questions yesterday of the Company's witnesses if there had been any contact with the IRS or the Department of

Revenue Administration, and the responses were "no". So, not only -- and I wasn't even familiar with this data response when I asked the question. And, so, that was a fact that came out in the testimony yesterday. And, now we're hearing this morning that that fact is not, in fact, correct. So, I'm just laying that out there.

MS. BROWN: And, I'd also like to echo that, because Staff had also asked Mr. St. Cyr to update 1-1. So, we have testimony in the record from Mr. St. Cyr saying, as of yesterday, there had been no contact. And, if Mr. Roberge had made contact last week, but hadn't told anybody, if you could just document that, that would be great.

MR. RICHARDSON: Well, that is, that's what happened. That was the dilemma, as Mr. St. Cyr testified. But he had no knowledge that Mr. Roberge had followed up, so.

CHAIRMAN IGNATIUS: All right. It's a little frustrating, Mr. Roberge was sitting there, and on a number of other issues he was prepared to answer questions, and I actually asked him to hold off until we got to that point. But it doesn't sound like he spoke up on that one, and I --

MR. RICHARDSON: Well, and understand as

well, I spent half the day thinking that the OCA was going to call Mr. Roberge as a witness, so that would have been an opportunity to clarify that. And, you know, this is really, I don't think the fact that communication occurred last week is, you know, going to change the fact that the Company didn't have any prior responses. And, obviously, we've heard the witnesses state that, you know, a material consideration is the actual tax liability and return.

CHAIRMAN IGNATIUS: All right. Let's move on.

MR. RICHARDSON: Thank you.

BY MR. RICHARDSON:

Q. Mr. Laflamme, another kind of follow-up question from your direct, and I want to kind of get through those, before we get into the kind of planned questions. You talked about a calculation of a rate of return -- or, excuse me, yes, a rate of return that was in the 12 percent area. Is that -- did I understand correctly?

A. (Laflamme) Yes.

Q. Have you performed a written calculation of that?

A. (Laflamme) Yes.

Q. You have that in front of you, I assume?

A. (Laflamme) I have that in front of me, yes.

Q. All right. Do you mind if I see that?

MR. RICHARDSON: May I approach?

CHAIRMAN IGNATIUS: That's fine. You can ask him about it as well.

MR. RICHARDSON: I was taught in law school to never ask a question you don't know the answer to.

CHAIRMAN IGNATIUS: And, just a moment ago you said "I don't have the answer" to a question you asked.

MR. RICHARDSON: Yes. Well, I know, and my follow-up was going to be "I've already violated that rule a hundred times over.

CHAIRMAN IGNATIUS: Yes.

MR. RICHARDSON: But maybe 101 would be the big mistake.

I'm not going to be prepared to break all this down. And, I've already got, you know, a line of questions going towards some of these items, based on Mr. St. Cyr's testimony and schedules. But what I'd like to do is perhaps just mark this for identification, in case we need it in the record, in case I need to respond to the "12 percent". And, then, we can, you know, we'll reserve the right to object to its admission as a full exhibit.

CHAIRMAN IGNATIUS: I'm a little lost by that.

MR. RICHARDSON: Well, --

CHAIRMAN IGNATIUS: You want to put it in, but then you may object to it being introduced or actually admitted to the record?

MR. RICHARDSON: Right. I don't think I can -- I don't want to take the Commission's time for me to -- I don't want to waive my right to look at this. And, then, perhaps if we have, you know, written comment or argument later, after the break, at some point in this proceeding, we'd like to be able to look at the assumptions. I don't know whether we would agree to this as a full exhibit at this point, just because, you know, it's come -- the way it would come in. Obviously, Staff didn't offer it.

CHAIRMAN IGNATIUS: Then, why are you trying to put it in? I guess I'm not following.

MR. RICHARDSON: What I'd like to do is have a copy of it, so that I could later introduce it into evidence, if it needs to be.

CHAIRMAN IGNATIUS: Well, that's fine. That's a very different question.

MR. RICHARDSON: All right. Well, can

we make that request, that the witness provide a copy? I don't know if he has an extra or this is his only one.

CHAIRMAN IGNATIUS: We'll copy it right now, for all the parties.

MR. RICHARDSON: Thank you.

BY MR. RICHARDSON:

Q. Now, Mr. Laflamme, you would agree with me that a tax expense is a legitimate cost of operations, right?

A. (Laflamme) Yes.

Q. And, that wasn't an expense that was included in the Company's most recent approved rates?

A. (Laflamme) There was no tax provision in the rates approved by the Commission in DW 10-141.

Q. So, if the Company were to pay the tax, that money would have to come from rates that were intended for something else, right?

A. (Laflamme) The Company would have to pay the tax from the rates that were approved by the Commission.

Q. Uh-huh. And, so, there were various, you know, operating expenses, there was a return on investment, a return on equity, as it were, debt. There's a variety of components that go into the rate calculation, right?

A. (Laflamme) Yes.

Q. And, there was none for tax in the rates?

A. (Laflamme) Correct.

Q. And, so, if the Company pays the tax, it's taking money away from rates that were intended for something else, right? I mean, just philosophically?

A. (Laflamme) The rates are intended to fund the Company's current operations. There are -- the rates are based on a pro forma test year, and there are -- there are expenses. There are inevitably expenses during the test year that the Company does not recognize in subsequent years. There are expenses that are not reflected in the test year that the Company will recognize in subsequent years. It's a very -- I think where you're heading is a very, very shaky subject area.

Q. Uh-huh. But I -- I understand. I was, actually, my follow-up question to you was that there are several options. I mean, one thing the Company could do is, you know, minimize different operations expenses, right? I mean, that would be one source of funds that could pay the tax?

A. (Laflamme) Yes.

Q. Another would be, you know, to take away from earnings, I assume, based on your testimony, you'd heartedly agree with that?

A. (Laflamme) Take away from earnings?
Q. Yes. You had made reference to the -- what Mr. St. Cyr classified as the "reduction in paid-in capital, the $123,000, right?
A. (Laflamme) Yes. Which would essentially have paid for the tax liability.
Q. But do you -- you recognize that the capital improvements that the Company made, I believe it was 130,000 and something in 2013 -- or, 2012, excuse me? Do you recall Mr. Dawson's discussion of those improvements?
A. (Laflamme) I recall him discussing it. As far as specifics, --
Q. Yes.
A. (Laflamme) -- you'd have to remind me.
Q. And, I believe what his conclusion, if I recall correctly, was is that, "if the Company were to take away or not fund those improvements, it would essentially impair service." Do you recall that?
A. (Laflamme) Yes.
Q. And, do you have any reason to doubt his conclusion?
A. (Laflamme) No. If the Company took funding away from system improvements, it would only make sense that it would impair the Company's operations. But, as I

indicated, the rates that were approved by the Commission are not meant to fund capital improvements by the Company. There needs to be sources of outside capital in order to do that.

Q. Right. But would you agree with me that there are some improvements a company has to make in order to meet its legal obligation to provide service that's just and reasonable or reasonably safe and adequate?

A. (Laflamme) Yes.

Q. And as well as to meet DES requirements?

A. (Laflamme) Yes.

Q. And, you're not aware of anything that would suggest that those capital improvements weren't intended for those purposes?

A. (Laflamme) I have no reason to believe not.

Q. Uh-huh. And, going forward, I mean, if you look at the last page of Mr. Dawson's testimony. Do you have that in front of you? I believe he's Exhibit 2. I can locate one, if you don't.

A. (Laflamme) I have his testimony.

Q. He's, you know, at least for budgeting purposes, it looks like he's planned or the Company's planned about $230,000 in capital improvements it believes will be required going forward.

A. (Laflamme) This is from Exhibit 2 of Mr. --
Q. Yes. The last page. It's on Page 33. "Capital Asset Budget 2013" is what it says on top.
A. (Laflamme) So, it's "Dawson Exhibit 6"?
Q. Yes.
A. (Laflamme) Okay.
Q. I mean, do you have any reason to doubt or to believe that the nature of these systems is going to change such that they no longer require a continuous reinvestment of capital?
A. (Laflamme) Based on what the Company has indicated, I have no reason to doubt, to doubt that.
Q. Uh-huh. And, that's to meet the same legal duty to provide service that's reasonably safe and adequate?
A. (Laflamme) Yes.
Q. Okay. I guess, what other source of funds do you think, you know, a group of small water systems like this could access to execute these problems, other than customer revenues?
A. (Laflamme) As I indicated previously, it's imperative for a utility to have access to outside capital sources, either infusions from ownership or debt capitalization from financing institutions.
Q. Uh-huh. But we're not dealing with, you know, a

Pennichuck or an Aquarion. I mean, are financial institutions, you know, seriously interested in loaning money to water systems that serve fewer than 100 customers? Is that a good investment?

A. (Laflamme) I cannot answer that question.

Q. Well, --

A. (Laflamme) It's a facts and circumstances -- it's a facts and circumstances scenario. And, if you're talking specifically about -- I can't answer that question.

Q. So, you don't know then whether systems like Lakes Region's are financeable by anybody? I mean, this is a fewer-than-100-customers per system. And, if you don't know whether those types of systems are, you know, investment grade or not, I mean, how can you reach the conclusion that the Company's not doing an adequate job to find sources of funding?

A. (Laflamme) I think the fact pattern goes beyond the size of the utility. And, it also, as Mr. Naylor pointed out, the Company's balance sheet, as it presently exists, makes it virtually unbankable.

Q. Uh-huh. But isn't, you know, you would agree with me, as water systems get smaller and smaller, they get riskier, in terms of their investment returns or their investment strength?

A. (Laflamme) All the water systems are different. And, you're asking me to give a general opinion. And, it's -- to me, the answer basically lies with the facts and circumstances relevant to particular water systems.

Q. So, then, you've -- the nature of the assets the Company is operating might play a fairly significant role in its ability to obtain financing and the nature of financing that it can obtain?

A. (Laflamme) That would be part of the equation.

MR. RICHARDSON: Would this be a good time to take a break? Because the next area I want to go into is some of the questions that Commissioner Harrington raised, and he's not at the table right now.

CHAIRMAN IGNATIUS: I think -- I know he'll be right back.

MR. RICHARDSON: Okay.

CHAIRMAN IGNATIUS: I think we do need to take a break for the sake of the court reporter. And, so, that's fine. Let's -- it's just after 10:30. Let's try to resume at 10:45. Thank you.

MR. RICHARDSON: Thank you.

(Whereupon a recess was taken at 10:35 a.m. and the hearing resumed at 10:51

a.m.)

CHAIRMAN IGNATIUS: All right. We're back from a break. And, Mr. Richardson, you have more questions.

MR. RICHARDSON: Thank you.

BY MR. RICHARDSON:

Q. Mr. Laflamme, you said, I believe on direct, that "the earnings were sufficient to allow the Company to earn its allowed rate of return." And, then, immediately after that, you said -- my mike was off, sorry. You said "the problem is one of cash flow."

A. (Laflamme) Yes.

BY MR. RICHARDSON:

Q. Do you recall that?

A. (Laflamme) Yes.

Q. Why don't we -- let's start with the allowed rate of return. And, I want to ask you questions about what's included in that calculation and what's not. And, I believe that's Mr. St. Cyr's response to Staff 1-3 in Exhibit 4.

CMSR. HARRINGTON: I'm sorry, what was that again?

MR. RICHARDSON: So, I'm going to go, with the benefit of the pages now, to Page 162.

CMSR. HARRINGTON: In Exhibit 4?

MR. RICHARDSON: In Exhibit 4, correct.

CMSR. HARRINGTON: Thank you.

MR. RICHARDSON: Thank you.

BY MR. RICHARDSON:

Q. Do you have that in front of you?

A. (Laflamme) Yes.

Q. Okay. So, the net operating income number is "$211,781", and that is something that you're -- that's being applied to the total average rate base, right?

A. (Laflamme) Correct.

Q. And, that results in the 8.717 percent actual rate of return shown there?

A. (Laflamme) Yes.

Q. And, that was $7,083 above the allowed rate of return?

A. (Laflamme) Yes.

Q. Okay. Now, that's a total amount of cash that has to cover a variety of things. And, one would be payment on interest on debts, right?

A. (Laflamme) What are you talking about?

Q. Well, I guess --

A. (Laflamme) I'm not sure what number you're referring to.

Q. This is -- I'm sorry, "211,781", I want to figure out what that can be used for. And, why don't we do this. Why don't we go to the schedule where that figure is derived. And, would you agree with me that, if you go to Page 167, you can see where that number is calculated?

A. (Laflamme) Is this the Company's response to Staff 1-5?

Q. That's correct. Exhibit 1, Page 2.

A. (Laflamme) "Statements of Operations and Retained Earnings"?

Q. Uh-huh.

A. (Laflamme) Okay. Yes.

Q. Okay. Now, you see, as you walk through this schedule on Page 167, there's a line item for "Interest Expense"?

A. (Laflamme) Yes.

Q. "73,419"?

A. (Laflamme) Yes.

Q. Okay. And, so, and that represents, for example, the TD Bank loan, is that right?

A. (Laflamme) Probably, yes.

Q. Do you know approximately how much the Company's loan to TD Bank was in 2012?

A. (Laflamme) I don't know off the top of my head.

Q. Okay. But, then, so, you deduct that, and then you arrive at net income of 142,617, right? That's what's shown on the schedule here?

A. (Laflamme) Yes.

Q. Okay. So, it wouldn't be accurate to say the 211,000 is, you know, was available to pay taxes. We're now down to 142,617?

A. (Laflamme) 211,000 is after taxes. It's after income tax expense.

Q. Okay.

A. (Laflamme) So, taxes should have been paid before --

Q. Okay.

A. (Laflamme) -- the 211.

Q. Okay. But this is all a calculation of revenues that are derived from rates, from the rate calculation, right?

A. (Laflamme) All it says is "Operating Revenues", the majority of which is probably through rates. But the Company also provides services as well, --

Q. Uh-huh. Yes.

A. (Laflamme) -- which are also included in operating income.

Q. So, it appears Mr. St. Cyr has calculated $97,949 for the "Provision of Income Taxes" in this schedule, right?

A. (Laflamme) Yes.
Q. And, then, there's an adjustment. Do you happen to know what that adjustment was? I was trying to figure out how that fits into this.
A. (Laflamme) To the right?
Q. Yes.
A. (Laflamme) "72,312"?
Q. Yes. Uh-huh.
A. (Laflamme) I believe that is the -- I believe that is the gross-up on the additional revenues that the Company is request -- the tax gross-up for the additional revenues that the Company is requesting in this case.
Q. Okay. But here's what interests me, is is that, as I go through this calculation, I don't see that, you know, the gross-up ever making its way over into the actual numbers. So, that's not taken into account in figuring out how much cash the Company would eventually have available from operations.

(Witnesses conferring.)

MS. HOLLENBERG: May I clarify? Is the suggestion that this schedule is incorrect?

MR. RICHARDSON: I'm actually asking because I don't understand the schedule. So, I'm trying to get the witness to explain it.

CHAIRMAN IGNATIUS: Well, that is very troubling. This is your company's witness's document. So, to have Mr. Laflamme try to figure out what might be correct or incorrect in that document is rather difficult. Are you withdrawing the document? Are you suggesting it's not valid?

MR. RICHARDSON: No. No, no, no. I'm just asking him, I'm trying to get his understanding, an explanation of, and I'm leading towards really the question of, you know, "what are the liabilities that the Company has to satisfy with its cash?" And, I want to go through the process of adding all of those up, including taxes, including the reduction in paid-in capital.

WITNESS NAYLOR: If I could? If I could --

CHAIRMAN IGNATIUS: Please.

WITNESS NAYLOR: -- attempt to add something that might help with the question? The very first column of numbers is Mr. St. Cyr's calculation of the Company's 2012 results, prior to any revenues that the Company might receive in this proceeding. I believe that's the case. And, the reason I think it's the case is, because you look at the "Provision for Income

Taxes-current", it's just under $98,000. It's very close to what the Company has requested here. I think it's -- the request is about 100,000, something like that.

The second column, "Adjustment", as Mr. Laflamme alluded to, reflects the gross-up, as explained in the Company's Petition, on the additional revenues they seek to pay taxes with. So, because those revenues to pay taxes are also taxable, they must do a gross-up.

Those numbers are then carried into the third column. And, Mr. St. Cyr has headed that column "Adjusted Preliminary Actual December 2012". So, now, what you have is a more complete picture of what 2012 looks like, taking into consideration not only the Company's books as they are reflected as of 12/31/12, but also considering approval of the Company's request in this proceeding for the additional revenues it seeks. This would be, I believe, what the Company's income statement would look like, if the request in this proceeding were granted.

CMSR. HARRINGTON: Excuse me. Did you just -- you said that the "170,261" would be what it would look like if the request was granted?

WITNESS NAYLOR: The "170,261" is a reflection of income taxes the Company would owe on a pro forma basis, if the additional revenues were approved in this case. So, it's an additional amount over what the 2012 year shows, because revenues received from customers through their rates to pay for income taxes that the Company has to pay are also considered "taxable" dollars. So, there has to be a tax gross-up applied to it. And, that's why the number becomes 170,000. That's very close to what the Company's request is in this Petition. I believe that's -- I believe that's the answer.

MR. RICHARDSON: Thank you. And, that was -- that sheds a lot of light. And, you know, I apologize. I, obviously, made a large mistake in this case, you know, assuming that all of this was going to be crystal clear when Mr. St. Cyr had concluded his testimony yesterday. And, that didn't happen.

BY MR. RICHARDSON:

Q. But I think there are some points that can be gleaned off of this. And, obviously, Mr. Laflamme, I think you would agree that the 97,000 that Mr. St. Cyr has shown for taxes, you know, that he, obviously, has adjusted that amount in arriving at the net operating income. That's what he's assumed for taxes. Is that correct?

A. (Laflamme) And, you're talking about the very most left-hand column.

Q. Yes, the left-hand column.
A. (Laflamme) Yes. That's the --
Q. When he's looking at the preliminary actuals.
A. (Laflamme) That's the income tax expense that Mr. St. Cyr has calculated.
Q. Uh-huh. And, if I understand from yesterday, you provided a schedule that Mr. St. Cyr reviewed. And, I think he agreed, subject to check, that the Company's tax liability would be reduced, at least from federal tax purposes, by about $17,000, is that right?
A. (Laflamme) Subject to check, yes.
Q. Okay. And, is that, I mean, do you, in general, subject to check, you agree with that?
A. (Laflamme) Yes. That would appear to be the case.
Q. Okay. Thank you. So, we've -- let's just, with the understanding that all the numbers are going to be off by somewhere around $17,000 or more as a result of that schedule, I want to walk through this and look at all of the Company's other liabilities and things that it has to pay.
A. (Laflamme) Uh-huh.
Q. And, so, the first is, that I see on this schedule, is an interest expense of "73,419". And, would you agree that that reflects what the interest expense is for the

Company?
A. (Laflamme) Yes.
Q. Okay. Thank you. Do you have a calculator with you? I was going to try to find mine.
A. (Laflamme) Yes.

MR. RICHARDSON: In my advancing years, I find sometimes spreadsheets also require a magnifying glass. And, if you want to borrow mine at any time, feel free to ask.

BY MR. RICHARDSON:
Q. So, then, let's -- what I'd like to do is deduct from that 211 -- well, so, we're down to 142,000. It's right there.
A. (Laflamme) Yes.
Q. Okay. And, that number carries over onto the cash flow statement, I believe, which is going to be the response to 1-4.

CHAIRMAN IGNATIUS: Page 164.

BY MR. RICHARDSON:
Q. And, just so I'm sure we're all on the same page, you see on the top we've got "Net Income", and that represents cash. I mean, you've taken the operating funds, you've paid your taxes --
A. (Laflamme) Not necessarily, no. No.

Q. Well, wouldn't it, I mean, you're starting with the assumption that you've paid off your expenses and your taxes in rates, after recovering the money in rates, and you paid -- we just paid off the interest expense. So, that's an amount of cash that's available to -- for other purposes, right?
A. (Laflamme) In creating --
Q. I mean, that's --
A. (Laflamme) In creating that statement of cash flow, you would start off -- you would start off with net income. And, from there, you would make adjustments in order to derive what is available in cash for the Company.
Q. Uh-huh.
A. (Laflamme) So, to say -- to say that "$142,617 reflects cash", it doesn't. It doesn't.
Q. Right. And, what I'm --
A. (Laflamme) It reflects the earnings of the Company.
Q. Okay. And, what I'm trying to, you know, walk through the process of, is "how much cash does the Company have available?" So, obviously, we'll get to those other adjustments.
A. (Laflamme) Okay.
Q. So, and, you know, what I see in going down this column is a couple of things that trouble me a little bit.

The first is, I want to jump to a fairly large number. And, you see, as you go down that first column, "2012", you see "$139,602". And, that's called "Increase, or Decrease in Accounts Payable". Do you see that?

A. (Laflamme) Yes.

Q. And, this is an increase, I presume, based on, you know, the numbers more or less as we would see in Exhibit 6?

A. (Laflamme) This is, if I may, this is an increase, because the Company is incurring expenses, which it is not paying. So, as the Company's payables increase, that is -- that adds to the debt, for purposes of the cash flow statement, the Company is incurring expense, which it's not paying, therefore, it reflects an increase in cash.

Q. In other words, the Company's receiving value for the services in essentially the amount that those services are being provided for, right?

A. (Laflamme) The Company is receiving -- is receiving services and incurring expenses for those services, but it appears that it is not actually paying, paying the payables that are created for those services.

Q. So, in other words, in this line item, it appears to me that there is a -- almost like a value for the services that's been assigned, but the Company hasn't paid the liability for that?

A. (Laflamme) This line item represents the -- is derived from the balance of accounts payable at the beginning of 2012, and the difference between the value -- the difference between the balance of accounts payable at the end of 2012.

Q. Uh-huh. So, --

A. (Laflamme) And, during 2012, the Company's accounts payable account increased by $139,602.

Q. But -- oh, that's -- thank you. That's kind of what I'm getting at. So, when we go down to the bottom of this subsection, it says "Net Cash Provided by Operating Activities". And, it looks like these positive numbers, "139,602", which is an increase in payables, is booked as cash?

A. (Laflamme) It's an adjustment to net income, and net income, those services, if you will, that the Company received, were booked as expenses. They weren't necessarily paid. So, what this is doing is is it's adjusting the net income number to reflect the fact that, while expenses were recorded by the Company, it did not pay those expenses. Therefore, its cash balance did not -- was not reduced.

Q. Uh-huh. But you would -- I guess you would agree with me, and I understand the distinction that you're making. But it wouldn't be fair to say that that 139,602 are actually funds that the Company has, you know, in its bank account?
A. (Laflamme) No. It's not funds, it's an adjustment.
Q. Uh-huh. So, we're adjusting the net cash upwards by an amount for payables, but we're not reducing it to reflect the liability to make the payment?
A. (Naylor) Well, that's not what the purpose of a cash flow statement is. This is strictly a cash-based statement. And, essentially, what you're doing is, in the top part of this statement you're converting accounts that are accrual-based into their impact on the cash account. Because what you do, when you come to the very bottom of this page, "$11,303", that should be the exact balance of cash on hand that the Company has at the conclusion of the year. It should balance right to their checkbook balance.
Q. Thank you for that clarification. But I guess what I'm trying to get at is is that, the process of going through and arriving at this number, "$408,616", that doesn't reflect the cash on hand that is available to pay taxes? Or, excuse me, not taxes, but is available

for spending for any purpose, because some of that are services, which come with a corresponding liability?

A. (Laflamme) Again, similar to -- similar to the discussion on accounts payable, while the Company incurred an expense for federal and state income taxes, it did not pay that liability. Therefore, there was no cash outlay by the Company for income taxes during 2012. So, therefore, that is an adjustment to net income, to reflect the fact that there was no cash outlay for income taxes during 2012.

Q. All right. But you've lost me in your answer a little bit, and I'm trying to get to a very simple concept. And, I guess I'll ask the question this way. I mean, can you give me a "yes" or "no" answer, that that $139,000 -- $139,602 does not reflect cash that's available for the Company to spend?

A. (Naylor) And, if I could provide an answer to that, and Mr. Laflamme can answer separately, if he wishes. The answer is "yes, it does." It absolutely does. You're not understanding the concept of this statement. The important figure here is the net cash provided by operating activities of $408,000. That is the net cash amount available for the Company to deploy during the year. That part of those expenses that you're referring to remain on the books as accounts payable has no impact on cash. I think you've made your point through your questioning, and I don't disagree with the premise, the Company has an associated liability going forward to pay those vendors. But that is money that's available. The 408,000 is the net amount of money available. And, then, from that point down, in the rest of the statement, it shows how that $408,000 was used.

So, this is -- this statement is, as I said before, very cash-specific. It's got really nothing to do with accruals of expenses or incurrence of liabilities. It's simply what used to be called a "sources and uses of funds statement" or "sources and uses of cash". It's the only name for it, but --

Q. Yes. Sure.

A. (Naylor) -- it's much more descriptive than the "statement of cash flow" that's used now.

Q. Mr. Naylor, you said at the beginning, your answer was "yes, it does reflect the liability" or maybe I misunderstood it. But could you show me where that liability is reflected?

A. (Naylor) I did not say that. I didn't say it reflected -- I didn't say anything about "liability". I said

that 400 -- or, that $139,000 --
Q. Okay. I stand corrected.
A. (Naylor) -- absolutely is cash that's available.
Q. Okay. So, and that, you're right, and I apologize for getting that wrong. Could you show me then where the corresponding liability is shown on this? Is it shown on this page anywhere?
A. (Naylor) This statement has nothing to do with assets or liabilities. This is strictly a statement of cash flow.
Q. Uh-huh.
A. (Naylor) It's all about dollars here, in terms of actual cash.
Q. Okay. But, if, you know, if Upton & Hatfield provided -- let's say they did the whole thing, which, obviously, isn't remotely true, but, if Upton & Hatfield provided $139,000 worth of services, that doesn't mean the Company has that amount of money available to spend on pipes? Obviously, you have to balance everything out through some other process.
A. (Naylor) You don't, with all due respect, you don't understand the premise of this statement. You're not really understanding what these numbers mean. This is not intended to reflect what the Company owes or who

they owe it to or anything like that.

Q. Understood.

A. (Naylor) This number, and you see how it's captioned, we're talking about this "139,602", and you see how it's captioned? "Increase" and then in parens "(Decrease) in Accounts Payable". So, if the number does not have parentheses around it, it means it's an increase. And, as Mr. Laflamme said, it's the difference between the beginning balance of that account for the year and the ending balance.

Q. Uh-huh.

A. (Naylor) That difference, if it's an increase, it is a provision of cash, because the recorded expenses that's in the net amount of the very top line, the "Net Income 142,617". So, the net -- they have shown the change in accounts payable from the beginning to the end of the year, it is a source of cash available to the Company. It has nothing to do with the schedules of accounts payable, anything like that.

Q. Right.

A. (Naylor) Or specific accounts payable. This is a change in the account balance as a whole.

Q. Understood. But I guess my question to follow up is, I mean, if I take out a loan to buy a house, you know,

$150,000, I can't book that as cash once I get it, because I've also got to pay it off. I mean, I'm not $150,000 richer in the sense, because there's a corresponding liability that occurs somewhere, maybe not on this sheet. Is that right?
A. (Naylor) You don't -- you don't understand the basis of a cash flow statement. I'm sorry, but that question tells me that you don't.
Q. Well, and so I --
A. (Naylor) You don't get it, so --
Q. Yes. And, I'm trying to make sure that the -- you know, that these numbers -- so, it's your opinion then that these numbers reflect money that can then be spent for various purposes, whether it's operating expenses, whether it's reducing payables. What does this number truly reflect then?
A. (Naylor) It's not an opinion, it's a fact. This is the sum total, the "408,616", assuming these numbers are all correct and accurately reflect the Company's books and records, --
Q. Uh-huh.
A. (Naylor) -- that is the amount of cash the Company generated throughout the year that is available for financing and investing activities.

Q. So, am I correct in understanding then that, by not paying the invoices for rate case expenses, the Company made more funds available for investing, is that basically what you're saying?

A. (Naylor) Essentially, that is correct. The reason it's correct is because they, assuming they did the accounting correctly, they expensed the invoices from the rate case expense vendors in that year, okay, so they properly put those into their expense accounts. And, those expenses are netted out against the Company's earnings or income, the revenue from customers, to reflect the net income at the very top of the column, "142,617". Those expenses are recognized in that "net income" number. That's where you start.

Q. Uh-huh.

A. (Naylor) That's really the only, I don't know, for lack of a better word, I guess, accrual-based number in here is the net income. Mr. Laflamme can chime in on that, he's an expert at this. But, from there on, it's just -- it's strictly cash.

Q. So, but here's -- here's my question then, in follow-up to that, Mr. Naylor. If the Company increased its payables by this amount, in 2012, it hadn't received any right to, I mean, the Commission hadn't approved recovery of rate case expenses, for example. So, there's no funds to pay this amount off?

A. (Naylor) You're not understanding again.

Q. Okay. That's fine.

A. (Naylor) The premise, you don't have the premise, with all due respect. And, I'm sure you know a lot more about law than I do. I'm just, you know, you don't understand the basis of the statement.

Q. I struggle with these things. And, I hope that, you know, the Commission, you know, doesn't, to the extent there had been changes to the numbers, if I could understand the numbers better, I mean, I would be on top of this like a hawk, I can assure you. Let me move on. I think, you know, we've kind of made the point. And, I'll just note, you know, there's other items in here that are being adjusted. You know, you go through, there's a -- it looks like there's a $29,000 credit for a decrease in inventory. Is that something that's typically recorded in this, in this activity we're going through?

A. (Naylor) Correct.

Q. And, then, depreciation is, obviously, another significant factor. And, once you reconcile all of these, you then get to $408,616. And, that's the number that we're looking at, obviously, with the knowledge that the tax liability going into the top of this form hasn't been done exactly right or doesn't appear to be. Is that right?

A. (Naylor) At the very end of your question, I'm not sure I understood. You said --

Q. Okay. Well, --

A. (Naylor) -- "the tax hadn't been done".

Q. Well, when we came to the "142,000", at the top of the form, "617" [142,617], that's on Page 164, in order to arrive at that number, there was a tax deduction or removal of tax that, at least according to Mr. St. Cyr's testimony yesterday, would likely need to be adjusted.

A. (Naylor) Based on Mr. Laflamme's exhibit with respect to the potential additional remaining loss carry-forwards?

Q. That's correct.

A. (Naylor) Okay. Yes.

Q. So, as we go through this then, you know, we start with the -- there's the "purchasing of plant and equipment", so that's something that comes off the 408,000. And, you know, do you agree, Mr. Naylor, that those are expenses that the Company was obligated to make in

order to provide service?
A. (Naylor) Well, of course. The Company needs to make capital improvements, no question about it. The Staff certainly agrees with that. I think everybody in the room agrees with that. Whether they thought they were necessarily obligated or maintained by law or by DES, we don't know that. But, assuming that the Company's decisions with respect to these investments in plant and equipment were prudent, then, yes, of course.
Q. Okay. And, then, you know, then there's a big item there for "Principal Payments on Debt". So, now, we've -- that's going to further reduce the amount of cash that's available to spend on taxes, right? Or, I'm sorry, excuse me, that the Company has to spend for any purposes, not just taxes?
A. (Naylor) Correct.
Q. And, then, I get -- you know, we get to the number that I guess you and Jay -- and Mr. Laflamme would both dispute, which is the decrease in additional paid-in capital of "$123,356". And, you know, we go through all of these expenses, and we see that the Company has $6,000 less in cash at the end of the year than it had at the beginning?
A. (Naylor) That's right.

Q. Uh-huh. And, in doing this, I'm concerned we're going to get right back to the areas where you said I didn't understand this form. But we haven't shown anywhere where the Company has made any progress on its payables. Is that right? I mean, the payables, there's nothing on here that reflects the Company's obligation to repay the amount it owes to its vendors?
A. (Naylor) No. You would have to go to the balance sheet and look at the "liability" section for that. The "liability" section indicates the Company's short-term loans, long-term loans, accounts payables, similar items.
Q. Let's look at Page 168 for a second please. And, we're back at Exhibit 1 of I believe this is Staff 1-5, the response to Staff 1-5, in Exhibit 4. I'm looking -- this is the statement of operating revenues that I want to focus on on the top. And, you see on the left-hand column, going down, there's "Unmetered Sales", "Metered Sales", and then there's a line item for "Rate Recoupment". And, that's "$52,202".
A. (Naylor) I'm sorry. Could you clarify which page you're on?
Q. I'm on Page 168.
A. (Naylor) Thank you. Yes, I see that.

Q. And, is it -- is my understanding correct that this is the permanent rate recoupment that was approved in 2012 for the last rate case?

A. (Naylor) What this tells me, this is Mr. St. Cyr's exhibit, entitled "Supplementary Information". So, this contains some detailed information that is presumably summarized elsewhere. This top part that ends with a total of "1,198,050", this is a detail of the Company's operating revenues that they recorded on their books for 2012. And, if this is done on an accrual basis, which I believe it is, then the "52,202" is the amount of revenue received from customers during 2012 for the recoupment of the difference between temporary rates and permanent rates in the last rate case.

Q. Yes. And, let me ask you a follow-up question. Because you said that's the "revenue received". But, if we're doing this on an accrual basis, really, what happened is is the Company accrued the right to recover 52,202 in 2012, is that right?

A. (Naylor) I don't know that it did that. I guess it would depend on when the order was issued.

Q. It was presumably after --

A. (Naylor) I'm not sure.

Q. -- after July 13th was the date of the Commission order approving the rate case expense, and then there was a -- maybe, I'm going to guess, --
A. (Naylor) Okay.
Q. -- subject to check, two or three months later.
A. (Naylor) Yup, I think you're right.
Q. So, the Company wouldn't have actually collected all 52,000 in 2012, but it accrued the right to collect it?
A. (Naylor) Presumably, if they did their accounting correctly, that's right. Now, it depends, the correctness of this number, if you will, it depends on what the Commission order said. I don't recall over what period of time the Company was permitted to recover the difference between temporary and permanent rates.
Q. Uh-huh.
A. (Naylor) But it's appropriate for the Company to make an entry recognizing revenues for the period of time during 2012 in which it was entitled to begin that recovery.
Q. Right. So, that's an adjustment that reflects cost of service provided all the way back to, I mean, the temporary rate period, excuse me, began in September of 2010, right?

A. (Naylor) I believe that's correct, yes.
Q. So, we've got 2010 service, 2011, as well as 2012?
(Witnesses conferring.)
BY THE WITNESS:
A. (Laflamme) Yes. If I could. There was a prior recovery of temporary rates by the Company. The temporary rate order was issued in early 2011, I believe. And, the Company made a subsequent petition in order to collect a portion of the difference between a portion of the temporary rates from the effective date. And, so, this, assuming that the amount approved by the Commission last fall was $52,000, this would be the balance of those, of the difference between temporary rates and permanent rates.
BY MR. RICHARDSON:
Q. Right. And, --
A. (Laflamme) So, there were --
Q. And, that's going all the way back to the effective date of the rate increase?
A. (Laflamme) Right.
Q. Okay. Thank you. So, we go down this column, we get to the total "$1,198,050". Do you see that?
A. (Naylor) Yes.
Q. Okay. And, then, if we look at the prior page, Page

167 of Exhibit 4, we see that is -- that's listed as the same number for the Company's operating revenues for 2012, and that leads down to the next operating income of "211,777"?

A. (Naylor) Correct.

Q. Now, that's the number that's -- I see, I think it's off by three or four dollars, on Page 162, that, when we started off earlier this morning, when we were calculating the Company's rate of return. And, I guess my question is is that, you know, what the Company earned in 2012 also reflected service provided in 2011 and 2010, because we added, essentially, a rate recoupment that happened or was realized in 2012?

A. (Naylor) Mr. Laflamme can answer as well, but I believe you're correct to a certain extent. We've had this discussion before in-house with respect particularly to rate proceedings that take a fair amount of time, you know, extend, for whatever reason, over a year or even longer, for various reasons. Sometimes the petitioner, you know, puts their case on hold, we've had examples of that, or they needed to do some compliance work or something. Anyway, what is the appropriate accounting for, you know, temporary rates, particularly when temporary rates are approved at a higher rate than the current rates, when does the company make those entries? So, if there's a difference of what accounting periods they recognize those revenues in and so on and so forth. Certainly, there's room for judgment on the part of an accountant in those circumstances. I don't know what the Company's decisions have been with respect to that.

Q. Uh-huh.

A. (Naylor) So, yes. You are correct. There may be some revenues recognized in 2012 and carrying forward, of course, through to the net income, that represent, you know, the recoupment of permanent rates back to a prior year. That's certainly possible.

Q. So, it's not accurate to say then that the Company's revenue it received for service in 2012, you know, exceeded its allowed rate for 2012, because there was -- there's this issue about revenue from other years?

A. (Naylor) No, you're point is well taken. And, certainly, if 2012 were to be selected by the Company as a test year for an additional rate case, one of the first things we would do, we would certainly expect the Company to do before it made its filing, was to evaluate its revenues for the test period, eliminate revenues that do not pertain strictly to service in that test year, and present a normalized income statement so that its earnings can be accurately calculated for purposes of determining a revenue deficiency. So, you are correct.

Q. And, the same type of adjustment would have to be made, I assume, and wasn't made when you calculated, Mr. Laflamme, the 12 percent figure that you indicated on direct?

A. (Laflamme) The $52,202 was -- was included in the net operating income.

Q. Okay. Thank you.

MS. HOLLENBERG: May I ask a quick question, just so that I make sure I understand? Is the result of this conversation or these questions that the schedules that we have in response to discovery are not accurate? I guess I'm trying to get is that -- is that what the Company's position is? That there are some entries in these schedules that shouldn't be where they are?

MR. RICHARDSON: No. I think that --

MS. HOLLENBERG: Okay.

MR. RICHARDSON: -- the schedules are accurate. The question really goes to "what conclusions can you draw from them?" And, if you look at the numbers and you go through the schedule, you'll see that there's a rate recoupment that effects an increase over, well, I'm not going to speculate what -- about a two-year period, maybe longer, I'm not sure. You'd have to look at the calendars. And, that's just something that has to be taken into account. And, looking at essentially what's -- I believe, well, I'm not trying to characterize the other witnesses' testimony, but I believe Mr. St. Cyr, did he say it was a "raw calculation"? I can't remember what he's told me.

MR. MASON: He and I both did.

MR. RICHARDSON: Okay.

BY MR. RICHARDSON:

Q. I want to -- let's look at, going back to the cash flow statement now, you know, another item that's been deducted. And, that's that reduction in paid-in capital.

CHAIRMAN IGNATIUS: This is Page 164?

MR. RICHARDSON: Yes.

BY MR. RICHARDSON:

Q. And, I don't know if Mr. Laflamme and Mr. Naylor is the better person to ask, so, either of you feel free to respond to this. Is it true, and you may recall on redirect I asked this question to Mr. St. Cyr, that the

paid-in capital -- or, reduction in paid-in capital, that represents a write-down in the Company's equity?
A. (Naylor) That's correct.
Q. And, so, when the Company takes this position or provides this treatment on its books, that means, when they go in for a rate case in 2012, they won't earn anything on it?
A. (Naylor) They will have less equity in their capital structure. And, since equity is a more expensive capital than debt, it will have a depressive effect on the overall cost of capital.
Q. And, am I -- and, in effect, you know, essentially, what the Company is doing is -- well, let me strike that. So, what is your opinion, because I don't think -- I think we've danced around this issue a little bit, but is this an appropriate form of adjustment, in your view?
A. (Naylor) I don't think I danced around it earlier on direct. I think you have to look at this in the context of where the Company is financially.
Q. I'm sorry, what I meant to ask was, is this a, from an accounting perspective, is this a permissible adjustment? Is the Company, from an accounting perspective, enabled to classify those payments as a

decrease in paid-in capital?

A. (Naylor) I don't think so. I do not believe so. I believe what this ultimately would be considered is a dividend. And, a dividend should be paid out of retained earnings. I do not believe that return of capital is something that is appropriate. I have not done a lot of research on it, I did a little bit last night and this morning, but not a lot. I'm not -- I don't think, for purposes of this proceeding, any of us should be all that concerned about the legal aspect of it. I think the issue pertains much more to the fact that some significant amount of cash was taken out of the Company. And, to focus on the other side of the entry, additional paid-in capital, is virtually meaningless. It's the cash that was taken out of the Company. At a time, within a matter of few months, the Company's here asking for emergency rates. I think that is the issue. So, whether the accounting is correct or not, really is a moot issue, in terms of this proceeding.

Q. Okay. But that was really all my question related to. But you did ask or raise an issue in your response just now about the timing. And, do you recall Mr. St. Cyr saying that these amounts were paid in 2011 and 2010, over a two-year period?

A. (Naylor) I believe he said "2011 and 2012". But, if that is actually the case, then this statement is wrong, because this is a statement of cash flow, and the 2012 column says "123,356". So, that would say that the Company had a net cash outflow of 123,356 in 2012. So, --

Q. Right. Right, I understand that. And, I'm not sure I understand that aspect of this any better than you do. But let me -- let me ask you this. Over, you know, let's say the last five years, are you -- actually, let me back up, because I think there's another question I want answered first before we get to that. And, to do that, I want to show you a schedule that Mr. Laflamme prepared in the last rate case.

(Atty. Richardson distributing documents.)

MR. RICHARDSON: Just for informational purposes, this is the schedule that was attached to the testimony of Mr. Laflamme that was shown yesterday. Does everyone have a copy?

CMSR. HARRINGTON: Is this going to be made an exhibit?

MR. RICHARDSON: Yes, please. I would

mark this for identification as our next exhibit.

CHAIRMAN IGNATIUS: That would be "Exhibit 14". But, let me, before we mark it, what's the -- this is taken from the prior rate case, DW 10-141.

MR. RICHARDSON: Yes. Yes. And, I want to ask questions related to the paid-in capital treatment.

CHAIRMAN IGNATIUS: And, what's the relevance of that for this proceeding today?

MR. RICHARDSON: The question primarily relates to, you know, the use of this mechanism and what it means for the Company. You know, whether the funds were actually available to the Company to spend, you know, on taxes, that type of thing.

CHAIRMAN IGNATIUS: And, tell me again what this document, why you need this document from a prior case to pursue that line of questioning? I just, knowing you go one step into the prior case, a lot of other people then say they have a right to keep on going, and we're at almost 12:00 on the second day of this. So, tell me why this document is necessary to discuss that with the witnesses?

MR. RICHARDSON: I apologize. I've kind of lost myself in the notes in the process of handing everything out here.

CHAIRMAN IGNATIUS: That's all right. Take your time to get reoriented here.

MR. RICHARDSON: There's two purposes for this exhibit. The first one we've just touched on, is that, you know, this is -- I just want to show how the accounting treatment of paid-in capital, as the Company has proposed it, has been used by Staff in the last rate case and the effect that has on the Company.

The second purpose is actually to respond to a comment that Mr. Laflamme made in his testimony, saying that the "reclassification of the shareholder loans is something that was not addressed or approved in the last rate case." And, that's also shown on this schedule.

CHAIRMAN IGNATIUS: All right. Let's try it on a kind of limited basis and see how far we go. And, make sure it's still staying relevant to this case.

MR. RICHARDSON: Sure.

(The document, as described, was herewith marked as **Exhibit 14** for identification.)

BY MR. RICHARDSON:

Q. Mr. Laflamme, you recall this schedule, right?

A. (Laflamme) Yes.

Q. And, so, you see where it says, I'm looking at Note C on the bottom of this exhibit, and it says "Co's", for "Company's, "Shareholder Loan converted to Additional Paid-in Capital." And, you have a line item for the balance of the shareholder loan as of 12/31/09, "$190,855"?
A. (Laflamme) Yes.
Q. You deducted pension and health insurance payments to the shareholders during the test year by 56, by that amount, and then it's that reduced amount that was then applied for purposes of calculated the Company's earnings, is that right?
A. (Laflamme) Yes. 130 -- the net amount of $134,026 was adjusted from shareholder loans to additional paid-in capital.
Q. And, I guess, you know, what concerns me is is when we look at the cash flow statement, and we treat the reduction of paid-in capital, you know, as if it is -- well, I guess it's simply that, that it reflects money that the Company doesn't have an opportunity to earn on, and it's essentially using the same approach that was used in this last rate case. Is that right?
A. (Laflamme) I'm sorry, could you repeat the question?
Q. Well, let me start with the first part. The Company no

longer earns on that for the purposes of -- when its next rates get calculated?

A. (Laflamme) If it's in owner's equity, then the company earns a return on -- a return on equity.

Q. But the Company's taken some of its rate of return and it's basically reinvested a greater amount back in in order to continue to provide service, because we've added 115 -- or, 131,000 in the same year. So, in an effect, you know, the Company is pouring money back in to provide additional service, and then it's taking money out for itself. But it then --

A. (Laflamme) The shareholders.

Q. Right.

A. (Laflamme) Okay.

Q. Right. But it then loses the opportunity to earn on it?

A. (Naylor) Well, that's a pretty small amount, because what you're talking about is just a sliver of the capital structure. And, then that goes into the weighting of the debt and equity amounts.

Q. Uh-huh.

A. (Naylor) This company has a total capitalization, as you can see in the first column of numbers, of just over $2 million. So, the impact of removing $123,000 of equity is a pretty small impact on the overall cost of capital. The issue is the cash. It's not -- really is not the capital structure, the impact on the cost of capital, or anything out of the accounting. It's the cash.

Q. But if we --

A. (Naylor) The shareholders cannot and should not be treating the corporation they own shares in as their own personal bank account. I don't believe return of capital is appropriate.

Q. Uh-huh. And, I understand your position in that regard. But I guess what I'm trying to get at is is that the Company's actually put in an equivalent amount of capital back into its system. And, at the same time, it took an amount out, and that has the effect of reducing its future earnings capacity.

A. (Naylor) Well, they're obligate to put capital in. The shareholders have chosen to invest in a public utility. They're obligated to put in capital. It's not something they're doing out of generosity. This is their obligation.

Q. Uh-huh. And, do you disagree that, in terms of this company, their only source of revenues or capital is money they receive in rates?

A. (Naylor) Yeah. That's a problem. We talked about it before.

Q. Uh-huh. Yes. No, that's fine. Let me -- okay. You know, Mark -- Mr. Naylor, you provide some interesting answers sometimes. And, I am susceptible to chasing them, when I'm really trying to go in a different direction.

A. (Naylor) Well, I'm just trying to be fully responsive --

Q. No, I understand that.

A. (Naylor) -- and provide my opinions to the parties and the Commission. That's all.

Q. Oh. So, you indicated that retained earnings is, not that you are recommending that this be put in retained earnings, but you think that's the better form of classification for this. Is that fair so say?

A. (Naylor) Well, I believe that the distribution should be classified as a "dividend" from the corporation. I mean, I've just never heard of a "return of capital". And, I don't -- I've not heard of it. It seems that it's more appropriately classified as a "dividend", and dividends are paid out of retained earnings in a corporation.

Q. Understood. So, this is a question either for you or for Mr. Laflamme. Do you know how much money this Company has paid its shareholders out of retained earnings since the 2009 test year?

A. (Naylor) I do not know. But I guess I would offer you this. I don't think, since 2009, any distributions of income are appropriate for a company that's in the financial position this one is in. It's just a fact.

Q. So, isn't the logical conclusion then that you're arguing that the shareholders don't get any return, actual return on their investment?

A. Not under the present circumstances. No, of course not. There's no possible way. This company does not have access to capital. It's not adequately capitalized. It can't go to banks and get loans. It's relying solely on its revenues from customers for all of its financing activities, all of its capital improvements.

Q. But what is it that the Company has done -- maybe I shouldn't ask this question. You know, what -- how do you distinguish, I mean, its predicament from just the nature of the systems it operates? I mean, we're dealing with less than a -- fewer than 100 customers per system?

A. (Naylor) I mean, honestly, the Company just simply does not have a defense that it's a hard business to be in. I mean, I respect what the Company does. And, it's clear from Mr. Dawson's testimony and Mr. Mason's testimony, the Company's done some good work in the field and they have fixed a lot of problems and taken care of a lot of problems. But, financially, going forward from this point, frankly, I don't know how the Company's made it to this point from a year ago. But this is -- this is quicksand.

Q. Uh-huh.

A. (Naylor) And, without outside capital, it's inevitable.

Q. Well, let me ask you this question -- ask the question this way. And, you know, subject to check, if this Company -- well, let's look at what its net investment is. Do you know what schedule that is on? I believe it's on the 1-3.

CHAIRMAN IGNATIUS: Mr. Richardson, we've been through this. I think I can give you the number from memory. We've looked at this line again and again. And, I'm fine, I just want to make sure you're leading to a question --

MR. RICHARDSON: Yes.

CHAIRMAN IGNATIUS: -- that's not just restating what we've already done.

MR. RICHARDSON: Absolutely. And, this is a fairly significant change at this point.

BY MR. RICHARDSON:

Q. I want to find the "Total Average Rate Base" on Page 162. Do you have that in front of you?

A. (Naylor) I do.

Q. Let's just look and assume that 2012 is an ordinary year, and that we classify that 123,000, I believe it was 356 [123,356], as what the Company earned as its return on its net investment in plant. Can you tell me what percentage that reflects?

A. (Naylor) I don't have a calculator, but I would say something around the range of 5 percent, something like that.

Q. Now, what if that was the only funds the Company received over the 2011-2012 period, as I believe Mr. St. Cyr indicated yesterday? It would be cut in half, right?

CHAIRMAN IGNATIUS: I'm sorry, I didn't follow your question.

MR. RICHARDSON: Well, if we're looking at a 5 percent return on the Company's investment in net plant in rate base, that 123,000 reflects 5 percent in 2012. And, by extension, I'm asking, if it was the only money they received over a two-year period, it would be two and a half percent?

WITNESS NAYLOR: I don't think the math changes the analysis that Staff is bringing to you. Sorry, I can't help you.

CHAIRMAN IGNATIUS: But I'm more concerned about the record for a moment. Are you asking us to disregard Mr. St. Cyr's exhibit, and not consider the 123,000 as being paid in 2012, and instead assume that it's being paid -- split between two years?

MR. RICHARDSON: No. No, my question is slightly different. And, I'm glad you've asked me this, because I think it's an important question to the case. If we assume that over a two-year period the only revenues that the Company got, whether, I mean, if you look at 2011 --

CHAIRMAN IGNATIUS: When you "the Company" -- "the revenues the Company got" is confusing.

MR. RICHARDSON: I'm sorry. All right.

BY MR. RICHARDSON:

Q. So, let's -- if we look at 1-4 again, the cash statement, you don't see any payment to the shareholders in 2011, right?

A. (Naylor) There was a very slight change in the

additional paid-in capital account. But I don't have any evidence to believe that that represents payments to shareholders, no.
Q. And, there were no payments to shareholders in -- that are reflected on the Company's books in 2010 either, are there?
A. (Naylor) Not that I know of.
Q. Okay. And, the Company didn't receive anything during -- from retained earnings in any of these periods, did it?
CHAIRMAN IGNATIUS: The "Company" or the "shareholders"?
MR. RICHARDSON: I'm sorry, the "shareholders".
CHAIRMAN IGNATIUS: Thank you.
MR. RICHARDSON: I'm an idiot.
BY THE WITNESS:
A. (Naylor) I'm not aware if there were dividends declared. I don't have any knowledge of that.
BY MR. RICHARDSON:
Q. Well, Mr. Laflamme, are you aware of any payments of dividends? I mean, I'm sure you must have looked at that in the last rate case?
A. (Laflamme) If there were dividends paid --

Q. That's correct.
A. (Laflamme) -- in the last rate case? No.
Q. By the Company? I mean, --
A. (Laflamme) During the test year in the last rate case.
Q. And, we looked at periods subsequent to that as well. I mean, I assume you'd be aware if the Company had paid any dividends?
A. (Laflamme) Yes.
A. (Naylor) And, if there were dividends paid, they should show up on the statement of cash flow.
Q. And, they don't appear anywhere, do they?
A. (Naylor) That's correct.
Q. Okay. So, it's safe to assume, if this schedule is accurate, that there were no dividends paid?
A. (Naylor) That's correct.
Q. And, if we treat this $123,356 as the only revenues the shareholders have received from their investment, what does that reflect as a rate of return on their investment?
A. (Naylor) Well, depends how many years you want to talk about.
Q. For three. For these three.
A. (Naylor) Well, I don't know. I'd have to do the calculation. I'm not sure it really matters, does it?

I mean, the Company is here with a Petition for Emergency Rate Relief, months after it issued a distribution to a shareholder of $120,000, where it already has $650,000 of accounts payable on its books. I mean, --

Q. And, I assume it's your position that that payment was unreasonable.

A. (Naylor) Yes.

Q. I guess what I'd like for you to do is to consider what the Company has received during other times, if anything?

CHAIRMAN IGNATIUS: You mean the "shareholders"?

MR. RICHARDSON: The "shareholders", again, I'm sorry.

CHAIRMAN IGNATIUS: I'm just -- I'm not trying to pester you, I just want the record to be meaningful.

MR. RICHARDSON: I know. And, I --

BY THE WITNESS:

A. (Naylor) I understand your question. I just -- I reject the premise of it, I'm sorry. I can't --

BY MR. RICHARDSON:

Q. Well, if --

A. (Naylor) You know, we see this stuff on the financial news from time to time. Corporations act badly or they do things or a president or CEO, you know, does things, or board of directors do things. And, you know, with publicly traded companies, there are sanctions from the Securities & Exchange Commission and all kinds of stuff goes on. There's reasons for those protections for publicly traded companies. There's certain structures in place to protect investors.

This is a closely held company, so you don't have all of those same kinds of structures in place. What you do have, though, in place of that, is a regulatory regime, established under state law here, in this state. And, a lot of those things are in a state law, in practice for over many years, you understand this, case law, and things that are traditional practices. And, here we are, looking at a company, that's asking the Commission for emergency rate relief, and you're trying to justify distributions.

BY MR. RICHARDSON:

Q. We're wondering far afield. And, it's a very simple question. If we wanted to calculate what the shareholders had earned over that three-year period, we could do so approximately by dividing what they have received in return by what their rate base is, right?

CMSR. HARRINGTON: Mr. Naylor, can I just ask a question. Just for the sake of maybe getting to the point here. Is it your contention that, given the financial circumstances of the Company over the last three years, that no amount of return to shareholders is warranted, no matter how small it would be?

WITNESS NAYLOR: Correct.

CMSR. HARRINGTON: Thank you.

BY MR. RICHARDSON:

Q. So, for 2012 then, you would agree that, if we were to try to calculate what that rate was, of what the shareholders received, versus what their total investment was, we would take that 123,356 and we would divide it by the total average rate base?

A. (Naylor) No. We would divide it by the total equity capital in the capital structure.

Q. Okay.

A. (Naylor) Which represents the shareholders' investment in the corporation.

Q. I stand corrected. You're right. And, can we find that number? I believe it's on Page 166.

A. (Naylor) Total stockholders' equity, according to Mr.

St. Cyr's "Adjusted Preliminary Actual December 2012", is about almost two-thirds of the way down the page, "1,458,148".

Q. I'm sorry, which column are you in?

A. (Naylor) It would be in the third column of numbers.

Q. Okay. So, 132, all right. So, 1,342,5 -- if you can do the calculation faster than me, I'd appreciate it, but --

A. (Naylor) It's between 7 and 8 percent.

CHAIRMAN IGNATIUS: Just to be sure I followed. The column that Mr. Naylor referred to is the third column over, adjusted for 2012, the column Mr. Richardson just referred to is the fourth column over, December 2011.

MR. RICHARDSON: Yes.

CHAIRMAN IGNATIUS: So, which is the one that you're looking at, Mr. Naylor or --

WITNESS NAYLOR: I was look at the 2012.

MR. RICHARDSON: Okay.

WITNESS NAYLOR: And, the reason I was looking at the third column of numbers, the "Adjusted Preliminary Actual" is because it appears that Mr. St. Cyr has essentially closed the net income to retain earnings in that second column of numbers, the 96,000, that represents the earnings, the Company's net income, presumably after all taxes and so forth, closed that to retained earnings, which becomes, in essence, shareholder equity. So, my calculation is 8.4 percent.

BY MR. RICHARDSON:

Q. And, if that -- if that's the only -- well, that's below the allowed return on equity that this Company is entitled to receive, right? Let me strike that question. I don't think that's really the right way to frame it. But, if this is the only money that these shareholders have received over a five-year period, that rate drops way down. I mean, this is not -- no one's making any money from a shareholder perspective out of this Company over the last five years.

A. (Naylor) Well, I guess, in terms of return on capital, sure, that's true. Mr. and Mrs. Mason were employed by the Company for some number of years. The Company did provide them with employment. So, that's -- I don't agree -- I wouldn't agree that that necessarily represents a return on their capital, that's just employment. But --

Q. And, the Company would have to hire somebody else, the shareholders of the Company, if they didn't have them working for the Company?

A. (Naylor) Correct. Correct.
Q. So, you would agree we're looking at a very low number, if that's all that shareholders have ever received?
A. (Naylor) We regulate a number of small water utilities where we've never seen the owners take a dividend. They never have the opportunity --
(Court reporter interruption.)

BY THE WITNESS:

A. (Naylor) They never have the opportunity to earn or take a dividend, because they never have the adequate earnings.

BY MR. RICHARDSON:

Q. Are you familiar with Dockham Shores?
A. (Naylor) I am.
Q. Are you aware that the owner of that company took a second job so that he could help pay for the Company's operations and investments?
A. (Naylor) I'm not aware of that, no. And, I'm not -- I'm not sure why that's relevant.
Q. Well, I guess, you know, there's a real systemic problem to operating small water systems.

MS. HOLLENBERG: Excuse me. I'm going to object here, because at this point the counsel is testifying. Thank you.

MR. RICHARDSON: Well, I'm asking him to --

MS. HOLLENBERG: Okay. So, maybe you could rephrase your question please.

CHAIRMAN IGNATIUS: And, just what is the relevance to an emergency petition? This is not a rate case. This is something you asked for on a particular item of an emergency. So, please, --

MR. RICHARDSON: Okay.

CHAIRMAN IGNATIUS: -- please try to stay focused on what's relevant to the Petition you filed.

MR. RICHARDSON: Thank you. And, the point's well taken. I would say we're at a good point to break, because I've got to read through my notes and figure out if there's areas I haven't covered. I believe I'm just about done, but I don't want to spend the Commission's time trying to read through my notes and figure out what I've missed. Would it be appropriate to break at this time?

CHAIRMAN IGNATIUS: I think we ought to talk about where we're going for the rest to conclude this. Let's go off the record.

(Brief off-the-record discussion ensued.)

(Chairman and Commissioners conferring.)

CHAIRMAN IGNATIUS: All right. Let's go back on the record. We're going to take a 15-minute break, resume at 12:30-12:35, for final questioning from the Company, some Commissioner questions, redirect from Staff, and then we will have -- that will be it for today. We will have written closing arguments after the receipt of the other reserved exhibits come in. And, at some point, we should settle on a date for when those should be received. But maybe, during the break, we can figure that out. So, we're adjourned until let's say 12:35.

(Recess taken at 12:20 p.m. and the hearing resumed at 12:40 p.m.)

CHAIRMAN IGNATIUS: All right. We're back after a break. And, back, I think, to Mr. Richardson for some more questioning?

MR. RICHARDSON: Yes.

BY MR. RICHARDSON:

Q. Mr. Naylor, during the break, my client informed me that the shareholders -- or, he expresses belief that the shareholders have never received any payment.

MS. HOLLENBERG: Objection.

BY MR. RICHARDSON:

Q. -- in return for their investments.

CHAIRMAN IGNATIUS: Before you answer, Ms. Hollenberg.

MS. HOLLENBERG: I guess I'm just, where now counsel for the Company is offering a statement of his client who was a witness at one point in time in the case, and now is using that as a basis for cross-examination. So, it's not a subject -- it's not a fact that's going to be -- I'm going to be able to cross-examine his client on.

I guess, if he wants to ask it in a hypothetical way. But, I mean, to basically suggest that that's a fact that's in the case at this point, I'm concerned about that. And, I'll allow the Commission to rule as it sees fit.

CHAIRMAN IGNATIUS: Mr. Richardson.

MR. RICHARDSON: I was going to make a record request and ask him if he was willing to look at the Company's annual reports and determine whether or not he agreed with the statement that I was offering him a chance to respond to.

CHAIRMAN IGNATIUS: Well, I think we have both a procedural question, and then, again, my concern about relevance. You heard Commissioner Harrington's question a moment ago to Mr. Naylor, "was it his opinion that any amount of a payment of any number, no matter how small, would be inappropriate?" And, his answer was "yes". So, I understand what you're pushing for, but I think we've established your point of view.

MR. RICHARDSON: That's correct. And, what I wanted to establish in the record somehow, somewhere, that other than this $123,000 reduction in equity, there really hasn't been any payment returned to shareholders. And, that was -- I was going to ask if he'd be willing to look at the annual reports and confirm that. When I asked him the question before, I think he said "it's not relevant, it's not material." But I'd still like to establish whether that's the case or not.

CHAIRMAN IGNATIUS: Well, if the request is to go through 30 some years of annual reports, is that what it would be? That seems --

MR. MASON: '76 to now.

MR. RICHARDSON: We could look at any period. I mean, I really -- I don't want to make this difficult. I was thinking, you know, I tried to do it based on five, and, you know, we could look at ten, whatever the -- you know, I think the further we go back, and before Tom Mason's time, you know, I don't really know what the relevance is. But I feel that it is relevant that, in five years, I think we're looking at the only distribution to shareholders is in that 123,000.

CHAIRMAN IGNATIUS: All right. And, can -- so, what is your real request, in terms of how far back you're asking Staff to go through annual reports? Or, presumably, you could go through annual reports.

MR. RICHARDSON: I think five years is reasonable.

MS. BROWN: Staff objects to this record request, only that the scope of the proceeding is not really how they got here, according to the case law, it's "is there a crisis and is the remedy that's proposed reasonable for dealing with the crisis?" And, this seems like it's going beyond the issue of "is there a crisis?" It's going back to how they got here, which I think is expanding the scope of the proceeding. And, I'd rather stick more linear to the topic at hand.

MR. RICHARDSON: But Staff's arguing there wasn't a crisis, being the Company paid itself money. And, I think those funds are, you know, so little and so insignificant in the grand scheme of things, I don't think they contribute to the crisis that the Company's in.

MS. HOLLENBERG: If I might just interject, and I will keep it brief. But, you know, you're talking about analyzing one portion of these annual reports, out of context, and not looking at anything else, and that's supposed to cause us to conclude that these amounts were reasonable, even if they weren't lawful. And, I'm very concerned about taking just that one piece of information out of context.

CHAIRMAN IGNATIUS: I guess what I think makes sense is if you can do it in the form of a hypothetical. Assuming that for five years the only payment made to shareholders was this 123,000 figure in 2012, and ask him what you think of that. Rather than delving into past records. All right?

MR. RICHARDSON: I think I know what he thinks of it. But, with the Commission's permission, I'll rephrase the question a little bit.

BY MR. RICHARDSON:

Q. Mr. Naylor and Mr. Laflamme, are you aware of any payment to shareholders through retained earnings in the last five years?

A. (Naylor) No.

A. (Laflamme) No.

Q. Okay. Thank you. And, any other form of payment to shareholders, other than these reduction in paid-in capital transactions that are reflected in, Mr.

Laflamme, in your testimony that's in the exhibit from your schedule, and then the one that Mr. St. Cyr has identified?

A. (Laflamme) The only -- the payments to shareholders that I'm aware of that happened in the past are wages, repayment of loans, and the so-called pension/medical premiums.

Q. Yes. And, which, in that case, you treated as a reduction in shareholder equity, right?

A. (Laflamme) Yes.

Q. Okay. Thank you. Mr. Naylor and Mr. Laflamme, I recall you both offering an opinion, although if I heard it in cross or in another context, I apologize. I essentially understand your position to be that there's no reason why this case couldn't be addressed through a regular rate case, with temporary and permanent rates. Is that fair to say that you agree with that?

A. (Naylor) I don't believe I testified to that.

Q. Okay.

A. (Laflamme) I don't believe I testified to that either.

Q. Well, let me ask you this then. Do you believe that the Company's un -- well, I'm going to use the word "unfunded", but let's use the word actually "unpaid"

tax liability, because it wasn't included in the Company's pro formas in the last rate case, could be recovered through a reconciliation in a 2012 rate case? Do you understand my question or should I rephrase it?
A. (Naylor) Well, I can try to take a stab at it. I think what you're suggesting is, excuse me, if the Company were to file a case currently, based on a 2012 test year?
Q. Yes.
A. (Naylor) So, it's filing a case in 2013, would it have the ability in that case to request additional tax dollars that relate to the 2012 year, in addition to the normal tax allocation or expense that it would receive in rates going forward in any event? And, I think the answer is "no". There's no provision for that. That's not how rate-setting works.
Q. So, then, to follow it more broadly, it's your view that, assuming the Commission doesn't approve the Company's request, that, you know, the Company could recover its tax liability going forward, but it could never recover the tax liability it hasn't paid for 2012?
A. (Naylor) That's true. It's really no different than other expenses that occur in years that are unexpected.

It's the same thing as saying "well, the company only earned 2 percent return on its rate base last year, so, the Commission authorized us to earn 8. So, we need the other 6." I mean, that's what the difference in the tax liability, it's the same thing. I mean, the Company has to manage its financial affairs appropriately, and come in for rates when appropriate, seek financing when appropriate.

Q. Let me ask you this. You, obviously, understand the Company requested tax expense in 2012 in the last rate case, right?

A. (Naylor) It was a subject in the hearing. And, of course, the Company's request for a rehearing on that issue. Yes.

Q. And, you know, had the -- and the Commission didn't allow it for rates. But let me ask you this. If the Commission had approved a tax expense, the rates would have been higher than what they were otherwise set, right?

A. (Naylor) Presumably, if that's the only -- if that's the only other item that changed from the Commission's decision, yes.

Q. And, I understand that, you know, your position to be that the rate -- the taxes are in the calculation.

But, by not putting them in the rates that were set, didn't the Commission kind of going forward now hamper the Company's ability to reduce payables?

A. (Naylor) Well, --

Q. Or, reduce its ability to reduce payables?

A. (Naylor) Well, I mean, the Company asked for recovery of tax expense in its revenue requirement. The Staff and the OCA and the Commission ultimately agreed that, based on a 2009 test year, it wasn't appropriate. And, the Company amended its tax returns to exhaust its -- or virtually exhaust its carry-forwards. So, it's Staff's position that the Company has not shown that it was required to amend those returns and exhaust those carry-forwards. The Company's put itself in this position. And, it's not appropriate for ratepayers to bail the Company out of this position.

Q. So, "the Company put itself in this position", I want to explore that concept with you. Do you have the OCA data responses, data request responses in front of you?

A. (Naylor) I do.

Q. Okay. Let's look at OCA 1-5. Have you had the chance to review this before? And, now, I'm asking this to Mr. Laflamme as well.

CHAIRMAN IGNATIUS: This is Exhibit 5,

Page 5?

MR. RICHARDSON: Correct.

BY THE WITNESS:

A. (Naylor) I do recall reviewing this.

BY MR. RICHARDSON:

Q. Uh-huh. So, you see where Mr. Mason says "A rate request is a major financial and administrative undertaking." Do you agree with that?

A. (Naylor) Yes, I do.

Q. So, is it your view then that, even before the Commission denied rehearing, the Company should have brought another rate case?

A. (Naylor) It's not -- no, that's not my position.

Q. Well, you just explained that the -- we couldn't make these adjustments for taxes, because the last rate case, approved in 2012, was based on a 2009 test year, right?

A. (Naylor) Correct.

Q. And, so, here the Company is in 2012, without a tax expense in its rates. Should the Company then have, even before its last rate case was approved, updated its test year in that last rate case? I mean, how do they get to getting taxes into rates in 2012? What should they do differently?

A. (Naylor) Going forward from here?

Q. What should they have done --

A. (Naylor) What should they have done?

Q. -- to avoid this dilemma?

A. (Naylor) Made a better decision about amending its tax returns and exhausting the carry-forwards. I think Staff provided testimony in the rate case on that. That the Company had substantial operating loss carry-forwards available to shield any net income for a number of years to come, --

Q. But Mr. Laflamme --

A. (Naylor) -- and the Company chose, in order to make a case, it appears, in the rate case last year, chose to amend its returns and eliminate those carry-forwards. And, it came to the Commission and said "well, look, now we don't have any carry-forwards to shield our income, so please give us taxes." And, the Commission said "no".

Q. Okay. But you heard Mr. Laflamme say that the Company couldn't have claimed those loses in 2012, because they were no longer reflected on its books. So, the fact that the amendments did or didn't occur is irrelevant, isn't it?

A. (Naylor) It's not irrelevant at all. The Company made the decision to take those steps. The Company made the decisions that they made.

Q. So, is it your opinion that the Company could have simply not amended its returns, and then claim those net operating losses, even though it had converted the shareholder loan to equity and it had treated the pension expenses as income?

A. (Naylor) The amounts could have been just simply booked below the line. There are costs that a utility incurs, a very good example would be charitable donations and things like that, that are not recoverable for rate purposes, but are legitimate expenses, in terms of the Company's income statement. And, those expenses could very easily have been treated as below-the-line going forward.

Q. Okay. Do you have -- I don't know the exhibit number, Staff -- the response to Staff 1-8 **[**LRWC 1-8**?]**? This was Mr. Laflamme's response. I know we marked it as an exhibit yesterday.

MS. HOLLENBERG: Eleven.

CHAIRMAN IGNATIUS: You're right. It's Exhibit 11, from the prior rate case.

MR. RICHARDSON: Do you mind, just for expedience, if I approach, so I can read it?

CHAIRMAN IGNATIUS: Sure.

BY MR. RICHARDSON:

Q. Could you read the first sentence for me please in Mr. Laflamme's response.

A. (Naylor) Well, let me ask Mr. Laflamme. It's his response.

Q. Okay.

A. (Laflamme) "Staff believes that the reclassification of such payments to an expense account of any kind is imprudent. Rather" --

Q. Okay. Sorry, I didn't mean to interrupt you. I thought you were done with the sentence.

A. (Laflamme) No, that's all.

Q. Okay. So, I mean, I see a little bit of a conflict here, because, when I hear Mr. Laflamme say "we can't treat these pension expenses as any form of an expense", and the Company accepted that treatment, I don't think we can classify them as an expense above the line or below the line. But, apparently, you see it differently. Is that what I'm to understand?

A. (Naylor) Well, I'll let Mr. Laflamme answer the question additionally. But I think it's -- I think it's implied in that sentence that, when he refers to "the classification of such payments to an expense account", he's talking about above the line, includable in rates.

Q. But I asked Mr. Laflamme a pretty direct question. And, I thought that his answer -- I thought the question was "could the Company have claimed a net operating loss for expenses that it had basically recognizes as income on its books?" And, I thought the answer was "in 2012, no, the Company couldn't do that." So, I understand you suggest that you have a different view, is that right?

A. (Naylor) Well, I think it's a different -- we're talking about two different things. We're talking about ratemaking and we're talking about tax law.

Q. But that's a pretty risky thing to do, from a tax perspective, to treat revenue collected in rates, paid to your company's shareholders as health insurance benefits or pensions as an expense? I mean, do you really think the IRS is going to agree with that position?

A. (Naylor) It's a "risky thing"? A risky thing for the Company to claim as an expense payments that it made on behalf or to shareholders?

Q. Right. So, when the Company accepted that reclassification out of, and I believe Mr. Laflamme says right in his response there in front of you, to move it to retained earnings, isn't that what he says?

A. (Naylor) "Offset loans or equity injections from the shareholders."

Q. And, what does it say about "retained earnings"?

A. (Naylor) "Staff believes that an adjustment to increase the Company's retained earnings account by the amount of the reclassified shareholder pension and health insurance premium payments may be appropriate."

Q. Uh-huh. So, --

A. (Naylor) That's a current -- that's a current period accounting entry.

Q. Right. But, if the Company were to claim those net operating losses for those payments, but on its books they were treated as an increase in retained earnings, don't you think that's a problem?

A. (Naylor) I don't know if it's a problem. We asked you what the authority is that the Company was following for amending it's tax returns, and you've provided nothing. So, to suggest that somehow now the Staff is your tax authority is ludicrous.

Q. Well, I'm not suggesting that at all.

A. (Naylor) The Company has to be accountable for the decisions it has made. It's not Staff that is the problem for you here.

Q. Mr. Naylor, you just told us that you felt the Company "imprudently exhausted its net operating losses", which I assume you mean it should have claimed them in 2012 in a greater amount. But Mr. Laflamme is saying that some of those losses should be treated as retained earnings, which I assume means income, right?

A. (Naylor) So, your operating results would have been different, either in whatever year those adjustments were made, whether it's a 2011, 2012. It's a current period accounting entry. Meaning, adjustments take place in the period in which the decision is made to make those adjustments. To me, it does not imply going back to prior years. There's no other conclusion to draw from the Company's decision to amend its tax returns, other than the fact that it was going to make a case to the Commission that it now had tax liability. What other reason? I mean, --

Q. I don't want to take up the Commission's time. I think we've covered this area. So, I'll let the record speak for itself. Let's go back to OCA 1-5, because I think that's how we got onto this issue.

CMSR. HARRINGTON: Exhibit number?

MR. RICHARDSON: It's Exhibit 5. I'm on

Page 5. And, I think we got to the first bullet.

BY MR. RICHARDSON:

Q. And, you see where it says, on the second bullet, "On September 6, 2012, the full extent of the Company's 2012 tax liability was not known." Do you think it would have been reasonable for the Company to come in for a rate case at that point for tax expense, without knowing what its tax expense was?

A. (Naylor) Well, I guess you're asking me to hypothesize about what the Company should have done with the information that it had at the time, based on the knowledge of what it had done months prior to that.

Q. Well, let me rephrase it differently. Why don't you assume, hypothetically, that the Company could not use the net operating losses that reflected the change of the shareholder loans to equity, in other words, the interest expense on that, and the health insurance and pension payments, it had to treat those as income, once it accepted Staff's recommendations. What should, under that hypothetical, what should the Company have done differently? Should they have started a rate case on a new test year at exactly that point?

A. (Naylor) Perhaps. Perhaps so. I mean, the Company, by its own admission, has only one source of income, and

that's rates from customers. It doesn't have access to other forms of capital. So, I guess so.
Q. But what's going to happen to its payables, if it says "Hey, let's file a new", you know, Mr. St. Cyr's testimony accepting Staff's treatment of the pension expenses and the conversion of shareholder loans to equity, that was in a response to, you know, Mr. Laflamme's response, which is October 31st, 2011. So, it's accepted in the Company's testimony in December of 2011. Isn't it going to be just an absolute disaster to then say "okay, we've now accepted this position, and now we have to change our test year for the third time in this rate case." I think it started out as 2008, it moved to 2009, and then now we're going to go to, I guess, in 2011, we could use 2011, but we still don't have our 2012 tax liability. What do we do?
A. (Naylor) At what point in time are you talking about? December of '11?
Q. Yes. Because the --
A. (Naylor) Well, you hadn't amended your tax returns at that point. So, you still had a whole lot of loss carry --
Q. Right.

A. (Naylor) -- net operating loss carry-forwards to utilize. So, the issue hasn't ripened as yet.
Q. Exactly. Because Mr. St. Cyr only accepted those treatments because of the way the rate case played out. It was December of 2011 that Mr. St. Cyr accepted Staff's treatment of those expenses that are shown in the data response, right? I mean, isn't that when that happened?
A. (Naylor) I guess so. I don't recall exactly what the timing was. I do recall that we were just about at hearing, just about a year ago, when the Company filed revised annual report forms reflecting changes. So, I don't know the timing of it from that perspective.
Q. Well, --
A. (Naylor) The issue to me isn't so much what should have been done at what times, but what has been done looking to now. And, to focus on this rate request -- the emergency rate request and what the merits of that request are at this time. I mean, we are where we are.
Q. Well, do you recognize that the Company was in an exceptionally difficult position as a result of accepting those treatments, and then not gaining a tax expense? I mean, wasn't the choice then to either move the test year forward, which would cause the Company to

incur more regulatory expense --
A. (Naylor) No.
Q. -- and increase its payables?
A. (Naylor) No. I think the Company put itself in that position. The Company put itself in that position. The Company could very easily have booked the pension and health premium payments below the line for the test year, accepted, if they wish to, the Staff's recommended rate treatment that they not be recovered through customer rates, and could have gone forward with the operating loss carry-forwards that were in place.
Q. On what basis do you conclude that the Company could carry those losses forward, despite changing its books to reflect those as either paid-in capital, as Mr. Laflamme had done on his schedule, a reduction, or retained earnings or any other form of treatment as income?
A. (Naylor) We asked the Company to provide us with the authority that it was operating under.
Q. That's not the question.
A. (Naylor) It goes to the very heart of the question. You have the burden of proof. It's not Staff's burden of proof. To this minute of this hearing the Company

still has not provided the Commission with the specific statute or IRS code section or whatever that required them to refile its tax returns. I mean, the burden of proof is --

Q. Well, that's a question of law, isn't it?

A. (Naylor) You put the burden of proof on the Staff, and it's just not appropriate.

Q. No, no. You see, I'm trying to get at a much simpler question. You've expressed an opinion that the Company could have claimed these net operating loss carry-forwards in 2012, that were effectively -- that we believe were eliminated. What is the basis for your conclusion?

A. (Naylor) That there were carry-forwards from prior years on net operating losses.

Q. So, you're not citing me any IRS rulings. And, I assume, therefore, I'm going to assume that you're unaware of any, any IRS regulations, any provisions in the Internal Revenue Code, that would say that, once, even though the Company has adjusted its books to reflect those payments as income, it can still claim a net operating loss. Where does it say that, that you can do that?

A. (Naylor) It's not the Staff's burden of proof.

Q. Okay. So, we --
A. (Naylor) We asked you to show us and show the Commission where your authority comes from. That is the proper analysis here.
Q. And, I think we have -- we can accept that the Company believes it's provided reasons why it can't, and we can accept that you don't agree with the Company's reasons. What I am trying to get at is is can you tell me what provision you base your opinion on that the Company could claim those net operating losses for pensions and conversion of the shareholder loans to equity in 2012? It's fine to say "no", if you don't know.
A. (Naylor) I haven't done the research. I don't need to do the research. Why would I do the research? We asked the Company. You have an obligation to comply with all of your regulatory obligations across the board, DES, PUC, IRS. We asked you in discovery for citations to the specific statutes, rules, code, and you've dodged the question right to this very minute. And, now, you're flipping the burden onto the Staff.
Q. You see, I don't think I'm dodging the question at all, Mr. Naylor. And, I'm sorry --
A. (Naylor) The Company -- The Company has dodged the question from the minute this filing came in.

MR. RICHARDSON: At this point, I'll ask the Chair for some guidance. I mean, I think we're beating a dead horse. I think I've asked for an answer, I'm not sure I've gotten one. I don't know if the Chair wants to ask the witness to answer the question or --

WITNESS NAYLOR: I just gave an answer that I thought he was looking for. I said "I have not done the research." I have not researched the IRS Code, I have not asked Ms. Brown or the Legal Staff to do any research in this area. We have not had time to do any research. I mean, I think it's clear, it's Staff's position that it's the Company's burden to provide what its authorities are.

BY MR. RICHARDSON:

Q. So, I'd like to get to the point where we can wrap this up then. So, it's your position then that the Company should -- excuse me, the Commission should deny the request for emergency rates that we've asked for. And, my question to you is is, if the Commission does that, and, as you have suggested, the unpaid tax liability can't be used as a reconciliation for the Company's future rates in order to recover that, why isn't that an emergency? Isn't that going to have a huge impact on the Company's financial position?

A. (Naylor) When I began my direct under questioning from Ms. Brown, my first statement was "by law, this Commission is obligated to balance the interests of shareholders and ratepayers." And, I don't believe approval of this Petition represents an appropriate balancing.

Q. Uh-huh.

A. (Naylor) The customers rates that were paid in 2012 are fully compensatory to the Company. Any increase is incorrect.

Q. So, then, you would agree with me that, in performing its role in balancing the interests of shareholders and customers, it would be appropriate for the Commission to consider the amount of revenue that the shareholders may have received over the last five years?

A. (Naylor) The amount of revenue that the shareholders may have received?

Q. Yes. What the shareholders have received in return for their investment of I believe it was $1.5 million approximately?

A. (Naylor) Well, we had this line of questioning earlier.

Q. But it is appropriate to consider it? Do you think --

A. (Naylor) Yes, it is. I probably should have stated earlier that, as a general rule, I do not have any objection to a utility declaring dividends for the benefit of its shareholders. That's, in an ideal world, a healthy utility is able to do that every year. And, if Lakes Region Water Company were a healthy utility, financially healthy, we would be perfectly happy to see dividends declared and paid to the equity holders. However, the timing of this distribution is as bad as I've ever seen. It's the timing.

Q. So, if the Company is unable to get emergency rates for taxes in this case, and -- for 2012, and it's unable to recover its 2012 unpaid tax liability in the permanent rate case, what effect is that going to have on this Company's financial position?

A. (Naylor) I think it's going to force the Company to consider -- reconsider how it's going to access capital, like utilities do.

Q. So, it's going to have to just think differently? What's going to happen --

A. (Naylor) No. It's going to have to act. It's going to have to get capital. This Company is refusing to get capital. We heard the testimony yesterday. We have equity capital going in the wrong direction.

Q. Uh-huh.

A. (Naylor) This is the problem. The funds cannot come from customers. They're paying compensatory rates. The Company has put itself in this position. And, the customer base is not a bailout option.

Q. Yes. I'm not arguing or asking you, you know, for an opinion on how we got there. I'm asking you for an opinion on what the impact is on the Company's financial position?

A. (Naylor) Well, it depends on what actions the Company decides to take.

Q. Would you agree that this tax liability, you know, if we can't recover it, it's going to cause a pretty close to a financial crisis, if the Company is unable to pay its tax obligations?

A. (Naylor) Yes. Yeah, I understand. I covered that in my direct. I made a statement about it. The Company is unable or unwilling to access capital.

Q. But that's --

A. (Naylor) Then, it may need to consider selling its assets and finding an equity holder who has the capability of accessing the capital markets. That's very simple.

Q. Do you have the Company's Petition for Emergency Rates in front of you?

A. (Naylor) I do.

Q. Could you turn to Paragraph 8 please. And, you see where it says, obviously, I'm quoting myself here, "the Supreme Court upheld the finding of an emergency where it was", and then the part in quotes by the Supreme Court, it was "unlikely that PSNH would be in a position to meet its cash obligations as they became due: Namely, interest and principal payments on debts, expansion of service to customers, and fuel expenses, payroll, and other related expenses". Did I read that correctly?

A. (Naylor) Yes.

Q. Okay. So, I mean, we've seen an expansion in the Company's payables as it tries to deal with rate case expenses, as it tries to deal with all of its obligations. And, those aren't all attributable to the payment to shareholders, are they?

A. (Naylor) No.

Q. Do you agree that this company is having difficulty paying for expansion of service to customers?

A. (Naylor) Is it -- would you state that again please.

Q. Well, there's two kinds of expansion, obviously. There's improvements of service to existing customers, and then there are, you know, kind of revenue-generating expansions. And, so, my question to you is is do you think that this Company is unlikely to be able to meet its obligation to provide expansions to customers or expansions of service to customers?

A. (Naylor) I don't really know. I would expect there would be some impact, yes. Certainly, there would be some impact.

Q. And, isn't the absence -- strike that. And, then, you see the Court, and the sentence continues. It says "investors in the market were", and then the part in quotes "unwilling to provide additional new funds for PSNH due to investor perceptions of high risk". And, let me even take out the "tax liability" question. Do you think that investors would perceive Lakes Region Water as having a high risk?

A. (Naylor) I don't think there's any question that investors would consider Lakes Region Water, the corporation, to be high risk. Lakes Region Water, the corporation, has assets that investors would be very much interested in.

Q. And, apart from -- but here's the question though. I mean, are investors -- would they be unwilling to provide new funds to Lakes Region Water Company? I understand, you know, anything's for sale at the right price. So, let me set that aside and just ask you this. Would investors be willing to invest in Lakes Region Water Company even without the tax issue being considered?

A. (Naylor) I don't know. I guess it -- I guess it depends on what, you know, what the investor's looking for, what kind of return they're looking for. I mean, this situation you point out here may be very germane to Lakes Region, because wasn't PSNH sold just a couple years after this decision?

Q. Yes. And, I -- well, I'm going to strike my "yes", because I don't actually know the answer to that question.

A. (Naylor) Okay.

Q. So, I feel like I should know it, but I can't claim that I do. But let me ask you this. And, there are people on the Bench that probably do know the answer to that question. So, let's back up. Mr. Mason testified that he didn't think he could get equity. Are you aware of any options that this company might have to get equity, where an investor might be willing to provide it?

A. (Naylor) No, I don't.

Q. Okay.

A. (Naylor) That's part of the concern.

Q. And, then, you know, so, is it true, you know, sometimes I look at this as, you know, the straw that broke the camel's back. And, the Company certainly isn't claiming or it shouldn't be suggested that taxes are the only issue. But would you agree with me that the absence of tax revenue in rates contributes to the risk?

A. (Naylor) Yeah, I'm sure it does. That, and many other things. But, again, the Company's request for emergency rate relief to be paid by customers is not the appropriate answer. Otherwise, we turn the customers into investors.

Q. And, the same, I guess, let me ask you this, is probably true for debt financing. I mean, this is a serious problem. And, banks are likely unwilling to loan the Company money, because of this tax problem and others.

A. (Naylor) Are you asking me if that's true or is that a statement?

Q. Do you agree with that statement?

A. (Naylor) I think the Company has indicated to Staff and OCA and other parties to their recent proceedings here that the limited terms they were offered were very, very difficult to accept. That there may have been some opportunities for bank financing, but the terms were very difficult to accept. And, so, yes. I think that's --

Q. Thank you. I think --

A. (Naylor) I think the equity capital needs to come before the debt capital, it can be possible.

MR. RICHARDSON: Thank you. I have no further questions.

CHAIRMAN IGNATIUS: Thank you. Commissioner Harrington, questions?

CMSR. HARRINGTON: Yes.

BY CMSR. HARRINGTON:

Q. Let's kind of -- I just want to walk through one thing here, to make sure I understand exactly what we're going. So, if we can go to Exhibit 4, Page 168. And, either of the two witnesses can answer, whoever is appropriate. And, just let me know when you get there. Okay. There's a block there called "Operating Revenues". And, if you go down, under "Preliminary Actual December 2012", there's a number of "$1,198,050". Now, am I correct that represents all the sources of revenue for the year 2012?

A. (Naylor) Correct. Yes.

Q. Now, if there had been approval -- let me just get back to the question, that's the 2012 revenue. Now, we go to 167. And, at the top of that page, under the same column, "Preliminary Actual December 2012", the same number appears, "$1,198,050". And, then, we go down a list of operating expenses. One of which is listed as "Provision for Income Taxes-current $97,949". Is that the -- I assume that's the tax liability or estimated tax liability for 2012?

A. (Naylor) That's correct.

Q. Okay. But, as we continue to come down, we get the net income of "142,617". And, if we follow that over to 164, that same number appears on the top of the page, under the column "2012" under "Net Income" again. And, we drop down that column, we get to the "Net Cash Provided by Operating Activities 408,616". Then, we go down to the very bottom and we end up with cash at the end of the year of "11,303". So, and my question I guess is, if we go back to Page 168, and we look at that number, the "$1,198,050", and that's a compilation of all the different sources of revenues that were made up during that year. But the 2012 taxes that show up as an expense, on Page 167, were not considered in determining the revenues on Page 168. Is that correct?

A. (Naylor) That's correct.

Q. Okay. I just wanted to make sure I followed that logic.

A. (Naylor) This is, just for additional clarification, on Page 167, this is essentially a simplified income statement. So, it's a statement of their earnings for the year, for the 2012 year. And, what Mr. St. Cyr, I believe is the author of this document, what he has done is, on a preliminary basis, taken their operations, their revenues, less their expenses, and he has calculated what their income tax would be, based on -- this is a -- there's two portions of it. There's a "current" and there's a "deferred", and we don't need to really get too far into that. But, part of the normal conclusion of a year or the close out of a year by an accountant is calculating what the provision for income taxes should be, so that you're accurately reflecting all of the expenses a company incurs in that year, not just the normal payroll and vehicle expense and all of that. Income taxes is very much a normal operating expense as anything else. It usually takes a month or two after the year is closed to get to the point where you do that calculation. But it very much pertains to that year.

Q. Okay. So, I guess what I'm trying to get at and get straight in my mind then is that, in these three pages, the expense for the income tax for the Year 2012, the "$97,949", shows up and it's listed as an expense. But there are no revenues based on having to pay that tax in the $1,198,050, because of the last rate case, which did not include a provision for the 2012 income taxes?

A. (Naylor) Yes. You're a little bit, you know, apples and oranges, a little bit, because to say that there are no taxes in the revenues goes back to the rate case. And, as we build rates from the revenue requirement that's approved, saying we "build rates" means we calculate what the unmetered rate should be, what the fixed meter charge should be, the consumption charge should be, and any other rate categories a company may have, fire protection. I don't think Lakes has any of those customer classes. But, anyway, you calculate what those rates are, and the total of all of those rates times the consumption for the year equals revenue requirement. So, then, you go forward with those rates. So, the revenues are likely going to differ somewhat from the revenue requirement established in the rate case, just because of normal changes. When you have a wet summer, for example, with water utilities, summer weather is a big impact. If you have a wet summer, your sales are going to be down. If you have a hot, dry summer, they're sales are typically going to be higher. So, the revenues are going to vary depending on circumstances. So, to say that the actual revenues they received for '12 didn't contain taxes, really isn't quite the exact comparison that --

Q. Well, what was projected then, when the calculation of the rates that led to the determination of that number, the 1,198,000 blah, blah, blah, that did not -- that assumed that there would be no federal tax liabilities for 2012, because the carry-forward would cover them from having to pay taxes?

A. (Naylor) Correct.

Q. Okay. I just wanted to make sure I got that part straight. There's been an awful lot of discussion on how we got here. But, for right now, I would like to limit that to the fact that we're already here. And, by that I mean, let's assume, for the sake of argument, that the 2012 taxes, the liability is there. They're going to have to pay those. Let's just assume it's due. They have penalties, interest and *etcetera*. Let's assume that the money that's been paid to the shareholders is gone, and that whatever the correct term is, "paid-in capital", or whatever it should have been, it's no longer there. So, having said all of that, how is the Company supposed to pay for the 2012 taxes?

A. (Naylor) Well, you're right, we've gone through -- gone through a lot of that. And, I guess it's a question of what decisions the Company is going to make from this point forward. We're really in the same position we were in a year ago. And, I provided testimony that I thought the Company's financial circumstances were such that it should be sold, the utility system should be sold to another company. And, I still feel that way. I think the situation is getting worse, not better, despite some optimistic testimony yesterday.

Q. Okay. So, kind of going along that line, in your direct examination, you basically said that "the emergency rates were not justified because the Company didn't show it had to amend its taxes and it made an unjustified return on capital to its owner." And, again, let's put those aside as reasons for not justifying the rates. Let's assume that's happened, it's, you know, the proverbial "water under the bridge". Based on that, and based on the fact of what the law says, it says "Whenever the Commission shall be of the opinion that an emergency exists", do you think that an emergency exists with regard to this utility?

A. (Naylor) No.

Q. Okay. And, why not?

A. (Naylor) Because it's -- the only remedy that appears imminent is for customers to bail out the Company. I honestly believe that this is a bailout. That there's no other way to suggest otherwise. There's no other word for it. It's a bailout. The Company has made bad decisions, financial decisions.

Q. Right. I understand that.

A. (Naylor) But that -- I think that has to figure into the calculation of a decision.

Q. I'm trying to get what the law says. There's nothing in the law that talks about "looking back". In fact, if you look at the Supreme Court decisions, it specifically says "how the company gets here is not relevant to whether an emergency exists." So, assuming again, I know you don't agree with it, but let's just say we're not looking back, the situation is what it is today. However we got here, we're there. Does an emergency exist for this company presently?

A. (Naylor) If you put aside the reasons the Company is in this position, which is tough to do, --

Q. Yes, I understand that.
A. -- very tough to do, and there are no other sources of capital available to the Company, which, by virtue of their filing this Petition, kind of tells us that they don't have any other sources of capital. Then, presumably, the Commission has to make a decision that they will approve the Petition.
Q. And, let's just say -- let's say that the decision is made that would agree with yours, that there is no emergency, because of for whatever reason, then what happens then? What are the Company's options, in your opinion?
A. (Naylor) If the Petition were denied?
Q. Yes.
A. (Naylor) Well, I realize that the financial situation gets worse and not better. They would have to do some quick thinking as far as what resources are available to them. Whether it's debt or equity. And, whether or not that, you know, an unfavorable regulatory decision warrants some other action. Whether they ask for a rehearing, whether they go to court, or whether they accelerate their -- any efforts that they may have taken to this point to explore buyers for their utility assets. I guess those are the options. So, --

Q. Let's assume for a second, let's go the other direction, and assume that the emergency rates were granted. Now, as we've discussed at length yesterday, the amount of the money that they're requesting would only cover the 2012 taxes. And, more than likely, not most of the penalties and interest associated with that. So, it would also be collected over a period of years -- of a year, and the taxes are all due in a couple days. The quarterly estimated taxes for 2013 are coming up shortly. So, they could make some type of a limited payment schedule, but they certainly wouldn't come close, even at the end of the year, to paying all of their 2012 taxes, penalties and fees, as well as trying to keep current on their 2013 estimated taxes. So, having said that, if emergency rates were granted, what could the Company do then to rectify that situation financially? What would be their course of action?

A. (Naylor) Well, I think it's probably going to be a case of limping along. They're going to have to make additional decisions about everything that they do. All their spending decisions, all their expenses. Perhaps look at, you know, relook at their capital improvements, scheduled capital improvements. What do they have to do and what can they put off? There are significant impacts from that, of course. But, you know, absent, I hate to keep saying the same thing over again, but absent external capital, whether it's debt or equity, they don't have any other choice. They have to work with the customer revenues, and that's all they have. In fact, that's why they're so handicapped, because --

Q. Could they come in for another rate case then? They've already spoke -- I think they said the term was "99.9 percent sure they were going to file a rate case in the spring"?

A. (Naylor) Yes. I read the testimony that indicated that they planned to do that. The preliminary analysis of their 2012 year provided by Mr. St. Cyr shows that they're not -- that they have no basis for a rate case based on a 2012 test year. Now, there was some discussion earlier that there may be some adjustments that are appropriate to those, to the preliminary 2012 results, which may ultimately show that the Company has a revenue deficiency for 2012, and that they could justify a rate filing. But --

Q. Well, let me follow up on that then. In your discussions, it was stated I think to the effect that,

if they came in 2013, and they used 2012 as the test year, that even though they had tax liabilities, and, in fact, by the time the rate case came about, and we're assuming they get the emergency petition, they have been paying at least something to the IRS for their 2012 taxes, I believe you stated that they "would not be able to put those costs in the rates, even if 2012 was the test year." Is that correct?
A.   (Naylor) I don't think I said that.
Q.   Well, maybe you can address that.
A.   (Naylor) I hope I didn't.
Q.   Maybe I misunderstood what you said. If they came in, let me put it this way, if they come in with a rate case in 2013, with 2012 as the test year, would they be able to put into their rates the income taxes for 2012?
A.   (Naylor) Generally, yes. I think, from Staff's perspective, and what, you know, at our level, if you will, and our review, I think that's a determination we would have to make later. Because, certainly, the Commission's order in this proceeding is going to provide us with some -- should provide us with some guidance. And, let me give you an example of what I mean by that. If the Commission were to issue a ruling in this case that the Company's amending of its tax

returns and the exhaustion of its loss carry-forwards was imprudent, then Staff could possibly recommend in the next rate case that they're not entitled to income taxes for as many years as the loss carry-forwards would have carried, you know, would have shielded them from taxes. I don't know. I mean, that's the kind of thing that it depends --

Q. I was hearing it as more absolute. And, what you're saying, it would be open for review, based on the validity of their using up their tax credits in 2012, whether they should, previous to 2012, whether they should have had carry-forward credits to use. So, that would be open for investigation?

A. (Naylor) Yes. Absolutely. And, as I said, I think the Commission's ruling in this case will provide us or should provide us with some guidance on that.

Q. I'll just go over my list here. Bear with me for a second. Oh, one other, just one question. You were also asked about some of the options that could be taking place. And, you talked about getting access to outside, to either equity or debt. And, it appears, at least on previous testimony, that no one is willing to loan them money. And, I think we all understand why, given the circumstances of their accounts payable and so forth. And, there is nobody else that's willing to put in more equity. You also mentioned that the Company could be transferred to someone who could have access to debt or equity. How long of a process would that be? Is it something that you think would take, if indeed were it to go forward, is it something that takes three months? Six months? Two years? I'm just trying to get a ballpark figure.

A. (Naylor) It's hard to say. I would think it would be more a matter of a number of months, rather than a number of years. Anyone that would be interested in the Company, I would surmise would be interested in purchasing the assets, and not the corporation, for one thing. Then, once someone of interest were to conduct their due diligence, they would certainly want to look at DES records, you know, do field visits and so forth, and get a handle on everything that they see in the field, and certainly do some analysis as to what kind of additional investment they would foresee in the coming years in those systems. Then, they would be in a position, I guess at that point, to make an offer. So, you know, from the time that a potential buyer were identified, to the time that a buyer, a potential buyer could make an offer, I would guess, would be a matter of, you know, four months, six months. I don't know, it's hard to say but.

Q. And, you mentioned that you thought someone would buy the assets and not the corporations. But, and, again, I'm going in an area where I really the -- asking questions you don't know the answers, I'm clearly there. If the -- that was to be done, and someone purchased the assets, that would leave the corporation without assets, without physical assets, but with an awful lot of debt. Wouldn't that accelerate people going to court to collect their debts and force the Company into bankruptcy?

A. (Naylor) Well, you'd have to see what the workout looked like. I mean, if the corporation sold its utility systems, depends what the price they get, whether that price is adequate to satisfy the debt and equity holders. Hopefully, it would be enough.

CMSR. HARRINGTON: All right. Thank you. That's all the questions I had.

CHAIRMAN IGNATIUS: Thank you. Commissioner Scott.

CMSR. SCOTT: Good afternoon. Again, I suppose the same rules apply. I think most of these questions are for Mr. Naylor, but either one of you, if you feel you can help.

BY CMSR. SCOTT:

Q. To start, am I correct that there's a difference between the handling of financial records to address the tax code, rather than rulemaking? Is that a correct statement? Ratemaking, excuse me.

A. (Naylor) There's a difference in the -- you said the handling of --

Q. Financial records. I can rephrase it, if you'd like.

A. (Naylor) Yes, if you would. I'm sorry.

Q. Do you need to treat financial records the same to meet the tax code requirements as you do for rulemaking requirements?

A. (Naylor) Ratemaking requirements.

Q. Thank you. Ratemaking.

A. (Naylor) Generally, yes. Yes. There are some differences, particularly in the area of depreciation. The tax -- typically, tax depreciation is done differently. But you work from your books and records that you keep on a regular basis to prepare your tax returns, work from those records.

Q. And, so, okay, so, you're saying basic -- effectively, it's the same set of books?

A. (Naylor) Correct.

Q. Okay. But how you treat it may be different?
A. (Naylor) In a few areas. Typically, what the accountant would do is, when he closes the -- he or she closes the year, then there's a series of adjustments that are evaluated. And, then, particularly tax items are identified, differences in depreciation. There are a number of other areas that the accountant will need to evaluate for purposes of tax reporting and the calculation of taxable income. But you're always working from the original books and records of the company.
Q. Okay. That's helpful. Thank you. And, in this case, we've been discussing below and above the line for, this is my shorthand, but expensing payments to shareholders and the tax -- potential tax treatment of that, Correct? That was one of the issues we've been discussing.
A. (Naylor) Correct. Yes.
Q. You deal with a lot of the utilities, correct?
A. (Naylor) I do.
Q. And, do you have any examples, have you seen examples where these below-the-line type expenses are treated similarly to what you're suggesting that -- on the tax return?

A. (Naylor) Yes. Yeah. They're not all that common. I use one example that had occurred to me when I was sitting up here was that a number of companies make charitable donations every year, to all kinds of different organizations and so forth. Those particular expenses are not recoverable through customer rates. So, they are booked "below the line", meaning that it's not includable in rates, for customer rates. So, it's fairly common.

Q. Thank you. And, on Mr. Mason's testimony, on Page 8, he discusses that he asked his accountant whether this could be -- they could have "lawfully avoided amending their tax returns?" And, the answer was apparently "no, they could not." And, going back to your discussion with Attorney Richardson. So, if I understood right, there's been no, even though that it's been expressed that the law requires, there's been no cite or nobody's ever produced anything saying what that judgment is based on?

A. (Naylor) Yes. I have not seen anything. I don't believe anything has been entered into the record that, in my opinion, provides the answer to that question.

Q. Okay. Thank you. And, if the Company were to decide perhaps they legally could do this, is it too late to

amend, re-amend, if you will, the tax returns?
A. (Naylor) I don't know the answer to that.
Q. So, I guess the answer would be, is this reversible, would be the same question -- same answer?
A. (Naylor) I don't know. I don't know. I suppose, if -- well, I guess that probably would actually require you to show very clearly why you were doing what you were doing a second time, whether you're reversing in whole or in part amendments that you've made. I guess, it seems logical to me, Mr. Laflamme may have an opinion, he used to do more tax work than I have ever done, but seems to me, if, ultimately, where you're getting is to the correct -- calculation of the correct taxable income, then the IRS should be satisfied.
But, I don't know, if, Mr. Laflamme, you have anything to add that to that?
A. (Laflamme) I believe that there's a three-year limitation on how far you can go back.
CHAIRMAN IGNATIUS: And, I might add that we have information from Mr. Richardson that Mr. Roberge did speak to the IRS. And, among the things that he talked about, and this is going to be updated in writing, was that it was about "amending returns and tax liability". So, whether that's amending an amended return

or something otherwise, that was one of the things that Mr. Richardson mentioned.

CMSR. SCOTT: Thank you.

BY CMSR. SCOTT:

Q. Another topic. In the last docket on this, I think there was some discussion about the "State Revolving Loan Fund". Do you know if that's still available to this company?

A. (Naylor) Yes, it is. Well, it's a program that's ongoing. The money is competitive. The companies submit projects that they would like to fund to DES, and the monies are competitive. But, yes, the program is still ongoing.

Q. And, I'm going to ask a question, so, you've already kind of given an answer, but I just want to hear it in a different way, I think. Is what we've heard from the Company, and I think you've somewhat agreed, is that right now, given the Company's financial state, certainly investors are reluctant to invest in the Company because of the high risk. Is that a correct statement, based upon what's been said?

A. (Naylor) I think it's a fair statement.

Q. Yet, in that context, do you feel it's reasonable for existing investors to expect a dividend, if the Company is in a state where new investors won't -- are reluctant to invest?

A. (Naylor) No, I don't. And, I think I've testified to that. Just the timing of the distribution was not -- was not good.

Q. And, finally, just to clarify, Attorney Richardson spent a considerable amount of time asking you questions about his client's submissions. Other than, you know, just to clarify, did either one of you have anything to do with the calculations or the submissions themselves in preparing those? So, this would be the attorney's responses to Staff questions?

A. (Laflamme) We had no -- had no input into what the Company provided in responses to Staff data requests.

CMSR. SCOTT: Okay. Thank you. That's all I have.

CHAIRMAN IGNATIUS: Thank you. I have a few questions. Though, much of this has been covered.

BY CHAIRMAN IGNATIUS:

Q. Mr. Naylor, the discussions about the challenges that small water companies face came up before. Are you familiar with small water companies in New Hampshire that have, despite being small systems, are able to meet their expenses and pay their taxes and invest in plant?

A. (Naylor) Sure. Yes.

Q. So, that size in and of itself doesn't mean that you're doomed to failure?

A. (Naylor) No, it doesn't. Everything is dependent on the circumstances, of course, and the ownership. We have a number of small systems that are owned by individuals or companies who are in the business or a related business or a construction business, which is certainly helpful, to have a parent company or a related party that has some expertise in the business. And, as I think the Commission knows, that, over a number of the last, you know, 11 or 12 years, the number of regulated water utilities this company -- this Commission has under its review now has gone from about 45 to 16, in that it sort of recognizes the difficulty of the small water companies and the challenges they face. There's no question about that. And, that's the primary reason for the declining number of companies that we regulate, is that they have been purchased by larger companies, in a few cases they have been municipalized, and homeowners have taken over a few. So, and that's not unique to our state, that's the trend we're seeing nationally. So, there are, there are some examples of solid, financially healthy small water utilities. But it is, unquestionably, a very challenging business.

Q. In the financials that were submitted by the Company that we've been through, it's been stated again and again that taxes were already accounted for, for example, if you look at Page 164, the operating net income at the top of the page, there's "142,617", and that that's a figure that already reflects an expectation of taxes being paid, correct?

A. (Naylor) Yes. Essentially, what it does is it recognizes the tax expense for the year. Doesn't mean it's been paid, but it recognizes the expense.

Q. And, that was on the cash flow statement, if you look at the Operations and Retained Earnings Statement on 167, again, there's a provision for income taxes, under "Operating Expenses". So, again, it's anticipating that those are liabilities the Company will have to face. And, that net income that is at the bottom, towards the bottoms of the page, is after recognizing that there are tax expenses that are -- that should be paid?

A. (Naylor) Right. That's exactly right. There's a tax expense for income statement purposes to reflect a cost that the Company's incurred in that year. And, then, there's also an entry on the balance sheet to reflect the fact that there is a payable to the government for those dollars.

Q. So, given that the Company, we all recognize, has extremely tight cash flows, because of other needs for investment in plant, for paying old receivables, other challenges to its cash flow, and given your acknowledgement that it is, you used the word "unbankable", and that there is no equity lender who has come forward at this point, what would you have done under those circumstances, once you knew there would be a tax obligation? What would you have done as a prudent manager, to avoid this situation?

A. (Naylor) Does that presume that I amended my corporation's tax returns? I mean, that kind of sets up the scenario of where I am.

Q. All right. And, I understand that you would not have done that, you said that that was a "poor choice". Are there -- if that had not been done, would that have resolved all of the issues here or would there still be other things that would have been appropriate to do?

A. (Naylor) Well, I still think that this company has got to find a way, if it's going to survive under its present ownership, it's got to find a way to access capital. Capital is the lifeblood of a utility. I quoted the Commission's order from about five years ago that "the access to capital is a cornerstone of a utility's" -- "valuation of a public utility's capabilities."

So, you know, absent the ability to access capital, it's hard to say what I would do with this particular company, because this is not a -- this is not just sort of, you know, XYZ Water Company. This is a company that's been owned by the same family for 35 years, 40 years.

MR. MASON: At least.

BY THE WITNESS:

A. (Naylor) A long time. And, Mr. Mason's parents founded this Company, and grew it. And, for a long time, Mr. Mason's father was active in acquiring small systems and bringing them into the Company, and, you know, fixing them. And, fortunately, for a long period of time, the Company didn't need a whole lot of money, a whole big slugs of capital, if you will. The kind of thing that started popping up in what, '05, '06, '07, with Hidden Valley, and some other systems, they had some real significant failures and problems that can happen with older, aging systems.

So, it's hard to say what I would do in the place of Mr. Mason, for example. It's very difficult. Because they -- his family is the owner of this Company, and it's hard to separate, you know, how to separate that out. And, I realize that. And, I realize it's difficult for Mr. Mason and his family to hear the Staff say some of the things we say. And, it seems like we're harshly critical. We have criticisms, but we also recognize the Company has done some excellent work, and has done -- made a lot of progress in last few years. But the financial situation is dire. It's dire, and it's unsustainable, so --

BY CHAIRMAN IGNATIUS:

Q. Could the Company, although there's a pressure from vendors, and echoed by the Commission, pressure to bring down the accounts payable, could the Company have backed off on some of that and set aside money to be able to pay taxes, once it knew that it absolutely had that obligation?

A. (Naylor) Yeah, I don't know. One of the issues that we had pursued with the Company, I think, initially, when we opened the investigation docket in 07-105, which was opened in, I think, September of 2007, we had talked to the Company about it, about the idea of hiring a business manager. That the Company, in its pursuit of, particularly, rate cases, but in a lot of other regulatory pursuits, like annual reports and so forth, was relying heavily on outside consultants, which seemed to be very expensive. So, that's one area that the Company has started to address.

I think that's -- I wish, and, frankly, and I guess I'm getting around to the point that, for the Company to pursue regulatory proceedings here has just become incredibly expensive. I mean, the Commission just approved a few months ago the recovery of rate case expenses in the amount of 150 something thousand dollars, for a company that has 1,600 and change number of customers. It's just a crazy number. Extraordinary case, with a lot of other things going on, a lot of, you know, a number of dockets involved and molded into it, and also some additional dollars deferred for their future case.

So, that's -- it has become and it's been a concern of the Staff, that it costs this company a lot of money to pursue regulatory proceedings here. And, we have tried to look at ways that that could be made easier.

Q. Yesterday, Mr. St. Cyr kept saying, "once the pension and medical insurance premium category was considered" -- "was no longer a valid expense, then the Company had no choice but to amend its returns." Is it your opinion that those are not valid expenses or that it was not appropriate for ratemaking purposes?
A. (Naylor) It's the latter. It's the latter.
Q. So, if that's the case, what could the Company have done to recognize that it's not a valid ratemaking expense that wouldn't have required amending tax returns?
A. (Naylor) Just book those expenses below the line.
Q. And, what would they have been called?
A. (Naylor) "Non-operating expenses".
Q. Is that something you've seen in other circumstances?
A. (Naylor) Yes.
Q. You mentioned "charitable contributions".
A. (Naylor) Right.
Q. Is that one?
A. (Naylor) Yes.
Q. Can you think of others?

MS. HOLLENBERG: Advertising.

WITNESS NAYLOR: Thank you.

BY THE WITNESS:

A. (Naylor) Advertising.

CHAIRMAN IGNATIUS: With a little assist there from the OCA.

WITNESS NAYLOR: A little birdie told me that.

MS. HOLLENBERG: I haven't had lunch yet. So now, my mouth is going to work uncontrollably.

BY THE WITNESS:

A. (Naylor) Yes. You know, particularly with the smaller companies, we've seen it from time to time. I don't know, I'd have to try and think. Way back, when I first got here, there was like somebody, like he fixed his daughter's car or something, and we were like, "no, you really got to book that below the line." So, I mean, it's just -- it's non-operating. It also could incur -- include expenses that are not expected to recur. So, we might not only remove them from the ratemaking, but suggest that all or a portion of them might be more appropriately booked below the line.

BY CHAIRMAN IGNATIUS:

Q. So, to say something is "not a valid expense for ratemaking purposes", doesn't mean it's an "illegal expense". It's nothing improper necessarily, it's just whether it should go into the ratemaking calculations?

A. (Naylor) Correct. That's absent any other type of prudence determinations. You know, if the owner of a small water company is driving a Maserati, for example, and he's charging the full cost to the company. Well, it's not unreasonable for him to have a car or a vehicle, but it's certainly imprudent that it's cost him $400,000.

Q. I'm going to go out on a limb and say that I doubt Mr. Mason is driving a Maserati. The options available, when you get into this sort of a situation, where you've got tremendous -- you've got rates that are adequate to cover the anticipated expenses of the Company, and a return, but are not designed to cover past arrearages -- past accounts payable or other cash flow demands, and are not designed to fund improvements to the system, is the situation we have here, correct?

A. (Naylor) Yes, it is.

Q. And, the options you talked about, you know, ideally, it's equity investment, but we know that that's difficult. It's debt, and we know that that's difficult currently. Is bankruptcy reorganization also an option?

A. (Naylor) I suppose it would be, yes.

Q. Is it -- can you think of any time where, because of an unusual circumstance, rates have included -- have been ordered by the Commission to include a short-term surcharge to allow for some increased revenue, followed by a reduction in rate revenue, not just cessation of the surcharge, but actually reduce below the base rates, in order for customers over the period, whatever period of time, let's say it's a year, to be made whole? So that, in effect, the ratepayers become a bit of a lender, to say, for six months they're going to pay extra to bring some greater cash flow to the Company. And, in the following six months, they're going to pay less than they -- otherwise the rates would have been. So, at the end of the year, they're paying the same amount they would have at the regular rates through the course of the year. So, the revenue is not increased over the 12-month period, the timing of the receipt of the revenue has changed, to be front-loaded at the beginning, and lower in the second half of the year. Can you think of any time there's been a mechanism like that?

A. (Naylor) I don't recall one offhand. And, I do know that there were some unique ratemaking mechanisms some years back. I know PSNH had a rate -- I think it was more of a rate phase-in, where rates were increased on an incremental basis, to prevent or mitigate rate shock. But I don't recall anything of this kind before.

Q. If something like that were proposed, in order to allow the payment of taxes to get moving, before the Company got further in the hole and incurred greater penalties, but did not increase the revenue overall over the course of the year, do you think that would be appropriate? Inappropriate?

A. (Naylor) Well, we can set aside the time value of the money, I think, because money has no value. Really. Right. I mean, interest rates are pretty low. So, you get -- you get the move-ins and the move-outs, potentially, you know, there's a little bit of a glitch on that, depending on how long you're increasing the rate, and at what point then it's reduced, presumably, the customer recovers. So, that's a small glitch. I think, also, you would have to make sure that you're evaluating how this is done with respect to making it independent of consumption on the part of customers that have meters, because then you're going to vastly complicate your reduction in rates. So, something like this would probably have to be implemented solely on a fixed charge. Which would certainly make it somewhat easy to apply to both metered and unmetered customers. That's about all I can think of at the moment.

MR. RICHARDSON: May I ask a question of the Chair?

CHAIRMAN IGNATIUS: Yes.

MR. RICHARDSON: Just to follow up on that. And, I'm not sure, it's so long ago, I can't remember if it applies. But was a similar mechanism to what you suggested used in the original approval for Schiller Station, back in about 2001? I seem to recall discussions at the Commission's hearings, this was back on Suncook Road, about effectively the Company's customers becoming almost partners in the modification, because they were funding part of the construction. I can't remember if there was a resolution along the lines that you suggested. But that was an example that jumped to my mind.

CHAIRMAN IGNATIUS: That's a -- and I have sort of some recollection also that there was some kind of sharing of benefits, if costs came in lower or something like that. But we can take a look at that. And, you know, this is just me thinking off the top of my head. It may be something that no one in the room, my colleagues included, thinks it's a good idea. So, I don't want you to assume we've cooked up a plan. I'm just trying to think of whether that would even be appropriate under ratemaking standards, if we could come up with something.

All right. Commissioner Harrington, another question?

CMSR. HARRINGTON: Try to make this real quick. Just one.

BY CMSR. HARRINGTON:

Q. Getting back to if the tax returns could be amended or not, and let's assume they could be. For whatever reason, the Company is able to go back, they're within the time limits, and it takes care of their tax liability for 2012, because they have enough carry-forward credits. So, that's the good side. They have no tax liability, income tax liability for 2012. What else happens? I mean, what's the result of doing that? The money just doesn't -- magically, the bill goes away, and nothing else occurs? That's what I'm trying to get straight.

A. (Naylor) With amended returns, to restore the operating loss carry-forwards?

Q. Yes. So, they end up with no tax liability. That's the good side. What's the bad side?

A. (Naylor) Presumably. Yes, presumably. I don't know. I mean, they're up against it. You know, they have to make a filing next Friday.

Q. Well, let us assume they did.

A. (Naylor) Either -- but the filing next Friday is either filing their corporate tax return for 2012 or a request for an extension. But they have to pay, they're obligated to pay their 2012 taxes in full next Friday. Whether it's the return or an extension, they still have to pay, in full --

Q. I understand.

A. (Naylor) -- of what their estimate is of their taxes.

Q. But, if they were to amend the previous years' taxes, have the roll-up, and then when they roll up, --

A. (Naylor) Yes.

Q. -- then they were able to get rid of that tax liability, what are the ramifications of that in other places? What happens then? Do they have more taxable income in future years? Or, it can't be a win/win/win.

A. (Naylor) Yes. I guess, if we assume that the -- that they're successful in amending the returns again, back to where they -- the status that they were before, that would restore the operating loss carry-forwards. Mr. Laflamme may have an idea exactly how many years, based on some estimate of what their, you know, earnings might be over the next few years, how many years they might be able to continue to shelter their net income from taxation. But --

Q. Maybe just stick with 2012. If they were able to do it, they have amended their returns for whatever year, that gave them enough carry-forwards, so they had no tax liability in 2012. That means they wouldn't have to pay that, whatever the amount is, 100 something thousand. So, what are the other ramifications, if that were to occur? Do they then have to pay money to somebody else or something else? Do they increase their future tax liability? Or, is it just they just get out of paying $100,000? That seems too good to be true. So, what's the downside?

A. (Naylor) Yes. I can only speculate that, that if the returns were successfully amended and restored the carry-forwards, then they're home free. I can't think of anything that implicates other things.

CMSR. HARRINGTON: Okay. All right. Thank you.

CONTINUED BY THE WITNESS:

A. (Naylor) You know, we're also talking about the State of New Hampshire, as well as the IRS, of course. So, they have two tax jurisdictions that they have to work with.

CMSR. HARRINGTON: That's all I had. Thank you.

CHAIRMAN IGNATIUS: Ms. Brown, redirect?

MS. BROWN: I've asked OCA to cover, because I need to leave at this point. And, there are just three questions, actually, on redirect.

CHAIRMAN IGNATIUS: All right.

MS. HOLLENBERG: There's ultimately four, just so you don't think I added one without permission.

CMSR. SCOTT: Don't worry.

MS. HOLLENBERG: Thank you.

REDIRECT EXAMINATION

BY MS. HOLLENBERG:

Q. Mr. Laflamme, you were asked a question about whether there would be a tax liability in 2013. Do you recall that question?

A. (Laflamme) Yes.

Q. And, I believe your response was that "it depends" -- that "it depends", right?

A. (Laflamme) Correct.

Q. Does your answer change if the question was about the

actual liability or about estimated tax payments?
A. (Laflamme) Yes. Because it would at least be prudent, based on the present anticipated 2012 tax liability, it would at least be prudent for the Company to make estimated payments for 2013, in order to avoid potential penalties, interest and penalties, for underpayment of taxes on 2013.
Q. Thank you. Mr. Naylor, Mr. Richardson asked you about distributions to shareholders over the period of ownership, and attempted to, in his questioning, have you agree that they were "minimal distributions, considering the amount of the shareholder investment during that period of time." Do you recall that line of questioning?
A. (Naylor) I do.
Q. Is a utility guarantied a -- or, is a utility's -- are utility's shareholders guarantied a return on equity?
A. (Naylor) No. They are not.
Q. Really, it's an opportunity to earn a return on equity that shareholders experience when they invest in a utility, is that correct?
A. (Naylor) That is correct.
Q. And, lastly, you were asked about examples of below-the-line items, expenses. Would you agree, in

addition, that a lobbying expense is something that would be booked below the line by a utility?

A. (Naylor) Yes, that's another example. That's correct.

Q. And not recovered through rates from customers?

A. (Naylor) That is correct.

MS. HOLLENBERG: Okay. Thank you so much. That's the only questions I have.

CHAIRMAN IGNATIUS: Thank you. Then, I think what we have left is just a little bit of housekeeping. I'd like to reserve Exhibit 15, if I haven't, is that the correct number, if I haven't already done so. And, that would be for the written update from Mr. Roberge regarding, or from Mr. Richardson, regarding Mr. Roberge's conversation with the IRS.

MR. RICHARDSON: Yes. And, just a procedural question. I spent most of the first day with my client and consultants on the witness stand. So, I don't have contemporaneous notes of what the record requests were. And, I also -- they always scare me, because I'm afraid that if I misinterpret what the question was, you know, and then I don't give the correct answer, you know, that could be construed as trying to avoid it.

CHAIRMAN IGNATIUS: All right. We'll go

through those.

MR. RICHARDSON: So, will the Commission provide me with the record requests and then I can respond to them?

CHAIRMAN IGNATIUS: Let's go through them right now.

MR. RICHARDSON: Okay. Oh, excellent.

CHAIRMAN IGNATIUS: The first thing is to give a number to the one regarding Mr. Roberge, that will be number 15.

(Exhibit 15 reserved)

CHAIRMAN IGNATIUS: So, I have three open requests that I've made note of. One is number 8, which is minutes of meetings of the Board of Directors, or any other documentation regarding authorization for the payment of the 123,000 and change payment made to Mrs. Mason. The second was item -- Exhibit Number 10, which was a breakdown of that $123,356. We were told that some was in the form of cash, some was in the form of purchases of services, and may be other categories, and that that needed to be delineated. And, the third thing was item -- excuse me, Exhibit 15, and this was a written account of what it is that the date that Mr. Roberge spoke to an agent at the IRS, and the issues that were raised, and, if there was any sort of answer from the IRS, what that was. Understanding that may be fairly preliminary, but that -- and who he spoke to. That's what Mr. Richardson said was that it was a discussion a week or so ago, with someone who was an agent at the IRS, and regarding amending returns and tax liability. But, obviously, we would need real detail, because it was in contradiction to what Mr. St. Cyr testified to. And, it may be that he just wasn't aware of that, not that anyone's intentionally misleading. But that what's in the record from Mr. St. Cyr is there's been no outreach to the IRS, and, in fact, it sounds like there has been. So, that would be good to know.

MR. RICHARDSON: Thank you. And, we'll give a full account of that.

CHAIRMAN IGNATIUS: Thank you.

MS. HOLLENBERG: Excuse me. I agree with what you have stated. I would also just note that I do believe that there was some questioning of Mr. St. Cyr yesterday about the differences between the ending balances of the 2009 tax return and the beginning balances of 2010 tax returns. And, we were specifically talking about Schedule L and Schedule M, which are found in Staff 1-1, at Attachment 1-1, Page 88. And, for the 2010 return, it's Staff 1-2, at Attachment 1-2, Page 6. And, those are both found within Exhibit 4 for this hearing today.

And, my recollection is that Mr. St. Cyr was not aware of why there were differences, but I asked for him to explain the differences and to explain what impact, if any, those changes would have on future tax returns.

CHAIRMAN IGNATIUS: I recall that. I don't think we ever asked for an exhibit, but that's appropriate, because he did commit to take a look and try to answer that question, those questions.

MS. HOLLENBERG: Thank you.

CHAIRMAN IGNATIUS: So, why don't we make that number 16.

(Exhibit 16 reserved)

CMSR. HARRINGTON: While we're on that, there was the issue of the revised amount of taxes that were actually due for next year, for 2012, the basis. I think we had at least preliminary agreement from the Company that the figure of around $17,000 less than what they were estimating, Mr. Laflamme had postulated, was correct. But I don't know if we need any follow-up from the Company to say that they agree, and they have checked it, and give them the opportunity to come back and say "we think that's correct"?

MR. RICHARDSON: I was going to request that we be given a chance to do that. Because I thought it did, Mr. St. Cyr's response was is that he wanted to check it, but he believed it was correct. So, I think that would be important.

CMSR. HARRINGTON: I think that's 17 then.

CHAIRMAN IGNATIUS: Okay. So, that would be 17.

(Exhibit 17 reserved)

MR. RICHARDSON: Could we go over Attorney Hollenberg's explanation of 16, because I lost it entirely. I didn't understand what she was describing.

CHAIRMAN IGNATIUS: All right. I think it was, if you look at Pages 88 of Staff 1-1, this is all within Exhibit 4, --

MR. RICHARDSON: Uh-huh.

CHAIRMAN IGNATIUS: -- and Page 6 of Staff 1-2, is where the discussion of Schedules L and M were, --

MR. RICHARDSON: Uh-huh.

CHAIRMAN IGNATIUS: -- and things that

were not lining up going from one year to the next.

MR. RICHARDSON: Okay. And, it was -- so, discrepancies in beginning and ending balances between Schedules L and M. Okay.

CHAIRMAN IGNATIUS: As I recall, sort of the carry-forward from one year, then didn't seem to carry forward, and some lines that did carry forward in some other lines to the next year.

MS. HOLLENBERG: I believe Mr. St. Cyr represented in his testimony that the changes from the amended returns were incorporated into 2010's return. And, I had asked him where that wasn't necessarily the case. And, so, I asked him to explain why that was the case and what impact that would have on the future tax returns.

MR. RICHARDSON: And, I thought that I understood his response to be that it wouldn't have an impact. And, I believe I asked that on redirect as well. We don't mind providing this information. But, I'm just curious, I mean, do you remember him saying it wouldn't have any impact?

MS. HOLLENBERG: Well, I guess, he may have said that, but it's hard for me to understand how he can say that, if he doesn't even know what the changes are and why they happened. And, so, if that's his testimony, then that's his testimony, that they won't have an impact. And, I'll accept that as the Company's testimony, and just have them explain why they didn't match up. I mean, it's up to the Company.

CHAIRMAN IGNATIUS: So, you're still seeking an explanation, but not the consequences of the change?

MS. HOLLENBERG: I was originally asking for an explanation of why they don't match up, if he says that they were "supposed to match up". And, to me, I guess it seems logical that the Company would want to confirm that, by making the corrections, there are no impacts to future tax returns. But that's something I'll let the Company decide if they want to do. If they're standing on their tax returns as accurate and correct, that's their prerogative to do that.

CHAIRMAN IGNATIUS: Well, I think it would be useful to have that included in the response, if, in fact, there's no impact, to explain why.

MS. HOLLENBERG: Uh-huh.

MR. RICHARDSON: Yes. We'll certainly look at that.

MS. HOLLENBERG: Thank you.

MR. RICHARDSON: I may learn something from it, I'm not sure, but we'll find out. Thank you.

CHAIRMAN IGNATIUS: Commissioner Scott has another tail here to follow.

CMSR. SCOTT: I hope not that much. During my questioning with Mr. Mason, I had noticed that, obviously, if I understood correctly, the Company is planning on filing taxes by the 15th. And, my question to Mr. Mason, if I remember, was to the effect that, rather than, your original request, if I understood it, was "grant us this, and then we'll come in, after we file our taxes, for a reconciliation." And, my point was, given that we're so close to the time you're going to file, would it not make more sense to give us those figures, assuming you get what you want? I guess my question would be, is that not appropriate, that you would provide us at the same time your revised figures?

CMSR. HARRINGTON: Maybe they could combine that with Exhibit 17, which is already going to address the change in income tax for 2012.

CMSR. SCOTT: That's fine with me. Would you like me to restate it?

MR. RICHARDSON: No, no. I mean, effectively, what you're asking for is a, you know, a tax return by the 15th, if it's available. And, I absolutely think that that's a relevant document. So, I would just as soon do that. I don't have Mr. Roberge here today to, you know, make him swear that he'll have it or confirm. I have heard him say before that he was -- intended to meet the deadline. But I, you know, I know the ways of the world don't always result in those things. But why don't we -- why don't we make every effort, and I'll do what I can to try to get a tax return to this Commission, you know, by whatever date we can. And, obviously, we'll report on the status of that.

CHAIRMAN IGNATIUS: All right. So, the date for all of the submission of these requests, I realize that final one is somewhat out of your hands, Mr. Richardson. But, for the six -- sorry, the five outstanding requests, if people know, you want to offer a date right now, that would be great. If it takes some more work in working it out, I would ask the parties to confer today or tomorrow, with e-mail, whatever, and submit something to the Commission with a commitment.

MS. HOLLENBERG: Ms. Thunberg also had left on her note an indication that she's looking to do written closings, which is something that we're okay with. She suggested a 5-page limit. And, her suggestion is that it be due by next Friday, but I'm not sure if we want the transcripts and the exhibits, record requests to be complete before closings are supposed to be prepared. So, I'll just bring those things up to you.

CHAIRMAN IGNATIUS: Yes. I think that getting the data in before closings would make more sense. And, so, we can set it as of, you know, two weeks after the receipt of the outstanding record requests, of, if you wanted the transcripts, then, you know, tag it to whatever the final thing is to arrive.

Rather than do all of that on the record, I think what is really best is for people to caucus a bit, either immediately after this, or later today, you know, after you've checked things back in your offices, and exchanged some emails, and come up with agreed-upon dates. So, if that's all right, we'll leave those dates for submission of the record requests and dates for the closing aside for now.

Is a page limit, Staff had suggested, thought a 5-page limit? Is that -- do you want a page limit at all? If so, is that the right number?

MR. RICHARDSON: I can't commit, because, I mean, five pages would just -- it would be too hard. I don't have -- I mean, I don't want to, you know, write a Supreme Court brief, but there's a lot of issues. You know, just the moving target of, you know, the tax returns itself, and having to figure out what impact that has, you know, I could see that taking a page on that issue alone. I see us having to, you know, brief a tax liability, you know, an amending return issue. This is going to be a challenge.

You know, I'm of no desire to go, you know, I mean, I would have love to have done oral argument, but I understand why that's not going to work here. But, you know, the cost is a big issue. I mean, I don't -- you know, it shouldn't come as a surprise, I don't expect to make a lot of money writing a closing argument, so, I'm not going to do 25 pages. But, I think, you know, maybe 10, or something in that range, will be the approach, and I'd just like to keep it reasonable. I mean, I think that, you know, the key is to get things right, rather than focus on a page limit.

CHAIRMAN IGNATIUS: I tend to think that 5 sounds too short. Whether there's no page limit or to set it at 10 or 15 or something, I think is fair.

CMSR. HARRINGTON: Let them add that with the caucus and do that.

CHAIRMAN IGNATIUS: All right. Why

don't you discuss that. And, if you want --

MS. HOLLENBERG: Uh-huh.

CHAIRMAN IGNATIUS: And, concise and clear writing is more important than the number of pages.

Then, the issue of the identification on all of the exhibits. Is there any objection to all of the exhibits being made full exhibits, striking identification?

(No verbal response)

CHAIRMAN IGNATIUS: Seeing none, we will do that. And, I guess we then would just await a written submission, whoever wants to send it in, if there's agreed upon date for the submission of the record requests, agreed upon date for submission of the briefs, talk about whether you need the transcripts first, and you'll have to consult with the court reporter on what that's likely to be. And, if you want to set a limit on the briefs, we'll leave that to you. And, just send us something in writing to the executive director with that information.

So, with that, we will take all of this under advisement, await the final materials. And, I appreciate everyone's hard work, working through a day where we didn't take much of a break, and it's now 2:30. So, thank you, everybody. We're adjourned.

MR. RICHARDSON: Thank you.

(Whereupon the hearing ended at 2:33 p.m.)