EXHIBIT
#11
DW 15-209

STATE OF NEW HAMPSHIRE

PUBLIC UTILITIES COMMISSION

DW 15-209 and DW 15-422

In the Matter of:
Lakes Region Water Company, Inc.
Petition for Permanent Rates
Petition for Approval of Transfer of Property from Affiliate

Direct Testimony

of

Jayson P. Laflamme
Staff Utility Analyst, Gas and Water Division

August 3, 2016

LINKED
8/8/16 CHP

Dockets DW 15-209 / DW 15-422
Lakes Region Water Company, Inc.
Direct Testimony of Jayson P. Laflamme
August 3, 2016

Table of Contents

New Hampshire Public Utilities Commission

Lakes Region Water Company, Inc.

DW 15-209 and DW 15-422

Petition for Permanent Rates
Petition for Approval of Transfer of Property from Affiliate

Direct Testimony of Jayson P. Laflamme

I. INTRODUCTION

Q. Please state your full name.

A. My name is Jayson P. Laflamme.

Q. By whom are you employed and what is your business address?

A. I am employed by the New Hampshire Public Utilities Commission (NHPUC) and my business address is 21 South Fruit Street, Suite 10, Concord, New Hampshire.

Q. What is your position at the NHPUC?

A. I am a Utility Analyst in the Gas and Water Division.

Q. Please describe your duties at the NHPUC.

A. I am responsible for the evaluation of rate and financing filings, including the recommendation of changes in revenue levels that conform to Commission approved regulatory methodologies. I represent Staff in meetings with company officials, outside attorneys and accountants relative to rate case and financing matters as well as the Commission's rules, policies, and procedures.

Q. Would you please describe your educational background?

A. I received a Bachelor of Science Degree in Accounting from Lyndon State College in 1989. In 1998, I attended the NARUC Annual Regulatory Studies Program at Michigan

State University. In 2002, I attended the 22nd Annual Western Utility Rate School in San Diego, California.

Q. Would you please describe your work experience?

A. In 1989, I was hired as a Staff Accountant by Driscoll & Company; a CPA firm located in Littleton, New Hampshire. I performed audits, reviews, and compilations as well as prepared tax returns for a variety of entities. I was eventually promoted to the position of Manager. In 1997, I was hired as a Utility Examiner in the Audit Division of the NHPUC. In that position, I participated in field audits of the books and records of regulated utilities in the electric, telecommunications, water, sewer and gas industries. I examined reports and filings submitted to the Commission by regulated utilities and performed rate of return analyses. In 2001, I was promoted to my current position as a Utility Analyst in the Commission's Gas and Water Division.

Q. What is the purpose of your testimony?

A. With regard to Docket DW 15-209, my testimony will provide Staff's recommendation relative to a permanent rate revenue requirement for Lakes Region Water Company, Inc. (LRWC or the Company). Additionally, my testimony will provide Staff's recommendation with regard to step adjustments for LRWC relative to this rate proceeding. My testimony will be based on Staff's recommendation to approve the transfer of a certain parcel of land in Moultonborough, New Hampshire, known as the "Mt. Roberts Property", from LRWC's shareholder to the Company. The Company submitted a filing seeking approval for this transfer in Docket DW 15-422. A full discussion of this issue along with Staff's recommendation to approve that transfer is contained in the direct testimony of Mark A. Naylor, Director of the Gas and Water Division.

Q. Would you please provide a brief overview of Staff's specific recommendations concerning LRWC's revenue requirement that will be discussed in your testimony?

A. With regard to a permanent rate revenue requirement, Staff is recommending an increase in revenues of $61,730, or 5.92%, effective on a service rendered basis on or after September 14, 2015. The calculation of Staff's recommended permanent rate increase is contained in Attachment JPL-1 of my testimony. With regard to step adjustments, Staff is recommending an additional increase in LRWC's revenues of $62,486, or 5.99%, to be effective either on or soon after the date of the Commission's order approving rates in this case. Staff's calculation of this step adjustment is contained in Attachment JPL-2 of my testimony. Staff is also recommending an additional step adjustment, with conditions[1], to become effective by either the end of 2017 or the beginning of 2018. Based on Staff's calculations, which are contained in Attachment JPL-3, it is currently estimated that this step adjustment will result in a further increase in LRWC's revenues of approximately $21,746, or 2.08%. The combined impact of Staff's recommendations will ultimately result in additional revenues for LRWC from its general metered and unmetered water customers of approximately $145,962, which represents an overall increase of 13.99%. The respective rate impacts of these revenue increases are calculated in Attachment JPL-4 of my testimony.

Q. You indicate that Staff's recommended rate increases in this case apply to LRWC's "general" customers. Please explain.

A. The majority of the Company's operating revenues are derived from the service it provides to its seventeen consolidated water systems whose customers comprise what Staff is referring to as LRWC's "general" water customers. LRWC also derives revenues from a special contract that it entered into with the Property Owners Association at Suissevale, Inc. (POASI). That special contract was approved by Commission Order No. 24,693 (10/31/06) in Docket DW 06-133, *Re Property Owners Association at Suissevale*. While Staff will have certain recommendations relative to the calculation of the revenues associated with LRWC's special contract with POASI, which will be illustrated and explained later in my testimony, the specific revenue requirement being proposed by Staff in this rate proceeding pertains to LRWC's general water customers who receive service in its seventeen consolidated systems.

II. <u>STAFF RECOMMENDATION FOR PERMANENT RATES</u>

Q. Please provide a brief summary of LRWC's request for permanent rates in this proceeding.

A. On August 5, 2015, LRWC filed a petition, including testimony and supporting schedules, requesting approval of a permanent rate increase designed to generate additional revenues from its general metered and unmetered customers of $398,274, representing a 38.18% increase. The Company utilized a 2014 test year in making its determinations. On May 19, 2016, LRWC submitted correspondence to the Commission which, among other things, stated that the parties to the rate proceeding were discussing alternatives to LRWC's request to recognize an Allowance for Funds Used During

[1] Per the Direct Testimony of Mark A. Naylor in this case, those conditions include the Company making a filing for this step adjustment by no later than December 31, 2017. Also, the Company must agree to not file its next general

Construction (AFUDC) relative to its Mt. Roberts Project. Specifically, the Company proposed to eliminate AFUDC from its rate base, but to record the direct costs associated with the entire Mt. Roberts Project, including the land, as Additional Paid-in Capital from its shareholder. However, because such an equity infusion would significantly increase the proportionate share of equity financing within LRWC's total capital structure, the Company also proposed to finance future capital projects that it was contemplating by using long-term debt procured from CoBank ACB. Based on these new proposals, the Company revised its permanent rate schedules and distributed such to each of the parties in this rate proceeding. A copy of LRWC's revised revenue requirement schedules is included in my testimony as Attachment JPL-5.

Q. Could you please briefly summarize the specific revisions the Company made to its revenue requirement as reflected in Attachment JPL-5?

A. In its original filing, LRWC proposed a rate base amount of $3,387,973. (See Schedule 3 of the Direct Testimony of Stephen P. St. Cyr) However, this amount included $189,944 of AFUDC as well as $1,564 of Accumulated Depreciation relative to such, for a net amount of $188,380. Schedule 3 of Attachment JPL-5 reflects the elimination of this amount, resulting in a revised proposed rate base of $3,199,593. With regard to its weighted average cost of capital, LRWC's original filing proposed a rate of 8.68% based on a capital structure consisting of $1,433,584 debt (43.78%) at a cost rate of 4.94% and $1,840,647 equity (56.22%) at a cost rate of 11.60%. (See St. Cyr Schedule 4) However, Schedule 4 of Attachment JPL-5 shows that LRWC has eliminated $415,906 in debt financing with which it had originally proposed in order to acquire the Mt. Roberts Land. Instead, the Company's equity capital has been increased by $225,962 to reflect the

---

rate case until no sooner than one which utilizes a 2019 test year.

Company's revised proposal to reflect this transfer as a capital contribution. These modifications result in a revised proposed weighted average cost of capital of 9.33%, based on a capital structure consisting of $1,017,678 debt (33.00%) at a cost rate of 4.71% and $2,066,609 equity (67.00%) at a cost rate of 11.60%. Finally, with regard to LRWC's proposed revenue requirement, St. Cyr Schedule 1 indicates LRWC's original proposed revenue increase for its general customers of $398,274 resulting in a revenue requirement of $1,441,417. However, Schedule 1 of Attachment JPL-5 reflects a revised proposed revenue requirement from its general customers of $1,459,817. This represents an additional proposed increase in revenues of $18,400 consisting of the following: 1) a $4,214 increase in LRWC's net operating income requirement (from $294,233 to $298,447); 2) an $18,205 increase in Income Tax Expense (from $163,691 to $181,896); 3) a $1,564 decrease in Depreciation Expense (from $197,717 to $196,153); and, 4) a $2,455 decrease in Other Tax Expense (from $94,037 to $91,582). In summary, the Company is now seeking a permanent rate increase from its general water customers that is designed to generate additional revenues of $416,674, representing an increase of 39.94%.

Q. Are temporary rates currently in effect in this docket?

A. Yes. On January 29, 2016, the Commission issued Order No. 25,862 authorizing a temporary increase in LRWC's annual revenues received from general metered and unmetered customers of $103,694, or 9.94%. LRWC's approved temporary rates are effective on a service rendered basis on or after September 14, 2015.

Q. Was an audit performed by the Commission Staff?

A. Yes and I would like to commend the Commission's Audit Staff for their excellent work in this case. The Audit Staff was quite thorough in its examination of the Company's test year and reported on a number of issues in its Final Audit Report dated November 13, 2015 (Final Audit Report). Many of the issues reported on by the Audit Staff have been incorporated into Staff's permanent rate and step adjustment recommendations. A copy of the Final Audit Report is included in my testimony as Attachment JPL-6.

Q. Have all of the outstanding issues contained in the Audit Report been resolved?

A. There were a number of issues described in the Final Audit Report which had not been resolved as of the conclusion of the Audit Staff's examinations. As a result, Staff made a number of follow-up inquiries with regard to these issues during the discovery phase of this rate proceeding. These are summarized as follows:

Audit Report Reference	Issue	Staff Discovery
Audit Report; Pg 31	Paradise Shores Mains	Staff DR's 2-19, 3-6
Audit Report; Pg 52	Affiliate Agreement	Staff DR 2-21
Audit Issue # 2; Pg 60	Physical Inventory	Staff DR 2-22
Audit Issue # 4; Pg 62	Deferred Assets	Staff DR 2-23
Audit Issue # 7; Pg 69	Long-term Debt	Staff DR 2-24
Audit Issue # 9; Pg 72	Customer Deposits	Staff DR 2-25
Audit Issue # 12; Pg 76	Mt. Robert's Costs	Staff DR 2-26
Audit Issue # 22; Pg 89	1200 Rules	Staff DR 2-28
Audit Issue # 23; Pg 90	Lack of Documentation	Staff DR's 2-29, 3-9
Audit Issue # 25; Pg 93	Non-recurring Expenses	Staff 2-31

A number of these issues are discussed in more detail later in my testimony. Staff believes that, with the possible exception of the Affiliate Agreement issue contained on Page 52 of the Final Audit Report, all of the outstanding audit issues have been adequately addressed by the Company in terms of this rate proceeding. However, with regard to the Affiliate Agreement issue, Staff would merely wish to bring to the Commission's attention the fact that LRWC continues to provide compensated services to LRW Water Services Company, even though, in a letter to the Commission dated November 4, 2013, the Company's attorney stated that such services had been discontinued. Further, there was no subsequent letter that was filed with the Commission reporting the Company's change of intention. In its response to Staff Data Request 2-21, the Company stated, "*The statement in the November 4, 2013 letter that the LRW Water Service "had no plans" to purchase services from Lakes Region Water Co., Inc., was entirely accurate at the time it was made. The Company considered the affiliate agreement to have been modified as required by the Commission. Subsequently, LRW Water Service did purchase services from Lakes Region Water Co., Inc., at the rate approved by the Commission. The Company is not aware of any requirement to notify the Commission because the rate had already been approved and filed with the Commission.*" However, Staff believes that given the Commission's attention to this matter during LRWC's last full rate proceeding, DW 10-141, which was expressed in Commission Orders # 25,391 (07/13/12) and # 25,578 (10/01/13), the Company should have been more diligent in keeping the Commission apprised of its change of intention with regard to this particular affiliate relationship.

Q. Please summarize Staff's recommendation regarding a permanent rate revenue requirement for LRWC in this case.

A. As illustrated on Schedule 1 of Attachment JPL-1, Staff is recommending a revenue requirement for LRWC's general water customers of $1,104,873. This represents an increase of $61,730, or 5.92%, over the water revenues from general customers earned by LRWC during its test year of $1,043,143. Staff's recommended revenue requirement is calculated utilizing a total rate base of $2,721,807 which is summarized on Schedule 2 of Attachment JPL-1 and provides for an overall rate of return of 7.81% which is calculated on Schedule 1a of Attachment JPL-1. The overall effective marginal tax rate reflected in Staff's calculations is 39.61% which is computed on Schedule 1b of Attachment JPL-1.

III. RATE OF RETURN

Q. Please explain how Staff derived its proposed rate of return of 7.81%.

Schedule 1a of Attachment JPL-1 contains Staff's calculation in support of its proposed weighted average cost of capital of 7.81%, which is indicated in Column 14 of that schedule. In reaching that determination, Column 1 shows LRWC's actual capital structure as of the end of the test year. Column 2 summarizes the Company's pro-forma adjustments to its capital structure as contained in its original rate filing. Column 3 reflects the Company's amendments to its proposed capital structure from Schedule 4 of its revised revenue requirement schedules (Attachment JPL-5). Column 4 summarizes Staff's proposed adjustments to LRWC's capital structure, identified as (a) and (b), which result in an adjusted total capitalization of $2,637,133, consisting of $888,678 (33.70%) in long-term debt and $1,748,455 (66.30%) in equity capital. (See Columns 5 and 6)

Columns 7 through 12 summarize Staff's cost of debt calculations from Schedule 1ai of Attachment JPL-1 resulting in an overall cost of debt of 4.28% as shown in Column 13. Column 13 also contains Staff's recommended cost of equity rate of 9.60%, which is explained in Footnote (c).

Q. Please discuss the calculation of Staff's proposed 4.28% cost of debt contained in Schedule 1ai of Attachment JPL-1.

A. Staff's calculations are based on LRWC's cost of debt calculations from Schedule 4B of its revised permanent rate schedules. (Attachment JPL-5) Staff made certain adjustments to the Company's calculations which are detailed in Footnotes (d), (e), and (f) of Schedule 1ai. These adjustments result in lowering LRWC's cost of debt from 4.71% to 4.28%.

Q. Please provide further explanation regarding the adjustment identified as (d) on Schedule 1ai.

A. The adjustment identified as (d) pertains to a reduction in the effective interest rate of two CoBank loans held by the Company. These loans were approved by Commission Order No. 25,655 (04/29/14) in Docket DW 13-335. The first loan had an original principal balance of $318,810 payable over a term of five years at an interest rate of 3.45%. The second loan had an original principal balance of $474,567 payable over fifteen years at an interest rate of 5.25%. In its financing petition seeking approval of these loans, LRWC indicated that it would be participating in CoBank's patronage program. The specifics of this program involved an initial $1,000 equity investment in CoBank by the Company, thereby, making LRWC eligible to receive annual patronage dividends from CoBank. Documentation provided by CoBank and included in LRWC's DW 13-335 financing filing states that participation in the patronage program will result in lowering the effective annual interest rate of each loan by 75 basis points. Therefore, Staff has reflected this reduction in the respective interest rates of the two CoBank loans by reducing the effective interest rate on the 5-year note from 3.45% to 2.70% as well as reducing the effective interest rate on the 15-year note from 5.25% to 4.50%. As a result, LRWC's pro-forma annual Interest Expense has been reduced by $5,624.

Q. Please discuss the adjustment appearing on Schedule 1ai that is identified as (e).

A. The adjustment identified as (e) also relates to the two CoBank loans approved in DW 13-335 and pertains to legal costs totaling $23,314 that were incurred in order to procure these loans. However, these legal costs were originally recorded by the Company as part of its regular operating expenses. Staff discovered these expenditures through its review of LRWC's General Legal Expenses for the years 2012 through 2014 relative to its analysis the Company's proposed Operating & Maintenance (O & M) Expense Adjustment # 7. (See Schedule 1B of Attachment JPL-5) Staff's full analysis of LRWC's legal expenses is contained in Schedules 11a through 11c of Attachment JPL-1, along with a summary of the specific legal charges which pertain to the two CoBank loans which appears on Schedule 11d. It is Staff's position that these legal charges should not have been recorded by LRWC as part of its regular operating expenses, but, instead, these charges should have been recorded as a Deferred Cost of Debt to be amortized over the lives of the respective loans. Footnote (e) shows Staff's allocation methodology relative to these legal charges as well as its calculations of the annual amortizations for such over the respective lives of the two loans which results in an increase in LRWC's annual cost of debt by $2,803.

Q. Please discuss the adjustment identified as (f) on Schedule 1ai of Attachment JPL-1.

A. LRWC's revised cost of debt calculation on Schedule 4B of Attachment JPL-5 includes a loan which pertains to certain capital additions that were completed by the Company in 2015 at its Indian Mound division. The Company is proposing that these additions should be included in its test year rate base for purposes of determining permanent rates in this case. The loan, in the amount of $129,000, was obtained from CoBank and was approved in Commission Order No. 25,753 (01/13/15) in Docket DW 14-285. With regard to the proposed asset additions at Indian Mound, it is Staff's position that, because these were constructed and went into service after the conclusion of LRWC's test year, it is not appropriate to include such in the determination of permanent rates in this case. Therefore, Staff removed the post-test year net plant additions at Indian Mound, along with others, in its Adjustments # 2 and # 13 on Schedule 2a of Attachment JPL-1 which will be discussed later in my testimony. As such, Staff has also removed the $129,000 CoBank loan associated with these improvements from its cost of debt calculation for permanent rates. It should be noted, however, that Staff has included the Indian Mound improvements along with the accompanying financing in its calculation of a proposed step adjustment for LRWC which will be presented later in my testimony.

Q. Are there any other issues pertaining to the Company's long-term debt which you would like to discuss at this time?

A. Yes. During the course of the Commission Staff's audit of the Company, it was discovered that LRWC had not obtained prior Commission approval, in accordance with RSA 369, for loans relative to the purchase of certain vehicles in 2010 and 2011. (See Audit Issue # 7 on page 69 of Attachment JPL-6) The first such loan, payable to Ford

Motor Credit, was issued in September 2010 in the amount of $31,301 for the purchase of a 2011 Ford F350XL pickup truck. The term of the loan was five years at an interest rate of 7.89%. The outstanding balance of the loan at the end of the test year was $5,430. The second loan, also payable to Ford Motor Credit, was issued in July of 2011 in the amount of $32,509 for the purchase of a 2011 Ford F150XL pickup truck. The term of that loan was also five years at an interest rate of 7.89%. The outstanding balance of that loan at the end of the test year was $11,707. It should be noted that LRWC's financing petition filed with the Commission in DW 14-285 included a request for after-the-fact approval of four vehicle loans that the Company procured during 2013 and 2014. However, that request did not extend to the vehicle loans described above that were procured by LRWC in 2010 and 2011. Staff Data Request 2-24 asked the Company for an explanation as to why this was so. In response, LRWC stated that this was an oversight on its part and that it had intended to obtain Commission approval for all of its then-unapproved vehicle loans. Commission Order No. 25,753 in DW 14-285 did include approval for the 2013 and 2014 vehicle loans on an after-the-fact basis. In that same order, the Commission also approved a mechanism whereby that, for a period of five years after the effective date of that order, any future long-term financings for vehicles or equipment undertaken by LRWC without having first obtained Commission approval for such would result in an automatic penalty of $1,000 per financing.

Q. What is Staff's recommendation relative to these previously unapproved loans for the purchase of the 2011 vehicles?

A. Whereas the two 2011 vehicles are included in LRWC's rate base in this case as well as the loans related to such are included in the determination of LRWC's cost of debt, it is

Staff's recommendation that the Commission should grant similar after-the-fact approval for these loans as it did with regard to the other vehicle loans in DW 14-285. As was the case with the other vehicle loans, Staff believes that the 2010-2011 loans were prudent towards enabling LRWC to provide a safe and adequate supply of water to its customers and that the specific vehicle additions which necessitated these financings were prudent and reasonable and that these vehicles were both used and useful to the Company in its operations. Staff also believes that the terms associated with each of the loans appear to be reasonable and will not adversely impact customer rates. As to whether the Company should be penalized for its failure to include these loans in its DW 14-285 financing submission, Staff recommends that the Commission waive such penalty in this circumstance. Staff believes that the DW 14-285 submission was an earnest attempt by LRWC to rectify its prior non-compliance with the provisions of RSA 369, but that its failure to include the two financings relative to the purchase of its 2011 vehicles was merely an oversight on its part. As such, and given that the two loans were issued prior to Commission Order No. 25,753 in DW 14-285, Staff believes that this matter should be deemed as simply the completion of LRWC's prior attempt to rectify its previous non-compliance with RSA 369.

Q. Turning our attention back to Staff's calculation of an overall weighted average cost of equity on Schedule 1a of Attachment JPL-1, please elaborate on the adjustment identified as (a) which reduces LRWC's Additional Paid-in Capital by $365,774.

A. This adjustment relates to the Mt. Roberts' equipment and land recorded by the Company as a capital contribution from its shareholder. The first amount of $281,783 indicated under Footnote (a) represents the Company's proposed direct costs relative to the Mt.

Roberts land contribution. Since this transfer of land did not occur before the end of the test year, Staff believes that it should not be reflected in LRWC's test year rate base for the purpose of determining permanent rates. Therefore, Staff included the removal of this post-test year land contribution from rate base as part of its Adjustment # 2 on Schedule 2a of Attachment JPL-1 which will be discussed later in my testimony. As such, Staff is also removing the related $281,783 equity contribution from its cost of capital calculation for permanent rates. It should be noted, that Staff has included the Mt. Roberts land and related capital contribution in its calculation of a proposed step adjustment for LRWC which will be discussed later in my testimony. The other amounts indicated under Footnote (a) relate to the shareholder's contribution of wells and other equipment totaling $216,113 located on the Mt. Roberts Property which occurred on 04/01/14. The first three of these amounts, which total $9,823, pertain to rate base eliminations which will be discussed in more detail later in my testimony relative to Staff Adjustments # 4 and # 5 on Schedule 2a of Attachment JPL-1. However, with regard to the remaining amount of $74,168 contained under Footnote (a), the reason for its elimination stems from the Company's responses to Staff Data Requests 2-19 and 3-6 which revealed that the shareholder had not actually paid for certain equipment, totaling that amount, which had been installed by LRW Water Services, Inc. at the Mt. Roberts site. Though Staff did not reduce LRWC's rate base relative to those plant additions, it takes the position that it is not appropriate to include the cost of that equipment in shareholder equity if the shareholder has not made an actual investment in such.

Q. Please explain the adjustment identified as (b) which increases LRWC's Retained Earnings by $47,620.

A. As will be discussed in much further detail later in my testimony, Staff has made a number of adjustments to LRWC's test year operating revenues and expenses as contained in Schedule 3a of Attachment JPL-1. A number of these adjustments were the result of corrections made to the Company's test year accounting records as identified in either the Final Audit Report (Attachment JPL-6) or Staff discovery. Additionally, the Company also included a correcting pro-forma entry in its revised permanent rate schedules to reduce its test year operating expenses by $782 for Depreciation Expense that it recognized relative to AFUDC. (See Attachment JPL-5, Schedule 1B, Adjustment 10A) Staff has chosen to reflect the net effect of these correcting adjustments in LRWC's test year-end overall equity capitalization for purposes of calculating the Company's weighted average cost of capital for permanent rates. Therefore, in Footnote (b) of Schedule 1a, Staff determined that the overall effect of these correcting entries will increase the Company's test year net income and retained earnings by $47,620.

Q. Please discuss Footnote (c) on Schedule 1a of Attachment JPL-1 relative to the Cost of Equity utilized by Staff in its calculation of a weighted average cost of capital for LRWC.

A. As I previously mentioned, LRWC proposed an 11.60% return on equity relative to its calculation of a weighted average cost of capital. The Company derived that amount by adding a 2.00% "risk premium" to the Commission's last approved cost of common equity for a New Hampshire water utility of 9.60%.[2] In support of its inclusion of that risk premium, LRWC stated that it is necessary in order to, 1) recognize the increased risks the Company faces by operating relatively small-sized water systems, and 2)

---

[2] See Commission Order No. 25,539 (06/28/13) in Docket DW 12-085, *Aquarion Water Company of New Hampshire, Inc*.

provide its shareholder with the opportunity to realize an appropriate return on investment in the form of dividends. See Mason testimony at 7. However, in reaching these conclusions, the Company did not employ the services of a cost of capital expert to undertake either a Discounted Cash Flow (DCF) analysis, Capital Asset Pricing Model (CAPM) analysis, or some other comparable earnings analysis that this Commission typically recognizes as the appropriate means towards determining a cost of equity for a regulated utility. Assumedly, LRWC did not hire such a cost of capital expert so as to minimize rate case expenses in this proceeding. This is understandable and common amongst the other small water utilities under this Commission's jurisdiction. However, in the alternative, it has been the typical practice of this Commission to use the last-approved cost of equity in a New Hampshire water utility rate proceeding. Therefore, it is Staff's position that the cost of equity rate to be utilized in deriving an overall cost of capital for LRWC in this proceeding should be 9.60%.

IV. EFFECTIVE TAX RATE

Q. Please discuss Staff's recommendation of an effective tax rate for LRWC of 39.61%.

A. Schedule 1b of Attachment JPL-1 contains Staff's calculation of an effective income tax rate for LRWC of 39.61% which is reflected in Staff's permanent rate revenue requirement calculation on Schedule 1 of Attachment JPL-1. The effective tax rate calculated by LRWC and contained in Schedule 5.1 of its revised permanent rate schedules (Attachment JPL-5) is essentially the same as that derived by Staff. Both the Staff and the Company's calculations utilize a marginal Federal Income Tax rate of 34.00% as well as a New Hampshire Business Profits Tax rate of 8.50%.

V. RATE BASE

Q. Please discuss the rate base amount being proposed by Staff relative to its permanent rate recommendation.

A. Staff is proposing an amount of $2,721,807 for LRWC's pro-forma rate base in this case. Schedule 2 of Attachment JPL-1 provides a summary of how Staff derived this amount. Columns 1 through 3 illustrate how LRWC derived the amount for rate base it proposed in its original filing of $3,387,973, and Columns 4 and 5 summarize its subsequent adjustments to derive an amended amount of $3,199,593 which is reflected in Schedule 3 of Attachment JPL-5. Columns 6 and 7 summarize Staff's rate base adjustments which are detailed on Schedule 2a of Attachment JPL-1. Staff's adjustments reduce the rate base amount proposed by LRWC by $477,786 in order to arrive at the amount recommended by Staff in this case of $2,721,807 in Column 8.

Q. A number of the pro-forma rate base adjustments proposed by LRWC in its revised schedules (Attachment JPL-5) appear to be for the purpose of reflecting the Company's rate base at year-end value instead of the traditional 13-month average value. Could you please discuss Staff's position with regard to these adjustments proposed by the Company?

A. Schedule 3A of Attachment JPL-5 includes nine pro-forma rate base adjustments (# 1, # 4, and #'s 8 - 14) which LRWC proposed to essentially reflect the Company's rate base at its test year-end value. However, the Company's approach in this regard differs from traditional ratemaking which employs the use of a test year average for valuing the various components of rate base. The New Hampshire Commission affirmed its use of a 13-month rate base average for the purpose of determining rates in Commission Order

No. 20,776 (03/01/93) in Docket DR 91-212, *Re Energynorth Natural Gas, Inc.* There, the Commission stated: "*In computing the Company's required revenues we will apply our traditional historical 'test year' methodology. That is* ***we will establish the Company's revenue requirement through an examination of a thirteen point average of the Company's rate base during the twelve month test year*** *with pro rata modifications to operation and maintenance expenses for 'known and measurable' changes in the twelve months following the test year. While we acknowledge that this methodology is neither statutorily nor constitutionally required (Cf., RSA 378:30-a), and that no methodology for setting rates into the future is perfect,* ***we have found that this methodology has resulted in just and reasonable rates to both utilities and their customers absent extraordinary circumstances.***" (Emphasis added.) In support of LRWC's proposal to employ a year-end rate base value in the instant rate proceeding, the Company's consultant, Stephen P. St. Cyr, in his pre-filed direct testimony, cited the fact that the Commission had previously approved such for LRWC in its last full rate proceeding before the Commission, Docket DW 10-141, in Order No. 25,391 (07/13/12). St. Cyr testimony at 4. However, Staff takes the position that the Commission's approval of a year-end rate base methodology in that case was neither unrestricted nor perpetual. In its order, the Commission clearly stated, "*Though we traditionally employ a 13 month average for rate base additions, we will make* ***a one-time exception for certain non-revenue producing plant in service****, as Lakes Region requested.*" (Emphasis added.) Further, Staff notes that the Commission's approval of such rate base treatment in that case did not even extend to all of LRWC's fixed plant additions, as services, meters, and vehicles were specifically excluded by the Commission in that order which stated that, "*such additions do not meet the essential criteria for non-revenue producing plant treatment.*"

Q. Why do you believe that the Commission made the rate base allowance that it did in that prior full rate proceeding?

A. It is Staff's opinion that the Commission's reasoning for allowing year-end rate base treatment in that case was due to the difficult financial circumstances that the Company found itself in at the time; the facts of which are prevalently described throughout the Commission's order. This allowance was one of a number approved by the Commission in order to assist the Company in regaining its financial footing. However, at present, LRWC finds itself in a much improved financial condition as compared to that of five years ago which is clearly indicated in Mr. Mason's testimony. See Mason testimony at 8 – 9. Therefore, for purposes of this rate proceeding, it is Staff's position that an allowance for year-end rate base valuation similar to that authorized by the Commission for LRWC in the prior rate proceeding is not justified.

Q. Please describe the pro-forma adjustments that are being recommended by Staff to convert LRWC's proposed year-end rate base to a test year average methodology.

A. Staff included the following adjustments in Schedule 2a of Attachment JPL-1 in order to reverse various LRWC pro-forma adjustments so as to conform the Company's rate base to a test-year average methodology:

Staff Adj	Co Adj	Rate Base Component	Amount
# 1	# 1	Utility Plant in Service	$(219,883)
# 11	# 4	Accumulated Depreciation	$ 66,279
# 24	# 8	Accum Amort – Acquisition Adj	$(4,228)

# 25	# 13	Contributions in Aid of Construction	$ 8,377
# 26	# 14	Accum Amort – CIAC	$(8,668)
# 29	# 9	Materials and Supplies	$ 9,680
# 30	# 10	Prepaid Expenses	$(3,494)
# 32	# 11	Prepaid Property Taxes	$ 52
# 38	# 12	Accum Deferred Income Taxes	$ 17,336
Net Reduction in Rate Base			**$(134,549)**

Q. Is Staff opposed to any recognition of a year-end valuation methodology relative to LRWC's rate base?

A. No. Staff supports the recognition of a year-end valuation methodology with regard to certain so-called "Non-revenue Producing Asset" additions that conform to very specific and identifiable criteria which has been established by the Commission. Later in my testimony, I will be discussing the recognition of such plant within the context of this rate proceeding and Staff's rate base proposal for permanent rates.

Q. There are two additional rate base adjustments being proposed by Staff whose purposes also appear to be to modify the Company's pro-forma adjustments to a test year average methodology. Please explain.

A. Yes. Since the rate base amount being proposed by Staff is based on a test year average methodology, Staff believes that the individual pro-forma adjustments to rate base proposed by the Company should also be made to conform to that, as well. Staff specifically noted two rate base adjustments proposed by LRWC which are presented in such a way so as to coincide with the Company's proposal to use a year-end valuation methodology. While Staff agrees with the basic premises behind each adjustment, it feels that they should be modified in order to conform to the test year average methodology being reflected in Staff's schedules. In LRWC's amended Rate Base Adjustment # 5, it proposes to increase Accumulated Depreciation by $17,498 in order to reflect a full year's depreciation on plant placed in service during the test year. (See Schedule 3A of Attachment JPL-5) Staff Adjustment # 12, reduces that amount by half, or $8,749, in order to reflect an average test year methodology. Additionally, the Company's Rate Base Adjustment # 15 increases Accumulated Amortization - CIAC by $218 in order to reflect a full year's amortization of CIAC for ratemaking purposes. (See Schedule 3A of Attachment JPL-5) Staff Adjustment # 27 decreases this amount by half, or $109, in order to conform the Company's adjustment to an average test year rate base methodology.

Q. LRWC has also proposed pro-forma adjustments for the purpose of including post-test year plant additions in the Company's test year rate base. Please discuss Staff's position relative to these adjustments.

Schedule 3A of Attachment JPL-5 includes four pro-forma adjustments (#'s 2-3 and #'s 6-7) proposed by LRWC in order to include anticipated 2015 net plant additions of $482,874 in its 2014 test year for purposes of determining permanent rates. This amount includes: 1) $281,782 relative to the shareholder's contribution of the Mt. Roberts land; 2) an estimated $124,434 in net plant upgrades at the Company's Indian Mound division; 3) an estimated $28,000 for the purchase of software and other computer equipment; and, 4) an estimated $48,658 in other general plant additions which are anticipated to occur after the Company's test year. However, in order to conform with previously established and approved ratemaking methodology, Staff takes the position that these post-test year plant additions should not be included in the determination of permanent rates, but, instead, should only be included in customer rates only within the contexts of either a step adjustment or a subsequent rate proceeding. Therefore, the following adjustments contained in Schedule 2a of Attachment JPL-1 reverse the pro-forma adjustments proposed by LRWC in order to remove these post-test year plant additions from the Company's test year rate base:

Staff Adj	Co Adj	Rate Base Component	Amount
# 2	# 2	Utility Plant in Service	$(446,557)
# 3	# 3	Utility Plant in Service	$(51,372)
# 13	# 6	Accumulated Depreciation	$ 12,341
# 14	# 7	Accumulated Depreciation	$ 2,714
Net Reduction in Rate Base			**$(482,874)**

Q. Please explain Staff Adjustments # 4 and # 15 which pertain to corrections made to Utility Plant in Service and Accumulated Depreciation as a result of the Staff audit.

A. These adjustments pertain to Staff Audit Issue # 12 on pages 76 and 77 of the Final Audit Report (Attachment JPL-6) relative to the fixed asset additions which occurred at the Mt. Roberts Property. The adjustments recommended by the Audit Staff actually result in a net increase in the Company's Plant in Service of $311. However, because the plant additions in question occurred on 04/01/14, Staff Adjustment # 4 to increase Utility Plant in Service by $215 and Staff Adjustment # 15 to increase Accumulated Depreciation by $14 reflect a test year average increase in rate base of $201.

Q. Please discuss Staff Adjustments # 5 and # 16 which reduce the cost of mains placed into service at the Company's Mt. Roberts Property.

A. LRWC's response to Staff Data Request 2-19 points out a typographical error contained in Mason Exhibit 6 resulting in a $300 overstatement in the cost of mains contributed by LRWC's shareholder to the Company, i.e., $76,894 instead of $76,594. Therefore, Staff Adjustment # 5 reduces Utility Plant in Service by $208 and Staff Adjustment # 16 reduces the associated Accumulated Depreciation by $4, resulting in a net reduction in test year average rate base of $204.

Q. Please explain Staff Adjustments # 6 and # 17 relative to adjustments being proposed to the cost of the Company's meters.

A. These adjustments are based on Staff Audit Issue # 16 discussed on pages 82 and 83 of the Final Audit Report (Attachment JPL-6) where it was found that the cost of a meter placed in service during 2013 was overstated by $95 and that the cost of a meter placed in service during 2014 was understated by $234. Staff Adjustments # 6 and # 17 correct the Company's net test year average rate base as a result of these findings by respectively increasing Utility Plant in Service by $22 as well as increasing the associated Accumulated Depreciation by $1, for a net increase in the Company's rate base of $21.

Q. Please discuss Staff Adjustments # 7 and # 18 relative to the cost of a pump that was mistakenly included in the property records for the Company's Paradise Shores division.

A. These adjustments are based on Staff Audit Issue # 18 which appears on page 85 of the Final Audit Report (Attachment JPL-6) where it was reported that the cost of a pump acquired during the test year in the amount of $4,030 had been erroneously included in the Company's plant records for Paradise Shores. Per the Company's response to this finding, Utility Plant in Service should be reduced by $4,030 and Materials Expense should be increased by the same amount. Therefore, Staff Adjustment # 7 in the amount of $2,790 reduces Utility Plant in Service by the test year average of the pump recorded in error, while Staff Adjustment # 18 reduces Accumulated Depreciation by the test year average amount of $279. Together, these entries result in a reduction to LRWC's net average rate base of $2,511. The related increase to the Company's Materials Expense is discussed later in my testimony relative to Staff Adjustment # 43.

Q. Please provide an explanation for Staff Adjustments # 8 and # 19 relative to certain hydrofracking costs incurred at LRWC's West Point division.

A. Based on an entry appearing on page 43 of the Final Audit Report (Attachment JPL-6), Staff learned that LRWC had incurred a cost of $2,592 during the test year relative to the hydrofracking of a well located in its West Point division. LRWC recorded this cost as an operating expense rather than as a capital improvement. In its response to Staff Data Request 2-20, the Company stated that the hydrofracking of the West Point well was undertaken in an attempt to remove obstructions from the well so as to increase its water flow. LRWC reasoned that because it was not able to determine either the increased longevity or production of the well as a result of the hydrofracking, it opted to expense this cost rather than capitalize it. However, it is the position of Staff that this cost should be capitalized and depreciated over a number of years because hydrofracking is normally undertaken with the intention of increasing the longevity and productivity of a well asset. Therefore, Staff Adjustment # 44 on Schedule 3a of Attachment JPL-1 reduces the Company's test year O & M Expenses by $2,592. Staff Adjustment # 8 effectively reclassifies this cost to LRWC's rate base by recording the test year average of such, or $1,296, in Utility Plant in Service. Staff Adjustment # 19 records the test year average of the Accumulated Depreciation on the well hydrofracking cost, or $43. The net increase in the Company's test year average rate base resulting from Staff Adjustments # 8 and # 19 is $1,253.

Q. Please explain Staff Adjustments # 9 and # 22 regarding certain truck tire rims that were purchased by the Company during the test year.

A. These adjustments are based on Staff Audit Issue # 25 on pages 93 and 94 of the Final Audit Report (Attachment JPL-6) where, among other expense items, the purchase of a set of truck tire rims during the test year in the amount of $844 was deemed to be a non-recurring item recommended for elimination from the Company's test year operating expenses. However, it is Staff's position that the purchase of these tire rims should not have been recorded as an operating expense of the Company, but, instead, should have been recorded as a capitalized vehicle asset and depreciated over a number of years. Thus, Staff Adjustment # 45 on Schedule 3a of Attachment JPL-1 reduces the Company's test year O & M Expenses by the $844 cost of the truck tire rims. Staff Adjustment # 9 effectively reclassifies this cost to Utility Plant in Service in the amount of the test year average for such, or $422. Staff Adjustment # 22 records the test year average of the associated Accumulated Depreciation of the truck tire rims, or $84. Together, Staff Adjustments # 9 and # 22 increase LRWC's net average test year rate base by $338.

Q. Please explain Staff Adjustments # 10 and # 23 relative to so-called "Non-revenue Producing Asset" additions during the test year.

A. Earlier in my testimony, I stated that Staff supported a test year-end rate base valuation methodology relative to certain utility asset additions which conform to very specific and identifiable criteria that has been established by the Commission. Specifically, in recognition of the financial pressures that small water utilities face in their efforts at meeting stringent regulatory requirements to provide safe and adequate water service to customers, the Commission has developed a modified rate base treatment relative to certain so-called "Non-revenue Producing Assets." Briefly, Non-revenue Producing Assets may be defined as certain utility plant that has been placed into service during the test year of a utility involved in a rate proceeding before the Commission which may be reflected in rate base at year-end, or full, cost rather than at a test-year average. However, this is a concept that has evolved over many years through a number of Commission orders.[3] Previously, utility plant that has been recognized for Non-revenue Producing Asset treatment has met certain general criteria. First, the acquisition or installation of the utility plant in question must be the result of some regulatory mandate. Second, the acquisition or installation of such plant must not result in a direct increase in revenues to the utility such as through an increase in its customer base or service capacity. Third, the cost of the specific plant projects under consideration must be, in and of themselves, substantive in nature. Fourth, the assets in question must be in service and used and useful by some date certain. However, in Order No. 25,693 (07/15/14) in Docket DW 13-130, *Pennichuck Water Works, Inc.,*[4] the Commission adopted the following specific standards relative to evaluating whether assets are eligible for year-end rate base valuation treatment as Non-revenue Producing Assets: (1) The underlying project that establishes the acquired or installed asset(s) must be in response to a

[3]Per the advice of Counsel, the concepts relative to Non-revenue Producing Assets have been developed in previous Commission orders including *Pennichuck Water Works, Inc.*, Order No. 21,026, 78 NH PUC 626 (1993), *Re Pennichuck Water Works, Inc.*, Order No. 22, 883, 83 NH PUC 200 (1998), and *Re Pennichuck Water Works, Inc.*, Order No. 23,923, 87 NH PUC 102 (2002).
[4] See also Commission Order No. 25,695 (07/22/14) in Docket DW 13-128, *Pittsfield Aqueduct Company, Inc.*, and Commission Order No. 25,696 (07/25/14) in Docket DW 13-126, *Pennichuck East Utility, Inc*.

regulatory mandate, such as a state agency's regulations or enforcement action or a municipality's construction project. (2) The underlying purpose of the project is not to increase a utility's revenues through either increasing its customer base or service capacity, and any increase in annual revenues resulting from the project should be both incidental and negligible. Incidental and negligible revenues are defined as those which result in an increase in annual revenues of less than 1% of a project's expended cost during the test year. When incidental revenues do result from a Non-revenue Producing Asset(s), those increased revenues should be reflected in test year revenues to the benefit of customers. (3) The expended cost during the test year on the project are significant, i.e., the resulting asset(s) placed into service has a book value greater than 1.5 times the reportable amount for filing a Form E-22 set forth in Puc 609.12 (d). For LRWC, the expended cost must exceed $45,000 ($30,000 x 1.5). (4) The asset(s) are used and useful by the end of the test year. If the asset(s) in question meet the above criteria, their value in rate base will be recognized at year-end value rather than at test year average. Such treatment will extend to Plant in Service, Accumulated Depreciation, Contributions in Aid of Construction (CIAC), and to Accumulated Amortization of CIAC. As such, Staff proposes that these criteria should also be applied to LRWC's test year plant additions in order to determine which of its assets, if any, are eligible for year-end rate base valuation.

Q. Did Staff ask the Company if it was amenable to the application of such criteria for the determination of Non-revenue Producing Asset treatment?

A. Yes, in Staff Data Request 1-11. LRWC responded that it was not amenable to agreeing to such criteria. It stated further that the $45,000 threshold that would be applied to LRWC for determining a project's financial significance was "*arbitrary and would deny* *the Company an opportunity to recover the costs of many small capital projects . . .*" However, Staff disagrees with the Company's assessment. Rather, Staff believes that application of the specific criteria identified above more effectively preserves the general standards for Non-revenue Producing Asset treatment that has been instituted by the Commission throughout the establishment of this methodology. Further, application of the above specific criteria for the determination of Non-revenue Producing Asset treatment removes most, if not all, of any arbitrary influence that may have previously factored into such determinations. Therefore, Staff believes that the above criterion achieves an appropriate balancing of the interests between the utility and its ratepayers.

Q. With regard to Staff Adjustments # 10 and # 23, did Staff apply the afore-mentioned criteria in its recommendation for Non-revenue Producing Asset treatment for LRWC?

A. Yes. Staff reviewed Schedule 7 of Attachment JPL-5 which details LRWC's test year plant additions. Staff found that only LRWC's plant additions and improvements to its Paradise Shores division, and specifically the Mt Roberts project, met the specific criteria adopted by the Commission for recognition of Non-revenue Producing Asset treatment. The Mt. Roberts project was initiated by LRWC in response to a NH Department of Environmental Services (NH DES) directive to increase the source of supply at its Paradise Shores division. That project was undertaken not with the goal of increasing the Company's revenues, but rather with the intention of better meeting its already-existing demand. The adjusted cost of the project during the test year was over $330,000, which is well over the $45,000 project significance threshold that would be applicable to LRWC. Finally, the Paradise Shores improvements which would be eligible for Non-revenue Producing Asset treatment were in service and used and useful at the end of LRWC's test year in this case. Schedule 4 of Attachment JPL-1 provides Staff's calculations in support of Adjustments # 10 and # 23 which respectively increase Plant in Service by $102,635 and Accumulated Depreciation by $3,729, resulting in a $98,906 net increase in LRWC's test year rate base.

Q. Please explain Staff Adjustment # 20 which increases Accumulated Depreciation by $1,251.

A. This adjustment is based on pages 19, 20, and 30 as well as Staff Audit Issue # 15 on pages 80 and 81 of the Final Audit Report (Attachment JPL-6) relative to the Company's use of incorrect depreciation rates for certain well assets. Specifically, there are two well assets to which this issue pertains. The first is a well placed into service during 2010 at the Company's West Point division. Rather than depreciating this asset over the generally accepted 30-year anticipated service life for wells[5], the Company is depreciating this asset based on a 50-year service life. The second pertains to the Mt. Roberts wells placed into service during 2014 which serve the Company's Paradise Shores division. For these, LRWC is using a 40-year service life rather than the generally accepted 30-year service life. Staff's computations relative to Adjustment # 20 are contained in Schedule 5 of Attachment JPL-1, resulting in an increase of $1,251 in the Company's test year average Accumulated Depreciation. Additionally, Staff's adjustments to the service lives of these two well assets also result in a $1,250 annual increase in the Company's Depreciation Expense which will be discussed later in my testimony relative to Staff Adjustment # 64.

[5] Based on "Appendix B: Typical Water Company Service Lives & Depreciation Rates" of the *Small Water Company Information Booklet* which was prepared by the NHPUC in 1991.

Q. Please discuss Staff Adjustment # 21 which decreases Accumulated Depreciation by $10,180.

A. This adjustment is similar in nature to Staff Adjustment # 20 as it involves a modification to the depreciation lives of the Company's vehicle assets. Specifically, this adjustment is based on pages 26, 27, and 33 as well as Staff Audit Issue # 15 on pages 80 and 81 of the Final Audit Report (Attachment JPL-6), where the Audit Staff cited the Company's use of depreciation lives for certain vehicle assets which are less than the generally accepted 7-year service life.[6] The Audit Report indicated that LRWC was presently assigning a service life of four years to its transportation vehicle assets for purposes of calculating Depreciation Expense and Accumulated Depreciation. The Final Audit Report contained LRWC's explanation for this where it stated, "*The Company's use of a 4 year life for a pickup truck instead of the recommended 7 years is due to the [C]ompany's expansive service area (approximately 25 mile radius) which subjects the vehicles to high mileage, including rugged road surfaces during winter and early spring months which in turn shortens the vehicles useful life.*" (See page 80 of Attachment JPL-6) Based on that explanation, Staff agrees that the Company's transportation assets, i.e., pickup trucks and associated equipment, should be depreciated over a shorter period of time than seven years. However, it is also Staff's position that the depreciation lives for the Company's vehicles should not be any less than the terms of the loans through which they are being financed. Staff reviewed the financings associated with LRWC's pickup trucks and found that all had loan terms of five years. Therefore, Staff is recommending that the depreciation lives applied to the Company's fleet of pickup trucks and associated

[6] Ibid.

equipment should be five years, as well. Schedule 6 contains Staff's recalculations of the Accumulated Depreciation and Depreciation Expense for the fleet of pickup trucks owned by the Company as of the end of the test year. In each case, Staff increased the service lives of the vehicle assets from four years to five years. The calculation on Schedule 6 supports Staff Adjustment # 21 which decreases the Company's test year average Accumulated Depreciation by $10,180. Additionally, Staff's adjustments to the service lives of LRWC's transportation vehicles also result in a $7,643 decrease in the Company's annual Depreciation Expense which will be discussed later in my testimony relative to Staff Adjustment # 65.

Q. Please explain Staff Adjustment # 28 which reduces the Cash Working Capital component of LRWC's rate base by $26,923.

A. The calculation of Staff's adjustment to cash working capital accompanies Adjustment # 28 on Schedule 2a of Attachment JPL-1. It is based on Staff's proposed adjustments to the the Company's O & M Expenses which result in a net decrease in those expenses of $149,092 as summarized in Column 6 of Schedule 3 of Attachment JPL-1 with regard to Staff Adjustment #'s 42 – 57. The specific adjustments, however, are detailed on Schedule 3a of Attachment JPL-1. According to LRWC's tariff on file at the NHPUC, all of the Company's customers are billed in arrears, with the exception of those who receive service at LRWC's Tamworth system who are billed in advance. This is reflected in Staff's computations which reflect distinct cash working capital components for the Tamworth system ($9,033) and for the other LRWC systems (-$140,059). When the cash working capital percentage applicable to LRWC's quarterly billing frequency of 20.55% is applied to the net of the two cash working capital components, or -$131,026, the result is a decrease in the Company's cash working capital component of $26,923. Therefore, Staff Adjustment # 28 reduces cash working capital by that amount from $176,270 to $149,347.

Q. Please discuss Staff Adjustment # 31 which decreases Prepaid Expenses by an amount of $752.

A. The basis for this adjustment is Staff Audit Issue # 3 on page 61 of the Final Audit Report (Attachment JPL-6). The issue cited concerns the fact that even though LRWC pays for propane by the delivery and not on a pre-buy basis, its Prepaid Expense account nonetheless reflects an amount relative to propane purchases. Thus, the Company's Prepaid Expense account is overstated by that amount. In its response to Staff Data Request 2-33, LRWC provided Staff with the information necessary to make the adjustment to Prepaid Expenses, which is calculated on Schedule 7 of Attachment JPL-1 and results in a $752 reduction in that rate base component.

Q. Please explain Staff Adjustment # 33 to reduce Prepaid Property Taxes by an amount of $7,947.

A. Staff reviewed the Company's calculation to derive the 13-month average relative to its Prepaid Property Tax Expense account in the amount of $11,779 which is contained in Schedule 3 of Attachment JPL-5. In its calculation, LRWC only reflected one adjustment in that account made during December of the test year. As such, Staff believes that the Company's calculation is skewed and inaccurate because it does not reflect the actual activity that should have been reflected in that account during the prior eleven months of the test year. To rectify this, Schedule 7 of Attachment JPL-1 includes Staff's analysis of LRWC's Prepaid Property Tax Expense account which reflects the Company's actual

Property Tax Expense activity that occurred during the entirety of the test year. Staff based this on LRWC's Prepaid Property Tax Workpaper which was included in its response to Staff Data Request 1-25(d). Based on its analysis, Staff determined that the actual test year average of LRWC's Prepaid Property Tax Expense account should be $3,832 which is $7,947 less than the amount proposed by the Company. Therefore, Staff Adjustment # 33 reduces that rate base component by this calculated difference.

Q. It appears that the next three Adjustments pertain to Deferred Assets which Staff is proposing to be recorded on the Company's books and included in its test year average rate base. Please discuss Staff Adjustment # 34 which pertains to a 'No Lead Rule' inventory write-off.

A. This adjustment is based on Staff Audit Issue # 25 on pages 93 and 94 of the Final Audit Report (Attachment JPL-6). That audit issue includes a finding relative to an inventory write-off which the Company recorded as an expense during the test year. That transaction, totaling $12,959, stems from the Company's compliance with "The Reduction of Lead in Drinking Water Act of 2011" which provides a 3-year window of compliance commencing in 2014. Staff deemed the transaction recorded by the Company during its test year to be of a non-recurring nature. While the Company concurred with that conclusion in principle, it nevertheless requested to reflect the inventory write-off as an amortized expense over a three year timeframe for ratemaking purposes. As such, Staff reduced the Company's O & M Expenses by the amount of the write-off during the test year of $12,959 in Adjustment # 46 on Schedule 3a of Attachment JPL-1. On Schedule 8 of Attachment JPL-1, Staff determined that the pro-forma test year average of the resulting Deferred Asset is $10,799 which has been included in LRWC's rate base via Staff Adjustment # 34. Staff has also calculated the annual Amortization Expense related to this Deferred Asset in the amount of $4,320 which will be discussed later relative to Staff Adjustment # 67.

Q. Please explain Staff Adjustment # 35 in the amount of $34,206 to record a Deferred Asset related to certain well field evaluation costs incurred at the Company's Paradise Shores division.

A. Pages 13 and 14 of the Final Audit Report (Attachment JPL-6) contain a discussion concerning a certain balance in the amount of $36,006 which has been included in LRWC's Construction Work in Progress (CWIP) account since 2010. The Company indicated that this amount represents costs associated with an evaluation of a certain well to supply its Paradise Shores division. LRWC further indicated that the results of that evaluation were negative and that it was planning to write-off some, if not all, of those costs during 2015. However, Staff believes that the Company should not be deprived of the opportunity to earn a return on its prudent efforts towards providing a reliable source of supply to its customers, even if such an attempt ultimately proved unsuccessful. Therefore, Staff proposes that the costs associated with this failed well evaluation should be recorded as a Deferred Asset and amortized over a period of 10 years. On Schedule 8 of Attachment JPL-1, Staff determined that the pro-forma test year average of the proposed Deferred Asset is $34,206 which has been included in LRWC's rate base through Adjustment # 35. Schedule 8 also shows the annual amortization of this Deferred Asset in the amount of $3,601 which will be discussed later in my testimony relative to Staff Adjustment # 68.

Q. Please discuss Staff Adjustment # 36 in the amount of $24,333 which reclassifies certain General Accounting Expenses as a Deferred Asset.

A. This adjustment is related to Staff Adjustment # 50 which will be discussed in more detail later in my testimony. Staff Adjustment # 36 pertains to a proposed reclassification of certain General Accounting Expenses in the amount of $29,200 to a Deferred Asset account and amortized over three years. Schedule 8 of Attachment JPL-1 provides Staff's calculation of the pro-forma test year average of the proposed Deferred Asset in the amount of $24,333 which is recorded by Staff in Adjustment # 36. Schedule 8 also shows the calculation of the proposed annual amortization of this Deferred Asset in the amount of $9,733 which will be discussed later with regard to Staff Adjustment # 69.

Q. Please explain Staff Adjustment # 37 which records the test year average of the Company's Customer Deposits account in the amount of $1,706.

A. Staff's review of the Company's proposed rate base components contained in Schedule 3 of Attachment JPL-5 revealed that it does not include a 13-month average relative to its Customer Deposits liability account. However, it is Staff's position that this account should be included as a component of rate base for ratemaking purposes. Therefore, Staff obtained the test year activity of LRWC's Customer Deposits account from the Commission's Audit Staff. Based on that information, Schedule 7 of Attachment JPL-1 provides the calculation of the test year average relative to this account in the amount of $1,706, which has been included in LRWC's rate base via Staff Adjustment # 37.

Q. Please explain Staff Adjustment # 39 which increases the Company's Accumulated Deferred Income Tax component by $7,946.

A. Staff reviewed the Company's calculation of a 13-month average for its Accumulated Deferred Income Tax account in the amount of $172,734 which is contained in Schedule 3 of Attachment JPL-5. Staff's review revealed that LRWC's only adjustment in that account occurred during December of its test year. As a result, Staff believes that the Company's calculation is skewed and inaccurate because it does not reflect the actual activity which occurred in that account during the prior eleven months of the test year. Therefore, Schedule 7 of Attachment JPL-1 contains Staff's calculation which is based on a normalized activity scenario relative to the Company's Deferred Income Tax account for the entire test year. Staff's calculations result in a revised 13-month average of $180,680. Therefore, Staff Adjustment # 39 increases the test year average proposed for this rate base component by $7,946.

VI. NET OPERATING INCOME

Q. Please discuss the Operating Income Statement for LRWC presented on Schedule 3 of Attachment JPL-1.

A. Column 1 presents the actual test year operating activity for the Company which resulted in its recognition of $126,723 in net operating income for 2014. Column 2 summarizes the adjustments presented by the Company in its original filing relative to its test year operating income and expenses which are discussed in Stephen P. St. Cyr's direct testimony. Those adjustments result in a $167,510 increase in LRWC's net operating income, resulting in an amount of $294,233 (Column 3) that was proposed by the Company in its filing. Columns 4 and 5 summarize the subsequent revisions LRWC made to its original filing, resulting in a further increase in its net operating income of

$4,214 to the revised amount of $298,447 in Column 5. (See also Schedule 1 of Attachment JPL-5) Columns 6 and 7 summarize Staff's pro-forma adjustments to the Company's proposed net operating income as detailed in Schedule 3a of Attachment JPL-1. Staff's proposed adjustments increase LRWC's pro-forma test year net operating income by $128,416 to an amount of $426,863 as indicated in Column 8. This amount is incorporated into Staff's revenue requirement calculations on Schedule 1 of Attachment JPL-1. Column 9 summarizes the results of those calculations, resulting in Staff's proposed decrease in the Company's proposed revenue requirement from its general metered and unmetered customers of $354,944 to an amount of $1,104,873 as indicated in Column 10. This results in a net operating income requirement for the Company of $212,513 as proven in Column 10. (See also Schedule 1 of Attachment JPL-1.)

Q. With regard to the adjustments that Staff is proposing to LRWC's Operating Revenues, please first discuss Staff Adjustment # 40 which increases the pro-forma revenues from LRWC's special contract with POASI by $2,105.

A. With regard to its test year operating revenues, LRWC proposed Operating Revenue Adjustment # 1 (See Schedule 1A of Attachment JPL-5) in order to reflect an increase of $65,754 in anticipated revenues from its special contract with POASI. In its responses to Staff Data Request 1-13 and Tech 1-3, the Company provided the supporting calculations for this adjustment which are based on its 2014 assets and operating activity as specifically related to its Paradise Shores division which supplies POASI. Based on that information, the Company calculated a pro-forma revenue amount for POASI of $202,280, from which it derived the $65,754 pro-forma increase in the special contract revenues it recognized during the test year of $136,526. However, the Company's calculations do not reflect the impact of the pro-forma adjustments it is proposing in this case which have a significant impact on the assets and operating activity of the Paradise Shores division. Additionally, a number of Staff's proposed adjustments also have a substantial impact on the Company's Paradise Shores division, as well. As I have previously indicated, the revenues derived by LRWC from its special contract with POASI have a direct bearing on the revenue requirement that is to be calculated relative to the Company's general metered and unmetered customers. Therefore, Staff has analyzed and computed the pro-forma impact that both the Company's and its own proposed adjustments will have on the annual revenues derived by LRWC from its special contract with POASI. These calculations are contained in Schedules 9a – 9j of Attachment JPL-1 and result in a $2,105 increase in the pro-forma revenues earned by LRWC from its special contract with POASI. These schedules can be divided into two sections. Schedules 9a – 9e contain the actual calculations from which Staff derived its proposed revenue adjustment. Schedules 9f – 9j contain the detailed adjustments which are reflected in Schedules 9a – 9e.

Q. Could you please briefly discuss Schedules 9a – 9e of Attachment JPL-1?

A. These are based upon the schedules provided by LRWC in its responses to Staff Data Requests 1-13 and Tech 1-3. Schedule 9a summarizes the supporting calculations contained in Schedules 9b through 9e to derive the pro-forma revenues under the POASI special contract. Schedule 9b calculates the tax affected return on rate specific to the Paradise Shores division. Schedule 9c details the Utility Plant in Service, Accumulated Depreciation, and Depreciation Expense for the Paradise Shores division. Schedule 9d details the Contributions in Aid of Construction (CIAC), Accumulated Amortization of

CIAC, as well as the annual CIAC Amortization relative to the Paradise Shores division. Finally, Schedule 9e contains the detail for the annual operating expenses that relate to the Paradise Shores division. The four revenue requirement categories indicated on each of these schedules, i.e., Volume Basis, Customer Allocation Basis, POASI, and Non-POASI, are the same categories utilized by LRWC in its revenue calculations. However, only the amounts contained under the first three categories are used in computing the revenues derived from the POASI special contract. The amounts contained in the "Non-POASI" category do not factor into the calculation of revenues under the special contract. There are also three additional categories of amounts under each of the revenue requirement categories: "Balance @ 12/31/14"; "Adjustments"; and, "Adjusted Balance". The amounts contained in the columns identified as "Balance @ 12/31/14" are those which were utilized by the Company in deriving its pro-forma amount for annual POASI revenues as reflected in its Operating Revenue Adjustment # 1. The amounts contained in the "Adjustments" columns represent the impact that the various Company and Staff pro-forma adjustments proposed in this case will have on the revenues from the POASI special contract. These amounts are derived from Schedules 9f – 9j of Attachment JPL-1. Finally, the amounts contained in the columns with the heading, "Adjusted Balance" are those upon which Staff based its calculations to derive the adjusted revenues under the POASI special contract.

Q. Could you please briefly discuss Schedules 9f – 9j of Attachment JPL-1?

A. Each of the entries contained in Schedules 9f – 9j reference the specific Company or Staff adjustments upon which they are based. However, only those Company and Staff pro-forma adjustments which directly impact the Company's Paradise Shores division are included. Schedule 9f pertains to the Company and Staff's pro-forma adjustments relative to Utility Plant in Service, Accumulated Depreciation, and Depreciation Expense. Schedule 9g pertains to Staff's working capital rate base component adjustments. Schedule 9h contains the Company and Staff's O & M Expense pro-forma adjustments. Schedule 9i pertains to the Amortization Expense pro-forma adjustments proposed by Staff, and Schedule 9j relates to Other Tax Expense pro-forma adjustments proposed by both the Company and Staff. It should be noted that the amounts indicated for each of the entries on these schedules may not exactly mirror the amounts of the specific Company or Staff pro-forma adjustments to which they pertain. There are at least two reasons for this: 1) The calculations to derive the POASI special contract revenues are based on the year-end values of various assets, whereas the pro-forma rate base adjustments proposed by Staff are based upon a test year average rate base methodology. As such, Staff modified its pro-forma rate base adjustments, for purposes of these schedules, in order to reflect the year-end valuation methodology used in calculating revenues under the POASI special contract. 2) Some pro-forma adjustments proposed by the Company and Staff apply to all of LRWC's divisions, and not just to the Paradise Shores division. This is especially true with regard to the pro-forma adjustments for operating expenses as well as general plant items, such as vehicles. In these circumstances, Staff reflected only an allocated portion of the total adjustment to Paradise Shores using a pro-rata methodology based upon either number of customers or the actual expense allocation by division employed by the Company during the test year. In such cases, Staff indicates the specific allocation methodology that it used.

Q. Aside from including the Company and Staff's proposed pro-forma adjustments from this case in the determination of adjusted revenues attributable to POASI, did Staff make any other adjustments to the revenue calculation under the special contract?

A. Yes. With regard to this, I would draw your attention to Schedule 9b which calculates a tax affected rate of return on the rate base components relative to the Company's Paradise Shores division. In its calculations, the Company utilized a rate of return of 10.00% and an effective tax rate of 22.22% which, in both cases, appear to have been unchanged since the initial approval of the special contract by the Commission in Order No. 24,693 in 2006. However, Staff's review of the language contained in the special contract as well as Commission Order No. 24,693 reveals that, in each, neither a specific applied rate of return nor a specific marginal tax rate is indicated. However, Paragraph 8.2 of the special contract does indicate that subsequent updates to the revenues charged to POASI are to be based on the actual expenses incurred by LRWC. In light of this, it seems appropriate to Staff that its calculation of the revenues under the POASI special contract should reflect both the updated rate of return and marginal tax rate applicable to LRWC in this rate proceeding. Thus, Staff is proposing that the rate of return applied to rate base under the special contract should be 7.81% as determined on Schedule 1a of Attachment JPL-1. Likewise, Staff also proposes that the income tax rate applicable to the revenues calculated under the special contract should be 39.61% (60.39% divisor factor) as calculated on Schedule 1b of Attachment JPL-1.

Q. What are the adjusted revenues that Staff calculated relative to the POASI special contract?

A. Schedule 9a indicates that Staff has calculated adjusted revenues under the POASI special contract of $204,385 which is an increase of $2,105 over the amount proposed by the Company of $202,280.

Q. In its review of the Company's calculations relative to the POASI special contract, did Staff come across any other items which it feels should be reviewed by LRWC and POASI going forward?

A. Yes. There are two items in the Company's calculations that Staff feels should be reviewed by the Company and POASI. The first relates to $158,566 in mains which are classified as CIAC and which appear to have been contributed by an entity other than POASI. However, despite the fact that these mains would normally be excluded from LRWC's rate base for general ratemaking purposes, it appears that with regard to the revenue calculation under the POASI special contract they have not been excluded from rate base. The second item pertains to Property Tax Expense, where despite the fact that the Paradise Shores plant assets, to which this expense directly relates, have been allocated amongst the four revenue requirement categories, i.e., Volume Basis, Customer Allocation Basis, POASI, and Non-POASI; a similar allocation is not performed relative to the Paradise Shore's Property Tax Expense. Further, it appears that the property taxes related to "Non-POASI" assets, i.e., services and meters, are not being excluded from the POASI revenue calculation. These items were brought to LRWC's attention in Staff Data Request 3-1. However, based on LRWC's response, it appears that the Company disagrees with Staff's analysis with regard to these issues.

Q. Please explain Staff Adjustment # 41 to increase LRWC's test year Other Operating Revenues by $200.

A. This adjustment stems from Staff Audit Issue # 31 on page 100 of the Final Audit Report (Attachment JPL-6) which concerns billings for services that occurred during November of the test year in the amount of $200 that were not recorded by the Company. The Company concurred with the audit finding and therefore Staff Adjustment # 41 increases the Company's test year Other Operating Revenues account by the appropriate amount.

Q. Turning our attention now to LRWC's O & M Expenses, please discuss Staff Adjustment # 42 which results in a reduction in the Company's operating expenses by $15,000.

A. Staff Adjustment # 42 relates to Staff Audit Issue # 17 on page 84 of the Final Audit Report (Attachment JPL-6) concerning $15,000 in costs recorded by the Company during the test year in its Source of Supply Miscellaneous Expense account. The Audit Staff recommended, and the Company agreed, that these costs should have been capitalized rather than expensed. Therefore, Staff Adjustment # 42 removes these costs from LRWC's test year operating expenses. Staff Adjustments # 4 and # 15, which I discussed previously, include these costs as part of the resulting net addition to the Company's test year rate base.

Q. Please explain Staff Adjustment # 43 which increases LRWC's test year expenses by $4,030.

A. I alluded to this adjustment earlier in my testimony concerning Staff Adjustments # 7 and # 18 which stemmed from Staff Audit Issue # 18 on page 85 of Attachment JPL-6. This relates to the cost of a pump purchased during the test year for $4,030 which was mistakenly included in the Company's plant records. While Staff Adjustments # 7 and #

18 remove this item from LRWC's rate base, Staff Adjustment # 43 records the increase in the Company's Material Expense account in the amount of $4,030.

Q. Please explain Staff Adjustment # 44 relative to a $2,592 proposed decrease in the Company's test year expenses.

A. This adjustment was previously mentioned in relation to Staff Adjustments # 8 and # 19 concerning a well hydrofracking cost in the amount of $2,592 at the Company's West Point division which Staff is recommending should be capitalized rather than expensed. Therefore, Staff Adjustment # 44 reduces test year operating expenses by this amount.

Q. Please discuss Staff Adjustment # 45 to decrease test year O & M Expenses by $844.

A. This adjustment relates to Staff Adjustments # 9 and # 22 which I previously discussed relative to an $844 expense item for truck tire rims which was deemed to be a non-recurring expense per Staff Audit Issue # 25 on pages 93 and 94 of Attachment JPL-6. However, Staff is recommending that this cost should be capitalized rather than expensed. Therefore, Staff Adjustment # 45 records the removal of this cost from test year operating expenses.

Q. Please explain Staff Adjustment # 46 relative to a proposed reduction in the Company's test year O & M Expenses by $12,959.

A. This adjustment relates to Staff Adjustment # 34 which I discussed previously with regard to certain inventory costs in the amount of $12,959 which were written-off by the Company during the test year in response to "The Reduction of Lead in Drinking Water Act of 2011". Per Staff Audit Issue # 25 on pages 93 and 94 of Attachment JPL-6, the Company agreed to amortize this cost over a 3-year period. Staff Adjustment # 46 removes this cost from test year operating expenses.

Q. Please explain Staff Adjustment # 47 to remove certain post-test year wages from the Company's test year expenses.

A. This adjustment is the result of Staff Audit Issue # 33 on page 102 of the Final Audit Report (Attachment JPL-6). It relates to wages actually earned in 2015 but which were included in the Company's test year operating expenses. LRWC agreed that $1,470 in employee wages should be eliminated from the test year. However, because the Company's O & M Expense Adjustment # 2 (Schedule 1B of Attachment JPL-5) increased LRWC's test year wages by 4.00%, Staff Adjustment # 47 reflects the reduction of an adjusted wage amount of $1,529 ($1,470 x 104%).

Q. Please explain Staff Adjustment # 48 which reduces a pro-forma adjustment proposed by the Company relative to its General Accounting Expense.

A. The Company's O & M Expense Adjustment # 6 (Schedule 1B of Attachment JPL-5) increased LRWC's pro-forma General Accounting Expense by a proposed $39,178 for the purpose of offsetting certain one-time accounts payable discounts received during the test year from its outside accounting professionals. In Tech Data Request 1-6, the Company was asked to provide further detail concerning the discounts that it received from certain legal and accounting professionals during the test year. Included in its response, LRWC provided a schedule which indicated, among other things, that it received discounts for general accounting services which totaling only $36,586; a difference of $2,592. In Staff Data Request 2-10(c), the Company was asked to reconcile and explain this difference. In its response, LRWC indicated that its pro-forma adjustment of $39,178 includes $2,592 in other Non-Utility Income. Therefore, Staff is proposing Adjustment # 48 in order to reduce the Company's General Accounting Expense adjustment by $2,592.

Q. Please discuss Staff Adjustment # 49 which reverses LRWC's O & M Expense Adjustment # 9.

A. The Company proposed O & M Adjustment # 9 to reflect the amortization of previously deferred costs stemming from Commission Docket DW 07-105. (See Schedule 1B of Attachment JPL-5) Commission Order No. 25,454 (01/17/13) approved the deferral of these costs and stated, ". . . *that Lakes Region shall be permitted to recover these costs through customer rates, **beginning at the date of a final order in its next filed full rate case**, via a five-year amortization* . . ." (Emphasis Added). As such, Staff believes that the collection of these costs should not be included in the determination of the Company's permanent rates which would have an effective date of September 14, 2015. Rather, Staff is recommending that the Company's recovery of these costs should commence at the conclusion of this rate proceeding as part of the proposed step adjustments in this case in order to comport with the Commission's directive. Therefore, Staff Adjustment # 49 reverses the Company's proposed amortization of these costs in the amount of $9,980 for purposes of permanent rates. Staff has included these costs as part of its proposal for an initial step adjustment for LRWC.

Q. Please discuss Staff Adjustment # 50 which reduces the Company's test year General Accounting Expense by an amount of $31,184.

A. Staff reviewed the specific invoices for services provided by its accounting professionals during the test year which were supplied by the Company in its responses to Staff Data Request 1-17(a) and Tech 1-5(a). Based on its review, Staff is proposing that a total of

$31,184 in test year General Accounting Expenses should be eliminated from LRWC's O & M Expenses and reclassified to other accounts. The support for these adjustments is contained in Schedules 10a and 10b of Attachment JPL-1. The majority of the adjustment relates to charges for services totaling $29,200 from Norman E. Roberge, who provided assistance to the Company with regard to its financial recording and reporting function. The specific services provided to the Company by Mr. Roberge during the test year have been summarized on Schedule 10a. Staff questions the future necessity of Mr. Roberge's services to the Company for two reasons. First, the Company added a Utility Manager position to its staff in 2013 at the specific suggestion of the Commission in Order No. 25,391 (07/13/12) in DW 10-141. The Commission later approved rate recovery for the costs associated with the Utility Manager position in Order No. 25,496 (04/22/13), also in DW 10-141, and stated, "*We share the hope and expectation of Staff and the parties that this hiring will henceforth begin a reduction in the reliance on outside contractors which has proven to be unwieldy and expensive.*" Second, the Company has transitioned to a new accounting software system, as the system it had previously been working with proved to have a number of deficiencies. In its response to Staff Data Request 2-11(a) the Company further explained, "*Norm Roberge has been involved with financial reporting largely because he developed the financial reporting system necessary to overcome* [the previous accounting system's] *limitations. As indicated in response to other requests, the Company has actively transitioned to* [the new accounting system] *to reduce its accounting costs and improve performance* . . ." In its proposal for a step adjustment in this case, which is discussed later in my testimony, Staff has included a recovery of the costs associated with the Company's new accounting software system. As such, Staff is proposing that the entirety Mr. Roberge's costs to LRWC during the test year should be eliminated from the Company's pro-forma O & M Expenses. However, in order to recognize the value of Mr. Roberge's services to the Company and its customers, Staff is also proposing that these costs should be transferred to a Deferred Asset account and amortized over a 3-year period. The recording of the Deferred Asset and associated amortization relative to Mr. Roberge's test year charges have been previously discussed in my testimony relative to Staff Adjustments # 36. With regard to the remaining portion of Staff Adjustment # 50 in the amount of $1,984, these relate to the consulting services provided by Stephen P. St. Cyr & Associates to the Company during the test year which are analyzed in Schedule 10b of Attachment JPL-1. Based on this analysis, Staff found that certain costs should not have been included in the Company's General Accounting Expense account, but rather, should have been classified as part of the cost of acquiring a certain debt issuance from CoBank ($1,035) and as part of the rate case expenses relative to the instant proceeding ($949). It should be noted that certain of these costs were first identified in Staff Audit Issue # 26 on page 95 of the Final Audit Report (Attachment JPL-6). Schedule 10b identifies Staff's specific cost reclassification proposals relative to these adjustments. The debt issuance, to which a portion of these costs relate, was approved in Commission Order No. 25,753 (01/13/15) in Docket No. 14-285 relative to the Indian Mound improvements financing. Later in my testimony, I will be discussing the inclusion of the Indian Mound improvements as well as the associated financing in a proposed step adjustment for the Company. As such, the cost of debt incurred to procure that financing will also be included in the rate of return calculation relative to that step adjustment, as well.

Q. Please discuss Staff Adjustment # 51 which reduces the Company's pro-forma General Legal Expense by the amount of $7,384.

A. This adjustment specifically relates to the Company's O & M Expense Adjustment # 7 (See Schedule 1B of Attachment JPL-5) which proposes a $13,317 reduction in the Company's test year General Legal Expenses from the amount it actually recorded of $29,017 to $15,700, which is based on a 3-year average of costs incurred from 2012 – 2014 . Staff reviewed copies of the Company's legal invoices for the years 2012 – 2014 which were provided in response to Staff Data Request 2-10(a) as well as Tech 1-6(a). Staff also obtained the amounts incurred by the Company for General Legal Expenses in 2010 ($4,169) and 2011 ($3,591) via the Company's response to Staff Data Request 1-18(c). In its review of the 2012 – 2014 invoices, which is summarized in Schedules 11(a) – 11(c) of Attachment JPL-1, Staff made a number of adjustments in order to reclassify certain charges originally recorded as General Legal Expenses to financing expenses, rate case expenses, or non-recurring expenses, as appropriate. As a result, Staff determined that the actual amounts of General Legal Expenses incurred by the Company during that three year period was as follows: 2012 - $16,094; 2013 - $6,639; and, 2014 - $8,316. As such, it is Staff's conclusion that there appears to be no adequate reason to employ any type of averaging methodology with regard to the Company's General Legal Expenses as it does not discern any type of apparent cyclicality with regard to these costs. Furthermore, it is Staff's opinion that the amount of General Legal Expenses incurred by the Company during 2012 is somewhat anomalous, especially when compared to the other years during the period from 2010 through 2014. As such, Staff believes that the inclusion of the 2012 costs in any type of averaging scenario would result in a disproportionately skewed amount that would not be representative of LRWC's normal annual activity relative to this expense. Therefore, Staff believes that the General Legal Expense, as adjusted, incurred by the Company during the test year provides a better representation of the annual amounts it incurs for this expense on a pro-forma basis. Thus, Staff proposes that the pro-forma legal expenses proposed by the Company in the amount of $15,700 should be further reduced by $7,384 in order to arrive at the adjusted expense amount for 2014 of $8,316.

Q. Please explain Staff Adjustment # 52 which eliminates certain Computer Support Costs from test year O & M Expense in the amount of $1,776.

A. This adjustment relates to costs incurred during the test year related to the Company's transition to a new accounting software system. In its response to Tech Data Request 1-1b, the Company indicated that in addition to computer support charges that it paid relative to its then existing software system, the Company also paid $1,776 in computer support fees relative to the accounting software system to which it was transitioning. Therefore, because the new software system was not yet in service and used and useful to the Company during the test year, Staff is proposing Adjustment # 52 to reduce test year operating expenses by $1,776.

Q. Please explain Staff Adjustment # 53 which reduces LRWC's test year Insurance Expense by $28,600.

A. In its response to Staff Data Request # 1-40, the Company indicated that because of changes made to its commercial and group medical insurance coverages during 2015 it was anticipating a combined reduction of $28,600 from the premiums it incurred for these policies during the test year. Therefore, Staff Adjustment # 53 reflects these anticipated savings in the Company's insurance premiums relative to the pro-forma test year.

Q. Please explain Staff Adjustment # 54 which decreases O & M Expenses by $285.

A. This adjustment is based on Staff Audit Issue # 27 on page 96 of the Final Audit Report (Attachment JPL-6) which identified a medical reimbursement in the amount of $285 that was actually incurred during 2013 but which had been paid for and recorded by the Company during the test year. Therefore, this adjustment removes this cost from the Company's pro-forma test year O & M Expenses.

Q. Please discuss Staff Adjustment # 55 which reverses an adjustment made by LRWC relative to a proposed pension plan for its employees.

A. The Company's O & M Expense Adjustment # 3 (See Schedule 1B of Attachment JPL-5) proposed a $16,000 addition to LRWC's pro-forma test year expenses relative to the implementation of an employee pension plan. However, in its responses to Staff Data Request 1-15(a) and Tech 4-4, the Company indicated that this plan has not yet been implemented. Given the fact that this plan is not currently in effect, Staff Adjustment # 55 reverses this pro-forma expense for purposes of determining permanent rates. However, Staff's proposed step adjustment for LRWC, which will be discussed later in my testimony, includes the expenses related to the Company's anticipated implementation of its employee pension plan.

Q. Please discuss Staff Adjustment # 56 to decrease LRWC's Regulatory Commission Expense by $16,943.

A. In its response to Tech Data Request 1-8(g), LRWC indicated that its test year Regulatory Commission Expense account contained costs pertaining to its Petition for Emergency

Rates in DW 13-041.[7] Based on page 47 of the Final Audit Report (Attachment JPL-6), the amount expensed by the Company during the test year relative to that case appears to be $16,943. It is Staff's position that, aside from the fact that the Company failed to meet its burden of proof with regard to the necessity for emergency rates in that case, these costs should be deemed to be of a non-recurring nature. Therefore, Staff Adjustment # 56 reduces the Company's test year pro-forma O & M Expenses by $16,943.

Q. Please explain Staff Adjustment # 57 which reduces LRWC's O & M Expenses by an amount of $5,454.

A. This adjustment stems from Staff Audit Issue # 25 on pages 93 and 94 of the Final Audit Report (Attachment JPL-6) relative to two charges recorded in the Company's Miscellaneous General Expense account which are deemed to be of a non-recurring nature. The first, in the amount of $1,546, relates to the removal of a tub and shower from LRWC's office facility. The second, in the amount of $3,908, pertains to a loan pre-payment fee that was paid by the Company during the test year. Therefore, Staff Adjustment # 57 reduces LRWC's pro-forma test year O & M Expenses by the combined amount of these charges, or $5,454.

Q. Turning now to Depreciation Expense, please explain Staff Adjustment # 58 which appears to reverse one of LRWC's pro-forma adjustments.

A. In Schedule 1B of Attachment JPL-5, the Company has proposed Depreciation Expense Adjustment # 12 for the purpose of including $15,055 in Depreciation Expense associated with the Company's proposed 2015 plant additions in its pro-forma test year operating expenses. However, Staff eliminated the post-test year plant additions to which

[7] The Commission denied LRWC's Emergency Rate Petition in Order No. 25,516 (06/04/13) as well as the Company's Motion for Rehearing in Order No. 25,557 (08/02/13).

this particular adjustment relates from LRWC's rate base in Staff Adjustments # 2, # 3, # 13, and # 14, as discussed previously. As such, Staff Adjustment # 58 reduces the Company's pro-forma test year Depreciation Expense by $15,055 for purposes of determining permanent rates. However, certain post-test year plant additions along with their associated operating expenses have been included in a proposed step adjustment for the Company which will be discussed later in my testimony.

Q. It appears that explanations for the remaining Staff adjustments to LRWC's pro-forma Depreciation Expense have at least been alluded to previously in your testimony. Could you please briefly go through each of these adjustments and specifically relate them to your earlier testimony?

A. Staff Adjustment # 59 relates to Staff Adjustments # 4 and # 15 which stem from Staff Audit Issue # 12 on pages 76 and 77 of Attachment JPL-6 relative to certain revisions in the Mt. Roberts rate base additions. This adjustment increases test year pro-forma annual Depreciation Expense by $20. Staff Adjustment # 60, which decreases annual Depreciation Expense by $6, is related to Staff Adjustments # 5 and # 16 which are based on the Company's response to Staff Data Request 2-19 regarding a $300 overstatement in the cost of the Mt. Roberts mains contributed to the Company by the shareholder. Staff Adjustment # 61 relates to Staff Adjustments # 6 and # 17 based on Staff Audit Issue # 16 on pages 82 and 83 of Attachment JPL-6 regarding corrections to the costs of two meter assets. This adjustment increases the Company's annual Depreciation Expense by $7. The basis for Staff Adjustment # 62, which reduces annual Depreciation Expense by $403, was previously discussed in relation to Staff Adjustments # 7, # 18, and # 43 which provided corrections relative to the purchase of a pump during the test year which had been erroneously added to the Company's plant records. Staff Adjustment # 63 relates to the discussion regarding a $2,592 well hydrofracking cost which was reclassified from the Company's test year operating expenses to Utility Plant in Service via Staff Adjustments # 8, # 19, and # 44. This adjustment increases LRWC's annual Depreciation Expense by $86. Staff Adjustment # 64 pertains to corrections made to the depreciation lives of certain well assets owned by the Company. These corrections, which were previously discussed in relation to Staff Adjustment # 20, are based on Staff Audit Issue # 15 on pages 80 and 81 of Attachment JPL-6 and result in an annual increase of $1,250 in annual Depreciation Expense as calculated on Schedule 5 of Attachment JPL-1. Also resulting from Staff Audit Issue # 15 is Staff Adjustment # 65 which pertains to Staff's proposed increases in the depreciation lives of the Company's transportation fleet as previously discussed with regard to Staff Adjustment # 21. This adjustment results in a decrease in the Company's annual Depreciation Expense of $7,643 as calculated on Schedule 6 of Attachment JPL-1. Lastly, Staff Adjustment # 66 is based on Staff Audit Issue # 25 on pages 93 and 94 of Attachment JPL-6, which pertains to a set of truck tire rims purchased in the amount of $844 which were reclassified from the Company's test year operating expenses to Utility Plant in Service by Staff Adjustments # 9, # 22, and # 45. Staff Adjustment # 66 increases LRWC's annual Depreciation Expense by $169.

Q. Please discuss Staff Adjustments # 67, # 68, and # 69 which all pertain to the annual Amortization Expense associated with three Deferred Assets that are being proposed by Staff which you discussed previously.

A. The calculations in support of these adjustments are contained on Schedule 8 of Attachment JPL-1. Staff Adjustment # 67 relates to the 'No Lead Rule' inventory write-off in the amount of $12,959 which Staff is proposing be reclassified from the Company's O & M Expenses to a Deferred Asset account by Staff Adjustments # 34 and # 46. Staff is proposing that the resulting Deferred Asset be amortized over a 3-year period, resulting in an annual Amortization Expense of $4,320. Staff Adjustment # 68 pertains to Staff's proposed reclassification of certain well evaluation costs in the amount of $36,006 from the Company's CWIP account to a Deferred Asset account as previously discussed relative to Staff Adjustment # 35. Staff proposes to amortize these costs over a 10-year period at an annual rate of $3,601. The basis for Staff Adjustment # 69 was discussed relative to Staff Adjustments # 36 and # 50 with regard to the reclassification of $29,200 in General Accounting Expenses to a Deferred Asset account. Staff is proposing that this Deferred Asset be amortized over a 3-year period, resulting in an annual expense of $9,733.

Q. Turning our attention now to Staff's proposed tax adjustments, please explain Staff Adjustment # 70 to Other Tax Expense.

A. Staff Adjustment # 70 is related to the proposed test year wage reduction previously discussed relative to Staff Adjustment # 47 which is based on Staff Audit Issue # 33 on page 102 of Attachment JPL-6. This adjustment applies the 7.65% payroll tax percentage to Staff's previously proposed wage adjustment of $1,529, resulting in a reduction in the Company's pro-forma test year Payroll Tax Expense of $117.

Q. Please discuss Staff Adjustments # 71 and # 72 which reduce the Company's pro-forma Property Tax Expense by a combined amount of $7,506.

A. Schedule 1B of Attachment JPL-5 contains the Company's Other Tax Adjustment # 15 in the amount of $3,055 as well as its Other Tax Adjustment # 17 in the amount of $4,451 in order to include the Property Tax Expense relative to certain post-test year plant additions in its test year operating expenses. As previously explained, Staff eliminated the post-test year plant additions upon which these adjustments are based from LRWC's test year rate base in Staff Adjustments # 2, # 3, # 13, and # 14. Therefore, Staff Adjustments # 71 and # 72 respectively reverse LRWC's Other Tax Adjustments # 15 and # 17.

Q. Please discuss Staff Adjustment # 73 regarding Staff's proposed adjustment to increase LRWC's pro-forma Property Tax Expense by $302.

A. During the test year, the Company incurred State and Municipal Property Tax Expenses totaling $47,515. Additionally, based on its test year plant additions, the Company proposed amended Property Tax Expense Adjustments # 14 and # 16, which together increase LRWC's proposed pro-forma Property Tax Expense by $6,371 to $53,886. (See Schedule 1B of Attachment JPL-5) However, for purposes of its pro-forma operating expenses, Staff is proposing that LRWC be allowed to recognize its 2015 State and Municipal Property Tax Expenses, but adjusted for modifications made relative to the Company's real estate assets as introduced in this case. Schedule 12 of Attachment JPL-1 contains Staff's calculations in this regard. Based on the Company's responses to Staff Data Requests 1-24, 1-25, 2-13, and 2-14, Staff determined that the Company's total State and Municipal Property Tax billings during 2015 were $55,258. However, based on the pro-forma rate base adjustments introduced in this case, Staff determined that the tax assessment valuation of the Company's taxable real estate should be reduced by $81,886, resulting in a calculated reduction in its 2015 property taxes of $1,070. Thus, Staff is proposing an adjusted pro-forma Property Tax Expense for LRWC of $54,188 ($55,258 - $1,070), which is $302 more than the amount proposed by the Company in its amended schedules.

VII. TAX EFFECT OF OPERATING INCOME AND EXPENSE ADJUSTMENTS

Q. Please discuss Staff Adjustments # 74 and # 75 which respectively record the State of New Hampshire and Federal Income Tax provisions resulting from Staff's proposed Operating Income and Expense adjustments.

A. The calculations in support of Staff Adjustments # 74 and # 75 are found on Schedule 3b of Attachment JPL-1. The basis for these calculations is Staff's Operating Revenue and Expense Adjustments # 40 through # 73 which have been previously discussed. Together, these adjustments result in a net increase in the Company's pro-forma net operating income of $162,640. With regard to the calculation of the State Income Tax provision, both the Company and Staff are proposing a marginal tax rate of 8.50%. When this rate is applied to Staff's proposed increase in pro-forma net operating income, the result is an increase in LRWC's State Income Tax Expense of $13,824.

Q. However, it appears that Staff has reduced its calculated State Income Tax provision by an amount stemming from an issue contained in the Final Audit Report. Please explain.

A. Yes. Staff Audit Issue # 34 on page 103 of the Final Audit Report (Attachment JPL-6) indicates that the State Income Tax Expense recognized by the Company during the test year is overstated by $2,966. This is relative to 2013 State Income Taxes that were included in its 2014 expense. Therefore, Staff has reduced its calculated State Income

Tax Expense provision of $13,824 by the overstated amount in order to derive an adjusted State Income Tax Expense provision of $10,858 which is reflected in Staff Adjustment # 74.

Q. Please continue with your explanation relative to Staff's calculation of a Federal Income Tax provision for LRWC?

A. Staff reduced the net increase in LRWC's net operating income of $162,640 by the adjusted State Income Tax provision of $10,858, resulting in an amount of $151,782 which would be subject to Federal Income Taxes. Therefore, Staff applied the 34.00% marginal Federal Tax Rate to this amount, resulting in an increase in the Company's Federal Income Tax Expense of $51,606. However, similar to the Company's test year State Income Tax Expense, Staff Audit Issue # 34 also indicates that LRWC's Federal Income Tax Expense during the test year was overstated by $3,810 also relative to 2013 taxes included in the 2014 test year. Therefore, Staff netted this overstatement against its calculated Federal Income Tax provision in order to derive an adjusted amount of $47,796 which is reflected in Staff Adjustment # 75.

Q. Please discuss Staff Adjustments # 76 and # 77 which appear to be modifications to the Federal and State Income Tax Expense provisions that are proposed by LRWC in this case.

A. Schedule 1B of Attachment JPL-5 contains the Company's amended Income Tax Adjustments # 20 in the amount of $124,302 and # 21 in the amount of $28,787 which adjust the Company's pro-forma test year Federal and State Income Tax Expenses, respectively, in order to conform to tax provision amounts calculated by the Company on Schedule 5 of Attachment JPL-5. The tax provision amounts calculated by LRWC on

Schedule 5 are $128,112 for Federal Income Taxes and $35,003 for State Income Taxes. However, Staff disagrees with the Company's calculations of the respective income tax provisions. Specifically, Staff found that the Company derived its proposed provisions through applying the respective marginal tax rates to its calculated equity return on rate base. However, for purposes of calculating permanent rates, which are based on an historical test year, this methodology circumvents the inclusion of the Company's actual test year Income Tax Expense in the determination of a revenue requirement. Further, Staff found that in the Company's determination of its pro-forma Income Tax Adjustments # 20 and # 21, it only considered the Current Income Tax Expenses it recognized during the test year, while ignoring its test year Deferred Income Tax Expenses. As such, Staff believes that the Company's pro-forma adjustments in this regard are overstated. Therefore, in its determinations of Adjustments # 76 and # 77, Staff recalculated LRWC's tax provisions through the use of the traditional approach of applying the marginal State and Federal Income Tax rates to the increase in net operating income (before income taxes) which result from the Company's amended pro-forma revenue and expense adjustments as contained in Schedules 1A and 1B of Attachment JPL-5. Staff calculated that increase to be $324,813 to which it first applied the marginal State Income Tax rate of 8.50% in order to derive a calculated State tax impact of $27,609 which is $1,178 less than LRWC's amended (State) Income Tax Expense Adjustment # 21. (See Staff Adjustment # 76 on Schedule 3a of Attachment JPL-1) Staff then applied the marginal Federal Income Tax rate of 34.00% in order to derive a calculated Federal tax impact of $101,049 which is $23,253 less than LRWC's amended

(Federal) Income Tax Expense Adjustment # 20. (See Staff Adjustment # 77 on Schedule 3a of Attachment JPL-1)

VIII. COMPUTATION OF PERMANENT RATES

Q. Please discuss Staff's computation of Permanent Rates contained in Schedules 1a and 1b of Attachment JPL-4.

A. Schedule 1a of Attachment JPL-4 shows a calculation of LRWC's customer rates based on the permanent rate revenue requirement being proposed by Staff of $1,104,873. The calculation of the various customer rates are consistent with the methodology employed in previous rate proceedings involving LRWC. Staff has also provided a report of proposed rate changes on Schedule 1b of Attachment JPL-4. A comparison of Staff's proposed permanent rates to the temporary rates currently in effect in this docket as well as the rates that were in effect prior to this docket is as follows:

Customer Class	Permanent	Temporary	Prior
WVG Pool	$1,538.73	$1,597.17	$1,452.76
Unmetered Customers	$ 662.66	$ 687.83	$ 625.56
Metered Customers:			
Customer Charge	$ 521.22	$ 541.02	$ 494.32
Metered Charge – per ccf	$5.07	$5.26	$4.81

Q. What is Staff's understanding relative to how the respective revenues under permanent rates and temporary rates will be reconciled?

A. Commission Order No. 25,862 (01/29/16) which approved temporary rates in this case indicates that the effective date for rates in this case is for service rendered on and after

September 14, 2015. Based on that order as well as Staff's understanding of RSA 378:29, the difference between the revenues LRWC actually derives under temporary rates and the rates it would have derived under the permanent rates approved by the Commission will be reconciled back to the September 14, 2015 effective date. Depending upon the results of that reconciliation, LRWC's general customers will either be credited or surcharged the difference.

IX. STAFF RECOMMENDATION FOR STEP ADJUSTMENTS

Q. Please provide a brief overview of Staff's recommendations for step adjustments in this proceeding.

A. Staff is recommending two step adjustments for LRWC in this proceeding. The first will encompass various plant additions and expenditures which were included in LRWC's request for permanent rates. However, since these plant additions and expenditures occurred outside of the test year, Staff is incorporating them into a proposed step adjustment to take effect on, or soon after, the Commission's Order approving rates in this proceeding. Staff's calculation for the first step adjustment is contained in Attachment JPL-2 and results in an additional $62,486, or 5.99%, increase in LRWC's revenue requirement for its general metered and unmetered customers. The second proposed step adjustment, which per the Direct Testimony of Mark A. Naylor is conditional, includes proposed system improvements at two of LRWC's water divisions as well as a proposed renovation to its main office facility located in Moultonborough which are anticipated to be constructed throughout the remainder of 2016 and into 2017. The estimated cost of these improvements is $237,000 which is to be financed through a loan obtained from CoBank ACB. The calculation of the estimated increase resulting from this step adjustment is contained in Attachment JPL-3 and results in an estimated additional increase in LRWC's revenue requirement for general metered and unmetered customers of $21,746, or 2.08%. Staff is anticipating that this step adjustment will become effective by either late 2017 or early 2018.

Q. With regard to the first step adjustment which is calculated on Schedule 1 of Attachment JPL-2, there appear to be several components which are included in this calculation beginning with certain additions to Plant in Service. Please briefly discuss these plant additions, starting with the Mt. Roberts Property.

A. A summary of Staff's recommended costs for inclusion in the Mt. Roberts plant addition is contained in Schedule 2 of Attachment JPL-2. This property was acquired by LRWC's shareholders during 2006 and it was the original intention of the remaining shareholder to sell it to the Company for an amount of $415,907, representing the shareholder's proposed accumulated investment in the property. That amount included the following: $250,000 for the actual purchase, $3,344 in legal expenses, $10,239 in surveying costs, $18,200 in paid property taxes, and $134,124 of AFUDC. As previously explained, LRWC has agreed to eliminate the proposed AFUDC, but to treat the transfer of the property as a capital contribution consisting of the remaining proposed shareholder investment of $281,783.

Q. It appears that Staff is proposing to eliminate certain other costs amounting to $19,688 from the remaining proposed investment in the property. Please explain.

A. Staff is proposing to eliminate the accumulated property taxes of $18,200 because Staff does not view such as being an investment in the property, but, rather, as part of the shareholder's annual cost of maintaining the property. Staff is also proposing to eliminate a legal charge which was incurred during 2010 in the amount of $1,488. Staff reviewed a copy of the supporting invoice which was included in the Company's response to Staff Data Request 3-7. The invoice, which was dated 08/19/09, revealed that the charge in question was for "Estate Planning" services relative to a property that the shareholders acquired in the town of Swansea, Massachusetts. In its response to Tech 4-6 the Company explained, "*This invoice relates to the . . . Tax Deferred Exchange used to acquire the Mount Roberts land and the subsequent lease. The Company expects that* [the law firm] *has additional documentation. However, the cost to recover and review the law firm's archived files would likely be significant relative to the amount involved ($1,488). The Company does not object to removal of this amount for rate purposes.*" Therefore, Staff has eliminated this charge from the shareholder's proposed investment in the Mt. Roberts land. After these eliminations, the adjusted proposed shareholder investment in the Mt. Roberts Property becomes $262,095.

Q. It appears that Staff is allocating a portion of the shareholder's investment in the Mt. Roberts Property to the cost of a building. Please explain.

A. Based on the discovery responses provided by the Company relative to the Mt. Roberts Property, i.e., Staff Data Requests 1-7, 2-3, 2-4, 2-5, 2-6, Tech 1-13, Tech 1-19, etc., Staff became aware of the fact that included in the property acquired by the shareholders was a certain residential dwelling. Therefore, Staff believes that a portion of the shareholder's cost of acquiring the property should be allocated to that dwelling. As such, Staff also takes the position that the investment attributable to the residential dwelling should be classified as Non-utility Property in accordance with Section 2(b) of the New Hampshire Uniform System of Accounts for Water Utilities (June 2015), and thus should not be included in LRWC's rate base upon its transfer to the Company. In determining the appropriate apportionment of shareholder's investment between land and dwelling, Staff based its calculations on the Town of Moultonborough's 2006 real estate tax bill for the Mt. Roberts Property. A copy of that bill was included in the Company's response to Staff Data Request 3-7. Staff chose to base its apportionment calculations on the 2006 property tax bill because it reflects an independent appraisal of the property at roughly the time of the initial sale. The bill shows that the Town of Moultonborough's total assessment for the property during 2006 was $269,300; of which, $54,600, or 20.27%, was attributable to the building, and $214,700, or 79.73%, was attributable to the land. Based on that apportionment, Staff attributed 20.27% of the shareholder's total cost for acquiring the Mt. Roberts Property, including legal expenses, to the residential dwelling. This amounts to $51,063, which Staff is proposing should be classified as Non-utility Property. Staff's apportionment calculation is detailed under Footnote (i) on Schedule 2 of Attachment JPL-2. In conclusion, it is Staff's determination that the costs attributable to the shareholder's investment in the land portion of the Mt. Roberts Property, including surveying costs, is $211,032. Staff proposes that this amount should be included in LRWC's rate base for the determination of the initial step adjustment.

Q. Moving on to the Indian Mound improvements shown on Schedule 3 of Attachment JPL-2; please explain the inclusion of this investment for purposes of the initial step adjustment for LRWC.

A. During 2015, LRWC made significant improvements to its water system at its Indian Mound division located in Ossipee, New Hampshire. These improvements were first brought to the attention of the Commission as part of LRWC's request for financing approval in Docket DW 14-285. In that petition, LRWC requested approval for a loan from CoBank ACB in the amount of $129,775 in order to partially finance its proposed improvements at Indian Mound. The Commission approved that financing in Order No. 25,753 (01/13/15). In its response to Staff Data Request 3-4, the Company indicated that it had invested approximately $200,000 in the Indian Mound system during 2015. Given the magnitude of LRWC's investment in these improvements, Staff is proposing that such should be included in the initial step adjustment that it is proposing for the Company. Schedule 3 of Attachment JPL-2 provides Staff's calculations to derive an addition to LRWC's rate base of $195,641 relative to the 2015 Indian Mound improvements.

Q. Turning our attention now to the New Accounting Software System addition detailed on Schedule 4 of Attachment JPL-2; please explain the inclusion of this investment in the initial step adjustment being proposed for LRWC.

A. In its initial filing as well as in various discovery responses, LRWC explained that it was in the process of transitioning to a new accounting software system. The Company indicated that the software system that it had been using since 2005 had a number of deficiencies, making its use very inefficient. As I previously discussed, these inefficiencies included the Company having to hire an outside accounting consultant in order to bridge the deficiencies caused by that system. As a result, included in Staff's determination of proposed permanent rates for LRWC, was the elimination of $29,200 in accounting costs from O & M Expenses. (See Staff Adjustments # 36, # 50, and # 69 on Schedules 2a and 3a of Attachment JPL-1) Staff's justification for that adjustment was attributed, in part, to LRWC's transition to this new accounting software system that was anticipated to result in greater cost efficiencies for the Company. In its response to Staff Data Request 2-1, the Company indicated that it had completed its conversion to the new accounting system in January of 2016. As such, Staff believes that the costs associated with the new accounting software system should be included in the determination of the initial step adjustment. Therefore, Schedule 4 of Attachment JPL-2 contains Staff's calculation of an amount of $31,884 as the cost of the new software system to be included in rate base for the determination of the step adjustment. The amounts included on Schedule 4 are based on the Company's response to Staff Data Request 3-2.

Q. With regard to Staff's calculation relative to Cash Working Capital that is shown on Schedule 1 of Attachment JPL-2, please explain the two expense components that are encompassed within that calculation.

A. The first component relates to an annual Pension Plan Expense that was proposed by the Company in its filing for permanent rates, but which was eliminated by Staff Adjustment # 55. (See Schedule 3a of Attachment JPL-1) In its response to Tech 4-4, the Company indicated that the Company would be offering the pension plan to its employees subject to the approval by the Commission in this case. As such, Staff calculated an annual Pension Expense in the amount of $8,779 to be included in the determination of the initial step adjustment on Schedule 6 of Attachment JPL-2. Staff based its calculation on LRWC's response to Staff Data Request 1-15, utilizing the Company's pro-forma test year wages and an average contribution percentage of 2.00%. With regard to the second expense component which is indicated as a $2,666 decrease in LRWC's annual software support fees, this is based on the Company's response to Tech 1-1(e). The calculation for such is found on Schedule 4 of Attachment JPL-2.

Q. Please explain the Deferred Asset that Staff is including in its determination of a step adjustment for LRWC.

A. As I discussed previously relative to Staff Adjustment # 49 on Schedule 3a of Attachment JPL-1, the Company proposed an adjustment to reflect the amortization of previously deferred costs stemming from Commission Docket DW 07-105. However, Commission Order No. 25,454 (01/17/13) directed that the Company begin recovery of these costs through customer rates beginning at the date of a final order in its next filed full rate case. Staff Adjustment # 49 removed the annual amortization of these costs in the amount of $9,980 for purposes of determining LRWC's permanent rates. However, Staff is proposing the inclusion of both a Deferred Asset containing these costs in the amount of $44,912 as well as the related annual Amortization Expense of $9,980 in this initial step adjustment for LRWC, which is proposed to go into effect either on, or soon after, the Commission's order approving rates in this proceeding. These amounts are supported by Staff's computations which appear on Schedule 5 of Attachment JPL-2.

Q. Have the costs which are contained in the proposed initial step adjustment for LRWC been audited by the Commission Staff?

A. No. However, Staff proposes that each asset or expense item be reviewed and verified by the Commission Audit Staff before implementation of the proposed step adjustment. The Audit Staff should issue a report to the Commission detailing its findings so that, if necessary, any modifications may be incorporated into the final determination of rates resulting from the proposed step adjustment.

Q. It appears that Staff has calculated a 7.33% rate of return relative to this initial step adjustment. Please explain how Staff derived this proposed rate of return.

A. The calculations in support of Staff's proposed 7.33% rate of return are contained in Schedules 1a, 1ai, and 1aii of Attachment JPL-2. As its basis for these calculations, Staff is using the rate of return it derived for permanent rates on Schedule 1a of Attachment JPL-1 of 7.81%.

Q. Is such normally the case when determining a rate of return relative to a proposed step adjustment?

A. No. Normally the applied rate of return that is determined for a step adjustment is calculated using the specific financing vehicles (debt or equity) which are associated with the particular rate base or expense items upon which the step adjustment is based. However, with regard to this particular step adjustment, a number of the rate base and expense items included in such are closely associated with the rate base and expense items that are included in the Company's test year upon which permanent rates are based, i.e., the Mount Roberts Property, the new accounting software system, and the proposed pension plan. For that reason, Staff believes that it is appropriate, in this case, to base its determination of the rate of return for the initial step adjustment on the rate of return it calculated for purposes of permanent rates.

Q. Please continue with your discussion regarding the calculation of the rate of return for the initial step adjustment.

In deriving the 7.33% rate of return that is being proposed relative to this step adjustment, Staff made certain adjustments relative to the rate of return for permanent rates calculated on Schedule 1a of Attachment JPL-1. The first is reflected on Schedule 1ai of

Attachment JPL-2, which is the calculation for cost of debt. On that schedule, Staff included the $130,000 CoBank financing associated with the 2015 Indian Mound improvements which have been included in this step adjustment. With regard to the interest rate reflected for that loan, Staff based this on the Company's response to Tech 4-5 which indicated a current interest rate of 3.18%. However, Staff reduced that rate by 75 basis points to 2.43% relative to LRWC's participation in CoBank's patronage program. Staff also included the annual amortization of financing costs associated with that loan in the amount of $425. This was derived from Staff's analysis of accounting invoices for the years 2014 and 2015 which revealed that costs totaling $6,371 were related to that loan's procurement. Staff's analysis is summarized on Schedule 1aii of Attachment JPL-2. With the addition of the CoBank loan, Staff derived a cost of debt of 4.09%. Staff made two other adjustments which are contained in Schedule 1a of Attachment JPL-2 relative to Staff's calculation of a weighted average cost of capital for the step adjustment. The first of these is the addition of $211,032 to Additional Paid-in Capital, which reflects the rate base contributed by LRWC's shareholder relative to the Mt. Roberts Property. This amount was derived from Staff's calculations contained in Schedule 2 of Attachment JPL-2 which has been previously discussed. This adjustment increases the Company's total equity financing to an amount of $1,959,487, which, without further adjustment, would result in a capital structure for LRWC roughly consisting of 34% debt and 66% equity. As I mentioned earlier in my testimony, in order to mitigate the impact on rates that would result from having such an equity-heavy capital structure, a further adjustment was made to the Company's capital structure in order to reflect an additional proposed CoBank financing of $357,000. The Company proposes to use the proceeds from this loan to finance the three additional capital projects which form the basis for the subsequent step adjustment in this case, as well as a proposed acquisition and upgrade of the Dockham Shores water system which is the subject of Commission Docket DW 16-619. With the inclusion of this proposed financing, the Company's capital structure becomes one consisting of 41.25% debt and 58.75% equity as indicated on Schedule 1a of Attachment JPL-2. After these adjustments are made, Staff's calculated weighted average cost of capital relative to the initial step adjustment becomes 7.33%.

Q. Would you please walk through the remainder of the step adjustment calculation shown on Schedule 1 of Attachment JPL-2?

A. By applying the 7.33% rate of return to the net increase in rate base being proposed relative to this step adjustment of $484,724, the result is an increase in LRWC's net operating income requirement of $35,511. To this amount, Staff has added associated increases in the Company's operating expenses such as O & M, Depreciation, Amortization, as wells as Property and Income Taxes. These are computed on the various supporting schedules within Attachment JPL-2 and together total $46,425, resulting in a total addition to LRWC's revenue requirement of $81,936. However, Staff also determined the impact of the rate base and operating expense additions which are included in the initial step adjustment on the revenues derived from the POASI special contract. Staff's calculations are contained in Schedules 7a – 7d of Attachment JPL-2. Based on its calculations, Staff determined that the revenues derived from the POASI special contract will increase by $19,450. Therefore, Staff deducted these revenues from the overall increase in its revenue requirement of $81,936 in order to derive the revenue increase applicable to LRWC's general metered and unmetered customers of $62,486.

Q. Turning our attention now to the second proposed step adjustment for LRWC which Staff has calculated in Attachment JPL-3, please provide an overview of the three future capital projects upon which this will be based.

A. In its response to Tech 5-1, the Company provided a description of the proposed improvements relative to each of the projects. With regard to the Company's Wentworth Cove System, a bulkhead is necessary in order to meet OSHA compliance standards for a confined space. In addition, as currently the electrical controls for that system's pumping station are located in a confined space area that is wet and damp, a building is also proposed for construction in order to better house these components. The proposed building will also provide the housing necessary for a manganese treatment system. Such treatment is necessary because the current level of manganese in the system interferes with the Company's pumping equipment which has resulted in customer complaints. Currently, the Company's sole means for resolving its manganese problem is a vigorous main flushing program. The Company also proposes to install equipment necessary in order to provide its water operators with real time system monitoring and control. Finally, LRWC is proposing to upgrade its source and distribution meters with real time telemetry which will enable it to control water loss as well as resolve any other problems which may arise with greater efficiency. With regard to the Waterville Valley Gateway system, its needs are similar to that of the Wentworth Cove system. There, a bulkhead also needs to be installed in order to meet OSHA compliance standards for a confined space. The construction of a building in order to house currently exposed electrical components is also necessary. The Company also proposes to install real time system monitoring and control equipment as well as real time telemetry upgrades to its source and distribution meters at this system. Lastly, LRWC is proposing the addition of variable frequency drive (VFD) booster pumps in order to more efficiently provide constant system pressure in the two distribution zones within that system as well as to reduce water main failure that is caused by pressure fluctuations. With regard to LRWC's proposed office space addition, this is necessary because its current facility is proving to be too small for the Company's current needs. LRWC's office facility houses its office staff as well as its operators and field staff. The Company also uses that facility for small tool storage as well as for storage of various inventory components and other supplies that are used in field repairs

Q. Did the Company provide cost estimates for the above described capital improvements?

A. Yes. The Company provided Staff as well as the other parties in this proceeding with detailed cost estimates for these projects. A copy of this is included in my testimony as Attachment JPL-7. With regard to the Wentworth Cove Project, the Company is currently estimating a total investment of $47,000. With regard to the Waterville Valley Gateway Project, the Company is estimating a required investment of $50,000. With regard to its proposed office renovations, the Company is estimating an investment totaling $140,000. Staff based its calculations contained in Attachment JPL-3 on the detailed cost information provided by the Company in Attachment JPL-7.

Q. Please explain how LRWC is proposing to finance these projects?

A. The Company intends to finance the three projects under consideration in this case along with its proposed acquisition of and improvements to the Dockham Shores water system through a loan with CoBank ACB. In its response to Tech 5-1, the Company stated that it was seeking to obtain a 20-year loan from CoBank for the approximate amount of $400,000. It also stated that, as of May 2, 2016, the anticipated fixed interest rate of that loan would be 5.27%. LRWC received a letter from CoBank dated May 2, 2016 which outlined these anticipated terms. A copy of that letter is included in my testimony as Attachment JPL-8.

Q. Please provide a brief overview of Staff's calculations in support of the estimated step adjustment resulting from these projects.

A. A summary of Staff's calculations appear on Schedule 1 of Attachment JPL-3. It is currently anticipated that, once completed, all three projects will increase LRWC's net rate base by $233,502. Applied to this increase in rate base, Staff has determined a rate of return of 4.92% which is calculated on Schedule 1a of Attachment JPL-3. The rate of return proposed by Staff is based on the currently anticipated interest rate of the CoBank financing less 75 basis points relative to LRWC's participation in CoBank's patronage program. Staff's rate of return calculation also anticipates the amortization of various financing costs which were provided by the Company. By applying the 4.92% rate of return to the estimated net increase in LRWC's rate base of $233,502, the result is an estimated increase in the Company's net operating income requirement of $11,486. Added to this are estimated increases in the Company's annual Depreciation Expense of $6,997 and Property Tax Expense of $3,592. In total, the resulting projected increase in LRWC's revenue requirement is $22,076. However, on Schedules 5a – 5d of Attachment

JPL-3, Staff calculated the anticipated impact on POASI revenues as a result of the proposed plant additions, resulting in an increase of $330. This amount has been deducted from the overall revenue requirement for the second step adjustment in order to derive a projected revenue increase applicable to LRWC's general metered and unmetered customers of $21,746.

Q. What is Staff's view with regard to the projected course of filings and approvals that are necessary in order to ultimately implement this step adjustment?

A. Based on conversations with the Company as well as the other parties in this case, final completion of these three projects will most likely occur during 2017. Therefore, for purposes of this rate proceeding, Staff would recommend that the Commission approve the proposed financing necessary in order to construct these improvements in accordance with RSA 369. At such time that the three projects are fully completed, but by no later than December 31, 2017, Staff recommends that the Company file a petition with the Commission in order to request final approval of the step adjustment resulting from these additions. Staff recommends that this petition should contain the actual costs incurred by the Company relative to these projects as well as details of any related plant retirements. LRWC's petition should also reflect the finalized terms of its proposed financing with CoBank. Staff further proposes that the information contained in LRWC's filing should be subject to examination by the Commission's Audit Staff, and that a report of any findings by the Audit Staff should be filed with the Commission. Staff anticipates that it, along with the other parties in this case, will have the opportunity to make recommendations to the Commission regarding LRWC's filing which will be considered by the Commission before it makes a final decision regarding the proposed step adjustment.

X. COMPUTATION OF RATES AFTER STEP ADJUSTMENTS

Q. Please discuss Staff's computation of rates after implementation of its proposed initial step adjustment as contained in Schedules 2a and 2b of Attachment JPL-4.

A. Schedule 2a of Attachment JPL-4 shows the calculation of various customer rates after implementation of Staff's proposed initial step adjustment of $62,486, resulting in a total revenue requirement of $1,167,359. Staff has also provided a report of proposed rate changes on Schedule 2b of Attachment JPL-4. A comparison of the rates proposed on that schedule to the temporary rates currently in effect in this docket as well as the rates that were in effect prior to this docket is as follows:

Customer Class	Permanent + 1 Step	Temporary	Prior
WVG Pool	$1,625.75	$1,597.17	$1,452.76
Unmetered Customers	$ 700.14	$ 687.83	$ 625.56
Metered Customers:			
Customer Charge	$ 550.70	$ 541.02	$ 494.32
Metered Charge – per ccf	$5.36	$5.26	$4.81

Q. Please discuss Staff's computation of rates after implementation of the proposed estimated subsequent step adjustment as contained in Schedules 3a and 3b of Attachment JPL-4.

A. Schedule 3a of Attachment JPL-4 shows the calculation of LRWC's various customer rates after implementation of Staff's proposed subsequent step adjustment of $21,746, resulting in a combined revenue requirement currently estimated at $1,189,105. Staff has also provided a report of proposed rate changes on Schedule 3b of Attachment JPL-4. A comparison of the rates proposed on that schedule to the temporary rates currently in effect in this docket as well as the rates that were in effect prior to this docket is as follows:

Customer Class	Permanent + 2 Steps	Temporary	Prior
WVG Pool	$1,656.04	$1,597.17	$1,452.76
Unmetered Customers	$ 713.18	$ 687.83	$ 625.56
Metered Customers:			
Customer Charge	$ 560.96	$ 541.02	$ 494.32
Metered Charge – per ccf	$5.46	$5.26	$4.81

Q. Does this conclude your direct testimony?

A. Yes.