

BEFORE THE STATE OF NEW HAMPSHIRE

PUBLIC UTILITIES COMMISSION

In the matter of:)
Lakes Region Water Company, Inc.)
DW 10-141)
Petition for Authority to Increase Rates)
Temporary Rate Phase)

Direct Prefiled Testimony

of

Stephen R. Eckberg
Utility Analyst

on behalf of
The NH Office of Consumer Advocate

Dated: **November 24, 2010**

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

2 A. My name is Stephen R. Eckberg. I am employed by the Office of Consumer
3 Advocate (OCA) as a Utility Analyst. I include as Attachment SRE-1 to my
4 testimony a statement of my education and experience.

5

6 **Q. Have you previously testified before the Commission?**

7 A. Yes, I have testified on behalf of the OCA in a number of dockets including both
8 phases of DW 08-070 related to Step Increases to rates for Lakes Region Water
9 Company.

10

11 **Q. Does the OCA support the Settlement Agreement that was filed on November**
12 **18, 2010 related to Temporary Rates in this Docket?**

13 A. No. The OCA participated in discovery, technical session discussions and settlement
14 discussions. While the OCA is supportive of certain elements included in the
15 Settlement, the OCA believes that the Settlement does not address other critical
16 concerns.

17

18 **Q. Please discuss the aspects of the Settlement Agreement that the OCA supports.**

19 A. The OCA would like to note its strong agreement with the Federal Income Tax rate of
20 zero percent that is applied in the Temporary Rate Settlement revenue requirement
21 calculations. This is consistent with the OCA's testimony in the first phase of DW
22 08-070. In our testimony in that case, we did not support the use of the 15% Federal
23 Income Tax factor for the Company, but instead pointed out that because the
24 Company had paid no Federal Income Tax in 2007 and it did not appear likely that
25 they would do so in 2008, the OCA believed that the appropriate Federal Income tax

1 rate used to calculate rates should have been zero percent. In fact, in response to
2 discovery in this case, the Company provided copies of its Federal Income Tax
3 returns for 2008 and 2009. These returns show that the Company paid no tax in
4 either of those years. It is the OCA's belief that the Company will likely not pay any
5 tax for the next several years. As seen on Schedule 4 of the Settlement Agreement, a
6 rate of 0% is used for the Federal Income Tax rate. We continue to support this
7 approach.

8 The OCA also supports the disallowances, based on the PUC Staff Audit in DW 08-
9 070 regarding capital additions included in the Third Step Increase, that are included
10 in the Settlement.

11

12 **Q. Despite supporting those aspects of the Settlement, does the OCA believe that**
13 **the Company should be allowed a Temporary Rate Increase based on the books**
14 **and records of the Company?**

15 A. No. While the books and records of the Company may demonstrate under-earning
16 and the possible need for a rate increase, the level of that under-earning is unclear,
17 and in the OCA's view is based in part on improper costs. However, for the reasons
18 discussed in this testimony, the OCA recommends that the Commission approve
19 Temporary Rates at a level no higher than current rates.¹ While such a decision does
20 not provide any additional revenue to the Company, it does provide the Company the
21 right to reconcile the amount of any final permanent rate increase back to the
22 effective date of Temporary Rates. More importantly, this approach does not allow

¹ The use of Current Effective Rates as Temporary Rates was approved by the Commission in DW 08-065 in Order No. 24,932.

1 the Company to increase rates until the parties have an opportunity to fully explore
2 the many issues in this case.

3

4 **Q. Please identify the specific issues that the OCA believes must be more fully**
5 **explored and addressed before the Commission approves the temporary rates**
6 **proposed in the Settlement Agreement.**

7 A. The issues include:

- 8 1. Costs related to pensions paid to the Company's owners;
- 9 2. Costs related to long term debt and the interest rate on long term debt paid to
10 the Company's owners;
- 11 3. Costs related to "service trades" between the Company, its affiliate, and third
12 parties;
- 13 4. Revenues related to the Special Contract with the Property Owners
14 Association at Suissevale, Inc., and the possible interconnection of a new
15 development at York Village.

16

17 **Q. Please begin by describing the first issue regarding pensions paid to the**
18 **Company's owners.**

19 A. In response to discovery, the Company provided details showing that it has made
20 weekly payments in the 2009 test year totaling \$52,337.50 to its owners, Thomas
21 Adam Mason (Mr. Mason, Sr.) and Barbara G. Mason, as "pensions."²

22

23

24

² See Attachment SRE-2, Company Response to OCA 1-17.

1 **Q. Please explain how these payments were authorized.**

2 A. My understanding from a discussion at the Technical Session on November 8, 2010
3 is that the Company's owners and sole stockholders voted to authorize payment of
4 these pensions to themselves at a Board of Directors meeting. These payments are
5 not from a funded pension plan, which is the normal approach to providing a pension
6 to retired employees of a regulated utility, but instead are paid directly from the funds
7 collected from today's ratepayers – more like a salary – and perhaps even from funds
8 borrowed from the owners.

9
10 **Q. Does the OCA consider these payments to be a legitimate expense?**

11 A. No. The OCA believes that these payments are not proper and do not represent a
12 prudently incurred expense that should be included in rates – either temporary or
13 permanent – that are paid by the Company's ratepayers. It is the OCA's position that
14 these costs must be removed from the calculation of rates as soon as possible.

15
16 **Q. Please address your second issue regarding costs related to debt, and the interest
17 rate paid to the Company's owners.**

18 A. In the Company's 2009 Annual Report, on the Supplemental Schedule included with
19 Table F-35 regarding Long Term Debt, the Company reports that during the 2009 test
20 year it increased its debt to the Company owners and sole stockholders by \$52,116.
21 The Company's schedule also indicates that it has applied the rate of 9.75% – the
22 Company's last approved equity rate, not an approved debt rate – to this amount as
23 well as to the already existing balance of \$138,739 in debt to the owners. A copy of
24 this Schedule is provided as Attachment SRE-3.

25

1 **Q. Why does the OCA believe that it is appropriate to raise this issue in the context**
2 **of Temporary Rates?**

3 A. We believe that it is necessary and appropriate to do so because the Company is
4 acting imprudently, and without Commission approval. This issue must be addressed
5 now because we believe that the Company has been increasing its long term debt
6 without Commission approval, and has also been applying an unapproved (and very
7 high) interest rate to that long term debt. These costs should not be included in rates,
8 whether Temporary or Permanent. In addition, the Commission should direct the
9 Company to immediately refrain from incurring any more long term debt without
10 approval, and to immediately change the interest rate on the debt to the owners to no
11 higher than the last approved rate of 7.25%.

12
13 **Q. Please address your third issue regarding costs related to so-called “service**
14 **trades” between the Company, its Affiliate, and third parties.**

15 A. The Final Audit Report of the Company’s Third Step Increase filing in DW 08-070
16 identified certain costs related to “service trades” which Audit recommended should
17 be disallowed. The Settlement Agreement filed by Staff and the Company regarding
18 the Third Step Increase did exclude those costs, and in my testimony in that Docket
19 the OCA expressed its support for those cost exclusions. However, the OCA went
20 further in that testimony to describe in more detail how these “service trades” have
21 been explained by the Company, and to express the OCA’s position that all costs
22 related to such “service trades” should be disallowed as they are inappropriate and
23 therefore imprudent costs incurred by the Company. We are concerned that the
24 Company may have continued the practice of using “service trades” and there may be
25 costs included in the Company’s 2009 test year expenses related to these types of

1 activities. It is the OCA's position that these costs must not be included in the
2 calculation of rates.

3

4 **Q. Please address your fourth issue regarding revenues related to the Company's**
5 **Special Contract with the Property Owners Association at Suissevale, Inc**
6 **("POASI" or "Suissevale") and concerns about York Village.**

7 A. I will first discuss issues related to Suissevale, and let me begin by saying that I
8 understand that large and complex issues such as this must be addressed in the
9 Permanent Phase of this rate case. However, this is one example of a major issue, for
10 which costs may have already been incurred, that should be brought to the
11 Commission's attention at this time, and which further supports setting Temporary
12 Rates no higher than Current Rates.

13 In reviewing data included in the Company's 2009 (the test year) Annual Report and
14 other sources cited below, the OCA notes the following statistics regarding the
15 Company and POASI:

- 16 1. The Company provides water directly to approximately 1610 customers and
17 indirectly to approximately 350 households through its Special Contract with
18 POASI. Therefore, POASI represents roughly 18% of the total number of
19 households served by the Company, but it is a wholesale customer.
- 20 2. In 2009, POASI used 11,666,000 gallons of the total 32,887,000 gallons the
21 Company supplied to its customers. Therefore, POASI used roughly 35% of all
22 the water produced.³
- 23 3. POASI's sole approved supply of water is via an interconnection with the
24 Company's Paradise Shores system. In 2009, the Company's Paradise Shores

³ See Schedule 6 of the Settlement filed November 18, 2010 in DW 10-141.

1 system sold 6,140,000 gallons of water to its customers in the Paradise Shores
2 system and 11,666,000 gallons to POASI. Therefore, the Company provided
3 roughly 66% of the water produced in its Paradise Shores system to a single,
4 wholesale customer – POASI.

- 5 4. In 2009, under its special contract with the Company, POASI paid \$131,382 for
6 water supplied from the Company’s Paradise Shores water system.⁴ The
7 Company’s total income from sales of water in 2009, including POASI’s
8 contribution, was \$897,863.⁵ Therefore, POASI provided roughly 15% of the
9 revenue received by the Company through water sales.

10
11 **Q. Does the OCA have any other relevant information regarding POASI?**

12 A. The OCA understands from discussions with representatives at DES’ Drinking Water
13 and Groundwater Bureau, that the current water supply in Paradise Shores is able to
14 produce adequate water to serve the needs of the customers of this regulated system.⁶
15 However, the Company, as part of this Docket, has requested authority to purchase –
16 from its owners – land to develop additional water supply from what is referred to as
17 the “Mount Roberts property” at an estimated cost of \$1.5 million. The Company’s
18 proposal involves an additional estimated step increase in rates of \$243,146 to fund
19 this transaction. According to the Company filing, this is approximately 40 acres of
20 land currently owned by the Company’s sole shareholders, Mr. Mason Sr. and
21 Barbara G. Mason. The OCA understands that the primary purpose of the proposed
22 acquisition of this land and development of additional water supply in the Paradise

⁴ See Attachment SRE-4, Company response to POASI 1-4.

⁵ See Attachment SRE-5, Table F-47 of the Company’s 2009 Annual Report as revised on June 8, 2010.
Copy included as testimony.

⁶ The OCA requested that DES be made a party to this Docket at the prehearing conference.

1 Shores water system is to meet the increasing needs of the system – a system in
2 which POASI consumes roughly two thirds of the water produced, and which
3 according to DES, has current supplies adequate to serve the regulated Paradise
4 Shores customers.

5

6 **Q. Does the OCA have a recommendation on this issue?**

7 A. Not yet. The OCA has identified these facts regarding POASI for the Commission’s
8 consideration as it is not at all clear if the revenues realized by the Company through
9 its special contract with POASI sufficiently represent the investment needed to serve
10 these customers. The OCA expects to more fully explore this issue during the
11 permanent rate phase of this case. It is possible that the existing Special Contract
12 needs revision, or that a different form of relationship should be established between
13 POASI and the regulated Company.

14

15 **Q. You also mentioned a development known as York Village. What is the OCA’s**
16 **understanding of the issues related to this development?**

17 A. In my testimony regarding the Third Step increase to rates in DE 08-070, I raised the
18 concern that as a result of the interconnection between Gunstock Glen and Brake Hill,
19 there may be new, additional customers and revenues that should be accounted for in
20 calculating the Temporary Rates from a development called York Village, which is
21 located adjacent to both Brake Hill and Gunstock Glen in Gilford. The OCA believes
22 that the water system supplying York Village may be connected to the newly
23 interconnected Brake Hill – Gunstock Glen systems. However, the Company has neither
24 sought a franchise expansion to serve the houses in this development as retail customers,

1 nor has it sought approval of any special contract to serve the development as a wholesale
2 customer.

3

4 **Q. Why does the OCA believe that this development is receiving water service from a**
5 **connection to the interconnected system?**

6 A. There are several indications that there is some relationship here that has not been fully
7 explained by the Company. First, in response to discovery in DW 08-070, the Company
8 provided a copy of the “Design Package for Gunstock Glen / Brake Hill Community
9 Water System” prepared by Lewis Engineering for the Company in July 2007. The cover
10 letter accompanying this plan is addressed to Mr. James Gill, P.E. at the Drinking Water
11 and Groundwater Bureau of DES. The cover letter states in the first paragraph “The
12 expansion is necessary to serve a new development in Gilford and to better serve the
13 existing neighborhood.” I have attached a copy of the cover letter as Attachment SRE-6.
14 Second, during the Technical Session held on November 8, 2010, when asked by the
15 OCA about this development, the Company indicated that it had received a Contribution
16 in Aid of Construction (CIAC) relative to this system. The Company indicated these
17 CIAC amounts were shown in the Company’s Annual Reports. The OCA believes these
18 amounts to be \$68,200 for Mains and \$9,900 for Services as listed in the 2009 Annual
19 Report at Table F-46 relative to the Brake Hill system (BH on Table F-46). I have
20 included a copy of this table as Attachment SRE-7.

21

22 **Q. When was this CIAC contribution received by the Company?**

23 A. I’m not certain. The OCA just learned about this contribution at the November 8, 2010
24 Technical Session. I have checked the Company’s Annual Reports for the last several
25 years and these amounts appear on the 2007 Annual Report as well. This is the earliest
26 Annual Report that was readily available. However, based on the values shown in the

1 Amortization of the CIAC columns, it appears that the CIAC was likely entered on the
2 Company's books in 2007.

3

4 **Q. Is there other information indicating that the development at York Village may be**
5 **receiving water service from the utility?**

6 A. It is clear from information provided in the Company's response to OCA 4-19 in Docket
7 DW 08-070 (see Attachment SRE-8) that the unregulated affiliate LRW Services has
8 performed a significant amount of work installing mains and services in York Village.
9 This work is the source of the unpaid debt which in turn resulted in the "service trades"
10 discussed in my testimony regarding the Third Step Increase in DW 08-070.

11

12 **Q. What is your overall recommendation for the Commission regarding the**
13 **Temporary Rate Settlement Agreement?**

14 A. The OCA believes that in light of the significant issues which must be fully
15 examined, and the fact that these issues will impact the Company's expenses and
16 income, the Commission should not approve the Settlement Agreement filed by Staff
17 and the Company, which proposes to grant a Temporary Rate increase of 18.15%.
18 Instead, the OCA respectfully requests that the Commission set Temporary Rates at
19 the level of Current Rates.

20

21 **Q. Does this conclude your testimony?**

22 A. Yes.