

STATE OF NEW HAMPSHIRE
PUBLIC UTILITIES COMMISSION

Docket Nos. DW 10-141, DW 07-105, DW 10-043, and DW 11-021

Lakes Region Water Company, Inc.

**RESPONSE TO STAFF'S OBJECTION TO
MOTION FOR REHEARING OR CLARIFICATION**

NOW COMES Lakes Region Water Company and requests leave to respond to Staff's Objection dated August 16, 2012 as follows:

1. Lakes Region Water Company requests leave to respond to Staff's August 16, 2012 *Objection* for the limited purpose of responding to the following new arguments not previously raised in this case:

- First, Staff states that: "Staff wishes to register its disapproval of Lakes Region wasting its scarce time and resources to engage in an attempt to enhance the case for its recovery of income-tax related expenses outside of the 2009 test year through its amended tax filings for past years." *Staff Objection* Para 3 (b) (emphasis added).
- Second, Staff argues that Lakes Region Water Company "may have imprudently amended its tax returns for prior years, so as to reduce its net operat[ing] loss carryforward" and that this "generated an unnecessary tax liability for the tax year 2012 that might not otherwise be incurred by Lakes Region." *Staff Objection*, Para. 3 (b) (emphasis added).

2. The Company strongly disagrees and offers the following brief response:

3. First, Staff's argument that Lakes Region Water Company is "wasting its scarce time" is unfounded. The parties obviously disagree on the merits. However, the Company's requested adjustment for tax expenses (\$68,732) represents 7.21% of the \$952,617 total revenue requirement approved by the Commission. *See* Order No. 25,391, Appendix A. By comparison, the other adjustments made by the Commission represent only \$13,853 (1.45%) of the total revenue requirement. *Id.* The omission of tax expense is a serious concern, particularly in light of the challenges facing small water systems, and is the primary reason the Company could not accept Staff's proposed revenue requirement.

4. The Company does not agree that the Commission addressed the issue. The Company stipulated to Mr. Laflamme's schedules and requested four adjustments in its testimony. *See LRW Exhibit 5, Reply Testimony of Stephen St. Cyr, Pages 2 – 7.* The Commission's decision and analysis in Order No. 25,391 specifically addressed three of the four requested adjustments: (1) Use of Year-End Rate Base (Page 15); (2) an Increase in its Rate of Return on Equity (Page 16); and (3) an Increase in its Retained Earnings (Page 16). Unfortunately, the fourth and most important adjustment is simply not addressed by the Commission's Order.

5. RSA 363:17-b requires that the Commission's Order include a "decision on each issue including the reasoning behind the decision". Order No. 25,391 does not state a decision nor a reason behind the decision as required. Rather, it appears that the issue was inadvertently overlooked by the Commission in its analysis. The Company has requested rehearing or clarification due to the importance of the issue and for any other reason or purpose. The suggestion otherwise is offensive and inappropriate.

6. Second, Lakes Region Water Company strongly disagrees that it imprudently amended its returns. The Company adjusted its retained earnings after Staff indicated that “an adjustment to increase the Company’s retained earnings account by the amount of the reclassified shareholder pension and health insurance premium payments may be appropriate.” *LRW Exhibit 31*. The Commission recognized this during the hearings, *see e.g. Transcript, Day 4 PM Session, Page 66* (Chairman Ignatsius: “And Mr. Laflamme said, yes, he thought it was appropriate.”), and noted in Order No. 25,391 that “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.” Page 16.

7. Mr. LaFlamme was questioned at length whether it would be “appropriate for the Company to go back to years prior to the test year and make those adjustments.” *Transcript, Day 4 PM Session, Page 68*. When asked if he had any reason to believe that the Company had “inappropriately” adjusted its tax returns he stated: “I don’t have any basis to say whether he did it correctly or incorrectly.” *Transcript, supra, Page 70*. He never suggested that an adjustment would be imprudent. His only response was that he would need to see the Company’s actual returns (Pages 68-70), which the Company offered to provide to allow Mr. Laflamme to respond to a record request (Page 71-72). Staff and Staff Advocates both objected. *Transcript Day 4 PM Session, Pages 72-76*. The Company remains willing to provide all of its returns at any time.

8. The law is clear that the Company was required to amend its prior tax returns. As a general matter, revenue the Company receives in rates is considered income. *Internal Revenue Code, 26 USC §61* (“gross income means all income from

whatever source derived”); *Commissioner v. Indianapolis Power & Light Co.*, 493 U.S. 203, 209, 107 L. Ed. 2d 591, 110 S. Ct. 589 (1990) (customer funds considered income unless the Company is obligated to return them). The Company can deduct Trade or Business Expenses but those expenses must be “attributable” to its trade or business. *Internal Revenue Code*, 26 USC 62 (a) (1) (“The deductions allowed by this chapter ... which are attributable to a trade or business carried on by the taxpayer”).

9. The elimination of the Company’s expenses for pensions and health insurance that Mr. Laflamme recommended and the Company accepted, were based on the fact that they were not properly attributable to Lakes Region Water Company’s business for rate making purposes. His testimony stated, for example, that the Company had paid these expenses for the “purpose of compensating its shareholders-during their retirement” who were “no longer involved in the daily operations of LRWC”. *Staff Exhibit 1*, Pages 22-23. He concluded on Page 23 of his Testimony that:

It is Staff’s position that the inclusion of these so-called pension payments in the operating expenses of the Company is inappropriate for ratemaking purposes. Staff believes that since no contributions were made on behalf of the shareholders to any type of pension or other retirement plan during the period of their employment with LRWC, it is the shareholder's responsibility to provide for their respective retirements themselves, which conceivably should include a strategy relative to their personal investments in LRWC. Customer rates charged by LRWC already include a return on equity component on the shareholders' investment. As such, Staff believes that the ratepayers of LRWC should not now be held

responsible to provide for the retirement needs of the shareholders through the operating expenses of the Company as well. Therefore, Staff has removed the amount of the pension payments from the Company's test year operating expenses and has reclassified them as a reduction in the shareholder loans reclassified to additional paid-in capital discussed previously.

10. The Company accepted Staff's position that the Company's shareholders were no longer involved in the business and were therefore responsible to provide for their own retirement. It adjusted its retained earnings as Staff and the Commission indicated. *See LRW Exhibit 31* (staff response); *Transcript*, Day 4, PM Session, Pages 68-69 (Laflamme testimony that "In actuality, it would be a reduction of expense that would increase income and therefore increase retained earnings.") (emphasis added); Order No. 25,391, Page 16 (Commission found that Staff failed to "make a corresponding adjustment to increase the Company's year-end retained earnings.").

11. The Company's agreement to remove these expenses and adjust its retained earnings meant the payments to the Company's shareholders could no longer be deducted from gross income as an expense attributable to the business under the Internal Revenue Code, 26 USC sec. 62 (a)(1). The Company had no choice but to amend its prior returns to recognize this as a "reduction of expense that would increase income and therefore retained earnings" as Staff indicated. *Id.*

12. Staff's *Objection* does not explain – and there is no evidence in this case – as to how the Company could do otherwise. The Company therefore urges the

Commission grant rehearing or clarification to allow the Company to close its books on the issue and focus on its business of providing water service to the public.

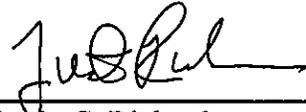
13. Finally, Staff's argues that under "long-established Commission precedent and practice" it cannot recommend adjustments more than 12 months beyond the test year. *Objection*, Para. 3 (a). However, this case has not followed the normal course and it is now three and one half years beyond the beginning of the test year. While matching revenue and expenses to a test year is important, the statutory purpose of a rate case is not to adjust for the past, but to provide rates that are sufficient for the present. RSA 378:27 & 28 (Rates "shall be sufficient to yield not less than a reasonable return on the cost of the property of the utility used and useful in the public service less accrued depreciation") (emphasis added); *Appeal of Richards*, 134 N.H. 148, 165-166 (1991) ("It is not the theory, but the impact of the rate order which counts."). When a precedent, practice or rule fails to provide for rates that are sufficient, it must yield to the statutory and constitutional duty to provide rates that "shall be sufficient" for the present. *Id.*

Respectfully submitted,

**LAKES REGION WATER
COMPANY, INC.**

By its Counsel,

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing was this day forwarded to all parties on the official service lists for DW 10-141, DW 07-105, DW 10-043, and DW 11-021.

A handwritten signature in black ink, appearing to read "Justin C. Richardson", written over a horizontal line.

Justin C. Richardson