

ORIGINAL

N.H.P.U.C. Case No. DW 10-141

Exhibit No. Staff Adv II

Witness: Mark Naylor

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**STATE OF NEWHAMPSHIRE
PUBLIC UTILITIES COMMISSION**

DW 07-105

In the Matter of:
Lakes Region Water Company, Inc.
Investigation into Quality of Service

Direct Testimony

of

Mark A. Naylor
Director of Gas & Water Division

October 14, 2011

1 New Hampshire Public Utilities Commission

2 Lakes Region Water Company, Inc.

3 DW 07-105

4 Investigation into Quality of Service

5 Direct Testimony of Mark A. Naylor

6

7 **Q. Please state your name, occupation, and business address.**

8 A. My name is Mark A. Naylor. I am Director of the Gas & Water Division at the New
9 Hampshire Public Utilities Commission. My business address is 21 South Fruit Street,
10 Suite 10, Concord, New Hampshire. My experience and qualifications are attached to
11 this testimony as Attachment MAN-2.

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

13 A. This docket was opened in September of 2007 in order to investigate the quality of
14 service provided by Lakes Region Water Company, Inc. (Lakes Region). The purpose of
15 my testimony today is to provide Staff's recommendation with respect to concluding this
16 investigative docket. There has not been any discovery with respect to the matters raised
17 in this docket for a considerable length of time, as the parties to this docket have been
18 engaged in review of the company's current rate case, DW 10-141. From May of this
19 year until recently, the Staff and parties engaged in comprehensive settlement discussions
20 regarding all pending matters with Lakes Region, but materials developed in that effort
21 are not available for use as they are considered confidential.

1 **Q. Please summarize the activity in this docket since the Commission last took evidence**
2 **in this matter.**

3 A. On July 25, 2008, the Commission issued its Order No. 24,877 approving a settlement
4 agreement dated May 7, 2008 (the settlement agreement) entered into between Lakes
5 Region and Staff. The settlement agreement contained a number of requirements for
6 Lakes Region to meet, including addressing issues with its managerial and technical
7 capabilities, moving ahead with new financing and recovery of capital improvements,
8 and the establishment of a monitoring process for Staff and the parties to discuss current
9 issues with the company on an ongoing basis and to review and monitor the status of the
10 company's compliance with New Hampshire Department of Environmental Services
11 (DES) requirements. Staff and the parties met nine times in technical sessions between
12 June 24, 2008 and September 24, 2010 to monitor the company's activities. These
13 technical sessions were suspended and subsumed into Lakes Region's rate case, DW 10-
14 141, after that case was filed in 2010. Reports of all of these meetings have been filed
15 with the Commission in this docket.

16 **Q. What is the status of Lakes Region's rate case at this time?**

17 A. The Commission approved temporary rates in its Order No. 25,196 issued February 18,
18 2011. These temporary rates are set at a level 18.51% higher than the company's
19 previously approved rates. The parties completed discovery on permanent rates prior to
20 the request of all parties to suspend the schedule for comprehensive settlement
21 discussions. Permanent rate testimony is being filed today, with Staff's recommendation
22 being provided by Staff Analyst Jayson Laflamme.

1 **Q. Please describe the major issues that continue to face the company.**

2 A. While the company has made progress in addressing some of the problems it has had
3 with its physical water systems, the company's most urgent problem is financial. Lakes
4 Region has capital needs going forward over the next several years in excess of \$1
5 million. This total does not include new infrastructure needed to enhance system
6 capacity at the company's Paradise Shores system. This water system provides water on
7 a wholesale basis to the neighboring Suissevale system by way of a special contract
8 approved by the Commission in 2006. Lakes Region currently uses wells located on the
9 "Mount Roberts" property, owned by its shareholders, for emergency purposes. A letter
10 from DES Staff is attached as Attachment MAN-1 which provides current information on
11 the status of this property and the wells located thereon. It appears the company will
12 need additional funds to comply with the requirements contained in this letter if it wishes
13 to use these wells again in the summer of 2012. At issue is the fact that the company
14 does not appear to have access to the needed capital, at rates reasonable or otherwise. As
15 mentioned in the testimony of Staff witness Laflamme, Lakes Region has turned down
16 the opportunity to obtain low-cost financing through the State Revolving Loan Fund in
17 both 2009 and 2010. While the company's stockholders have contributed new equity
18 capital in the last two years, it has not been nearly enough when considering all of the
19 current and future needs. As a result of the company's continuing critical need for
20 capital, the company's current cash flow situation is very poor. The Commission Audit
21 Staff completed an audit of the company in February of this year, based on the
22 company's test year for the rate case. That audit revealed that the company's accounts
23 payable as of the end of the test year was in excess of \$350,000, with nearly 70% of that

1 balance over 90 days past due. This is an exceptionally high level of payables for a
2 utility with annual revenues of just under \$1 million in its 2009 test year.

3 **Q. Given that the test year for the rate case was the calendar year ending December 31,**
4 **2009, what is the company's current financial status?**

5 A. The company's financial status has deteriorated. In spite of three step adjustments
6 approved by the Commission in Docket No. DW 08-070, and the increase in rates granted
7 for temporary rates in DW 10-141, the company's cash flow situation continues to
8 worsen. According to the company's 2010 Annual Report, its accounts payable was in
9 excess of \$471,000 at the end of 2010.

10 **Q. What are the primary causes of the company's poor financial condition?**

11 A. It is a combination of factors that has led the company to this point. These factors
12 include a \$110,000 fine obligation from the court system related to the Tamworth well
13 situation that has been documented earlier in this proceeding. The company is making
14 monthly payments of \$3,060. A second factor is the ongoing need for substantial
15 amounts of new capital to make improvements and upgrades to the company's water
16 systems. Since the end of 2006 the company has increased its balance of plant in service
17 by over \$1 million, or 33%. As mentioned, it will need more than \$1 million more in the
18 next several years. A third factor in the company's poor financial situation is that the
19 company is not structured to request and receive timely rate relief for its capital projects.
20 It has never engaged in a comprehensive planning process by which it acquires capital,
21 deploys it, and timely obtains rate relief. The company has been unable to transition
22 from a small family-run operation, one with relatively limited capital needs, to one that

1 must acquire and deploy larger amounts of capital with a minimum of lag time. Only in
2 the monitoring phase of this docket has the company been conducting a more
3 comprehensive review of its system needs. The company has not had the in-house
4 capability to manage its business affairs and react quickly. Staff has urged the company
5 in the last few years to consider a qualified business manager; instead, to this day, the
6 company still relies on consultants. That reliance, in Staff's opinion, has proven costly
7 and largely ineffective.

8 **Q. How will the company address its pending capital needs if it is in such poor financial**
9 **condition?**

10 A. This is a question that needs to be asked of the company. It is the company's
11 responsibility to provide safe and adequate service, and if it needs substantial amounts of
12 capital in order to do so, it must have the capability of acquiring it. It is Staff's
13 observation that it no longer has this capability.

14 **Q. If Lakes Region cannot access the capital it needs, what does Staff recommend?**

15 A. Absent a comprehensive plan for getting the company stabilized financially, including a
16 demonstration that the company has access to the amount of capital it needs now and in
17 the next several years, Staff recommends that the company seek a qualified buyer and sell
18 its utility assets.

19 **Q. Does this conclude your testimony?**

20 A. Yes it does.