

**STATE OF NEW HAMPSHIRE**  
**BEFORE THE PUBLIC UTILITIES COMMISSION**

**Lakes Region Water Company, Inc.**

**Docket IR 22 – 048**

**LAKES REGION’S RESPONSES TO QUESTIONS PRESENTED**

NOW COMES Lakes Region Water Co., Inc., (“Lakes Region”) and responds to the Commission’s August 26, 2022 *Order of Notice* in this proceeding as follows:

**I. The Commission’s Order of Notice.**

On August 26, 2022, the Commission issued an *Order of Notice* to commence an investigation into the practice by regulated utilities of requesting step adjustments to permanent rates in rate proceedings governed by RSA 378:7, stating:

Step adjustment filings have become a frequent feature of ratemaking in our State before this Commission. A high volume of step adjustment filings for utilities in the electric, gas and water industries are often under review, with these filings typically accompanied by a considerable amount of supporting accounting schedules and technical information. Furthermore, the methodologies, durations, and calculations of step adjustments amongst the regulated utilities remain inconsistent and uncoordinated. Despite the complexity involved in our review, petitioners frequently request procedural schedules consisting of an expedited and, in many cases, relatively abbreviated review by the Commission, the New Hampshire Department of Energy (DOE), and other interested persons and stakeholders.

The Commission believes that the issue of step adjustments is ripe for review, given the differences regarding the calculation methodologies used in developing step adjustment schedules, as well as the administrative challenges of adjudicating multiple step adjustment petitions each year with an abbreviated review schedule. As such, the Commission requires an investigation of all aspects of step adjustment development and process. We have determined that this investigation should embrace utilities in the electric, gas, and water industries.

We therefore open this investigatory proceeding to examine all pertinent aspects of step adjustments by electric, gas, and certain water<sup>1</sup> utilities in

New Hampshire. This investigation will aid the Commission in its role of examining step adjustment petitions to ensure just, reasonable, and accurate rates, and may serve as a starting point for reconciliations of recent step adjustment calculations and modifications of future proposals. See, e.g., Order Nos. 26,623; 26,656; 26,657; and 26,661. See also RSA 374:2; 374:4; 374:8; 374:10; 374:11; 374:13; 378:5; 378:7; 378:8.

The Commission directed that Lakes Region and other utilities address in general terms: “the necessity for ongoing step adjustments for utilities; the ratemaking and calculation methodologies used; the number of step adjustments, if any, between rate cases and the resulting procedural schedules; and the processes used by the Commission, petitioners, and participating parties for developing data and recommendations.” In addition, the Commission requested that the following questions be addressed:

1. The advisability for continuing the step adjustment ratemaking paradigm in the current regulatory and economic environment in New Hampshire;
2. The calculation methodologies used to develop step adjustments, including the treatment of depreciation and other categories of expense, rate of return, etc.;
3. The role of the DOE’s Audit Division in step adjustment review proceedings;
4. Potential enhancements to review proceedings, including timing of step adjustment filings and proposed rate effective dates;
5. The role of settlement agreements in full rate case proceedings in guiding step adjustment filings and criteria, including criteria related to project qualification;
6. The qualification criteria for step adjustments in general; and
7. The appropriateness of reconciliation adjustments.

As requested, Lakes Region offers this response to both the general and specific questions raised by the Commission.

## **II. Lakes Region’s Business Operating Small Water Systems.**

Lakes Region believes that the value and need for step increase depends in part on the nature of utility. In Lakes Region’s case, it is a stand-alone utility which operates 19 small community water systems serving 1,824 customers<sup>1</sup> located in New Hampshire’s Lakes and White Mountain regions, an average of 96 customers per system. Lakes Region employs a staff of 6 technical professionals (with 2 currently open positions)<sup>2</sup> who specialize in operation of small community water systems as well as office and customer service staff and a Utility Manager, Leah Valladares, responsible for reporting to the Commission. Lakes Region’s affiliate, LRW Water Service Co., Inc., provides additional support under an affiliate agreement approved by the Commission.

All of Lakes Region’s small water systems were built by real estate developers prior to the capacity assurance requirements administered by the Commission<sup>3</sup> and the Department of Environmental Services (“DES”).<sup>4</sup> As a result, many of Lakes Region’s systems were poorly designed, lacked adequate well supply and treatment systems and have poorly constructed, leaky and/or inadequate distribution, pumping and storage systems. Lakes Region acquired nearly all of its systems at the request of the prior

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<sup>1</sup> Annual Report for the Year Ending December 31, 2021, Form S-9

<sup>2</sup> Lakes Region notes that labor markets have changed dramatically in the last year which suggests that it would be imprudent to limit step adjustments to plant additions. Lakes Region recommends that any costs eligible for inclusion in a rate should also be eligible for inclusion in a step increase as may be determined on a case by case basis.

<sup>3</sup> See RSA 374:22, III (“No water company shall obtain the permission or approval of the commission to operate as a public utility without first satisfying any requirements of the department of environmental services concerning the suitability and availability of water for the applicant's proposed water utility.”).

<sup>4</sup> RSA 485:3, XII (“The commissioner may adopt rules to ensure long-term viability of public drinking water systems as required by section 119 of the federal Safe Drinking Water Act Amendments of 1996, 42 U.S.C. section 300g-9 to qualify for full eligibility for federal and state revolving fund capital grants.”).

owners, or in some cases, the DES and/or the Commission, because these small water systems were not financially viable on a stand-alone basis.<sup>5</sup>

By consolidating small community water systems into a single regional company, Lakes Region is able to provide technical, financial and administrative expertise to its 19 systems that would not be available on a stand-alone basis. Lakes Region's professional certified water operators and other staff are available to support both normal operations and planning for all of its systems as well as technical staff available are available on-call on a 24/7 basis in the event of an emergency. In the event of a leak or interruption in service, Lakes Region has the ability to respond in real time and provide information to customers using its web site and One-Call Notification system.

### **III. Small Water Utility Business Challenges.**

#### **A. Drinking Water Challenges.**

The challenges facing the owners of small water systems are significant and well documented. In 2008, the NH Department of Environmental Services published a multi-volume Water Resource Primer which includes a chapter discussing the challenges facing small water systems in New Hampshire:

#### **8.2.2 New Hampshire Has a High Proportion of Struggling Small Community Systems**

Even large community water systems find the Safe Drinking Water Act regulations difficult and costly to meet, so it is no surprise that it is much more difficult for small water systems. Figure 8-7 depicts the many challenges that small water systems may encounter as they provide safe drinking water. New Hampshire has a large proportion of small systems which are widely distributed and often impossible to interconnect. Per customer costs may be dramatically different than those associated with large systems. These small stand-alone systems require fairly sophisticated operations, yet they cannot afford to hire full-time staff that

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<sup>5</sup> See Testimony of Thomas A. Mason, President of Lakes Region Water in Docket No. 20 – 187.

specialize in drinking water. Some small municipal water systems may have to share one part-time staff member with the highway department, the fire department and others.

Conversely, larger systems benefit from economies of scale and can afford to hire highly educated, specialized staff teams with in-depth knowledge of treatment, distribution, and other aspects of drinking water provisions. As a result, customers of the smallest systems often pay the most for the least in services. It is also important to note that providing water supply is a highly capital intensive mission where even the largest systems struggle to maintain and replace their aging infrastructure.

It is important to note that the definitions of a small water system used by the DES and NARUC are based on the Safe Drinking Water Act which classifies a small water system as one serving a population of fewer than 3,300 persons.<sup>6</sup> This is nearly ten times larger than the average size of the small water systems operated by Lakes Region which have an average of 96 customers per system on average.<sup>7</sup> Lakes Region's water systems should be considered on the extreme end of small.

In its 2018 *Capacity Development Annual Report to the EPA* (October 2018), the DES reports that small water systems serving populations fewer than 250 people “exhibit a multitude of hardships to manage and maintain water system compliance (Figure 1), have a limited rate base, and incur the highest number of violations both for health-based parameters and for monitoring and reporting requirements”.<sup>8</sup> According to the data,

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<sup>6</sup> See e.g. 42 USC sec. 300g-1 (b)(4).

<sup>7</sup> The American Water Works Association's 2012 Water and Wastewater Rate Survey uses a “median service population per account” of 3.62 which results in an average population of 344 persons per system. This ratio should be considered high for New Hampshire and the areas served by Lakes Region because of New Hampshire's aging, rural demographic, a high seasonal customer demand, and, the absence of large commercial and/or industrial water customers in the Lakes Region service territories.

<sup>8</sup> Page 2 of 13. More recent data and reports are available at [des.nh.gov](http://des.nh.gov).

23.54% of these small systems had monitoring and reporting violations in 2018, compared to 5.38% for those serving populations over 1,000 (5.38%).

By operating its systems on a consolidated basis, Lakes Region has successfully improved operations and performance of its small water systems. In all of its recent rate cases, Lakes Region has used step adjustments as a mechanism to address water quality, pressure problems, aging mains and/or treatment systems in many of its systems. Step increases played a critical role in improving service to customers and maintaining compliance with drinking water standards, while avoiding the greater commitment of time and expenses which would be required for a full rate case.

**B. Financial Challenges.**

The financial challenges facing small water systems have been recognized by the National Association of Regulatory Utility Commissioners (NARUC). NARUC has adopted a series of resolutions recognizing that: “Traditional cost of service ratemaking, which has worked reasonably well in the past for water and wastewater utilities, no longer adequately addresses the challenges of today and tomorrow. Revenue, driven by declining use per customer, is flat to decreasing, while the nature of investment (rate base) has shifted largely from plant needed for serving new customers to non-revenue producing infrastructure replacement and compliance with new drinking water standards”.<sup>9</sup> To overcome these challenges, NARUC recommends that state utility commissions implement a number of “Best Practices” to help attract the capital that is necessary to provide service to the public. These best practices include practices such as

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<sup>9</sup> NARUC, *Resolution Endorsing Consideration of Alternative Regulation that Supports Capital Investment in the 21st Century for Water and Wastewater Utilities* (2013).

“a) the use of prospectively relevant test years; b) the distribution system improvement charge; [...] h) a streamlined rate case process”.<sup>10</sup>

Lakes Region submits that step increases are a critical tool used by water utilities to maintain compliance and provide quality service to the public. Without step increases and other “best practice” regulatory mechanisms, small water utilities like Lakes Region would be forced to incur the costs of a rate case more frequently which would increase rates and regulatory costs for both Lakes Region and its customers. Step adjustments are in a very real sense a form of “streamlined rate case process” recommended as a “best practice” by NARUC which allows the utility to defer the costs of a full rate case by one or more years while meeting the challenges of providing high quality service that customers expect and deserve.

### **III. Step Adjustments in General.**

The term Step Adjustment is not defined by statute or rule. However, Lakes Region understands the term to mean an adjustment to permanent rates in a rate proceeding to recover known and measurable changes to costs to provide service due to circumstances which may arise subsequent to the effective date of permanent rates based on the test year. This understanding is consistent with prior Commission orders treating step adjustments as adjustments to permanent rates in the same proceeding noticed by the Commission. *See e.g., Liberty Utilities, Order Following Hearing on 2019 Step Adjustment*, Order No. 26,377 (June 30, 2020), Page 11;<sup>11</sup> *Hampstead Area Water*

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<sup>10</sup> NARUC, *Resolution Supporting Consideration of Regulatory Policies Deemed as “Best Practices”* (2005).

<sup>11</sup> Explaining that: “While Liberty argued that Staff’s scope of inquiry regarding prudence in this step adjustment phase was limited, Liberty acknowledged that the Commission could review both the selection and execution of the projects for prudence. The Commission must find investments

*Company, Order Approving Return on Equity and Change in Rates*, Order No. 26,195 (November 28, 2018), Pages 1 – 2.<sup>12</sup> *Pennichuck East Utility, Order Approving Permanent Rates*, Order No. 26,179 (October 4, 2018).<sup>13</sup>

Step adjustments therefore benefit from the review of a test year which occurs in a rate case, while allowing an adjustment to occur beyond the 12-month period for adjustments to the test year. Because a step adjustment occurs as part of the approval of a rate proceeding in which notice has been provided, rates have been suspended pending investigation and discovery, and a record developed, it avoids the significant costs to prepare an additional round of schedules, testimony and other information that would be required for a rate case in a subsequent year. Step adjustments also avoid some of the procedural costs and delays which would be required for a fall rate case, including: (a) publication of new orders of notice to customers under RSA 378:3; (b) suspension of rates under RSA 378:6; or (c) petitions to intervene under RSA 541-A:31 by interested parties who could assert new or different claims not raised in the rate proceeding.

In addition, a step adjustment is a necessary mechanism because, in the two years subsequent to a rate proceeding, the Commission has the discretionary authority to decline a request for rate increases even if the utility is under-earning under RSA 378:7 which states that: “The commission shall be under no obligation to investigate or hear any rate matter which it has investigated within a period of 2 years, but may do so within said period at its discretion.” Thus, step adjustments often address changes to a utility’s

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prudent, used, and useful under RSA 378:28 before including a return on those investments in permanent rates. Without such inquiry, the Commission could not make the required finding.”

<sup>12</sup> Explaining that: “Both the rate increase and the step adjustment were based on a revenue requirement ...”.

<sup>13</sup> Explaining that: “PEU’s requests for an increase in permanent rates and a step increase are based on the Settling Parties’ proposed new ratemaking methodology.”



cost to provide service which are anticipated to occur within the 2-year period subsequent to a rate case, during which period the Commission is not required, unless it is for emergency rate relief under RSA 378:9.<sup>14</sup> Step adjustment therefore balance the interests of the utility and its customers by avoiding the costs of a full rate case while allowing critical improvements to service to be recognized in rates.

#### **IV. Responses to Questions Raised by the Commission.**

Lakes Region looks forward to working with the Commission, the Department of Energy, the Consumer Advocate and other interested parties in this proceeding to address the questions and concerns raised by the Commission. In furtherance of that goal, Lakes Region provides the following preliminary responses to the questions raised by the Commission in its Order of Notice:

**1. The advisability for continuing the step adjustment ratemaking paradigm in the current regulatory and economic environment in New Hampshire;**

For the reasons set forth herein, Lakes Region believes that Step Adjustments are a critical mechanism to improve service and maintain compliance with DES and PUC drinking water standards which benefit customers by reducing the frequency and costs of rate proceedings. This is particularly true in the 2-year period following a rate case under RSA 378:7 when the statute gives the Commission the discretion to deny consideration of a rate case in the absence of an emergency.

**2. The calculation methodologies used to develop step adjustments, including the treatment of depreciation and other categories of expense, rate of return, etc.;**

Lakes Region's practice has been to work with the interested parties to make post-test year adjustments using traditional utility rate making principles.

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<sup>14</sup> **378:9 Emergency.** – Whenever the commission shall be of the opinion that an emergency exists, it may authorize any public utility temporarily to alter, amend or suspend any existing rate, fare, charge, price, classification or rule or regulation relating thereto.

**3. The role of the DOE’s Audit Division in step adjustment review proceedings;**

Lakes Region believes that the DOE’s Audit Division plays an important role in step adjustment proceedings. Without the involvement of the DOE Audit Division, third party intervenors would likely request delays to conduct their own reviews of utility records which could create additional delays, costs and uncertainties in the regulatory process.

**4. Potential enhancements to review proceedings, including timing of step adjustment filings and proposed rate effective dates;**

Lakes Region looks forward to working with all of the interested parties to provide recommendations to the Commission on this question.

**5. The role of settlement agreements in full rate case proceedings in guiding step adjustment filings and criteria, including criteria related to project qualification;**

Lakes Region believes that in the absence of a settlement agreement or Commission order authorizing a step adjustment, a utility would be required to incur the costs of a full rate case, with or without waivers, in order to recover the costs of improvements to provide service to customers.

**6. The qualification criteria for step adjustments in general; and**

Lakes Region believes that the qualification criteria for step adjustments should include any costs which would ordinarily be allowed in a rate case within a reasonable time period. This is typically an item that is negotiated by the utility and the interested parties. The circumstance in each case will differ. For example, in Lakes Region’s case, it does not have a mechanism for recovery distribution system or other utilities such as are employed by the Pennichuck and Aquarion utilities. At a minimum, step adjustments should be available for the entire 2-year period following conclusion of a rate case investigation under RSA 378:7. A period of 3 to 5 years following the test year is recommended. It is important to recall that the Commission has statutory authority and discretion to require a full rate case to be filed on its own initiative or upon complaint at any time.  
RSA 378:7

**7. The appropriateness of reconciliation adjustments.**

Lakes Region looks forward to working with all of the interested parties to provide recommendations to the Commission on this question.

Respectfully submitted,

**LAKES REGION WATER CO., INC.**

By its Counsel,

**NH WATER LAW**



Dated: October 4, 2022

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**CERTIFICATE OF SERVICE**

I hereby certify that a copy of the foregoing was this day forwarded to all parties on the official service list for this proceeding.



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Justin C. Richardson