

**STATE OF NEW HAMPSHIRE
PUBLIC UTILITIES COMMISSION**

DW 07-105

LAKES REGION WATER COMPANY

Investigation into Quality of Service

Order Approving Settlement Agreement

ORDER NO. 24,877

July 25, 2008

APPEARANCES: Ransmeier & Spellman, P.C. by Daniel J. Mullen, Esq. on behalf of Lakes Region Water Company, Inc.; Orr & Reno, P.A. by Douglas L. Patch, Esq. on behalf of Property Owners Association at Suissevale, Inc.; Office of the Consumer Advocate by Meredith A. Hatfield, Esq. on behalf of residential utility ratepayers; and Marcia A.B. Thunberg, Esq. for the Staff of the New Hampshire Public Utilities Commission.

I. PROCEDURAL HISTORY

Lakes Region Water Company, Inc. provides water service to approximately 1,900 customers of various water systems in Campton, Conway, Freedom, Gilford, Laconia, Moultonborough, Ossipee, Tamworth, Thornton, Tuftonboro, and Wolfeboro. On September 19, 2007, the Staff of the Commission requested a formal investigation into whether Lakes Region continues to have the managerial and financial capacity to provide safe and adequate service to its customers, whether it has the ability to acquire necessary capital to fund needed system improvements, and whether Lakes Region should be placed in receivership pursuant to RSA 374:47-a.

Staff explained that the Department of Environmental Services (DES) issued a letter of deficiency to Lakes Region on October 31, 2006, concerning insufficient water supply to customers at Lakes Region's Hidden Valley system in Tuftonboro and Wolfeboro. DES issued a second letter of deficiency on September 11, 2007, concerning the suspected use of an

unapproved well in Tamworth that had been previously disconnected due to high levels of uranium.

Subsequent to Staff's letter, on October 4, 2007, DES issued an administrative order concerning the conditions at Hidden Valley. DES determined that Lakes Region had: (1) without obtaining the requisite permission from DES, added users to this system by interconnecting it with a second system, known as Hidden Valley Shores, (2) failed to meet certain commitments it made to DES in response to the 2006 letter of deficiency, (3) violated N.H. Code Admin. Rules Env-Ws 372.12 by failing to have a source capacity of not less than two times either the water system's daily demand or its design flow, and (4) violated Env-Ws 372.23 by failing to maintain a tight seal around the entry ports of two wells being used for public water supply.

In light of these events, the Commission issued an Order of Notice on October 10, 2007, scheduling a prehearing conference and technical session for November 27, 2007. The Office of the Consumer Advocate (OCA) entered an appearance and the Property Owners Association at Suissevale, Inc. and Hidden Valley Property Owners Association filed motions to intervene. These motions were granted by the Commission at the prehearing conference.

On November 21, 2007, Lakes Region filed a response to the investigation as well as a system evaluation report by Lewis Engineering, PLLC, a consultant hired to address the water quality issues raised by DES and Staff.

On November 28, 2007, Staff filed a report of the technical session and a letter proposing a procedural schedule for the remainder of docket. The procedural schedule was approved by secretarial letter on December 5, 2007. Staff and the parties conducted discovery and ultimately entered into a settlement agreement regarding rates, financing, quality of service, as well as

Lakes Region's managerial, financial, and technical capabilities, which was considered at the hearing held on May 8, 2008.

II. POSITIONS OF THE PARTIES AND STAFF

A. Lakes Region Water Company and Staff

The positions of Lakes Region and Staff are set forth in the settlement agreement.

B. Office of Consumer Advocate

The OCA did not sign the settlement agreement. It agreed, however, with Staff that the issues raised had not necessarily been fully resolved, and it supports the proposal in the settlement agreement to keep the docket open pending the resolution of these issues. In addition, it seeks the opportunity to revisit some of the violations in the future once more information is available and it requests that subsequent Letters of Deficiency or related communications be circulated to the parties. The OCA concluded that a monitoring docket was an excellent way to resolve the issues.¹

C. Property Owners Association at Suissevale, Inc.

The Suissevale property owners' association did not sign the settlement agreement since it had only recently seen the construction schedule. The association wished to see a more detailed construction schedule before it would commit to supporting the settlement agreement. The group reiterated its concern that Lakes Region be able to supply Suissevale with adequate water.

¹ On June 26, 2008, the OCA submitted a letter expressing concerns about Lakes Region's compliance with the proposed settlement agreement. Among other things, it asserted that the company was not timely providing the parties with important documents and that it was unilaterally modifying its obligations under the settlement agreement. Staff responded by letter on July 3, 2008 that, in essence, the Company was in substantial compliance with respect to certain obligations set forth in the settlement agreement. Staff acknowledged that Lakes Region needed to improve its communications but concluded that the monitoring docket offered the best means to addressing the OCA's concerns.

D. Hidden Valley Property Owners Association

The Hidden Valley property owners' association did not sign the settlement agreement and did not take a position on the settlement agreement at the hearing.

III. SETTLEMENT AGREEMENT

Lakes Region and Staff agreed to recommend that this docket remain open for a limited period to monitor Lakes Region's compliance with the commitments described below.

A. Financing and Step Adjustment Filing

Lakes Region agreed to make a filing with the Commission by May 15, 2008, with respect to approval of new financing and the recovery of certain capital improvements in service or soon to be placed in service to customers. This filing would also involve Staff's review of the company's proposed capital structure and on going access to capital needed for system improvements. An additional consideration in this filing would be the status of land and wells developed by the stockholders' of Lakes Region and how those assets will be treated for ratemaking purposes.

B. Tamworth Well

Lakes Region and Staff acknowledged that Lakes Region had not provided any information to the parties in this docket regarding the re-connection of a well at the Tamworth system in light of a pending investigation by the Attorney General. Lakes Region agreed to provide Staff with the details of the outcome of that investigation. The utility agreed to respond fully to Staff discovery requests and any possible settlement which may result from the Attorney General's investigation, consistent with the terms of any resolution of the outcome of that investigation. Lakes Region acknowledged that the Commission retains authority pursuant to RSA 374:4 to access any information Lakes Region provides to the Attorney General's office.

C. Managerial and Technical Capabilities

Lakes Region agreed to reorganize its management. Thomas Mason, Jr. is now the vice president in charge of the company's water utility operations and is the primary contact person for regulatory agencies. A new contract between Mr. Mason's company, Lakes Region Water Services, Inc. (LRWS) and Lakes Region will be executed which will outline the relationship between the two companies. Lakes Region agreed to submit this new contract to the Commission pursuant to RSA 366 upon its execution, by July 15, 2008. Bi-weekly management meetings are now in place and are attended by the board of directors (comprised of Mr. and Mrs. Thomas Mason, Sr.), Mr. Mason Jr., (who serves Lakes Region as vice president in addition to his role at LRWS), Norm Roberge, the company's outside accountant, and the company's office manager. These meetings are for the purpose for reviewing each of the operating systems as to regulatory issues, consumer communications, present and future needs of the systems infrastructure, including projected costs. Lakes Region agreed to provide a brief report of the results of these bi-weekly meetings to Staff and OCA. Lakes Region and Mr. Roberge will discuss restructuring his time and compensation to provide a regular and predictable presence at the company and with a greater emphasis on day to day finances, cash flows, planning for capital projects, seeking long-term financing to include banks, seeking rate relief, participating in government programs, and arranging for contributions in aid of construction. Lakes Region has hired another licensed operator to reduce the use of outside contracted services. The company is also taking steps to improve and enhance customer communications.

Lakes Region agreed to meet quarterly for the next two years with Staff, OCA, and DES to discuss the status of meeting any pending DES requirements. To the extent these meetings involve issues pertaining to water service provided to Suissevale, then the Suissevale property owners' association would be entitled to attend. To the extent these meetings involve issues pertaining to

water service provided to Hidden Valley, the Hidden Valley property owners' association would be entitled to attend.

Attached to the agreement are construction schedules Lakes Region committed to meeting at Paradise Shores and Hidden Valley.

D. Financial Capability

1. Capital Expenditures/Source and Use of Funds

Lakes Region agreed to prepare a construction budget for 2008 through 2010 and a source and use of funds statement for that same period. As part of the capital/financing requirements to be filed May 15, 2008, Lakes Region agreed to address requirements associated with land and wells near Paradise Shores, which are being developed and financed personally by the company's stockholders.

2. Financing

Lakes Region agreed to submit a financing and step increase filing by May 15, 2008. The requests would be for additional funds needed for projects located in Paradise Shores, Hidden Valley, 175 Estates, Gunstock Glen, Brake Hill, and Indian Mound. The financing would attempt to achieve a balanced debt-to-equity ratio. Lakes Region provided assurance that it has the financial resources to complete the water storage tank at Paradise Shores. In addition, Lakes Region agreed to seek low interest financing through the revolving loan fund administered by DES.

3. Step Increases

The settlement calls for Lakes Region to submit, along with the financing request, a request for three step increases by May 15, 2008. The first step increase would be for projects completed and placed in service during 2007. The second step increase would be for the Paradise Shores/Emerson Road tank project anticipated to be placed in service by June 30, 2008. The third step increase would be for projects completed and placed in service during 2008.

4. Rate Increase

Based on a calculation of its actual 2007 rate of return, Lakes Region agreed to pursue a general rate increase beyond the step increases discussed above if its actual rate of return is sufficiently below its last authorized rate of return. This rate of return calculation must be submitted by May 30, 2008. On an annual basis, Lakes Region agreed to calculate its actual rate of return, and include that calculation with its annual report to the Commission. If necessary, Lakes Region agreed to prepare and file more frequent requests for rate increases.

IV. COMMISSION ANALYSIS

This docket was opened to investigate the managerial, technical, and financial capabilities of Lakes Region. Staff and the parties conducted discovery and their efforts have produced a settlement agreement for our consideration. Staff and Lakes Region request that, in light of Lakes Region having made a number of changes in its management and operations, the Commission allow Lakes Region time to integrate these changes before ruling on whether Lakes Region has the requisite managerial, technical, and financial capabilities to maintain its utility franchise.

In the September 19, 2007 letter that began this proceeding, Staff expressed many concerns. It alerted the Commission to the fact that DES had issued letters of deficiency as well as an administrative order concerning unsafe and inadequate water service at Lakes Region's Hidden Valley and Tamworth systems. The letters of deficiencies and administrative order required Lakes Region to undertake certain capital improvements and Staff expressed concern that Lakes Region might not have the financial capability to undertake these improvements.

Pursuant to the agreement, Lakes Region filed for approval of new financing and for step adjustments to its rates for recent and intended 2008 capital improvements. This filing has been

docketed as DW 08-070. Lakes Region has committed to seeking low-cost State Revolving Loan Funds through DES. Lakes Region has also committed to preparing a construction budget for the coming two years which will identify the sources and use of funds for that same time period. We consider the ability to raise capital on reasonable terms in order to implement capital improvements to be a cornerstone of any evaluation of a public utility's capabilities. All of these commitments relate to Lakes Region's ability to secure capital to meet the challenges of operating and maintaining water systems in compliance with water quality regulations. We therefore find the settling parties' recommendations relative to Lakes Region's financial commitments to be reasonable. We will take up the issue of Lakes Region's capital structure in DW 08-070.

Staff had also expressed concern about Lakes Region's continued managerial capabilities. In its September 19, 2007 letter, Staff reported that Lakes Region had missed many deadlines set by DES and had reduced its staff over the past year. According to the settlement agreement and testimony provided at hearing, Lakes Region has changed its management structure and has added staff. Lakes Region's board of directors, Thomas Mason Sr. and Barbara Mason, has elected Thomas Mason Jr. as vice president of water utility operations. Mr. Mason testified at hearing that he is now the primary contact person for regulatory issues. Through his company, LRW Water Services, Inc., which has been providing services to Lakes Region as a contractor, Mr. Mason will now be responsible for the day-to-day operation of Lakes Region. An affiliate agreement between Lakes Region and LRW Services, Inc. for these services will be filed by July 15, 2008. Lakes Region has agreed to restructure the time and compensation for their accountant, Mr. Roberge, so that he will provide more emphasis on day-to-day finances, cash flow, capital project planning, acquisition of financing, and planning and preparing for rate

relief at regular intervals. Mr. Mason also testified that Lakes Region has added a licensed operator. We find these commitments to be reasonable.

Lakes Region's management will continue to be monitored by Staff and the parties. Lakes Region's bi-weekly management meetings will be reported to Staff and OCA. Lakes Region will meet with Staff, OCA, and DES on a quarterly basis to discuss all current issues and review the company's status of meeting any pending DES requirements. Representatives of the appropriate property owners' association will be invited to any meeting where issues pertaining to their respective systems will be discussed. We find all of these changes to be necessary and reasonable, not only to address the managerial concerns expressed by our Staff and other parties, but also for the financial health of the company as a going concern. Furthermore, we require that Lakes Region provide the parties, in advance of quarterly meetings, any new Letters of Deficiency issued by the DES or any communications by the Company to DES relating to any new or pending Letters of Deficiency. At the next quarterly meeting, Lakes Region and the parties are directed to address any outstanding issues concerning the nature and extent of Lakes Region's communications obligations and, to the extent necessary, report any outstanding disputes or resolutions as part of the monitoring process.

As noted by Staff and the OCA throughout this proceeding, there is reason to be concerned about the adequacy of the service provided by Lakes Region to its customers. The settlement agreement seeks to improve the Company's financial, technical, and managerial capabilities through a monitoring process that avoids placing the Company in receivership. Insofar as Lakes Region can improve its capabilities and thereby its service to its customers through a monitoring docket and the settlement agreement, customers will be better served than they would be by placing Lakes Region in receivership. The OCA's June 26, 2008 letter does

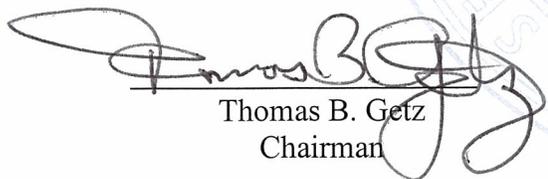
not disturb this basic conclusion but, to the extent Lakes Region was not already on notice, the monitoring aspect of this proceeding will be used to closely watch its progress and protect the interests of customers. For these reasons, we will approve the terms of this settlement agreement.

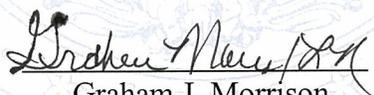
Other issues remain unresolved. The Attorney General has not completed the investigation of Lakes Region's use of an unapproved well at Tamworth and Lakes Region's financing docket, DW 08-070, has not yet been completed. The continuation of this docket, therefore, to monitor Lakes Region's progress toward meeting its commitments is reasonable and appropriate.

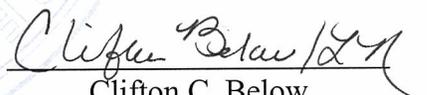
Based upon the foregoing, it is hereby

ORDERED, that the settlement agreement presented by Staff and Lakes Region at the May 8, 2008 hearing is APPROVED.

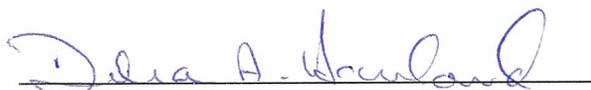
By order of the Public Utilities Commission of New Hampshire this twenty-fifth day of July, 2008.


Thomas B. Getz
Chairman


Graham J. Morrison
Commissioner


Clifton C. Below
Commissioner

Attested by:


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Upon request, Staff may waive receipt of some of its multiple copies of bulk materials filed as data responses. Staff cannot waive other parties' right to receive bulk materials.

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