STATE OF NEW HAMPSHIRE
PUBLIC UTILITIES COMMISSION

DW 07-105, DW 10-043, DW 10-141, DW 11-021

LAKES REGION WATER COMPANY, INC.

Investigation into Quality Of Service, Affiliate Agreement with LRW Water Services, Inc., Permanent Rate Proceeding, and Petition to Approve Long-Term Debt

Order Approving Permanent Rates, Affiliate Agreement (with Modifications), and Financing, and Recommending Managerial Enhancements

O R D E R N O. 25,391

July 13, 2012

APPEARANCES: Upton & Hatfield, LLP, by Justin C. Richardson, Esq., for Lakes Region Water Company, Inc.; Orr & Reno, P.A., by Douglas L. Patch, Esq., for Property Owners Association at Suissevale, Inc.; Ed Newman, *pro se*, for Hidden Valley Property Owners Association; Office of the Consumer Advocate on behalf of residential ratepayers, by Rorie E.P. Hollenberg, Esq.; Marcia A.B. Thunberg, Esq. for Advocate Staff; and Alexander F. Speidel, Esq. for the Non-Advocate Staff of the Public Utilities Commission.

I. PROCEDURAL BACKGROUND

Lakes Region Water Company, Inc., (Lakes Region) is a regulated public utility that provides water service to approximately 1,615 customers in the Towns of Campton, Conway, North Conway, Freedom, Gilford, Moultonborough, Ossipee, Tamworth, Thornton, Tuftonboro, Wolfeboro, and the City of Laconia. Docket No. DW 10-141 was initially established for the Commission's review of Lakes Region's petition for temporary and permanent rates, filed on July 19, 2010; on February 18, 2011, the Commission issued Order No. 25,196, approving Lakes Region's petition for temporary rates, and outlining the docket's procedural history as of that date. On April 25, 2011, the Commission, by secretarial letter, approved Lakes Region's proposed schedule of surcharges for the implementation of temporary rates for service rendered on or after September 17, 2010, pursuant to Order No. 25,196. On March 23, 2011, Lakes Region withdrew the request, presented in its original rate petition filing, for a step increase associated with its Mt. Roberts property.[1]

Subsequently, the parties in DW 10-141 thought it advisable to consolidate DW 10-141 with three other proceedings involving Lakes Region, specifically, DW 07-105 (Investigation into Quality of Service), DW 10-043 (Affiliate Agreement with LRW Water Services, Inc.), and DW 11-021 (Petition to Approve Long-Term Debt). The Commission determined that consolidation would promote the orderly and efficient consideration of the various issues related to Lakes Region's ability to provide safe and adequate service at just and reasonable rates, and approved the parties' request for consolidation by a secretarial letter dated October 10, 2011. As of October 10, 2011, the parties to the separate Lakes Region-related proceedings were Lakes Region, the Office of the Consumer Advocate (OCA), the Property Owners Association at Suissevale, Inc. (POASI), the Hidden Valley Property Owners Association (Hidden Valley), and Staff. All of the underlying proceedings prior to consolidation are available on the Commission's website. Going forward, these parties each participated in the consolidated DW 10-141 docket, and Lakes Region's various petitions were considered within the context of a single proceeding.

The secretarial letter of October 10, 2011 established a procedural schedule for the consolidated Lakes Region docket with testimony filed on October 14, 2011, and related

[1] This proposed step increase is discussed in Order No. 25,140, issued in the DW 10-141 docket on August 17, 2010, at Page 2.

discovery to be propounded in late October 2011. On October 14, 2011, pursuant to the approved procedural schedule, POASI, OCA, and Staff filed the written testimony of John Skelton, Stephen Eckberg, and Jayson Laflamme, respectively. Staff also filed the testimony of Mark Naylor on October 14, 2011. On November 3, 2011, Lakes Region filed a motion to designate Staff Advocates, to which Staff objected on November 10, 2011. Lakes Region, in turn, filed a response to Staff's objection to its motion on November 16, 2011. Thomas A. Mason, President of Lakes Region, also filed an affidavit in support of Lakes Region's motion on December 1, 2011. The Commission, by secretarial letter dated December 9, 2011, granted Lakes Region's motion, and designated Mr. Naylor and Attorney Marcia Thunberg as Staff Advocates.

On December 12, 2011, Lakes Region filed the written rebuttal testimony of Robert Montville, Thomas A. Mason, and Stephen P. St. Cyr. On February 6, 2012, the Commission, by secretarial letter, denied Lakes Region's motion to strike the testimony of Mr. Skelton of POASI, filed on January 6, 2012. On March 2, 2012, OCA and POASI jointly filed a motion *in limine* to strike certain portions of Lakes Region's rebuttal testimony. This motion was ruled upon by the Commission at the first day of hearings on the merits for the consolidated Lakes Region proceeding, held on March 8, 2012. In its ruling on the OCA-POASI motion to strike, the Commission established that the ratemaking proposals presented in Mr. Montville's testimony would be considered for informational purposes only, as a guide to potential future petitions by Lakes Region, and not as a component of the rate proposal considered in the instant proceeding. *See* Transcript of March 8, 2012 Public Hearing, Morning Session (Tr. 3/8/12-

Morning) at 28-33. Lakes Region, and the other parties, assented to the Commission's bench ruling on this issue. Tr. 3/18/12-Morning at 31-32.

Subsequent days of hearings were held on March 15, March 21, and March 27, 2012. As requested by the Commission at the March 27, 2012 hearing (*see* Transcript of March 27, 2012 Public Hearing, Afternoon Session (Tr. 3/27/12-Afternoon) at 104, 148-149). Lakes Region, POASI, OCA, and Staff Advocates filed written closing statements on April 9, 2012, and Hidden Valley filed a written closing statement on April 10, 2012.

II. POSITIONS OF THE PARTIES, STAFF ADVOCATES, AND STAFF

A. Lakes Region

Lakes Region states that it provides reasonably safe and adequate service, as required by RSA 374:1. *See* Closing Statement of Lakes Region. Lakes Region rejected any inference that receivership, forced sale, or other coercive remedy for its financial difficulties was appropriate or legally permissible, instead arguing for comprehensive rate relief to enable its financial condition to improve. Lakes Region states that all non-revenue generating assets included in its rate base calculation were necessary to comply with New Hampshire Department of Environmental Services (DES) regulations, and that exclusion of these assets would understate Lakes Region's additions to plant in service used for the provision of customer supply, and also deprive Lakes Region of a fair return on equity for the same.

Lakes Region also rejected certain of Staff's proposed adjustments to retained earnings and for federal income taxes. Lakes Region pointed to alleged inconsistencies in Staff's testimony related to accounting treatment of disallowance of health care and pension expenses, which, if corrected for, would require an adjustment of $68,732 to provide for state and federal income taxes that Lakes Region asserts it will incur going forward. *See* Hearing Exhibit LRW-5, Reply Testimony of Stephen St. Cyr, at 4-5.

Lakes Region described the particular challenges of small water systems and asserted that though it serves over 1,600 customers, its service territory consists of a number of small water systems, described by Lakes Region witness Mason as “physically deficient,” largely constructed by developers without provision for long-term operation or financial viability, and plagued by the challenges identified by DES. *See* Hearing Exhibit LRW-6, Reply Testimony of Thomas Mason, at 3 and 9. Mr. Mason acknowledged that Lakes Region has been the subject of several letters of deficiency in recent years, but argued that, since he acquired managerial control over the system in 2009, he has successfully resolved a number of operational problems, and that Lakes Region has made much progress with limited financial resources, resolving nearly all outstanding letters of deficiency by early 2012. Transcript of March 15, 2012 Public Hearing, Morning Session (Tr. 3/15/12-Morning) at 81-82; LRW-6 at 4-5. [2]

Lakes Region acknowledged that the system faces supply problems, and that the Mt. Roberts property is under consideration as a source of additional supply for the POASI supply system. LRW-6 at 11-12. In the meantime, the request to include Mt. Roberts in rate base had been withdrawn by Lakes Region from consideration in this case, as Lakes Region was uncertain

[2] Lakes Region had also been the subject of criminal charge for water contamination, a matter which resulted in felony convictions against Lakes Region in Superior Court, and imposition of significant fines that Lakes Region has been paying down without resort to ratepayer funds.

if POASI would remain a customer of Lakes Region, necessitating further development of the Mt. Roberts property. Tr. 3/15/12-Morning at 122-124.

On company financial needs, Lakes Region conceded that the state of affairs was not good, in that numerous vendors were owed significant amounts of money. For instance, Mr. Mason confirmed that, as of December 2011, Lakes Region owed approximately $471,000 in outstanding invoices. LRW-6 at 5-6. In response to a Commission record request, Lakes Region submitted a summary of its accounts payable, which included nearly $400,000 in accounts due over 90 days. *See* March 21, 2012 Lakes Region Response to Commission Record Request 2. In response to another Commission record request, Lakes Region supplied a number of demand letters indicating that Lakes Region was in property tax arrears with several towns in its franchise area. *See* March 30, 2012 Lakes Region Response to Commission Record Request 6. Mr. Mason also testified that it was very difficult to obtain financing for the system, because traditional lenders were not confident of his ability to repay a loan. LRW-6 at 5-6. The State Revolving Loan Fund (SRF) program offered by DES at less than 3.5% interest was not an option for Lakes Region, in Mr. Mason's view, because it required a loan repayment schedule over 20 years, while its return on physical plant investments made through the proceeds of the SRF loans would be realized over a longer (typically 40 to 50-year) period. Tr. 3/15/12-Morning at 24-25. Moreover, the SRF loan provider had required a personal guarantee from the shareholders of Lakes Region, which led to a concern on the part of the shareholders that executing an SRF loan, in light of the mismatch between rate recovery and loan repayment, and the general condition of Lakes Region, would present excessive financial risk. LRW-6 at 6; Tr.

3/15/12-Morning at 24-25. Mr. St. Cyr also supported Mr. Mason's position regarding Lakes Region's inability to participate in the SRF program. LRW-5 at 5-6.

Lakes Region in its original filing requested a return on equity of 9.75 percent. Hearing Exhibit LRW-1, Testimony of Stephen St. Cyr, at 15. As the case continued, however, Lakes Region financial witness Mr. Montville testified that the company needed at least 12 percent return on equity. He based the recommendation not on an analysis of the company's risk or application of the discounted cash flow methodology used by the Commission, but instead on his expectation of the revenue needed for the system, and the percent return on equity needed to reach that revenue level. Hearing Exhibit LRW-7, Reply Testimony of Robert Montville, at 2-9. Lakes Region did not support the use of 6 percent for certain investments, as proposed by Mr. Laflamme. Hearing Exhibit LRW-5 at 4-5.

Lakes Region also requested use of a year-end rate base rather than the Commission's standard 13 month average rate base calculation, to fully capture the investments made in the test year of 2009, and put into service. Hearing Exhibit LRW-5 at 3-4.

Management of the company was a challenge, according to Mr. Mason. He stated the Lakes Region Board of Directors consists of his mother, father[3] and two sisters, but noted that the Board was not active, because his parents are elderly, in ill health and not mentally strong. Tr. 3/15/12-Morning at 62-63. Further, Mr. Mason stated that one of his sisters lives out of state, and the second works as a nurse, and that neither have any additional role in Lakes Region aside

[3] Since the date of the hearings, Tom Mason, Sr. passed away.

from voting at Board of Directors meetings occasionally during the course of a year. Tr. 3/15/12-Morning at 64-65, and 122-123.

Lakes Region also supported the terms of its affiliate agreement with LRW Water Services, Inc. (LRW), stating that the $19 standard labor rate paid by LRW for the services provided by the utility Lakes Region's personnel was equal to the hourly rate that LRW would pay to hire a part time employee to perform the same service. Lakes Region did offer, however, to increase this rate to $25 going forward. Tr. 3/15/12-Morning at 109-110. Lakes Region also stated that it benefited from its affiliate-agreement relationship with LRW, in that LRW offered "below-market rates" and flexible payment terms, together with significant revenues from LRW's use of Lakes Region personnel, amounting to approximately $18,000 in the test year. Closing Statement of Lakes Region at 11-13; *see also* Tr. 3/15/12-Morning at 106-112.

B. POASI

POASI, as a contractual water-supply customer of Lakes Region, expressed its concerns related to the long-term viability and stability of Lakes Region's financial position and managerial competence. *See* Closing Statement of POASI. POASI stated that it was especially concerned with Lakes Region's management of its Mt. Roberts expansion project. John Skelton of POASI also testified as to the existence of significant unaccounted-for water losses through the Lakes Region-supplied system. Transcript of March 21, 2012 Public Hearing, Morning Session (Tr. 3/21/12-Morning) at 44-47.

C. Hidden Valley

Hidden Valley expressed its concerns with Lakes Region's managerial acumen, financial stability, and the potential impacts of rate increases on Hidden Valley's membership. *See* Closing Statement of Hidden Valley.

D. OCA

In general terms, OCA did not oppose the revenue requirement recommendation made by Non-Advocate Staff witness Laflamme, however, OCA did note that this should not be construed as supporting the affiliate agreement between LRW and Lakes Region, though the revenue requirement recommendation presumably included revenues and expenses associated with the agreement. *See* Closing Statement of OCA at 9. OCA recommended that the Commission require that Lakes Region conduct a cost of service study as part of Lakes Region's next rate case; that any rate case expense filing be made before the Commission; and that the affiliate agreement between LRW and Lakes Region be rejected, on the basis that the labor-cost differential therein was unjust and unreasonable. OCA also expressed its various concerns regarding Lakes Region's managerial structure, financial stability, and future prospects, and recommended managerial improvements to remedy these problems. *See* Closing Statement of OCA at 1-4.

E. Staff Advocates

Staff Advocate Mark Naylor, at the time that his testimony was filed on October 14, 2011, sought to supplement Mr. Laflamme's rate recommendations (incorporated by reference) with an overview of Lakes Region's difficult financial and managerial condition, and appropriate remedies for resolving these. *See* Hearing Exhibit Staff Adv.-11, Testimony of Mark Naylor. Mr. Naylor expressed deep concern with Lakes Region's lack of access to capital, its rejection of the SRF funding option, its reliance on costly outside consultants to supply basic managerial services, deteriorating financial condition, and failure to enhance its compliance posture. Hearing Exhibit Staff Adv.-11 at 3-5. Given the ongoing managerial problems and failures to comply with Commission Orders and other legal requirements, Mr. Naylor had recommended that the Commission require that Lakes Region be sold to another utility. Because of Lakes Region's continued financial difficulties arising from what Advocate Staff described as "prima facie evidence that [Lakes Region's] operation of its systems presents a serious and imminent threat to the health and welfare of its customers," Mr. Naylor recommended that Lakes Region's franchise be revoked, thereby allowing for an "orderly ownership transition." *See* Hearing Exhibit Staff Adv.-11; Closing Statement of Advocate Staff at 10. Advocate Staff recommended that Lakes Region's petition for financing be approved as being in the public good, because the equipment financed was used and useful for the provision of utility service, but opposed the approval of the affiliate agreement with LRW claiming the agreement was inequitable. Advocate Staff also supported the revenue requirement recommendation made by Mr. Laflamme.

F. Non-Advocate Staff

Non-Advocate Staff's position was outlined in the testimony of Mr. Laflamme, which recommended that Lakes Region be allowed a permanent rate increase of $145,120, or 18.50 percent, over its pro-formed test year operating revenues from general customers of $784,397.

The revenue generated from the permanent increase would be reconcilable back to September 17, 2010, the effective date of the temporary rate increase of 17.52 percent[4], approved by the Commission in Order No. 25,196.

Mr. Laflamme also recommended that Lakes Region be allowed a step increase in its operating revenues of an additional $9,247, or 1.18 percent. This step increase would enable Lakes Region to charge rates on plant it placed in service during 2010, which was subsequent to the test year. The revenue earned from this step increase, however, would not be reconcilable back to the approved effective date of September 17, 2010. The combined increases (base rate plus step increase) recommended by Mr. Laflamme would result in a proposed revenue requirement of $938,764, representing a total operating revenue increase of $154,367, or 19.68 percent, plus the reconciliation of the difference between temporary rates and permanent rates from September 17, 2010 to the present. In deriving the proposed permanent increase, Mr. Laflamme recommended a test year average rate base amount of $2,333,649. He reduced the rate base proposed by Lakes Region of $2,608,571 by $274,922 through adjustments to reflect a thirteen-month average rate base rather than the Company's proposed end of test year rate base methodology. Mr. Laflamme also made adjustments to remove certain post-test year plant additions from rate base which were included by Lakes Region.

Mr. Laflamme's proposed rate of return for permanent rates was 8.08 percent. The components of Mr. Laflamme's proposed rate of return included Previously Approved Debt of $777,323 with a cost rate of 7.04 percent as well as Unapproved Debt of $87,861 with a cost rate

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[4] Please refer to Footnote 5 on Page 19 below for additional background regarding temporary rates.

of 4.46 percent. The Common Equity portion of Lakes Region's capital structure proposed by Mr. Laflamme consisted of $842,145 at a cost rate of 9.75 percent and $134,028 at a proposed cost rate of 6.00 percent.

The Unapproved Debt consisted of nine loans from various lenders from 2004 through 2009 for which Lakes Region did not seek previous Commission approval in accordance with RSA 369. Mr. Laflamme recommended that the Commission grant retroactive approval of this debt as the plant financed by this debt was now included in Lakes Region's rate base.

Mr. Laflamme's recommendation for a 6.00 percent cost rate for a portion of Lakes Region's Common Equity was based on the Company's apparent reluctance to pursue low-cost financing for its capital improvements, and reliance instead upon shareholder financing which carried a relatively higher cost to its customers.

The pro-forma test year operating income recommended by Mr. Laflamme was $318,065. In deriving such, Mr. Laflamme made a number of test year adjustments to both operating revenues and expenses. Many of these adjustments were based upon recommendations made by the Commission's Audit Staff upon review of Lakes Region's books and records. In sum, Mr. Laflamme increased Lakes Region's proposed operating revenue of $222,208 by $95,857 for a total pro-forma operating income amount of $318,065.

As part of his overall recommendation for permanent rates, Mr. Laflamme recommended that Lakes Region's revenue requirement should not include any provision for Federal or State income taxes. This recommendation was based on the fact that as of December 31, 2009, Lakes Region had a Federal Net Operating Loss Carryforward of $228,981 and a State Net Operating

Loss Carryforward of $269,600. Given the magnitude of these accumulated prior year losses that could be used to offset future taxable income, Mr. Laflamme did not anticipate the immediate need for Lakes Region's revenue requirement to include a provision for income tax expense. Lakes Region proposed a total Federal and State income tax expense amount of $49,528 in its initial filing; Mr. Laflamme proposed eliminating $47,030 of this expense, leaving aside only $2,498 as a component to cover Lakes Region's New Hampshire business enterprise tax liability.

In deriving his proposed Step Increase, Mr. Laflamme's recommendation was based upon a total of $97,405 of plant placed in service by Lakes Region during 2010 along with an accompanying net increase in its operating expenses of $2,835 consisting of depreciation expense and property taxes. Mr. Laflamme proposed a rate of return of 6.58 percent based upon $31,301 of debt at 7.89 percent and $70,170 of Additional Paid-in Capital at a proposed cost of 6.00 percent. Consistent with his position for permanent rates, he proposed no Federal or State Income Tax provision for the Step Increase.

III. COMMISSION ANALYSIS

This has been a contentious proceeding, with a record that spans four dockets and multiple areas of concern regarding the financial and managerial health of the company. The pertinent facts and standards governing our decisions in this case will be the focus of this order. *See Legislative Utility Consumers' Council v. Granite State Electric Co.*, 119 N.H. 359, 362 (1979), *citing New England Tel. & Tel. Co. v. State*, 95 N.H. 353, 359 (1949). Our purpose is to provide clear guidance to Lakes Region in its efforts to ensure safe and adequate service to its customers at just and reasonable rates, with special attention to Lakes Region's long-term financial and managerial viability. In doing so, we note that, though this Commission may consider facts and recommendations brought forward by the parties to a case, we may also devise remedies on our own motion to meet our duty of fixing just and reasonable rates.

A. Permanent Rates, Including Rate Impacts

RSA 378:7 authorizes the Commission to fix rates after a hearing upon determining that the rates, fares, and charges are just and reasonable. In determining whether rates are just and reasonable, the Commission must balance the customers' interest in paying rates no higher than are required with the investors' interest in obtaining a reasonable return on their investment. *Appeal of Eastman Sewer Co.*, 138 N.H. 221, 225 (1994). In circumstances where a utility seeks to increase rates, the utility bears the burden of proving the necessity of the increase pursuant to RSA 378:8. Pursuant to RSA 378:28, the Commission shall not include in permanent rates any return on any plant, equipment, or capital improvement which has not first been found by the Commission to be prudent and used and useful in the provision of utility service.

Having reviewed Lakes Region's original permanent rate filing, testimony filed by the parties in this case, and the overall record in this case, we believe that, with certain modifications, the rate recommendations prepared by Mr. Laflamme of Non-Advocate Staff offer the best means of providing just and reasonable rate relief to Lakes Region at this time. While our order may not resolve all challenges facing Lakes Region, it offers a starting point for Lakes Region's financial and managerial rehabilitation, and recovery of past investments in rate base.

1. Revenue Requirement

We will approve a revenue requirement for permanent rates of $940,844. This reflects an increase in operating water revenues from general customers of $156,447, or 19.94 percent, over pro-forma test year water revenues from general customers of $784,397. (Appendix A attached hereto presents detailed figures regarding the revenue requirement and other terms resolved in this order).

In deriving the approved permanent increase, we utilize a test year rate base of $2,381,072. This amount is based on Mr. Laflamme's proposed rate base amount of $2,333,649 but adjusted to reflect the test year-end net book values of certain non-revenue producing plant placed in service by Lakes Region during the test year. The resulting $47,423 increase in rate base reflects net increases in the net plant values of certain pumping equipment, mains, tanks, structures and land improvements placed in service during the test year which we believe were, both necessitated by regulatory mandate, and did not result in increased revenues for Lakes Region by virtue of increasing its customer base or production capacity. We made no adjustments, however, to the rate base values for services, meters and vehicles placed in service during the test year because we believe that such additions do not meet the essential criteria for non-revenue producing plant treatment. Though we traditionally employ a 13 month average for rate base additions, we will make a one-time exception and utilize the year end rate base for certain non-revenue producing plant in service, as Lakes Region requested. We find that the rate base used to calculate this revenue requirement is prudent and used and useful in the provision of utility service, in accordance with RSA 378:28.

We have determined that a rate of return of 8.39 percent should be applied to rate base. We made two adjustments to Mr. Laflamme's recommendation of an 8.08 percent rate of return. First, we increased the value of Lakes Region's Common Equity component from $976,171 to $1,033,000; an increase of $56,829, to reflect the combined amount of certain disallowed pension payments and health insurance premiums paid to Lakes Region's shareholders during the test year. Even though Mr. Laflamme reduced Lakes Region's test year operating expenses by this amount, he did not make a corresponding adjustment to increase the Company's year-end retained earnings for purposes of calculating a weighted average rate of return. The second adjustment applied the 9.75 percent Cost of Equity rate to the whole of Lakes Region's Common Equity component rather than splitting it between 9.75 and 6 percent as requested by Non-Advocate Staff or 12 percent as requested by Lakes Region. We appreciate the Non-Advocate Staff's as well as the other parties' expressed concerns regarding Lakes Region's lack of access to lower cost financing. Nonetheless, we believe that Mr. Laflamme's proposal to apply a lower cost equity rate to a portion of Lakes Region's Common Equity component may be more punitive than constructive in light of Lakes Region's current financial circumstances.

2. Step Increase

Step adjustments to rates are employed as a means of ensuring that a regulated utility retains its ability to earn a reasonable rate of return after implementing large capital projects, and to avoid placing a utility in an earnings deficiency immediately after a rate case in which a revenue requirement was based on a historical test year. In this case the test year was 2009. We find that the capital improvements and expenses recommended in the step increase, as modified by Staff in its recommendations, are used and useful and should be included in rate base. Traditional rate-of-return principles permit a utility to have "the opportunity to make a profit on its investment, in an amount equal to its rate base multiplied by a specified rate of return." *Appeal of Conservation Law Foundation*, 127 N.H. 606, 634 (1986). Having reviewed the record and testimony presented at hearing, we approve the proposed step increase to Lakes Region's revenue requirements, generally, as modified by Mr. Laflamme's recommendations.

We will approve a Step Increase in revenues for Lakes Region of $11,773, or 1.50 percent, over pro-forma test year water revenues from general customers of $784,397. The only modification we have made to Mr. Laflamme's Step Increase proposal is to increase the Rate of Return applied to the 2010 Plant Additions from 6.58 percent to 9.18 percent. This is the result of applying a 9.75 percent Cost of Equity rate to the Additional Paid-in Capital component for purposes of determining a Weighted Average Cost of Capital. Mr. Laflamme proposed a 6.00 percent Cost of Equity rate, but for the reasons stated above, we feel that a 9.75 percent rate is more appropriate under the circumstances.

The combined Permanent Increase and Step Increase that we are proposing will result in a total revenue requirement of $952,617. This represents a $168,220, or 21.45 percent, increase over pro-forma test year water revenues from general customers of $784,397.

3. Rate Impacts

The revenue requirement, as amended by the Step Increase, and our own adjustments to Mr. Laflamme's proposal, would impact customer quarterly water rates as follows:

Customer Class	Old Base Charge (prior to Temporary Rate Increase)	New Base Charge	Old Consumption Charge per CCF (prior to Temporary Rate Increase)	New Consumption Charge per CCF
Metered Customers	$93.31	$114.53	$3.92	$4.81
Non-Metered Customers	$126.67	$147.34	N/A	N/A
Waterville Valley Gateway Community Pool	$291.60	$354.14	N/A	N/A

We find that these rates appropriately collect the revenue requirement from the various customer classes, and we find them to be just and reasonable pursuant to RSA 378:7.

4. Temporary and Permanent Rate Recoupment

We approved temporary rates for Lakes Region by Order No. 25,196 (February 18, 2011) in the amount of 18.51%,[5] and in this order we have fixed just and reasonable permanent rates in accordance with RSA 378:7. Pursuant to RSA 378:29, temporary rates are effective until the final determination of the rate proceeding. If the final rates are in excess of the temporary rates, the public utility is permitted to amortize and recover the sum of the difference.

We have approved a permanent rate increase of 19.94 percent, excluding the Step Increase. We hereby order Lakes Region to file a calculation of the recoupment of the difference

[5] Order No. 25,196 approving temporary rates for Lakes Region indicates an increase in Lakes Region's revenue requirement of $143,964, or 18.51%. This was based upon pro-forma test year revenues from general customers of $777,865. However, for purposes of calculating permanent rates, the amount of pro-forma test year revenues from general customers was increased by an additional $6,532 to $784,397. Therefore, the actual increase in revenues from general customers resulting from temporary rates was only $137,432, or 17.52%.

between temporary and permanent rates, through a surcharge to customer bills over a period of 12 months, as reconciled to the effective date of September 17, 2010. However, rates applied in the Step Increase are not reconcilable back to September 17, 2010, but rather, are effective as of the date of this order. We will await Lakes Region's temporary and permanent rate recoupment calculation filing, and Staff and the parties' recommendations, before determining the appropriate surcharges for rate recoupment and rate case expenses.

B. Affiliate Agreement with LRW Water Services, Inc.

Pursuant to RSA 366:5, the Commission is authorized to investigate any affiliate arrangement, after notice and hearing, and to make a finding that the contract or arrangement is just and reasonable. The public utility has the burden of proving the reasonableness of any such contract. *Id*. Lakes Region has contracted with LRW to provide maintenance and operational services for its physical plant, and LRW, in turn, has contracted with Lakes Region for the provision of certain water sampling and other ancillary services by Lakes Region employees for LRW, when convenient to the Lakes Region employees' work schedule. Under the terms of the agreement, LRW is to pay Lakes Region an hourly standard labor rate of $19 per hour, and Lakes Region is to pay LRW a standard labor rate of $50 per hour. Lakes Region states that the fees are reasonable and appropriate, and that Lakes Region benefited from the additional revenue (approximately $18,000 in the 2009 test year, according to Lakes Region) provided by LRW's use of Lakes Region personnel. Lakes Region also notes that LRW offers the utility flexible payment terms for the use of LRW services.

Though we do agree that Lakes Region receives a benefit from the flexible payment terms afforded by LRW, and from the technical expertise of LRW technicians, we do take note of OCA's and Advocate Staff's concerns regarding the reasonableness of the labor-rate differential between LRW's costs assessed to Lakes Region and Lakes Region's costs assessed, conversely, to LRW. Therefore, we shall require the submission to Commission Staff and the OCA, no later than December 1, 2012, of a schedule of market rates charged by LRW Services' competitors for services rendered to Lakes Region on a recurring basis, to be considered in adjustment of the affiliate agreement between LRW Services and Lakes Region. Subject to these conditions for approval, we find the terms of the affiliate agreement to be just and reasonable and for the public good, and approve the inclusion of agreement-related costs in Lakes Region's revenue requirements.

C. Petition to Approve Long-Term Debt

Pursuant to RSA 369:1, public utilities engaged in business in the State may issue evidence of indebtedness payable more than 12 months after the date thereof only if the Commission finds the proposed issuance to be "consistent with the public good." Analysis of the public good consideration involves looking beyond actual terms of the proposed financing to the use of the proceeds, and the effect on rates, to insure the public good is protected. *See Appeal of Easton*, 125 N.H. 205, 211 (1984). As we have previously noted, "certain financing related circumstances are routine, calling for more limited Commission review of the purposes and impacts of the financing, while other requests may be at the opposite end of the spectrum, calling for vastly greater exploration of the intended uses and impacts of the proposed financing." *In re PSNH*, Order No. 25,050 (December 8, 2009) at 14.

We admonish Lakes Region to seek advance approval of future loan undertakings, as required by RSA 369. Nonetheless, having reviewed the loans entered into by Lakes Region totaling $216,547 from the years 2004, 2006, 2007, 2008, and 2009, we recognize that the loans for which the Company, with Staff's support, seeks retroactive approval were critical to Lakes Region's operations and system reliability, as they were used to purchase various items of plant and equipment. We also note, and concur with Staff, that the terms associated with each of the loans are reasonable, and will not adversely impact customer rates. Therefore, we approve these loans as being consistent with the public good.

D. Managerial Enhancements

Pursuant to RSA 374:22, "[n]o person or business entity shall commence business as a public utility within this state . . . without first having obtained the permission and approval of the commission." The Commission grants requests for franchise authority upon a finding that it is for the public good pursuant to RSA 374:26. In determining whether a franchise is for the public good, the Commission assesses the managerial, technical, and financial abilities of the petitioner. *See Hampstead Area Water Company, Inc.*, Order No. 25,318 (January 18, 2012). Pursuant to RSA 378:5 and RSA 378:7, the Commission is authorized to investigate whether rates, fares, charges, or prices a utility proposes to put into force are just and reasonable. Also, pursuant to RSA 374:4, the Commission has the power and duty to keep informed as to all public utilities in the State, including "…their capitalization, franchises and the manner in which the line and property controlled or operated by them are managed and operated, not only with respect to the safety, adequacy and accommodation offered by their service, but also with respect to their compliance with all provisions of law, orders of the commission and charter requirements." RSA 374:4.

These statutory powers and duties of the Commission establish a framework through which the Commission may exercise ongoing supervisory powers over the managerial personnel of a public utility such as Lakes Region. The Commission is charged with ensuring that Lakes Region's management is capable of meeting the challenges of operating its franchise, and providing safe, adequate service at reasonable cost to its customers.

The recent history of Lakes Region, which has grown from a small utility to an amalgamation of multiple systems and over 1,600 customers, is troubling. We cannot in good faith simply increase utility revenues and assume that the problems will be resolved. The concerns are myriad, but common throughout them is a lack of long-term planning, as it relates to financial health, adequate water supply, or engineering to address infrastructure needs.

It became clear in the hearings that Lakes Region is deficient in its ability to strategically plan. Until recently, Lakes Region was not in the habit of even producing a long-range capital improvements plan. Without such, it appears that much effort and resources were expended inefficiently in order to keep the Company's many aging water systems operating effectively. Also, without the benefit of such long-range planning, Lakes Region was severely hampered in its ability to effectively budget its limited resources as well as plan the most cost efficient and cost effective means to finance its numerous capital improvements. The extent of this was seen in Lakes Region's lack of success in being able to take advantage of low cost financing made available through the State's revolving loan fund.[6] In addition, while it appears that Lakes Region regularly petitioned the Commission for various rate increases over the past number of years; by virtue of its lack of planning, such requests were either not frequent enough or comprehensive enough in order to effectively meet its financial needs. We are especially concerned regarding Lakes Region's large number of outstanding tax delinquencies and accounts payable (especially those more than 90 days overdue), and expect immediate action by Lakes Region to resolve these problems.

Lakes Region also appears to have placed too great a reliance on outside financial and accounting professionals in order to obtain the necessary financial direction which is required to effectively operate this utility. While we do not demean the services provided by these financial professionals, the expense incurred by the Company to hire outside professionals rather than employ someone in-house to provide financial planning and management services appears to have placed a drain on Lakes Region's limited financial resources to the detriment of its other creditors and resulted in a utility that lurches from one crisis to the next.

Lakes Region appears to be caught in an increasingly desperate attempt to "put out fires" to keep the system going, without an awareness of the need to find better ways to manage the utility. It is unfortunate because we have no doubt that Mr. Mason has his customers' best interest in mind, and is doing his best to respond to a difficult situation. We are always reluctant

[6] We note that SRF funding terms may be more flexible in the future, and encourage Lakes Region to take advantage of the program if possible.

to intrude into the management of a utility, and do so only when it is a necessary step to avoid even greater regulatory response, up to and including receivership and termination of a franchise. The following, therefore, are management changes that we will request of Lakes Region in an effort to put the utility on the path of financial and operational stability.

Board of Directors. It is clear from the testimony that the current Board is not providing management oversight. Of the four members listed in Lakes Region's 2010 year-end annual report, Thomas Mason, Sr. has passed away, Barbara Mason is elderly and, in Mr. Mason's view, now incapacitated, a third resides out-of-state, and the fourth works full-time as a nurse. Given the importance of a functioning Board of Directors to the operations of Lakes Region, we ask that two new members, unrelated to Mr. Mason, be appointed to replace Mrs. Mason and the late Mr. Mason, no later than September 1, 2012. Ideally, the replacement directors will have some level of managerial experience; further, the Board may want to consider turning to customers of Lakes Region to recommend one of the new members of the Board of Directors, so as to enhance communication and coordination between Lakes Region and its customers. We also hereby require Lakes Region to promptly inform Commission Staff of the identity and professional experience of the replacement directors.

Manager. We agree with Advocate Staff and other parties that Mr. Mason, as President of Lakes Region, faces difficult challenges in his efforts to ensure Lakes Region's continued financial viability, while continuing to handle the daily operations of Lakes Region's physical plant. To that end, we strongly recommend that Lakes Region hire a new full-time, permanent Manager to address financial, compliance, and planning matters, to be appointed by the reconstituted Board of Directors as soon as possible, hopefully no later than January 1, 2013. The salary of the Manager (to be set at $70,000 per year plus standard Lakes Region employee benefits) would be paid by means of a rate surcharge applied equally to all customer bills. The conditions for hiring the Manager are as follows: (1) the Manager must be a resident of Lakes Region's service area (Belknap, Carroll, or Grafton Counties), so as to ensure the Manager's availability for full-time service to Lakes Region; (2) the Manager must have documented experience in (i) utility management/compliance, (ii) business accounting, or (iii) financial restructuring (ideally, the Manager would have experience in all three areas); (3) the Manager must be selected through an open hiring process that would include (i) advertising in the Laconia and Conway newspapers, (ii) a one-time mailing to Lakes Region customers advertising the opening, and (iii) posting on an employment opportunities website with New Hampshire-wide exposure; (4) the Manager will report to the Board of Directors of Lakes Region. The documented costs of these hiring efforts are to be recouped through the Manager-related rate surcharge, which shall be accounted for, and submitted to the Commission for approval, within 10 days of the hiring of the Manager.

After being hired, the Manager would be responsible for: (1) Lakes Region's efforts in maintaining ongoing compliance with New Hampshire and federal laws, including environmental and labor regulations; (2) Lakes Region's internal efforts at financial restructuring, including the development of rate filings, as needed; (3) the day-to-day management of Lakes Region's finances, including the satisfaction of its creditors; and (4) the development of financial planning related to capital projects, including the Mt. Roberts proposal.

It is our expectation that, after the Manager is hired by Lakes Region, Mr. Mason, as President, will be better able to focus on the physical plant operations of this utility, and Lakes Region will move forward on the path towards long-term financial and managerial stability. We will continue to monitor Lakes Region's ongoing financial and managerial challenges closely, and request that Lakes Region provide Staff with timely information regarding its financial condition and operational status.

We also order Lakes Region, pursuant to N.H. Admin. Rules Puc 604.1(b), to notify the Commission in writing within 10 business days of its being notified of a DES water-quality investigation (including Notices of Violation, Letters of Deficiency, and Administrative Orders). This will ensure that Lakes Region is providing up-to-date information regarding its outstanding compliance challenges. We also direct Lakes Region personnel to take actions to survey for and reduce water losses throughout its system, to further ensure that Lakes Region is using its financial and physical plant resources wisely.

As mentioned previously, we do not take these steps lightly, realizing that only in extreme cases should the Commission become this involved in the actual operation of a utility. In this case, however, we are concerned that the only alternatives would be to pursue a change in ownership or receivership for the company. We consider either of these to be steps of last resort, and have the expectation that successful implementation of the provisions of this order will avoid these drastic measures.

E. Rate Case Expenses

With regards to expenses incurred by Lakes Region during this proceeding, we hereby order Lakes Region to prepare a filing of its rate case expenses with sufficient detail to demonstrate that the expenses are reasonably related to the core DW 10-141 rate proceeding (as opposed to ongoing professional-services expenses more properly included in Lakes Region's general expense accounting), to be submitted to the Commission no later than September 1, 2012. We will review these expenses when filed, and will provide for recovery of prudent, reasonable expenses in a separate order.

Based upon the foregoing, it is hereby

ORDERED, that Lakes Region Water Company, Inc. is authorized to collect from customers, permanent rates as discussed herein, subject to the conditions that: (i) Lakes Region Water Company, Inc. shall file a calculation of the recoupment of the difference between temporary and permanent rates, through a surcharge to customer bills over a period of 12 months, as reconciled to the effective date of September 17, 2010; (ii) rates applied in the Step Increase are not reconcilable back to September 17, 2010, but rather, are effective as of the date of this order; and it is

FURTHER ORDERED, that Lakes Region Water Company, Inc. is authorized to recover from all customers the difference between its temporary and permanent rates, subject to the submission of documentation within 20 days of this order, and further subject to review and approval, as discussed herein; and it is

FURTHER ORDERED, that Lakes Region Water Company, Inc. shall file an accounting of its rate case expenses for the temporary and permanent phases of this proceeding by September 1, 2012; and it is

FURTHER ORDERED, that, by September 1, 2012, Lakes Region Water Company, Inc. must file a report regarding the composition of its Board of Directors; and it is

FURTHER ORDERED, that the petition for approval of long-term debt is hereby APPROVED; and it is

FURTHER ORDERED, that, subject to the conditions discussed herein, that the Affiliate Agreement between Lakes Region Water Company, Inc. and LRW Water Services, Inc., is hereby APPROVED, subject to the condition that the labor rate schedules discussed herein shall be submitted by December 1, 2012; and it is

FURTHER ORDERED, that subject to the conditions discussed herein, that Lakes Region Water Company, Inc. hire a Manager as soon as possible, preferably no later than January 1, 2013, and submit the accounting for the authorized Manager Surcharge for the Commission’s approval within 10 days of the Manager’s hiring.

By order of the Public Utilities Commission of New Hampshire this thirteenth day of July, 2012.

Amy L. Ignatius Chairman	Michael D. Harrington Commissioner	Robert R. Scott Commissioner

Attested by:

Debra A. Howland
Executive Director

Appendix A

DW 10-141
LAKES REGION WATER COMPANY, INC.
COMPARATIVE ANALYSIS OF APPROVED REVENUE INCREASE

	Commission Approved Combined Permanent & Step Revenue Increase	Non-advocate Staff Proposed Combined Permanent & Step Revenue Increase	Commission Approved Temporary Revenue Increase*	Company's Original Request for Permanent & Step Revenue Increase
Rate Base	$ 2,478,477	$ 2,431,054	$ 2,324,509	$ 4,044,806
Rate of Return	8.425%	8.019%	8.230%	8.956%
Operating Income Requirement	$ 208,801	$ 194,948	$ 191,307	$ 362,242
Revenue Requirement	**$ 952,617**	**$ 938,764**	**$ 921,829**	**$ 1,339,602**
Less: Pro-forma Test Year Revenues	**(784,397)**	**(784,397)**	**(784,397)**	**(784,397)**
$ Increase in Revenue Requirement	**$ 168,220**	**$ 154,367**	**$ 137,432**	**$ 555,205**
% Increase in Revenue Requirement	**21.45%**	**19.68%**	**17.52%**	**70.78%**

* Commission Order No. 25,196 in DW 10-141 approving temporary rates for LRWC indicates an increase in the Company's revenue requirement of $143,964, or 18.51%. This was based upon pro-forma test year revenues from general customers of $777,865. However, for purposes of calculating permanent rates the amount of pro-forma test year revenues from general customers was increased by an additional $6,532 to $784,397. Therefore, the actual increase in revenues from general customers resulting from temporary rates was only $137,432, or 17.52%.