

**STATE OF NEW HAMPSHIRE
PUBLIC UTILITIES COMMISSION**

DW 13-041

LAKES REGION WATER COMPANY, INC.

Petition for Emergency Rates Pursuant to RSA 378:9

STAFF OBJECTION TO MOTION FOR REHEARING

NOW COMES Commission Staff and respectfully objects to Lakes Region Water Company, Inc.'s (Lakes Region or Company) motion for rehearing.

LEGAL STANDARD FOR MOTIONS FOR REHEARING

The Commission may grant a motion for rehearing if “good reason for the rehearing is stated in the motion.” RSA 541:3. Pursuant to RSA 541:4, this includes errors of law, as a motion for rehearing must specify “every ground upon which it is claimed that the decision or order complained of is unlawful or unreasonable.” *Appeal of Campaign for Ratepayer Rights*, 145 N.H. 671, 674 (2001). The “purpose of rehearing ‘is to direct attention to matters said to have been overlooked or mistakenly conceived in the original decision...’” *Dumais v. State Pers. Comm’n*, 118 N.H. 309, 311 (1978) citing *Lambert v. State*, 115 N.H. 516, 519 (1975) (quotations omitted.) For the reasons below, Staff does not believe that Lakes Region has demonstrated that Order No. 25,516 is unlawful or unreasonable, that the Commission overlooked or mistakenly conceived matters, or that good cause exists for rehearing or reconsideration of Order No. 25,516.

SUMMARY OF REHEARING REQUEST AND STAFF’S OBJECTION

Lakes Region’s arguments are as follows:

1. The Commission’ inclusion of rate recoupment in its calculation of Lakes Region’s 2012 revenue and rate of return violates New Hampshire and Federal constitutional principles;

2. Order No. 25,516 erred by treating increases in unpaid liabilities on Lakes Region's 2012 cash flow statement as cash available to pay taxes;
3. Order No. 25,516 erred by failing to consider Lakes Region's legal obligation to repay accounts payable incurred due to prior deficiencies in rates; and
4. Order No. 25,516 erred by concluding that Lakes Region "substantially reduced the availability of net operating loss carry-forwards and Section 179 Carry-Forwards that could have shielded future income."

In general, Lakes Region's arguments misconstrue the hearing transcript, evidence, and Order No. 25,516. It offers new information that is more appropriate for a motion to reopen the record rather than a motion for rehearing. Through a smoke of unfocused arguments and incorrect calculations, Lakes Region still fails to establish that a crisis exists that warrants emergency rates.

In its affidavit attachment to its motion, Lakes Region now argues that the crisis is not only the payment of \$50,873 in 2012 income taxes, but also payment of its accounts payable and payment of its 2013 taxes. Lakes Region did not argue that either of these last two issues were a crisis. Instead, these were ancillary arguments. Lakes Region argued paying down its accounts payable would suffer if the Commission did not help it address its tax crisis. Lakes Region was unable to identify with specificity its 2013 tax liability; therefore, it was not part of the purported tax crisis.

In its motion for rehearing, Lakes Region attempts to paint the equity withdrawal as *de minimis* by stating that it was "overshadowed" by the 2013 tax liability. The Commission did not deny Lakes Region's motion due to the withdrawal of equity, rather, the Commission noted its concern that Lakes Region had withdrawn equity from the Company when it could least afford it. Lakes Region's argument is no excuse. Even if Lakes Region had identified a specific

2013 tax liability and could have established it as a crisis, it still does not make the equity withdrawal sound.

Furthermore, Lakes Region's accounts payable is not the crisis. Lakes Region has previously testified in Docket No. DW 10-141 that it pays its accounts payable when it can and that its vendors and professionals are understanding and are not pressing for payment. See Hearing Transcript of March 15, 2012, afternoon session, of Docket No. DW 10-141 at 88 line 3 - 89 line 24.

Lakes Region blames the Commission for failing to authorize a specific amount for income tax expense when it is Lakes Region itself who filed a 2009 test year, a year in which it had no such expense. Lakes Region blames its consultants for errors in its filing and evidence at hearing rather than take responsibility for documents it files with the Commission and with the Internal Revenue Service. Lakes Region persists in avoiding the real culprit behind its financial predicament: its inability or unwillingness to access outside capital. Staff offers a more detailed response to each argument below.

I. The Commission's Inclusion of Rate Recoupment in its Analysis of Whether Lakes Region had Funds Available to Pay its 2012 Taxes does not Violate New Hampshire and Federal Constitutional Principles

Lakes Region's basic argument is that when the Commission looked at its 2012 earnings to determine whether Lakes Region had sufficient funds to address the purposed crisis, i.e., that \$50,873 in federal 2012 taxes were due, these earnings were artificially inflated due to the inclusion of \$52,202 in revenues from a temporary and permanent rate recoupment which the Commission had authorized during 2012. Lakes Region then argues that these funds were dedicated to recoupment and that they are not to be used to pay taxes and that to pay taxes with these funds violates its constitutional right to these revenues. For the Commission to include the

\$52,202 in its assessment of whether funds were available to pay taxes amounts to double counting, and as such, is confiscatory and violated its right to collect rates pursuant to 378:29 and Part I, Article 12 of the N.H. Constitution.¹

The Commission should reject this argument; it is erroneous. First, it is important to note that it was Lakes Region itself who booked the \$52,202 in permanent rate recoupment revenues in its 2012 schedules of revenues and expenses. Lakes Region's argument that it "was unaware that its schedules showed it 'paying' a tax" is an affront to the adjudicative process. The Commission, Staff, and intervenors should be able to rely on information provided at hearing under oath. Here, Lakes Region attempts to shed responsibility for its filings and blame its consultants. If Lakes Region felt that the inclusion of such revenues in its 2012 earnings was inappropriate, it should have adjusted its own schedules to reduce the appropriate portion of these revenues. Lakes Region made no such adjustment in any of the schedules it presented in this case. Furthermore, Lakes Region's 2012 tax returns (Exhibit 18) include the full \$52,202 recoupment amount in its taxable earnings for 2012. Lakes Region cannot have it both ways. If Lakes Region is counting \$52,202 in its calculation of the tax payment purported to be a crisis, then it was reasonable for the Commission to rely on an earnings amount that includes these recoupment revenues.

Second, if the Commission were to reduce Lakes Region's 2012 revenues by the \$52,202 in recoupment earnings, an adjustment must also be made to reduce the income taxes related to these earnings; and therefore, the purported crisis amount of 2012 income taxes. Staff calculates

¹ [Art.] 12. [Protection and Taxation Reciprocal.] Every member of the community has a right to be protected by it, in the enjoyment of his life, liberty, and property; he is therefore bound to contribute his share in the expense of such protection, and to yield his personal service when necessary. But no part of a man's property shall be taken from him, or applied to public uses, without his own consent, or that of the representative body of the people. Nor are the inhabitants of this state controllable by any other laws than those to which they, or their representative body, have given their consent.

the associated reduction in income tax expense as \$21,033.² Ultimately, this reduction in income tax expense would net against the revenue reduction for purposes of determining net operating income. Staff calculates the net reduction in net operating income as a result of removing the recoupment revenues as \$31,169 (\$52,202 - \$21,033).

Third, Lakes Region states, “Removal of the \$52,202 in revenue attributable to recoupment from the net operating income of \$211,781, Ex. 4, p. 162, without any other adjustment, reduces the Company’s actual income in 2012 to \$159,579, and its rate of return to 6.57%, below its allowed rate of return . . .” (emphasis in original). Lakes Region’s analysis leading to this statement is fundamentally flawed in two respects. First, the Company fails to account for the previous adjustments made to its income tax expense in Exhibits 17 and 18 which result in a \$44,693 increase³ in its 2012 net operating income from \$211,781 to \$256,474. Second, Lakes Region does not account for the net tax effect resulting from the reduction of the recoupment revenue from its 2012 earnings discussed previously. Therefore, the revised net operating income amount would be \$225,305 (\$211,781 + \$44,693 - \$31,169). The resulting rate of return would be 9.27%, or approximately 85 basis points above Lakes Region’s presently allowed rate of return of 8.425%.

Fourth, Lakes Region also makes the statements that:

“Order No. 25,516 adopted Staff’s inclusion of recoupment revenue that accrued (but was not collected) in 2012 in its calculation of the Company’s 2012 earnings. By including this revenue in its earnings, the Commission double-counted the revenue the Company had a right to collect due to a deficiency in its prior rates...” and *“...the Company’s Net Operating Income show in Exhibit 4 includes*

² The reduction in federal income tax would be \$20,359 (\$52,202 x 39%) and Staff has determined that the reduction in the 2012 NH Business Profits Tax would be the full \$674 calculated by the Company in Exhibits 17 and 18. Combined, this amounts to a total reduction in income tax of \$21,033.

³ Federal and state income tax expense for 2012 per Exhibit 4 was \$97,949 leading to a net operating income amount of \$211,781 for 2012. However, per exhibits 17 and 18, the Company revised its federal and state income tax expense for 2012 to \$53,256. This results in a reduction in operating expense and thereby an increase in net operating income for 2012 of \$44,693.

\$52,202 rate recoupment due to prior rates that were legally deficient. See Order No. 25,423. The Company did not even begin to collect this revenue (for service rendered during the period from September 17, 2010 to July 13, 2012) until its November 1, 2012 bills....”

Contrary to Lakes Region’s statement that it was Staff who proposed that the recoupment revenues be included in Lakes Region’s 2012 earnings, as discussed previously these revenues were actually included in Lakes Region’s own schedules it filed with the Commission, without adjustment. Lakes Region’s arguments are fundamentally flawed in that they would necessitate using a cash method of accounting just for the 2012 recoupment revenues. This, however, is directly contrary to Puc 607.07⁴ and the Commission’s requirement of the accrual method of accounting.

Fifth, Lakes Region argument that applicable law provides for recovery of taxes in rates should be rejected. Motion at 3. Lakes Region has attempted to include tax payments in its rates under two separate authorities, both of which have separate legal standards. Under RSA 378:7, taxes can be included in rates in a general rate case if the utility demonstrates it pays taxes but in Docket No. DW 10-141, Lakes Region did not demonstrate that it would be paying taxes. Under RSA 378:9, taxes can be included in emergency rates if a crisis exists but in the instant docket, Lakes Region failed to prove that paying its 2012 tax liability created a crisis. Therefore, the Commission’s denial of Lakes Region’s emergency rate petition was not in error. The Commission did not overlook or mistakenly conceive evidence. Order No. 25,516 is not confiscatory and does not violate State and Federal constitutional principles.

⁴ Pursuant to N.H. Code Admin. Rule Puc 607.07, Uniform System of Accounts, (a) Each utility shall maintain its accounts and records in conformity with the "Uniform Classification of Accounts for Water Utilities" established and issued by the commission as a uniform system of accounts pursuant to RSA 374:8. Pursuant to the Uniform System of Accounts, part 610.01(b) (Attached as Attachment A), requires: The company’s financial records shall be kept in accordance with generally accepted accounting principles to the extent permitted by this system of accounts. The books of accounts of all water utilities shall be kept by the double entry method, on an accrual basis. Each utility shall keep its accounts monthly and shall close its books at the end of each calendar year. (Emphasis added).

II. Lakes Region's Argument that the Commission Erred by Treating Increases in Unpaid Liabilities on Lakes Region's 2012 Cash Flow Statement as Cash Available to Pay Taxes is Without Merit.

The Commission did not "misread" Lakes Region's cash flow statement. None of Lakes Region's arguments within this argument make sense largely because Lakes Region does not understand what a cash flow statement illustrates. Lakes Region is confusing balance sheet and income statement concepts with cash flow statement concepts.⁵

First, Lakes Region argues that recoupment ought to be removed because recovery of those funds did not commence until November 2012. As noted above, the Commission requires accrual method of accounting. Under the accrual method of accounting, the recoupment would remain in the year in which Lakes Region recognized it. Furthermore, Lakes Region is not under-earning. As stated above, it is earning over its (8.39% plus step increase = 8.425%) authorized return. Its citation on page 9 of its motion that its rate of return is 6.57% is also an erroneous calculation and renders its argument moot. Staff actually calculates a revised rate of return for 2012 of 10.56% (256,474 from page 5 of Staff's objection divided by a rate base of \$2,429,696 from Exhibit 4) which is again, above its authorized rate of return.

Second, regarding payment of interest on debt, Lakes Region appears to be implying that there was no consideration given to Lakes Region's interest obligations on its debt by the Commission. This is flatly incorrect. When Lakes Region's present rates were established in Docket No. DW 10-141, a portion of the return on rate base included in its approved revenue

⁵ Statement of Cash Flows is a statement that reconciles the balance of cash on hand at the beginning of an accounting period with that at the end of the accounting period. Also referred to as a "sources and uses of cash" statement.

A Balance Sheet is a summary of the financial balances of a business entity, and is comprised of assets, liabilities, and equity accounts. It is a "snapshot" of the financial position of a business entity at a single moment in time.

Income Statement, also known as a Profit and Loss Statement ("P&L"), measures the operating results of a business entity over a defined period of time (an accounting period).

requirement was based on a cost of debt component which was substantially comprised of its interest obligations. Furthermore, the fact that Lakes Region's recent earnings history has shown it exceeding its approved rate of return (which includes interest coverage), indicates that the Company's present rates and earnings are more than sufficient to cover its interest obligations. The Commission should reject Lakes Region's argument.

Third, Lakes Region argues that changes in assets and liabilities booked as cash in its cash flow statement are not actually cash available to pay taxes. This argument confuses the purpose of the various asset and liability adjustments that are contained in the Statement of Cash Flows. The purpose of these various adjustments is to convert Lakes Region's net income as indicated on its income statement to the cash amount indicated on its balance sheet. Lakes Region appears to mistakenly interpret the net result of these various adjustments as somehow equating to a demonstration of additional cash on hand for the Company. This is clearly not the purpose of the statement of cash flows and it was not interpreted as such by the Commission in Order No. 25,516. For these reasons, the Commission should reject this argument.

The same objection is applicable to Lakes Region's fourth argument concerning expenditures for compliance with the Safe Drinking Water Act and principle payments; this is a misunderstanding of the accrual method of accounting. Lakes Region also implies that the Commission somehow overlooked its capital investment or debt service obligations in Order No. 25,516. On the contrary, the Commission acknowledged Lakes Region's capital investment and financing needs when it stated,

“Significant amounts of capital have been required in some of Lakes Region's water systems in recent years and Lakes Region or its shareholders, the elder Mr. and Mrs. Mason, have invested heavily in the company. Shareholder investments totaled over one million dollars over the last five years. Lakes Region Closing at 18. Lakes Region testified that it made \$113,629 in capital improvements in 2011 and \$115,550 in capital improvements in 2012. Exh. 1 at 10. These investments

are consistent with the needs of older systems. We are aware of the pressure water utilities face in meeting state and federal water quality standards, as well as the challenges of aging infrastructure. When a water utility makes a business of acquiring older systems, as has Lakes Region, such a business requires that utility to acquire and deploy needed capital for those older systems in order to meet its obligation to provide safe and adequate service pursuant to RSA 374:1.” (Order No. 25,516, pages 9-10)

On page 12 of its motion, Lakes Region states it provided cash and services to Mrs. Mason in 2011 and in 2012. It states that \$53,443 in cash was provided in 2012. This can't be. We know from its cash flow statement presented at hearing that it withdrew \$123,356 in equity in 2012. Either Lakes Region's motion is incorrect, or its cash flow statement is incorrect. The problem is that the cash flow statement reflects a payment of \$123,356 for 2012 but now Lakes Region is stating that the cash flow statement reflects \$53,443 in cash as going to Mrs. Mason. If Lakes Region's more recent argument is correct, this means that there was an unidentified withdrawal of \$69,913 in 2012 from the Company. Despite Lakes Region's efforts to correct its calculation errors, more just seem to occur.

In summary, none of Lakes Region's arguments demonstrate a crisis exists; the Commission was not unreasonable in finding that a crisis did not exist. Nor did the Commission overlook or mistakenly conceive evidence.

III. The Commission did not Err by Failing to Consider Lakes Region's Legal Obligation to Repay Accounts Payable Incurred due to Prior Deficiencies in Rates.

On page 4 of Lakes Region's motion, it states that the Commission, “by the stroke of a pen” eliminates all Lakes Region's progress and “pushes the Company backwards.” This argument should be rejected since, as stated earlier, Lakes Region testified in its rate case, Docket No. DW 10-141, that its vendors were not pressuring Lakes Region for repayment. Lakes Region never argued in the instant docket that its accounts payable constituted a crisis pursuant to RSA 378:9. The fact that Lakes Region has been able to pay its accounts payable

down is of no great surprise since its rate of return is up where it should be, in fact, it has been over-earning. Lakes Region's schedules filed in this docket show that Lakes Region is in better financial shape in 2013 than it was in 2012.

A portion of Lakes Region's argument also misunderstands the purpose of utility ratemaking. The Commission uses a historical test year in evaluating a utility's revenue needs. Under this type of test year review, when a utility files a full rate case, it provides schedules which normalize the test year, adjusts expenses that are not recurring and make *pro forma* adjustments for known and measureable expenses. Lakes Region filed such a test year in its 2010 rate case and used a 2009 test year. Rates are not designed to consider past accounts payables. That the Company did not seek adequate rates in previous years is not now a "cost" that should be collected from customers through rates.

Second, Lakes Region extends its accounting misunderstanding to emergency rates. Under emergency rates, the burden is on the utility to prove that a crisis exists. Lakes Region argued the crisis was that it could not pay its 2012 taxes. In its motion, it now says the crisis includes 2013 taxes, however, it never put into the record exactly what that tax liability would be. It was left undetermined. To argue that in denying emergency rates the Commission is somehow preventing Lakes Region from recovering "any income tax expense and thereby confiscating its investment in plant and its right to earn a reasonable return" is without merit. If Lakes Region wants to include income tax expense in its revenue requirement, it must file a test year that demonstrates that it has such an expense. The more proper method of incorporating income tax expense into a revenue requirement is through a full rate case, based on traditional test year analysis, not through emergency rates per RSA 378:9, especially when it is over-earning. Under RSA 378:9, if a utility argues that a crisis exists and it cannot pay its taxes, it

must show that its financial affairs are in such a crisis that immediate and substantial disaster threatens unless prompt relief is given. In the instant proceeding, Lakes Region failed to establish a crisis existed and therefore, one never gets to the second part of the analysis of awarding income tax expense. For these reasons, the Commission should reject Lakes Region's motion.

IV. The Commission did not Err by Concluding that Lakes Region "Substantially Reduced the Availability of Net Operating Loss Carry-Forwards and Section 179 Carry-Forwards that could have Shielded Future Income."

Staff first wishes to note that the issue of exhausting operating losses arose in Docket No. DW 10-141, Lakes Region's rate case. Initial discovery concluded in the spring of 2011, Staff filed testimony in the fall of 2011, and Lakes Region discovered on Staff testimony thereafter. Hearings were held in early 2012 and Lakes Region did not inform Staff that it had amended its tax returns until the eve of the hearings. Therefore, Staff's pre-filed testimony and discovery responses did not take amended tax returns into account, especially Staff's response to LRWC 1-8, which was marked as Exhibit 11, which Lakes Region makes much about. The late raising of this issue and the errors in Lakes Region's exhibits at hearing raised serious doubt as to the level of income tax expense, if any, Lakes Region would be responsible for. The Commission's order reflected that lack of such evidence.

Second, Staff wishes to also note that in Order No. 25,516, the Commission only mentioned the issue of the loss carry forwards as a concern. It was not the basis of its finding that a crisis did not exist. The Commission instead relied upon the fact that Lakes Region was over-earning and had actually accounted for payment of taxes in its schedules. Whether it was proper to exhaust the carry forwards is, thus, an ancillary issue.

On page 18 of Lakes Region's motion, it states: "[t]he intimation by Staff that the Company should maintain one set of books for the Commission and a different set for the

Service is also precluded by the Code.” The source is noted as Hearing Transcript of Day 2 at 19-20. Staff has read this section of the transcript and strongly disagrees with and takes exception to the Company’s characterization that Staff encouraged Lakes Region to maintain “ a different set [of books]” for tax purposes. Staff never encouraged Lakes Region to maintain separate accounting records for regulatory and tax purposes. Staff is fully aware that such a practice is disallowed by the IRS. It is Staff’s hope that the Company’s wording on this point was itself just merely an “inartful” use of a common colloquialism for tax fraud. If not, however, Staff takes extreme umbrage to Lakes Region’s inferred assertion.

The section of the cited transcript concerns issues captured in Exhibit 11, Staff’s October 31, 2011 response to LRWC 1-8. The response regarded classifying pension and health care expenses paid to Lakes Region’s elder shareholders as a utility expense. Staff stated in the response that the expense should not be recovered in customer rates. Staff also testified at hearing, on Day 2 at 19-20, that Lakes Region removed these items as a utility expense but then went further. After the date of this response, Lakes Region amended its tax returns, not only for the 2009 test year, but for 2007 and 2008. In addition, Lakes Region eliminated interest expense on the debt from its shareholders which was not an issue in the rate case, nor was it an issue addressed in Exhibit 11. Because Staff’s response was made without knowledge that Lakes Region intended to amend its tax returns or eliminate interest expense, Lakes Region’s use of Exhibit 11 on page 14 of its motion to argue that accepting Staff’s position required it to amend its tax returns is inappropriate. Had Staff known on October 31, 2011 that Lakes Region intended to amend tax returns and eliminate interest expense, its response would have taken that into account. Lakes Region should not blame Staff for its poor tax advice received from its own

consultants. Staff reaffirms that Lakes Region's decision to amend its returns was in no way initiated by Staff.

CONCLUSION

Argument and evidence provided in Lakes Region's motion is misconstrued, incorrect, and redundant. Lakes Region's arguments that its 2013 taxes, accounts payable, and compliance with Department of Environmental Services requirements constitute a crisis were not argued in its initial petition. Lakes Region has not met its burden of showing that its financial affairs are in such a crisis that immediate and substantial disaster threatens unless prompt relief is given. Staff disagrees that good cause exists to grant a rehearing of Lakes Region's emergency petition. The Commission's Order No. 25,516 is not unlawful or unreasonable and the Commission did not overlook or mistakenly conceive matters. Order No. 25,516 is not confiscatory and does not violate State and Federal constitutional principles.

WHEREFORE, Staff respectfully request that the Commission:

- A. Deny Lakes Region's motion for rehearing; and
- B. Grant such other and further relief as may be just and equitable.

Respectfully submitted,



Marcia A. Brown, Staff Attorney

CERTIFICATE OF SERVICE

I hereby certify that a copy of this objection has been forwarded to all parties on the service list in this docket.

Dated: July 15, 2013



Marcia A. Brown, Staff Attorney