

DW 00-167

CENTRAL WATER COMPANY

Review of Short-Term (one year) and Long-Term (five year)
Proposals for Necessary Capital Improvements

O R D E R N O. 23,708

May 18, 2001

APPEARANCES: For Central Water Company, Mary Ellen Goggin, Esq.; For Locke Lake Colony Association, Joanne Hager; Larry S. Eckhaus, Esq. for the Staff of the New Hampshire Public Utilities Commission.

I. PROCEDURAL HISTORY

On October 25, 1999, the New Hampshire Public Utilities Commission (Commission), in Docket DR 98-128, issued Order No. 23,326 approving an increase in the permanent rates of Central Water Company (Central or the Company). In addition, the Commission ordered the Company to file, no later than January 31, 2000, a plan setting forth the Company's short-term (one year) and long-term (five year) proposals for necessary capital improvements and retirements, the estimated dates on which the capital improvements are expected to be completed, the Company's best estimate of the potential rate impact of such improvements and retirements, the steps the Company will take to reduce its operating expenses, financing costs, and cost of service, the potential of selling the system to a larger water utility and related impacts thereof, and compliance with the recent Staff Audit of

the Company. The Commission also ordered that a hearing be held, no later than April 30, 2000, to consider the Company's plan and whether the system should continue under the Company's management or be transferred to another, larger utility. On January 31, 2000, the Company, in Docket DR 98-128, filed a Capital Improvement Plan, Preliminary Year 2000 Profit Plan, Statement on Potential Sale of System and Letter to the Commission's Chief Auditor and Finance Director on compliance with Rate Case Audit. Since that time, the Company and Commission Staff (Staff) had several teleconferences to discuss the filing. On March 23, 2000, the Company provided responses to questions raised during one of those sessions. In one of those responses, the Company indicated that it had retained Lewis Companies to conduct a follow-up study (Lewis Study) to determine the best combination of supply and storage in order to meet the requirements of WSPCD Administrative Order No. 91-10. After many delays, Staff was told, at the May 26, 2000 teleconference, and by letter dated May 16, 2000, that the study would not be concluded until some time in July, 2000. Although the Company and Staff had hoped to meet in time for a hearing to be held on April 30, 2000 as required by the Order, conflicting schedules and the pending engineering study made that impossible.

On May 10, 2000, the Company and Staff requested additional time in which to meet and attempt to resolve the issues addressed in the Order. To that end, the Company and Staff held a teleconference on May 26, 2000. Staff agreed to inform the Commission of the progress that had been made, and anticipated scheduling a hearing no later than June 23, 2000. On June 23, 2000, Staff informed the Commission of progress to date, hoping to schedule a hearing for mid-August, 2000.

On August 11, 2000, the Commission issued an Order of Notice that ordered Central to file copies of the Lewis Study with the Commission no later than August 25, 2000, and that established a hearing on September 28, 2000 at 10:00 a.m.

On September 21, 2000 the Company filed an Assented-to Motion to Postpone and Reschedule the September 28 hearing. The Commission granted the Motion and rescheduled the hearing for November 7, 2000.

On November 7, 2000, at 10:05 a.m. the hearing was conducted.

II. POSITIONS OF THE PARTIES AND STAFF

A. Locke Lake Colony Association

Joanne Hager, on behalf of Locke Lake Colony Association, stated that Central Water customers are paying the highest water rate in the State of New Hampshire, and that

the engineering study suggests an amount of work to be done that would create an enormous impact on rates. She indicated that an average family of four is paying a little more than \$600 per year for a conservative 5,000 gallons per month consumption. For the existing rate to escalate higher would be devastating to the community.

Through July 4th, 2000, the community has had adequate water with relatively few complaints. Occasionally, when lines must be bled, dirty water is experienced. Basically, the service has been fine. In closing, Ms. Hager indicated that these customers cannot afford to pay more for their water service.

B. Central Water Company

At hearing, Central presented two witnesses, Stephen St. Cyr and Raymond Seeley.

Mr. St. Cyr, of Stephen P. St. Cyr and Associates, serves as the Company's accountant. He indicated that he had prepared the Company's Year 2000 Profit Plan, which consists of a projected income statement as well as a number of assumptions. Mr. St. Cyr listed the following assumptions:

- 1) the Company provides safe and reliable water,
- 2) the Company operates within the revenue requirement as established in its last rate proceeding,
- 3) the Company meets its current

obligations on time, 4) the Company begins to pay some of its past due obligations, 5) the Company requires a two or three year period operating under the recently approved rates before it commits to new debt or equity to fund any significant improvements, and 6) the Company anticipates that future replacements and improvements will be at a rate of about \$20,000 in 2000, gradually increasing to \$30,000 annually in 2004, and such improvements will be primarily for main replacements and other distribution plant.

Mr. St. Cyr described the Company's Year 2000 Profit Plan, and a number of associated financial objectives. Among these are reduction of payables, maintenance of operating expenses within the level established by the Commission in the last rate proceeding, and steps taken by the Company to reduce operating and financing costs. He indicated that the Company had transferred one of the notes payable to Mr. Fischer along with the related accrued interest to Integrated Water, in consideration of amounts owed to Central. He also indicated that the Company had recently filed for permission with the Commission to refinance an \$80,000 note to Mr. Fischer, which would improve the Company's cash flow as a result of more favorable terms and the forgiveness of accrued interest on that note. Mr. St. Cyr stated that the Company's profit plan

was working well through three quarters of 2000, but that certain one-time events in the fourth quarter would impact earnings for the year. On an overall basis, the Company's earnings were slightly below those projected through September.

With respect to the Company's proposals for short-term and long-term capital improvements, Mr. St. Cyr indicated that Central would proceed with improvements within the budget constraints as described earlier, and that the Company would also seek grants to the extent available. He described the Company's preference for on-going capital needs as being, first, internally generated funds; second, grant funds; and third, State Revolving Loan Funds (SRF).

Mr. St. Cyr addressed the issue of sale or transfer of the Company to a larger water utility. He indicated that he had reviewed the Company's income statement as a way of evaluating whether or not a larger company could generate savings and provide reliable water service to Central's customers at lower rates. Mr. St. Cyr felt that in many areas such as electric, water testing, regulatory expenses, and others, the costs would be the same. In terms of maintenance expenses, he felt that some costs would actually be higher: he

assumed that a larger company would pay more and provide more costly benefits to its employees. The area of greatest potential for savings, in his opinion, is in Administrative and General expenses. Mr. St. Cyr felt that a larger company would likely have accounting and computer systems in place that could offer savings over what Central now expends in those areas. In addition, A & G savings might be achieved in legal expenses. And even recognizing some offsets to those potential savings, by way of allocation of the larger company's existing costs to Central, he conceded there would likely be some savings to customers overall. In his opinion, however, he believes such savings would be relatively small.

Mr. Seeley, President of Central Water Company, provided testimony with respect to a number of operational areas of the Company. He described the overall condition of the Company's production and distribution system, the Company's relationship with DES, and the so-called Lewis Study. The Lewis Study was completed recently in order to evaluate the condition of the water system and to make recommendations for prioritizing future capital improvements. Mr. Seeley indicated that the Lewis Study contained recommendations for approximately \$1.5 million in improvements. Of that amount, about \$787,000 was recommended

for the distribution system, with the focus primarily on main replacements along Varney Road, the main artery through the Locke Lake franchise area. Mr. Seeley also discussed the Capital Improvement Plan 2001, which is Exhibit 7 in this proceeding. He indicated that it primarily relies on internally generated funds and avoids any new borrowing, because Central's customers have objected to higher rates that would result from new significant projects. Mr. Seeley discussed the potential use of State Revolving Loan Funds (SRF) for improvements, indicating that such funding would also require shorter depreciation lives for the affected assets to match the loan pay-back period of 20 years. He also related discussions he had with Barnstead Selectmen with respect to the potential for other forms of grant monies which may be available, since the Town has indicated a desire to repave Varney Road. Mr. Seeley also indicated that, in addition to distribution improvements, production and storage improvements were recommended in the amount of approximately \$600,000. Mr. Seeley went on to provide the rate impacts of the recommended improvements in the Lewis Study. He suggested that if all the recommended improvements were completed, with either internally generated funds or State Revolving Loan funds, the annual per-customer impact would be \$217.68.

Mr. Seeley then discussed the overall financial situation of the Company. He indicated that it was his opinion that Central's financial circumstances had improved over the past year. He explained that the Company has been more restrained in committing funds for improvements to the system, recognizing that it could not be brought up to standard in a short period of time. He discussed the company's town property tax situation, indicating that the Company was in no danger of losing its property because of unpaid tax bills. Mr. Seeley also indicated that the Company had spent approximately \$150,000 on professional fees in recent years, and although those expenses were necessary, he pointed out that the system would have been much better off if those funds had been committed to system capital improvements.

Mr. Seeley also discussed the issue of another larger water utility purchasing the system at Locke Lake. He indicated that it was his belief that it was a misconception that rates would be substantially lower due to the level of improvements still needed in the system. In addition, his company has learned a lot about the system since owning it and such knowledge would need to be re-learned in a new company. He pointed to the Company's rates as being quite high, but

also pointed out that the seasonal nature of the franchise area caused the rates to be somewhat higher since year-round usage varies considerably. On a year-round comparison, Mr. Seeley insisted that customer bills on an annual basis would only be 12th highest among the state's regulated water companies. Mr. Seeley stated that he felt that the Company had made considerable progress recently, that the financial situation had improved and that Central would continue to improve the system as its finances allowed.

C. Staff

Staff did not present any witnesses, instead they cross-examined Central's witnesses and presented a closing statement. Staff questioned the Company's witness Mr. St. Cyr with respect to his analysis of cost savings that could be achieved through the sale of the Company to a larger entity. Staff also asked about the Company's Profit Plan 2000, and some of the assumptions contained in it. In addition, Staff asked about the repayment of the Company's liabilities, and the progress that has been made in reducing past-due balances. Staff also asked about the inter-company payables, and why Central Water had loaned funds to affiliated companies when it was having problems paying its own bills.

In cross-examination of Mr. Seeley, Staff asked about the Company's rates, and where they stand relative to other utilities in New Hampshire. Staff also asked follow-up questions to Mr. Seeley's direct testimony about whether the Company had ever been approached to sell to a larger utility. In addition, Staff inquired of Mr. Seeley about Central's property tax situation with the Town of Barnstead. Mr. Seeley indicated that progress has been made in paying the taxes, but that tax liens still exist for the 1998 and 1999 years.

Staff then asked a series of questions about the Lewis Study. Particular focus was on the unaccounted-for water that was noted in the report. Staff asked about the leak detection efforts of the Company, and how that issue was being addressed. Staff asked further questions about the recommended improvements in the Lewis Study, and the Company's position with respect to the potential for implementing those improvements.

In its closing statement, Staff indicated that it felt that the Company had made some progress in its ability to provide safe and adequate service to its customers. Staff recommended that the Commission continue to monitor this company closely, in order to ensure that improvements occur as they should. In addition, Staff stated that the Company should continue its leak detection efforts, and it should provide its financial reports to the Commission on a quarterly basis. Staff noted that the issue of loans to affiliated companies was problematic because the Company was incurring late charges from its other vendors.

III. COMMISSION ANALYSIS

The challenges faced by this Company are many. We recognize that the water system purchased by Central in 1993 needed significant repairs at that time, and we understand

that the Company has worked to improve service reliability to its customers. However, it is clear that there remains much to be done.

First, with respect to Central's financial situation, we recognize that some improvement has been made. It appears that the Company's payables balances have been reduced, and that the Company is not in immediate danger of losing its property due to unpaid property taxes. Clearly, however, there is a need to operate profitably on a continuous basis. It concerns us greatly when we see a utility that is unable to pay its bills, including payments on some of its notes payable. We understand that Mr. Fischer, one of the note holders, is a related party, and that appears to be the reason this Company has not been foreclosed upon. But this reflects a precarious situation indeed. Central must live within the revenue requirement established in its last rate case. It does not appear to have done so at any time since it was first franchised in 1993, and this has created the cash flow problems for Central.

This situation has been exacerbated by intercompany loans and/or advances to Integrated Water, its parent, and other affiliates. Central must cease this practice immediately. It is a poor reflection on management when the

Company is providing loans or advances to affiliates while it is subject to tax liens due to outstanding property taxes, not to mention the cash needs to make system improvements. Such loans or advances must cease immediately, and we will require the Company to begin demanding repayment of those amounts. We can think of no reason why this Company must prepay its management fee, or provide loans to affiliated entities when it needs cash as badly as it does.

In terms of the Company's reporting to this Commission, we accept the recommendations of the Staff with respect to frequent monitoring. We will require the Company to file reports with this Commission on a quarterly basis beginning June 30, 2001. These reports are due no later than 45 days following the close of the quarter, and will allow our Staff to monitor Central on a more detailed level. We will require the Company to provide an income statement and a balance sheet, as well as an accounts payable aging. In addition, we will require the Company to provide a report on the inter-company receivables, and we expect to see progress on repayment.

With respect to engineering and system improvements, we believe the Company must first seek the input of the Department of Environmental Services (DES) regarding the

system's demand basis, adequacy of supply, and atmospheric and pressure storage requirements. Our Staff has reviewed the Lewis Study and indicates that this input is needed before final priorities can be set. The Company in its Capital Improvement Plan 2000 (Ex. 1) provided for \$20,000 out of its cash flow for improvements including the Lewis Study, gradually increasing to \$30,000 annually in 2004 as related by Mr. St. Cyr at hearing (Tr. at 36). Mr. Seeley discussed the possibility of grants or low interest loans such as SRF, and we direct the Company to first pursue grants such as Community Development Block Grants (CDBG) to avoid rate impacts to the customers. We would encourage the Company to engage the assistance of Locke Lake Colony Association in this regard. However the Company ultimately funds the necessary improvements, we believe based on the Lewis Study and input from our Staff that a formal leak detection survey, as well as moving toward the Varney Road main replacement, needs to be strongly considered in setting priorities going forward.

To those ends, we also will direct Central to comply with additional reporting requirements as follows:

Monthly

- 1) production, consumption, and lost water
- 2) leak detection man-hours expended

- 3) leak repair man-hours expended
- 4) number of leaks repaired
- 5) Form E-14, Report of Pressure Complaints
- 6) Form E-16, Report of Water Meter Complaint Tests
- 7) Form E-18, Report on Interruptions of Service Over 30 Minutes Duration

Quarterly

- 1) Line item listing of all system repairs and/or improvements completed by location during the quarter
- 2) Other progress on Lewis Study improvements during the quarter, including progress toward obtaining grant funding
- 3) Capital improvements planned for the coming quarter
- 4) The cumulative amount spent on capital improvements v. the amount anticipated by Exhibit 7, for the quarter and cumulative from January 2001 to date of report
- 5) Status of DES input on the four issues identified above, until finalized

Annually

- 1) Form E-15, Annual Report of Water Meter Tests

As a number of projects are itemized in the Lewis Study without cost estimates being provided, we direct the Company to provide those estimates within 45 days of the date of this Order.

These reporting requirements are intended to continue to focus management's attention on the important issues it faces with respect to system maintenance and improvement. We expect to see progress and improvement in all areas of the Company's operations. We will direct our Staff to report on the Company's financial picture and the status of improvements on the two-year anniversary of this Order, and we will determine at that time whether the Company has made sufficient progress or whether fines, penalties or receivership may be appropriate. Additionally, we place the Company on notice at this time that fines and/or other penalties may be imposed in the future for non-compliance with all directives in this Order, as well as with rules of this Commission.

Based upon the foregoing, it is hereby

ORDERED, that Central Water Company, Inc. begin quarterly financial reporting to this Commission, effective June 30, 2001, such reports due no later than 45 days following the close of each quarter, to consist of an income statement and a balance sheet, an aging of accounts payable, and a report on progress made with respect to inter-company receivables; and it is

FURTHER ORDERED, that Central immediately work with

our Staff and the Staff at the Department of Environmental Services, to priortize system improvements as detailed in this Order; and it is

FURTHER ORDERED, that Central seek grants and loans as discussed in this Order, in order to minimize future rate impacts to customers; and it is

FURTHER ORDERED, that Central provide reports on a monthly, quarterly and annual basis as set forth in this Order, in order that this Commission can gauge progress with respect to leak detection efforts, system improvements planning, and other operational matters; and it is

FURTHER ORDERED, that Commission Staff, on the two-year anniversary of the date of this Order, provide us with a report on the Company's financial picture and status of improvements.

By order of the Public Utilities Commission of New Hampshire this eighteenth day of May, 2001.

Douglas L. Patch
Chairman

Susan S. Geiger
Commissioner

Nancy Brockway
Commissioner

Attested by:

Claire D. DiCicco
Assistant Secretary