

BEFORE THE STATE OF NEW HAMPSHIRE

PUBLIC UTILITIES COMMISSION

In the matter of:)
Lakes Region Water Company, Inc.)
DW 08-070)
Petition for Authority to Finance and to Increase Rates)
Third Step Increase Proposal)

Direct Prefiled Testimony

of

Stephen R. Eckberg
Utility Analyst

on behalf of
The NH Office of Consumer Advocate

Dated: **November 24, 2010**

OFFICE OF CONSUMER ADVOCATE

TESTIMONY

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 Advocate
3 (OCA) as a Utility Analyst. I include as Attachment SRE-1 to my testimony a statement
4 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 the earlier
8 phase of this Docket which resulted in the Commission's approval of two Step increases
9 for Lakes Region Water Company (LRWC) in Order No. 24,925.

10

11 **Q. Please briefly describe what the Company seeks in the Third Step Increase request.**

12 A. The Commission's Order No. 24,925 dated December 30, 2008 approved a Settlement
13 Agreement which granted the Company two Step Increases related to completion of a
14 number of capital additions. That Settlement also called for a third step increase to be
15 filed when certain other capital additions were completed. On May 20, 2010, LRWC
16 filed its request for approval of its third step adjustment. As filed, the third step includes
17 recovery of an additional \$245,193 plant in service, and the application of LRWC's
18 consolidated rates to the Company's Gunstock Glen customers.

19

20 **Q. Does the OCA support the Settlement Agreement that was filed on November 18,**
21 **2010 related to the Third Step Increase in this Docket?**

22 A. No. While the OCA is supportive of certain aspects of the Settlement, the OCA believes
23 that the Settlement does not address certain critical issues caused by the Company's
24 financial, technical and managerial challenges, which I will discuss. As a result, the

1 OCA believes that it is necessary to file this testimony to identify several issues and make
2 recommendations to the Commission regarding our concerns in order to protect the
3 interests of residential ratepayers. While we understand that many of these issues can be
4 considered by the Commission in the Company's current rate case, DW 10-141, we
5 believe that the importance of these issues requires us to raise them in this docket as well.

6

7 **Q. Did the OCA support the Settlement Agreement in the earlier phase of this Docket**
8 **which resulted in Steps 1 and 2 being granted to the Company?**

9 A. No. The OCA did not sign the Settlement Agreement in the earlier phase of this Docket
10 in 2008, which provided the Company with two step increases to rates and was approved
11 in Order No. 24,925 on December 30, 2008. At that time, the OCA believed that
12 granting any step increases to the Company outside the full consideration of a general
13 rate case constituted single issue ratemaking. In other words, the OCA felt that rather
14 than grant a step increase in rates for the Company's capital additions and incremental
15 expenses related to these specific improvements it would have been more appropriate to
16 evaluate those additions and expenses in the context of a comprehensive review of all the
17 Company's revenue, expenses, rate base investments and cost of capital as would be done
18 in a full rate case. The OCA continues to have this same concern regarding the third step,
19 though acknowledges that Order No. 24,925 granted the Company permission to file for
20 this third step increase to rates once the improvements had been completed.

21

22 **Q. Is the Company's current filing for the Third Step Increase to rates being made**
23 **according to the time line contemplated in the Settlement approved by Order No.**
24 **24,925?**

25 A. No. The earlier settlement contemplated that the assets related to the Third Step
26 additions in the Hidden Valley and Gunstock Glen systems would be in service around

1 the end of 2008, with a related filing sometime thereafter. The Company did not make its
2 Third Step filing until May 20, 2010.

3

4 **Q. Does the OCA have specific concerns regarding the improvements or process**
5 **related to the Third Step increase?**

6 A. In addition to our concern stated above that we consider these Step Increases to be single
7 issue ratemaking, the OCA also has the following specific concerns with the proposed
8 Third Step Increase which I will discuss in my testimony. They include:

- 9 1. Issues identified in the Staff Audit regarding certain expenses recommended for
10 exclusion;
- 11 2. Water Service which may be provided to the development known as York
12 Village through the newly interconnected regulated systems of Brake Hill and
13 Gunstock Glen in the town of Gilford, but which is not within the Company's
14 franchise territory;
- 15 3. The Company's increase in debt to its owners Thomas Adam Mason and Barbara
16 G. Mason which lacks Commission approval;
- 17 4. The Company's use of an unapproved debt rate of 9.75% on the increase in debt;
- 18 5. Mark up of costs of materials from the Affiliated LRW Services to the regulated
19 Company; and
- 20 6. Changes made to the Affiliate Agreements between the Company and LRW
21 Services which may not meet the Commission's cost standards.

22

23 **Q. Please address the OCA's first concern regarding issues identified in the Staff Audit**
24 **Report of the Company's Third Step Increase filing.**

25 A. Audit Issues 3 and 4 relate to the Affiliate Agreements, and items recommended for
26 exclusion from the calculation of rates, including costs related to Affiliate transactions.

1 These are both of concern to the OCA not simply because of Audit's recommended
2 disallowance, but also because the actions appear to reflect inappropriate business
3 practices. I will address our concerns regarding the Affiliate Agreements later in my
4 testimony. First, I will address Audit Issue 4 regarding certain items that Audit
5 recommended for exclusion. The Settlement Agreement entered into by Staff and the
6 Company did exclude, for purposes of calculating the Step Three revenue requirement,
7 all of the Audit's recommended exclusions. The OCA is supportive of this approach.
8 However, we are very concerned about the Company's comments regarding two of
9 Audit's recommended exclusions, as they suggest that although the Company has agreed
10 to remove these items from the Third Step, they may be continuing to engage in these
11 practices. I have included a copy of the Final Audit Report dated September 22, 2010 as
12 Attachment SRE-2 to my testimony so that the Commission can review the complete
13 discussion of these issues by Audit Staff.

14

15 **Q. What are the two recommended exclusions in the Audit related to Affiliate**
16 **transactions?**

17 A. The first one is "the 16% - 20% markup" on bills from subcontractors hired by LRW
18 Services for work performed for the regulated Company. Audit Staff stated that these
19 costs were not allowed as they were not specifically identified in the Affiliate
20 Agreements. The second issue is that the regulated Company "paid" certain amounts to
21 debtors of LRW Services as "service trades" which amounts are identified on page 6 of
22 the Final Audit Report and total \$13,650.

23

24 **Q. Please discuss the markup issue.**

25 A. The OCA does not support the approach taken by the affiliated LRW Services, which is
26 owned by Thomas Albert Mason (Tom Mason Jr.), the current president of both the

1 regulated utility and LRW Services, to markup subcontractor services before billing the
2 utility. As President of the regulated Company, Mr. Mason could simply directly
3 contract with the provider of these services on behalf of the regulated utility. The
4 Company stated in its “Company Comment” on Audit Issue 4 that “...the Company
5 believes it is reasonable for LRW Water Services and other contractors to have a markup
6 built into its charges. The Company believes that the 16% - 20% markup identified is
7 reasonable. The Company will incorporate a markup in its Affiliate Agreement.” The
8 OCA disagrees. We also believe that such markups are inconsistent with the current
9 Affiliate Agreement, and furthermore are not appropriate to include in any updated
10 Affiliate Agreement.

11

12 **Q. Are there other aspects of this issue which concern the OCA?**

13 A. Yes. As indicated above, the Company states that it intends to rewrite its Affiliate
14 Agreements in order to formalize the practice of marking up subcontractor costs to the
15 regulated utility. The OCA does not believe that this is reasonable, as dealings between
16 utilities and their affiliates must be. As a result, in addition to disallowing these types of
17 costs, the OCA believes that the Commission should also direct the Company to
18 immediately stop including any such markup provisions in its transactions between the
19 affiliated companies.

20

21 **Q. Would you please describe your other issue of concern identified in the audit
22 regarding the “service trades.”**

23 A. Yes. At the bottom of page 10 of the Final Audit Report it states:

24 Audit notes that the Company stated on four occasions that a job cost was
25 arrived at through an agreement “reached between the parties as a service
26 trade”, using the dollar amount a company owed LRW [Services] as a basis.
27 Therefore, Audit considers there was no adequate support sent by the
28 Company for these items.

1
2 The OCA sought additional information from the Company regarding these “service
3 trades” which the Company provided in response to discovery. Attachment SRE-3 is a
4 copy of the Company’s response to OCA Data Response 4-19. The Company’s
5 explanation makes it clear that Company management used the regulated utility to reduce
6 a debt that was owed to LRW Services, the unregulated affiliate from a third party. This
7 type of “bartering” is not a proper transaction for a regulated utility to undertake, and the
8 OCA believes that these transactions do not reflect prudent utility practice.
9

10 **Q. Have the expenses related to “service trades” been removed from the Third Step in**
11 **the proposed Settlement Agreement?**

12 A. Yes they have. The four items which total \$13,650 (\$800 + \$1,150 + \$9,500 + \$2,200)
13 are related to improvements under consideration in this Third Step proceeding,¹ but these
14 costs are not included in the proposed rates in the Settlement. The OCA is supportive of
15 this approach in the Settlement.
16

17 **Q. Does the recommended disallowance and exclusion from rate calculations in this**
18 **Third Step sufficiently address the OCA’s concern?**

19 A. No it does not. The OCA is very concerned that these expenses may be reconsidered or
20 that other costs derived from “service trade” agreements may be included elsewhere in
21 the permanent rate case now in progress as DW 10-141. The recommendation in the
22 Audit Report states that “there was no adequate support sent by the Company for these
23 items.” This may leave the impression with the Company that if it can provide or offer
24 additional documentation then the charges will be considered for inclusion in the

¹ Page 3 of Attachment SRE-3 shows a total debt of \$52,250 owed by “York Village” to LRW Water Services. In addition to the 4 items totaling \$13,650 relating to Step 3 additions, there is similar “Credit Memo #98850” in the amount of \$4,250 which does not appear to have been reviewed in the Step 3 Audit. Nonetheless the OCA includes this invoice and amount in our concerns discussed later in this testimony.

1 calculation of rates, perhaps in the Company's rate case. The OCA therefore respectfully
2 requests that in addition to disallowing these costs, the Commission direct the Company
3 to refrain from entering into these types of arrangements in the future.

4

5 **Q. Please address the second issue from your original list above regarding Water**
6 **Service in the development known as York Village through the newly**
7 **interconnected regulated systems of Brake Hill and Gunstock Glen in the town of**
8 **Gilford.**

9 A. Order No. 25,925 approving the Settlement granting the Steps 1 and 2 rate increases and
10 giving the Company authority to file for the third step stated that it would defer
11 consideration of applying consolidated rates to Gunstock Glen customers to the time
12 when LRWC makes the appropriate filing. In the current Settlement now before the
13 Commission regarding the Third Step increase to rates, Staff and the Company propose to
14 apply the consolidated unmetered rates to the Company's Gunstock Glen customers. The
15 OCA agrees that if the Commission were to approve the Settlement, it is appropriate to
16 apply the consolidated unmetered rates to these customers. There is, however, another
17 group of potential customers that have not been addressed in this Settlement Agreement,
18 and the OCA believes that more information is needed before this Settlement can be
19 approved. Specifically, as a result of the interconnection between Gunstock Glen and
20 Brake Hill, there may be new, additional customers and revenues that should be
21 accounted for in calculating the rates relative to this Third Step increase to rates.

22

23 **Q. What potential new customers are you referring to?**

24 A. I am referring to a development called York Village, which is located adjacent to both
25 Brake Hill and Gunstock Glen in Gilford. The OCA believes that the water system
26 supplying York Village may be connected to the newly interconnected Brake Hill –

1 Gunstock Glen systems. However, the Company has neither sought a franchise
2 expansion to serve the houses in this development as retail customers, nor has it sought
3 approval of any special contract to serve the development as a wholesale customer.
4

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

7 A. There are several indications that there is some relationship here that has not been fully
8 explained by the Company. First, in response to discovery, the Company provided a
9 copy of the “Design Package for Gunstock Glen / Brake Hill Community Water System”
10 prepared by Lewis Engineering for the Company in July 2007. The cover letter
11 accompanying this plan is addressed to Mr. James Gill, P.E. at the Drinking Water and
12 Groundwater Bureau of DES. The cover letter states in the first paragraph “The
13 expansion is necessary to serve a new development in Gilford and to better serve the
14 existing neighborhood.” Second, during the Technical Session held on November 8,
15 2010, when asked by the OCA about this development, the Company indicated that it had
16 received a Contribution in Aid of Construction (CIAC) relative to this system. The
17 Company indicated these CIAC amounts were shown in the Company’s Annual Reports.
18 The OCA believes these amounts to be \$68,200 for Mains and \$9,900 for Services as
19 listed in the 2009 Annual Report at Table F-46 relative to the Brake Hill system (BH on
20 Table F-46). I have included a copy of this table, and the cover letter referenced above,
21 as Attachment SRE-4 and SRE-5 respectively, to my testimony.
22

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

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

1 Annual Report that was readily available. However, based on the values shown in the
2 Amortization of the CIAC columns, it appears that the CIAC was likely entered on the
3 books in 2007.

4

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

7 A. It is clear from information provided in response to OCA 4-19 (see Attachment SRE-3)
8 that the unregulated affiliate LRW Services has performed a significant amount of work
9 installing mains and services in York Village. This work is the source of the unpaid debt
10 which in turn resulted in the “service trades” discussed earlier in my testimony.

11

12 **Q. Does the OCA have a recommended adjustment regarding the situation at York**
13 **Village?**

14 A. The OCA does not have a specific recommended adjustment to the Third Step increase
15 because the Company has not provided enough information regarding the relationship
16 between York Village and the Company’s interconnected Brake Hill – Gunstock Glen
17 system. It is clear, however, that just as additional revenues from Gunstock Glen
18 customers have been included in the calculation of rates for this Third Step increase, if
19 there are other revenues related to the York Village system they too should be included
20 now in the calculation of the Third Step increase.

21

22 **Q. Absent a specific adjustment to the Third Step, does the OCA have a**
23 **recommendation?**

24 A. The OCA recommends that the Commission direct the Company to provide all relevant
25 information concerning the relationship between the Company, LRW Services, and York
26 Village so that the parties in this Docket can fully review any financial impacts of these

1 relationships prior to granting any increase in rates related to this Third Step increase.
2 The OCA also respectfully requests that the Commission make clear to the Company that
3 it is required to take certain steps if it wishes to expand its franchise territory.
4

5 **Q. Please address the OCA's third issue from your earlier list regarding the**
6 **Company's unapproved increase in debt to its owners Thomas Adam Mason and**
7 **Barbara G. Mason.**

8 A. In the Company's 2009 Annual Report, on the Supplemental Schedule included with
9 Table F-35 regarding Long Term Debt, the Company reports that during 2009, it
10 increased its long term debt to the Company owners and sole stockholders, Thomas
11 Adam Mason (Sr.) and Barbara G. Mason, by \$52,116. See Attachment SRE-6. During
12 2009, the Company did file a financing petition which was docketed as DW 09-098.
13 That petition, however, dealt with the Company's request to incur debt from the State's
14 Revolving Loan Fund, not a request for approval to increase long term debt from the
15 Company's owners. This action is in violation of RSA 369, which requires utilities under
16 the Commission's jurisdiction to receive Commission authorization prior to incurring
17 long term debt.
18

19 **Q. Did the Company provide any additional information about this increase in long**
20 **term debt?**

21 A. Yes. In response to data requests in the Company's current rate case, DW 10-141, the
22 Company stated that it did "not specifically" have Commission authorization to increase
23 its long term debt. See Company response to OCA 1-19(g) included as Attachment SRE-
24 7.
25

1 **Q. Does the OCA have a recommendation regarding this unauthorized increase in**
2 **debt?**

3 A. The OCA recommends that the Commission impose a penalty on the Company for this
4 violation of RSA 369, and also direct the Company to immediately cease taking on new
5 long term debt, from any source, that is not approved by the Commission.
6

7 **Q. Please discuss the fourth item from your earlier list regarding the Company's use of**
8 **an unapproved debt rate of 9.75% on the increase in debt you just discussed.**

9 A. In addition to the Company engaging in an unauthorized increase in its long term debt,
10 the Company is applying an unauthorized interest rate on that debt to its owners.
11

12 **Q. What is the Company's basis for using this rate?**

13 A. In response to discovery in DW 10-041, the Company stated that "The Company has
14 historically used its cost of equity rate for the shareholder loan." See response to OCA 1-
15 19(h) in DW 10-141 included as Attachment SRE-7.
16

17 **Q. You stated that this rate was an "unauthorized interest rate" yet the Company**
18 **states this is its historical practice. Is there Commission approval of this practice?**

19 A. Not that I am aware of. I have reviewed numerous documents in several relevant dockets
20 for this Company, including Commission Orders, and find no approval of what the
21 Company refers to as its "historic practice." In fact, Exhibit E to the Stipulation
22 Agreement from the earlier phase of this current Docket, which covered the Step 1 and 2
23 increases to rates, is a schedule which provides the overall rate of return calculation. On
24 that schedule there is clearly an entry in the calculation for "Shareholder Loan" at 7.25%.
25 A copy of that Schedule is included as Attachment SRE-8.
26

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

2 A. Yes. The OCA recommends that the Commission direct the Company to retroactively
3 apply a rate that is no greater than the “Shareholder Loan” interest rate of 7.25%, rather
4 than the equity rate of 9.75%, to all Commission approved amounts borrowed from the
5 Company’s owners/shareholders. This change would likely adjust the Company’s costs
6 and rates calculated for this Third Step. For this reason, the OCA recommends that the
7 Commission require this change if it approves the Settlement Agreement regarding this
8 Third Step increase. In addition, we believe that 7.25% may not be an appropriate rate
9 for borrowings from the owners of the Company. Other utilities are borrowing monies at
10 much lower rates as a result of the low market interest rates available today. Lakes
11 Region customers should also benefit from those low interest rates.

12
13 **Q. Please address the fifth issue from your earlier numbered list regarding excessive
14 mark up of costs on materials from the Affiliated LRW Services to the regulated
15 Company.**

16 A. In the course of reviewing discovery responses, the OCA has noted that the Company
17 acquires many of its materials and supplies from its unregulated affiliate LRW Services,
18 rather than purchasing them directly from suppliers. The OCA requested that the
19 Company provide a copy of an invoice showing what the unregulated affiliate had paid
20 for one product, in order to compare that with the price that the unregulated affiliate then
21 applied when selling the same item to the regulated Company.

22
23 **Q. What were the results of this comparison?**

24 A. Included in charges for the purposes of the Third Step increase, LRW Services charged
25 the Company \$3.00 per foot for “4” PVC Drainpipe.” Despite our request, the OCA did
26 not receive a copy of an invoice showing the cost that LRW Services paid for 4” PVC

1 drainpipe at a roughly comparable point in time as the pipe that was used. Rather, LRW
2 Services provided a copy of a current “price quote” received on November 11, 2010 for
3 this material. This price quote showed that 4” SDR 21 PVC pipe could be purchased for
4 \$1.89 per foot. While I do not claim engineering or materials specification expertise,
5 based on my research, I believe that these are comparable products. The OCA’s
6 calculations indicate this represents a 59% mark up in price charged by the unregulated
7 affiliate in providing this material to the regulated Company. A copy of documentation
8 showing each of these prices per foot in included as Attachment SRE-9.

9

10 **Q. Does the OCA believe this is reasonable?**

11 A. No. In addition, the Company has not met its burden in explaining why it should
12 purchase materials at a 60% mark up from its unregulated affiliate when it could itself
13 purchase and store reasonable amounts of regularly used materials thus avoiding these
14 extra costs which are passed on to the utility’s ratepayers.

15

16 **Q. What does the OCA recommend?**

17 A. The OCA recommends that the Commission exclude these and other similar excessive
18 costs from the calculation of rates proposed in the Settlement regarding the Third Step
19 increase in rates. As it is likely that additional time will be needed to assess the impact of
20 this recommendation on the proposed Third Step increase, the OCA recommends that the
21 Commission not approve the Settlement Agreement under consideration.

22

23 **Q. Before you address the sixth issue on your list regarding changes made to the**
24 **Affiliate Agreements between the Company and LRW Services, please explain why**
25 **you raise the issue of the Affiliate Agreements in the context of this relatively small**
26 **Step 3 increase in rates.**

1 A. The OCA raises this issue now, as we did in the earlier phase of this Docket, because the
2 majority of the costs included in these Step Increases are the result of work performed by
3 the Company's affiliate LRW Services². Therefore, the costs specified in those
4 agreements are very important in the calculations of expenses included in these proposed
5 Step Increases.

6
7 **Q. Please continue with the explanation of the OCA's concerns about the Agreements.**

8 A. In the OCA's Joint Testimony of Kenneth Traum and Stephen Eckberg in the earlier
9 phase of this docket regarding Steps 1 and 2, the OCA expressed concern that the
10 Company's affiliate agreements did not meet applicable PUC Standards. See Joint
11 Testimony at page 6 lines 6-10. The OCA stated that those standards were "...that rates
12 for services provided to the affiliate by the utility must be at the greater of market value
13 or actual cost ... [and] that costs for services provided by the affiliate to the utility must
14 be at the lesser of market value or actual cost."

15
16 **Q. How are those standards relevant to the current Agreements?**

17 A. They are relevant because the Company is not complying with those pricing standards.
18 In addition, there is some irregularity regarding the effective dates of the Agreements. In
19 discovery, the OCA requested "a copy of the Affiliate Agreement, as approved by the
20 Commission, effective during 2009." The 2009 year is when many of the improvements
21 included in this Step 3 Increase were made. In response, the Company provided a copy
22 of Affiliate Agreements signed on February 15, 2010, which the Company states were in
23 effect April 1, 2009. The OCA believes these Agreements have not been approved by the
24 Commission, so that an earlier version was in effect. See OCA 4-14 included as

² See Attachment SRE-10; The Company's response to OCA 4-4 indicated that \$133,803 of the \$245,193 (55%) proposed costs were billed by LRW Services to the Company.

1 Attachment SRE-11. Therefore, it is not clear what Affiliate Agreement applies, and
2 whether or not it is in compliance with Commission standards.

3

4 **Q. What components of the Agreements are of concern to the OCA?**

5 A. I have already discussed several issues related to costs that are not covered in the
6 Affiliate Agreements which the regulated Company has incurred from its unregulated
7 affiliate, and which it seeks to include in rates. These include cost mark ups from
8 subcontractors hired by the affiliate, and also excessive cost mark ups on materials
9 purchased by the affiliate and then sold to the Company. I am also very concerned about
10 a disparity in hourly rates between the two affiliated companies which have now been
11 included in this latest set of Agreements.

12

13 **Q. What is the disparity in rates that you refer to?**

14 A. In Appendix A to the new Affiliate Agreement titled “Contractor Utilization of Water
15 Company Personnel and Equipment,” it states that the Contractor may utilize equipment
16 of the Water Company to provide assistance to the Contractor, and that the Contractor
17 will pay the Water Company \$19 per hour for personnel including use of a pick-up truck.
18 However, in Appendix B to the Agreement titled “Water Company Utilization of
19 Contractor Personnel and Equipment,” the agreement shows that the reciprocal charge for
20 Company use of Contractor Personnel is \$50 per hour including use of a pick-up truck.
21 Referring to the pricing standards quoted above, it is nearly impossible to believe that
22 when the Affiliate provides services to the Utility under Appendix B rates of \$50 per
23 hour apply with these costs representing “the lesser of market value or actual cost,” that
24 there could then exist some rational basis that justifies the regulated utility earning only
25 \$19 per hour when the Contractor uses the Utility personnel, such as Mr. Mason himself
26 or Mr. Dawson, the Company’s licensed water operator.

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Q. What is the OCA’s conclusion regarding these Affiliate Agreements?

A. The OCA’s conclusion is that the prices included in these Agreements are not reasonable or market based, and that a thorough review of all costs incurred by the regulated utility and income earned via these Agreements must be conducted in order to ensure that the Utility’s ratepayers have not experienced both overcharges and under-earning from the use of utility personnel and property. We also note again our general concern that the Company does not use requests for proposals or seek bids for projects, so that it is very difficult to judge whether the costs for work performed by the affiliate are appropriately priced.

Q. When does the OCA believe such a review should take place?

A. The OCA’s position is that such a review must take place *prior* to establishing any rate increase related to Step Three, as costs to and from the utility related to these Agreements are currently included in the calculation of rates in the Settlement.

Q. Please summarize the OCA’s positions and recommendations included in your testimony.

A. The OCA recommends that the Commission not approve the Settlement Agreement as filed. Instead, we recommend the Commission direct the Company to make certain changes to its Third Step request and to make changes in certain practices prior to approving the Third Step Increase.

Our positions and recommendations are:

1. The OCA supports the removal of costs related to the 16% - 20% markup of subcontractor bills as identified in the Final Audit Report and as included in the Third Step Settlement Agreement.

- 1 2. The OCA supports the removal of costs related to “service trades” as identified in
2 the Final Audit Report and as proposed in the Third Step Settlement Agreement.
3 Whereas the Company may have continued this practice, and whereas there may
4 be some amount of debt still owed to the affiliated LRW Services by this third
5 party, we also recommend that the Commission direct the Company to remove
6 any and all costs related to “service trades” from its permanent rate case filing in
7 DW 10-141, and to desist from any additional transactions of this type.
- 8 3. With regard to the uncertain nature of the relationship between the Company and
9 the development known as York Village, which is adjacent to the Company’s
10 interconnected Brake Hill – Gunstock Glen systems, we recommend that the
11 Commission direct the Company to fully disclose all information regarding any
12 arrangements that have been made between the Company, its affiliates, and York
13 Village including details about Contributions in Aid of Construction, special
14 contracts made or under consideration, and whether and how York Village will
15 receive water service from the Company’s water systems.
- 16 4. The OCA recommends that the Commission impose a fine related to the utility’s
17 unauthorized increase in long term debt, and direct the Company to seek
18 approval of any new debt.
- 19 5. The OCA recommends that the Commission direct the Company to apply a long
20 term debt rate not to exceed 7.25% to all approved existing loans to its
21 owners/shareholders rather than the Company’s current unauthorized practice of
22 applying the approved equity rate to a loan. We recommend that the
23 Commission not approve the current Settlement prior to recalculating any impact
24 that this change would have on the rates proposed in the Third Step Settlement.
25 Further, we recommend that the Commission recalculate the amount that the

1 Company should credit to its ratepayers for having used an unauthorized and
2 excessive interest rate on this unapproved long-term debt.

3 6. Regarding the excessive markup on materials sold to the regulated utility by its
4 affiliate, we recommend that the Commission direct the Company either to
5 purchase materials and supplies directly in the marketplace, or for those materials
6 and supplies it chooses to purchase from its affiliate to pay no more than the
7 amount that the affiliate has paid for those materials. That is, the affiliate should
8 sell materials and supplies from its inventory at cost – with no mark up – to the
9 regulated utility. Further, we recommend that the Commission direct the
10 Company and its affiliate to formalize this arrangement in another revised
11 Affiliate Agreement that must be approved by the Commission.

12 7. With regard to the cost inequity currently contained in the Affiliate Agreement,
13 the OCA recommends that the Commission direct the Company to revise the
14 Agreement to remove the pricing disparity that increases costs for ratepayers.
15 The OCA recommends that the Commission require this change prior to
16 approving the Settlement Agreement on the Third Step as costs from this
17 Affiliate Agreement are included in the calculation of rates in the Third Step.

18
19 **Q. Do you have any additional comments regarding this Third Step increase in rates?**

20 A. Yes. While the OCA understands the challenges faced by LRWC, we believe that the
21 management of LRWC must understand that they must comply with the regulatory
22 requirements for prudent utility management. The parties in this Docket have expended
23 considerable effort to work productively with the Company here and in other Dockets
24 such as DW 07-105 and DW 10-141. There have been a few improvements in the
25 Company's management approach, but overall the OCA believes that the Company must
26 demonstrate significantly more financial and managerial discipline in order to meet the

1 standards required. We are hopeful that the Company is moving in that direction, but we
2 strongly urge the Commission to require full compliance with all prudent utility practices,
3 statutes and regulations immediately. Customers can not wait any longer.

4

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

6 A. Yes.