STATE OF NEW HAMPSHIRE
BEFORE THE
PUBLIC UTILITIES COMMISSION

**City of Nashua: Taking Of Pennichuck Water Works, Inc.**

**Docket No. DW 04-048**

# DIRECT TESTIMONY OF JOHN F. JOYNER

**February 27, 2006**

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1 **Q. Please state your name, employer and business address.**

2 A. My name is John E. Joyner. I am President of Infrastructure Management Group,
3 Inc. ("IMG"). My business address is 4733 Bethesda Avenue, Suite 600,
4 Bethesda, Maryland 20814.

5 **Q. What is the purpose of your testimony?**

6 A. IMG was engaged by Pennichuck Water Works to review the City of Nashua's
7 process for selecting a third party contractor to operate the water system in
8 Nashua as well as the proposed contract that has been negotiated between Veolia
9 Water North America--Northeast, LLC (which I will refer to as Veolia or
10 VWNA) and the City. In performing the review, I worked with other IMG
11 professionals, including David Mason, Thomas Kennedy, Terry Tobel and
12 Christopher Malinowski. The members of our team all have significant prior
13 utility industry experience, as shown in Attachments JEJ-1 through JEJ-5. My
14 testimony will summarize the most significant findings based on the review we
15 have conducted.

16 **Q. Please summarize the relevant experience and expertise that you and others**
17 **at IMG have that qualifies you to conduct such a review.**

18 A. As noted in Attachment JEJ-1, I have more than 20 years of senior management
19 experience in city planning, public-private partnerships, municipal infrastructure
20 project development and operations. IMG is nationally recognized as an expert in
21 negotiating public-private partnerships for owners and operators of public use
22 infrastructure. It was presumably because of that experience and expertise that I
23 was contacted on behalf of the City of Nashua to appear on a panel in Nashua in

1 2005 to speak about public-private partnerships in operating municipally owned
2 water systems. I was unable to attend at the time, and so IMG's Chairman, Steven
3 Steckler, participated in my place.
4 **Q. Have you ever participated directly in the contracting process for operation**
5 **of a municipal water or waste water system by a private company?**
6 A. Yes, on many occasions. Some of these include Bexar County, Texas (where San
7 Antonio is located), Milwaukee, Wisconsin, Atlantic Beach, North Carolina and
8 Atlanta, Georgia. The other IMG team members bring experience from dozens of
9 other water and waste water utility operating contracts. In addition, IMG has
10 experience with procurement and contract negotiations from other public use
11 infrastructure projects including solid waste agencies, airport authorities and
12 transportation authorities.
13 **Q. Have you had have an opportunity to review the process under which Veolia**
14 **was selected to operate the water systems of Pennichuck Water Works if**
15 **Nashua is ultimately successful in its efforts to take those systems by eminent**
16 **domain?**
17 A. Yes. I reviewed the request for proposals ("RFP") issued by the City and the
18 responses received by the City. I also reviewed the final unsigned version of the
19 contract negotiated by the City and Veolia, attached as Exhibit B to the January
20 12, 2006 testimony of Philip G. Ashcroft et al.
21 **Q. Are you familiar with Veolia's experience for the operation of entire water**
22 **systems like PWW, including treatment plant, distribution, and multiple**
23 **community water systems?**

1 A. Veolia has quite a bit of experience in operating waste water treatment plants, and
2 also has experience operating water treatment plants. It has far less experience
3 operating entire drinking water systems that include the raw water intake and
4 supply sources, water treatment facilities and distribution system. Veolia has only
5 one domestic water system operation contract that is comparable to the size of the
6 Nashua core system and that is the one in Indianapolis. The other complete water
7 systems which Veolia operates are much smaller than PWW and not so
8 geographically dispersed. Based on information that I understand Veolia has
9 provided in response to questions from PWW, Veolia only operates two water
10 distribution systems in the entire northeast (Sturbridge, MA and Smuggler's
11 Notch, Vt.), both of which are very small.
12 **Q. What experience does Veolia have in working as a team of two contractors,**
13 **with Veolia supplying operations management, and R.W. Beck performing**
14 **oversight, with respect to publicly owned water supply systems, and how**
15 **common is it to have the public owner contract out both operations and**
16 **oversight?**
17 A. Based upon the materials which Veolia and Beck have supplied, the proposed
18 Nashua contracts appear to be unique, both for Veolia and Beck. Neither
19 company has pointed to a situation in which a public owner of a water supply
20 system has contracted out the entire operations and the entire oversight to separate
21 contractors. In Indianapolis, at the time the city purchased the Indianapolis Water
22 Company assets, it established a water department to oversee Veolia's contract
23 operations. My understanding is that Nashua does not propose to establish a

1 water department, relying instead upon the oversight of R.W. Beck. As I
2 understand it, the only project which Veolia and Beck have pointed to, in
3 response to Pennichuck's request in Data Request 3-2 for the names of similar
4 contracting for both operations and oversight, is the Tampa Bay Water Authority.
5 Yet that project is owned by and water distribution is also operated by a public
6 entity: Tampa Bay Water Authority, i.e. there is no private operator except for the
7 treatment plants. Also, the contracted services provided by Beck in Tampa are
8 limited to oversight of water treatment facilities, and not water distribution. From
9 my knowledge, the Nashua contracts represent the first municipally owned water
10 system which separately contracts out both the entire operations and oversight to
11 third parties.
12 **Q. What conclusions did you reach as a result of your review of the**
13 **Nashua/Veolia contract?**
14 A. That review revealed that the City's RFP process and the contract negotiated with
15 Veolia have numerous serious deficiencies that call into question whether the
16 savings projected by Nashua can ever be achieved. In addition, the contract lacks
17 performance standards such that there is no way to ensure that operation of the
18 system after an eminent domain taking will meet basic service quality measures.
19 **Q. Please summarize the problems you identified in the City's RFP process.**
20 A. First, the City's proposal evaluation and selection process appears to have been
21 less formal and structured than most procurements of this magnitude. In virtually
22 all of the large number of utility procurements that IMG has been involved with,
23 the standard practice has been to establish an evaluation committee of municipal

1 officials, impose specific evaluation criteria, rank proposals based on those
2 criteria and then clearly document the record of decision. This helps to avoid
3 expensive challenges and maintains transparency in the procurement process.
4 Those specific steps do not appear to have been taken in this case. In fact, it is my
5 understanding that the review of responses was conducted primarily by the City's
6 consultant who has been promoting the eminent domain taking in this case. To
7 my knowledge, no City procurement, financial or other officials were involved in
8 the review process in any meaningful way.
9 Second, I was surprised to find that only two proposals were received. This is not
10 typical in the current market where the number of RFP's for outsourcing
11 opportunities have become more limited. In fact, companies that engage in
12 contract operations are very anxious to find attractive new RFP opportunities. It
13 is certainly an indication that the other potential bidders saw problems of some
14 sort that caused them to be reluctant to commit to entering into a contract at this
15 time. I am aware that a number of the other potential bidders felt that it was
16 simply not possible to make a serious, well-conceived proposal to operate a water
17 system in the middle of an ongoing eminent domain battle because there would be
18 insufficient access to assets facilities and operating records to allow for a proper
19 due diligence process. It is my understanding that both Veolia and R.W. Beck
20 acknowledged this deficiency in recent depositions. These problems cause me to
21 seriously question how reliable the representations by Veolia are at this point,
22 because there are so many unknowns that they simply cannot account for under
23 these unusual bidding circumstances. This is significant because, as will become

clear when I review the contract that Veolia and Nashua have submitted, the ultimate costs of operating the system could turn out to be quite different than those that are initially estimated.

**Q. Please summarize the problems you have identified in the proposed contract that Nashua has negotiated with Veolia and submitted to the Commission.**

A. Set forth below is a listing of the most significant problems I have identified in the Veolia contract.

- **Termination for Convenience** – The contract provides for significant payments if the City wants to terminate the contract for convenience. While such a payment is not unusual in and of itself, it is highly unusual to provide payments to the proposed operator in circumstances where the contract is terminated prior to the issuance of a notice to proceed. Under the contract that Nashua has negotiated, it would be required to pay Veolia $800,000 if for any reason it decides not to litigate the eminent domain case through to conclusion. In addition to being unclear what Veolia has done to earn such a payment, it would seem to me to be antithetical to public policy because such a huge penalty payment appears intended to dissuade Nashua from entering into a settlement with Pennichuck or otherwise deciding not to proceed with eminent domain if it decides that stopping that effort is contrary to the public interest. In my experience, industry practice is that the operating company has no claim to a termination for convenience payment until the notice to proceed is issued.

- **Lack of Performance Standards** – For the most part, the contract does not impose any significant performance standards on VWNA. Although it does require them to respond to customer complaints within a certain time, many of the performance standards that are common in operating contracts are not present in this one. The lack of performance standards is inconsistent with the concepts presented in Veolia's proposal to Nashua when it submitted its response to the RFP. Examples of typical standards that are not in this contract include:

    - Unaccounted for Water
    - Maximum percentage of meter re-reads
    - Maximum allowable time to complete water line repairs (including laying of asphalt)
    - Maximum allowable time to review requests for new service
    - Percentage of preventative maintenance work orders completed on time.

- Repair of fire hydrants, i.e. 5 days after discovery of need for repair

- **Unclear About Taxes** – Article 8.8 on page 14 of the contract leads one to believe that it is still unclear if VWNA will have to pay sales, excise, ad valorem, property, disposal, franchise, occupational, or other taxes for work performed on the project. This is surprising as this is usually resolved before any final contract is presented for signature by City leaders.

- **Responsibility for Electricity and Fuel** - Article 8.15 on page 15 states that the City is responsible for paying for all electricity and fuel. While this is not abnormal, what is missing is a consumption guarantee by VWNA. Normally, the operator must guarantee consumption rates (e.g., kWh/million gallons treated). The lack of such a guarantee results in no incentive for the operator to improve electric efficiency of its operations. The absence of such a guarantee is even more noteworthy given that, as I understand was revealed during the deposition of one of the witnesses from R.W. Beck, the oversight contractor proposed a performance standard for energy use, but it still did not end up in the contract.

- **Payment for Scope Changes** – Article XI lays out reasons for scope changes. Section 11.2 states that increased or decreased costs associated with these changes will be paid to VWNA plus 10%. While this is normal for materials, chemicals, etc., it is not appropriate for increased labor where the labor rates are obtained from tables used for capital projects.

- **Rebidding of Project** – Article 13.1 does not provide a definite end of the contract when it must be bid out again. This is highly abnormal. A municipality should re-bid a project such as this one occasionally (e.g., every 6 or 10 years) to ensure that a) prices are kept competitive and b) efficiency gains in technology, legislation, or management can be incorporated. This contract includes an initial term of 6 years, plus three 2-year terms that are automatically renewed. In addition to the problem of not ensuring that VWNA will have to compete against other contractors to continue to operate the system at the end of the initial 6 year term, the short length of the renewal terms could lead to short term decision-making and insufficient commitment and investment by VWNA with regard to the Nashua system because when the contract term is extended VWNA will not have any assurance that it will continue to be the operator for more than two years at a time.

- **Pay and Benefits** – There is no language in the contract that requires VWNA to provide a pay and benefits package for existing Pennichuck employees who would become VWNA employees that is equivalent to what they now receive. There is no mention on what is to be done on any pension program of Pennichuck, nor how seniority will be handled. This could allow VWNA to scuttle any existing pension program that Pennichuck has in place. Also, it

could allow VWNA to offer low salaries to existing employees and decide not to retain many of the existing Pennichuck personnel who have the accumulated knowledge necessary to ensure a smooth transition of the system. Staffing plans should be outlined in the contract. It was my understanding from VWNA's response to Nashua's RFP that VWNA would be retaining most of the existing Pennichuck personnel in order to ensure that the operating knowledge and capabilities of those individuals was not lost. In fact, the original VWNA proposal makes clear the importance of retaining existing employees to ensure a smooth transition. The contract with Nashua provides no such assurance and could lead to a contrary result.

- **Health Care** – There is no mention of health care costs in the contract. Every year health care premiums are rising many times faster than the rate of inflation. Currently, the only way for VWNA to increase its base fee is through a CPI adjustment. If this contract were to continue for 6 or 10 years, increases in health care costs could impact the profitability of the project for VWNA, forcing either a confrontation with the City, or forcing them to cut costs elsewhere to make up for this shortfall thereby threatening the quality of service.

- **Current Pennichuck Activities not included in VWNA price** – Numerous operation and maintenance activities that are conducted by Pennichuck are not included as part of the base fee in the contract. These include:

  - Customer Service Functions (billing and collection functions)
  - Review of new construction
  - Inspection of new construction
  - Creating as-built plans
  - Preparing a hydraulic model
  - Fire flow tests
  - All repairs to and almost all maintenance of pipes, service lines, equipment
  - Capital program management
  - IT support

  These services would undoubtedly increase the cost of the O&M of the system significantly above the base fee in the contract and need to be taken into account in determining whether the claimed "savings" associated with City operation of the water system are illusory.

- **Capital Improvements** – Appendix G of the contract says that the City can negotiate with VWNA or with outside contractors to complete capital improvement projects. I would seriously question whether under public bid laws, Nashua can simply negotiate with VWNA for construction of capital works rather than putting such projects out to bid. This type of single contractor process could well lead to excessive costs for Nashua and litigation

from others who are injured by such a process. In addition, it is my understanding that Nashua's oversight contractor (R.W. Beck), its subcontractor (Tetra Tech, Inc.), and Veolia's subcontractor (Dufresne-Henry) also have the opportunity to work on capital improvements projects, creating many opportunities for conflicts of interest and unusual dealings among the various players and additional cost for Nashua and VWNA.

- **Transition payment** – This calls for payment of a fixed sum for limited services set forth in Appendix Q to the contract, with many important transition services, such as implementation of IT plans, operational plans and consolidation of offices to be separately billed as supplemental services. Given that so much of the transitional services are supplemental, there should not be a lump sum payment at all, but rather payment based upon time and materials.

- **Repairs and Maintenance** – VWNA does not provide for corrective maintenance of assets in its $5 million annual fee, but rather includes only preventative and "housekeeping" maintenance (e.g., exercising of valves, flushing program, lawn mowing). This means, for instance, that repairs to broken pipes or replacement of pipes and valves are not included in the annual fee. With regard to this corrective maintenance, VWNA is reimbursed 100% of any item, regardless of its size. Items over $10,000 must have prior approval from the City. If the City refuses to "promptly" approve these large items, VWNA can make a claim. This is likely to significantly increase the cost of the contract and must be taken into account in calculating the cost of the total package of services to be provided by VWNA. In addition, if VWNA uses its existing maintenance staff that is already included in the base fee to provide corrective maintenance services, there is the potential for double billing for these services. In addition, VWNA is not responsible for paying any fees for permits or costs of pavement replacement in rights of way. It is doubtful that the City realizes the magnitude of this potential expense, which is likely to be significant.

- **Unclear Definitions** – There are numerous ambiguous definitions, that are ripe for creating disputes. These include:
  - Prudent Industry Practices
  - Appendix C; 5.0--"reasonable efforts" to bring raw water into compliance with applicable legal standards.

- **Other Miscellaneous Items**
  - Scope Changes: Article XI gives Veolia the opportunity to broadly interpret the scope of the contract and what would justify a change in the base annual fee. At a minimum, this provision is likely to lead to ongoing disputes between the City and its contract operator.
  - Schedule C, as identified under Definitions A.1 ("Acceptable Raw Water"), sets forth the parameters for raw water which Nashua has the

obligation to supply to Veolia for treatment. If the raw water does not meet those parameters, then Veolia is relieved of its commitment to meet state water quality standards for the finished water coming out of the treatment plant. (See Section 5.2(C) of the contract.). Thus while Nashua will not have control over raw water, it will have the responsibility on its own to meet the raw water specifications.

- The Contractor should be required to provide a water sampling and analysis plan.
- The base annual fee for the contract should include connection of the average number of new meters per year and replacement meters per year, rather than providing for all connections to be charged as an extra under the RRRM section of the contract.
- Numerous cost items remain undetermined, with blanks in the contract in Exhibit E (supplemental services) and H (renewal, repair and replacement maintenance services). These include costs for materials used in repair and maintenance, and standard time periods to be billed for specific jobs.

**Q. Why do you think that the contract contains so many unusual and open ended provisions?**

A. As an experienced operator and participant in public-private partnerships, Veolia was appropriately careful to define and limit its risk in all of the important areas. Naturally, this risk assignment will result in some easily defined additional costs as well as other potential costs being "passed through" to the city of Nashua. As Nashua and their consultants work to minimize the annual service fee, Veolia has no choice but to minimize their risk. In essence, Veolia sought to shift as much risk as possible to Nashua in order to meet Nashua's apparent goal of minimizing the base annual fee of the contract. The more Veolia could narrowly define the services it would provide and shift unknowns and less predictable items to surcharges, the better able they were agree to a fixed annual fee for those basic services. Veolia is certainly well aware from its experience in operating other water systems that it will be able to charge Nashua substantial amounts for many services that are not included within the base annual fee. Yet, in evaluating the

Veolia contract, these additional costs must be taken into account to get a realistic sense of Nashua's ultimate operating costs.

**Q. Are you aware that the Veolia contract has been presented by Nashua as resulting in substantial annual savings for customers?**

A. Yes.

**Q. Do you think the contract will result in such savings?**

A. No. The savings that Nashua asserts it will achieve under the Veolia contract are illusory at best. Those savings have been projected using the following assumptions, among others:

- Nashua assumes Pennichuck's 2007 O&M expenses for the City system to be $8.738 million, plus property taxes of $1.536 million and other taxes and depreciation/amortization. See GES Exhibit 2.
- Nashua assumes its costs for utilities (primarily electricity) to be $500,000. GES Exhibit 4.
- Nashua assumes its annual cost of "unplanned maintenance" is $185,000. GES Exhibit 4. (Interestingly, in Veolia's proposal, it had estimated this item to be $1 million, which is much closer to Pennichuck's actual experience, as I understand it.)
- Nashua assumes that its property taxes will be $1.4 million (GES Exhibit 4).

Using these numbers, Nashua has claimed that it can achieve substantial annual savings, as shown on GES Exhibit 7. However, the assumptions used by Veolia or incorporated in the City's analysis are incomplete and, in a number of cases, incorrect.

**Q. Please provide some examples of the more significant errors and oversights by Veolia and Nashua in coming up with their claimed savings in operating the water system.**

1 A. There are a number of costs that the City has not included in arriving at its claim
2 that the Veolia contract will result in savings. As for known costs, there is
3 Veolia's one-time startup charge of $1.38 million plus Beck's startup charge of
4 $0.23 million. These startup costs need to be amortized over the terms of the
5 contracts to make an accurate comparison.
6 In addition, the City and Veolia assumed that the base year cost of electricity and
7 fuel would be $500,000, considerably lower than the actual cost of $1,000,000 for
8 electricity alone that Pennichuck has experienced. Similarly, the City assumed
9 that the cost for "unplanned maintenance" was much lower than Pennichuck's
10 experience. Pennichuck spends in excess of $2.2 million for maintenance, so
11 assuming that, based on Veolia's initial proposal, it included $500,000 to
12 $700,000 for maintenance in its base annual fee, the unplanned maintenance
13 beyond Veolia's contractual limit is understated by at least $1,000,000 and
14 perhaps much more. Even assuming that the entire $500,000 contingency item in
15 GES 4 is attributable to unplanned maintenance, this cost factor is still
16 significantly understated. Adding just the understated electricity and understated
17 unplanned maintenance into the savings calculation reduces the forecast savings
18 substantially before even considering other erroneous assumptions.
19 Some other potential errors that jump out on first inspection are that Nashua's
20 revenue requirement calculation (GES Exhibit 4) includes only about $100,000
21 for the cost of potable water purchased from other systems, whereas Pennichuck
22 actually incurs over $180,000 annually. With more time to obtain and analyze
23 detailed information from Nashua and Veolia and compare it to what has actually

been experienced in operating the water systems owned by Pennichuck, it is possible that most of the claimed savings would be eliminated. Moreover, I have not done any analysis of the impact of a purchase price that is higher than what Nashua has assumed, which would of course have a significant additional impact on any projected savings.

**Q. Are there other differences between the Veolia contract and the services provided by Pennichuck to which you have not attached a dollar amount?**

A. Yes. Examples are as follows:

- Pennichuck, as a private utility, is solely liable for all its actions and inactions including payment of fines to the State or federal government for non-compliance with health or safety regulations as well as environmental liability. There was no evidence of environmental liability insurance included in the Veolia proposal.

- The responsibility and risk for capital investment has been assigned to the City in the base proposal.

- Pennichuck provides other services such as providing "Dig-Safe" support by locating service lines; provides police for road work; provides full hydrant maintenance and replacement. These would presumably be extra-cost items for the City.

- The City would have to provide staff or consultants to do all its capital investment, planning and procurement, a function currently performed by Pennichuck.

- The City would have to provide additional support for services such as personnel, accounting and legal, especially if it was to take on the billing and collection services.

These items are likely to add substantial additional costs that the City will have to bear, although it is difficult to quantify them at this time.

**Q. Why would the various items you have identified be left out of the contract?**

1 A. As I indicated earlier, as Nashua squeezes Veolia for reduced cost, I would expect
2 a smart contractor such as Veolia to do what it can to shift risk and costs to the
3 city, so that its base annual fee would initially reflect only those limited costs that
4 Veolia could predict fairly easily. Beyond that, Veolia was no doubt under
5 significant pressure from the City to show substantial savings relative to operation
6 by Pennichuck. One way to show savings is to make assumptions that will
7 support such a result. Finally, Pennichuck's costs, as reported to the PUC,
8 obviously reflect all costs of every kind that the utility incurs. Veolia and the City
9 can, instead, only rely on assumptions, projections and forecasts, rather than the
10 hard cold reality that comes with a history of actually operating a system. While I
11 believe public-private partnerships can be a an efficient business model for water
12 system operations, experience has shown that true costs must be clearly
13 understood by both parties. That does not appear to be the case in this instance.
14 **Q. What is your conclusion regarding Veolia's contract with Nashua?**
15 A. My conclusions are as follows. First, the procurement process employed by the
16 City and its consultant differed materially from those employed by most cities that
17 have achieved successful public-private partnerships. Second, the contract differs
18 substantially from what was described in the City's RFP and in Veolia's response
19 to the RFP. Third, the savings calculations developed by the City's consultant
20 inexplicably left out a number of important cost items, all of which are normally
21 included in a city's service options analysis. Failure to include these costs
22 violates the basic analytic standards for assessing the benefits of public-private

1 partnerships, and properly including them appears to reverse the calculated

2 balance of benefits and undermines the findings of the City's consultant.

3 **Q. Does that conclude your testimony?**

4 A. Yes, it does.