

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

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

Docket No. DW 04-048

REVISED DIRECT TESTIMONY OF DONALD L. WARE

February 27, 2006

1 **Q. Mr. Ware, have you previously provided testimony in this proceeding?**

2 A. Yes. I submitted testimony on January 12, 2006.

3 **Q. What is the purpose of this additional testimony?**

4 In its Order No. 24,567, the Public Utilities Commission allowed the City of Nashua to
5 submit new information concerning the City's plans to use a third party contractor to
6 operate the water systems now owned by Pennichuck Water Works (PWW). The PUC
7 imposed a very short timeframe for discovery on that additional testimony and for PWW
8 to submit responsive testimony. As it turns out, Nashua is actually proposing to use four
9 different outside contractors—Veolia, R.W. Beck, Tetra Tech and Dufresne-Henry—to
10 operate the PWW systems if it is ultimately successful in its eminent domain efforts. In
11 addition, at the February 21, 2006 technical session, the City's consultant, George
12 Sansoucy, indicated that the City is considering contracting out the billing and collection
13 function, rather than retaining it as previously indicated by the City in its submissions to
14 the Commission.

15 Because of the enormity of the task of conducting discovery on the four very large
16 companies identified by Nashua, the nature of their relationship with Nashua and their
17 track record, if any, of operating similar systems under this type of arrangement, I am
18 limiting my comments at this time to Veolia because that company is being put forward
19 by Nashua as the lead operator of the water systems the City seeks to take from PWW.
20 This testimony will set forth what we have learned about Veolia's track record in other
21 communities in the United States where it has done business. In addition, Mr. John
22 Joyner of Infrastructure Management Group will provide his analysis of the proposed
23 contract between Nashua and Veolia, and I, in contemporaneously-filed testimony, will

1 discuss how the arrangement with Veolia compares to the service that customers receive
2 today from PWW.

3 I should stress that because of the time constraints imposed by the procedural schedule
4 established in Order No. 24,567 and a lack of cooperation or delayed responses from
5 Nashua, PWW has not yet had an opportunity to complete its investigation of Veolia and
6 the other contractors that the City proposes to engage, but I will discuss what we have
7 found thus far. I or other witnesses for PWW will certainly update this testimony at a
8 later date based on what we are able to determine once Nashua has responded to all of
9 our data requests regarding Veolia and once they have made all of the requested
10 witnesses available and we have had a chance to complete our own investigation
11 regarding Veolia's track record in other communities.

12 In addition, I have reviewed the contract between Veolia Water North America -
13 Northeast, LLC ("Veolia" or "VWNA") and Nashua for operation of the Pennichuck
14 Water Works water systems that Nashua submitted to the Commission on January 12
15 and wish to discuss some concerns regarding that proposal. I have also reviewed the
16 R.W. Beck oversight contract submitted to the Commission by Nashua on January 12.

17 **Q. The City has proposed to contract with Veolia Water North America—Northeast,**
18 **LLC ("VWNA"). What is this entity?**

19 **A.** VWNA is an operating subsidiary of Veolia Environnement, a very large French owned
20 company that is publicly traded on the Paris Bourse, the principal French stock exchange.
21 Veolia Environnement is the former water industry business of Vivendi Universal, which
22 used to own approximately 15% of Philadelphia Suburban Corporation ("PSC"). This is
23 the very same business that Nashua complained so loudly about in 2002 at the time of the

proposed merger of PSC and Pennichuck Corporation. When it was part of Vivendi, Veolia Environnement was known as Vivendi Environnement, but in 2003 the company changed its name. It is French controlled, with headquarters in Paris. The business that is conducted today by VWNA was known as US Filter when it was owned by Vivendi. Included as Attachment DLW-5A to this testimony is some basic background corporate information regarding Veolia Environnement and how VWNA fits in that was obtained from Veolia's filings with securities regulators.

Q. How does the French ownership of VWNA relate to the issues in this proceeding?

A. As I noted above, the City itself protested in 2002 that the merger of Pennichuck Corporation with PSC could mean the shifting to far away places of management of the water system. At the time, "far away" meant Philadelphia. (It is worth noting that, at the time of the PSC transaction, it had been publicly announced that Vivendi was in the process of selling off its entire interest in PSC.) Under the City's proposal, the decision as to how to staff and operate the water system will ultimately be made by people who are responsible to shareholders in France. The immense multinational company that these executives are responsible for managing for their French shareholders, owns or operates assets not just throughout the entire United States, but also in Europe, Asia and many other locations. In such a huge corporate structure, the needs of Nashua are likely to be of little significance and will not be a high priority. The City can be certain that VWNA will not provide resources or services that are not spelled out in the contract with the City without additional cost to the City. It is therefore quite likely that, to a far greater extent than Nashua has accused PWW, the interests of shareholders will guide the choices made by the contract operator. Unlike for Veolia, throughout Pennichuck's 150

1 year history Nashua has been, and for the foreseeable future will continue to be,
2 Pennichuck's largest "customer".

3 I should also note that the few individuals employed by Veolia who may be assigned to
4 live in or near Nashua as part of the relationship with the City will be people who are not
5 likely to be senior executive officers or other high level personnel in the overall Veolia
6 corporate structure, but rather will be individuals who can be changed over very easily
7 and quickly if they do not meet the goals of the larger corporate entity.

8 These concerns exist in such a structure because Nashua will be such a tiny part of the
9 overall Veolia economic framework. In fact, the staffing model that Veolia is using for
10 its agreement with Nashua shows that many of its operations will be located elsewhere.
11 Senior regional management, transitional services, accounting, human resources,
12 environment, health, safety and security will all be located in Norwell, MA. Information
13 technology will be located in Indianapolis. And payroll will be located in Houston. I
14 have included as Attachment DLW-5B (previously DLC-9) an excerpt from the
15 deposition of Robert R. Burton, a Veolia employee who has submitted testimony in this
16 proceeding. I am also including as Attachment DLW-5C (previously DLC-10), Exhibit
17 82 from that deposition.

18 **Q. What concerns do you have regarding the proposed contract between Nashua and**
19 **Veolia?**

20 **A.** I have a number of concerns relating to operational and cost issues. In particular, the
21 basic proposal does not include certain fundamental utility services or treats them as
22 extras to which additional charges will apply. As a result, the contract falls short of
23 providing the type of comprehensive approach to water supply and distribution and

customer service that PWW provides and makes it difficult at best to do a complete comparison between Nashua's proposal for operating the utility and PWW's current operations. Some of the most significant examples of this problem are as follows:

1. Unplanned maintenance – Under the contract between Nashua and Veolia, unplanned maintenance is not included in the basic annual fee. Under PWW's ownership and operation, unplanned maintenance is part of the company's operating budget and is included in the current rate structure. Based on PWW's historical costs, the cost of unplanned maintenance (such as broken mains, hydrant repairs, large meter testing, service box repairs and the like) is probably more on the order of approximately \$1,000,000. In fact, in its proposal even Veolia estimated this cost at a range of \$850,000 to \$1,150,000.
2. Management oversight – As the Commission is aware, Nashua proposes to engage R.W. Beck to oversee Veolia. The cost of Beck's work, estimated by Nashua at \$315,000 annually, is in addition to the costs incurred for Veolia. Under PWW's ownership, this type of oversight structure is not required and so the cost is avoided entirely.
3. Billing and collections - The Veolia base fee does not include the cost of the billing and collections function. The City has previously indicated that it planned to perform this function in-house, although I understand that City representatives have now stated that they may outsource this function to a third party contractor. The true cost for the City to provide this additional function is completely speculative at this time.

4. Customer service - The Veolia staffing model (DLW-5C) shows only two customer service employees to handle customer complaints and requests for service. PWW has at least a half dozen employees who field well over 10,000 calls a year from customers on a wide range of inquiries. This reduction in staffing can be expected to have a direct impact on responsiveness to customer concerns. In addition, as noted above, customer service related to billing and collection issues has been assigned to the City, while other customer service issues are the responsibility of Veolia. This is likely to lead to confusion for customers, fragmentation of service, and delays in responsiveness.
5. Purchased water - The City's revenue requirement analysis includes only \$100,000 for purchased water. However, PWW's purchased water needs for its customers in Milford, Amherst and Bedford totaled \$182,125.
6. Hydrant checks - The contract with Veolia does not provide for hydrant checks in accordance with the Insurance Service Organization (ISO) requirements which call for each hydrant to be checked two times per year, one wet and one dry check. This essential maintenance function insures that hydrants will work when required and accounts for 3% of a city's ISO rating. Instead of committing to comply with this standard, the Veolia contract only calls for hydrants to "be inspected on a regular frequency after report of an emergency leak." This is reactive not preventative maintenance. The cost of providing the two times per year hydrant checks required by the ISO in 2005 was \$23,967.
7. Permitting and police protection - The Veolia contract specifically excludes the cost of permitting and police protection associated with work in roadways.

1 Instead of covering these costs, the contract makes clear that they will be borne by
2 Nashua. Just the annual cost of police protection provided in Nashua to
3 Pennichuck during 2005 was \$12,417.

- 4 8. Power costs - Veolia's contract also excludes the cost of electricity and fuel,
5 which must be borne by the City. In performing his revenue requirement
6 analysis, Mr. Sansoucy has estimated the annual cost of electricity and heat at
\$500,000, but the actual amount spent on electricity and fuel in 2005 for PWW
8 was \$975,758 and PSNH's rates have increased substantially for 2006.

- 9 9. Labor expense - Veolia's labor costs, including benefits for construction and
10 maintenance projects (i.e., amounts to be billed separately to Nashua) are 30% to
11 40% higher than PWW's labor rates with benefits. (These costs are listed in
12 Exhibit E-1 and Exhibit H-1 to the proposed contract.) PWW's labor costs
13 already include substantial benefits to its employees, including pension and
14 retirement health benefits, and it is my understanding from the depositions of
15 witnesses made available by Veolia in this case that Veolia does not intend to
16 maintain these benefits for the workers it hires. This must mean that Veolia has
17 assumed high profit margins in its labor cost rates. Of even greater concern is that
18 it means that the amount of service provided by Veolia must be less than that
19 provided by Pennichuck if the same dollars are to be expended. Additionally all
20 of the "extras" that will be incurred by Nashua because of services that are not
21 included in the basic annual fee, such as unplanned maintenance, will cost more
22 for Veolia to perform than PWW due to these higher labor cost rates, so the

1 understatement of cost for unplanned maintenance could well be even greater than
2 I indicated earlier.

3 10. Dig Safe - Veolia's proposal does not provide any staff to perform Dig Safe
4 activities, presumably because the City is not obligated to belong to Dig Safe.
5 Setting aside the public safety issues that could be caused by failing to participate
6 in Dig Safe, it is likely that the City's failure to participate in this vital safety
7 service will result in numerous broken mains and services each year and the
8 consequent cost and customer disruption that results from lack of service and
9 colored water. PWW's expense for the Dig Safe program in 2005 was \$78,198.

10 11. CMMS - In its proposal to Nashua, Veolia touted its use of a computerized
11 maintenance management system ("CMMS") as a tool that would make their
12 operations efficient. PWW has used a CMMS package for over five years so
13 Veolia will gain no "operating efficiencies" over Pennichuck's current operations
14 by using a CMMS.

15 12. GIS - The Veolia proposal requires the City to provide a fully functional GIS
16 system. Currently, there is no GIS system for the PWW water systems, so one
17 would have to be developed. The cost of developing and implementing such a
18 system will cost the City in excess of \$1,000,000 to implement.

19 **Q. Do you have other concerns regarding the division of responsibilities between Veolia**
20 **and Nashua and how that may affect the quality of water service received by**
21 **customers?**

22 A. Yes. The contractual arrangement between Nashua and Veolia demonstrates some of the
23 problems and concerns that can arise in such a relationship that simply don't exist when

1 the owner and operator are one and the same. Aside from the issues raised by the
2 multiplicity of contractors and the significant potential for responsibilities to fall into
3 gaps between those relationships or for finger pointing to occur among the various
4 players, or for delay while the four contractors and the city attempt to figure out who is
5 responsible for any given task, there is the concern about whether any one party has
6 ultimate responsibility for meeting basic performance standards and how those standard
7 will be met. In the case of PWW, we are obligated on a day-to-day, ongoing basis to
8 provide safe, reliable drinking water service to our customers in a manner that meets all
9 applicable legal standards. The company itself is obligated to make such investments and
10 incur such expenses as are necessary to achieve that goal. Veolia, instead, is obligated
11 under Section 5.2(C) of the proposed contract with Nashua to meet applicable water
12 quality standards only if the raw water supplied to it by Nashua is "acceptable". PWW,
13 on the other hand, is obligated to sell water that meets all applicable standards, regardless
14 of the quality of the raw water. In order to achieve that, PWW must continuously
15 monitor and upgrade as necessary its water treatment processes to meet that critical
16 standard. If additional investment or expense is required, then it must undertake that
17 expenditure, and if it fails to do so in a timely and effective manner it is subject to
18 sanctions by the Public Utilities Commission and the Department of Environmental
19 Services.

20 **Q. Do you have concerns about Veolia's prior experiences operating public drinking**
21 **water systems and how that experience relates to the task of successfully operating**
22 **the many systems owned and operated by PWW?**

1 A. Yes. Based on information provided by Veolia during discovery, it is clear that the
2 systems operated by PWW are significantly different from the drinking water systems
3 that VWNA has previous experience operating. First, it is my understanding from
4 information provided by VWNA in discovery that, other than the Indianapolis system, all
5 of the systems operated by Veolia are far smaller than PWW. Second, Veolia does not
6 appear to have any experience operating a system that consists of a sizeable urban core
7 with many small outlying satellites scattered over a broad region. As indicated in my
8 prefiled testimony and that of Mr. Correll, PWW owns and operates 21 satellite water
9 systems throughout southern and central New Hampshire. In addition, PWW services the
10 31 satellite systems that are owned by Pennichuck East Utility. The successful operation
11 of these systems, including meeting the often significant water supply and distribution
12 challenges they pose, is something that few companies have mastered. As an example of
13 this problem, I need only point to the experience of Consumers Water Company here in
14 New Hampshire. That utility was very experienced and capable, but as they acquired
15 numerous satellite systems in southern New Hampshire, they could not meet the
16 challenges posed. The problems they encountered eventually lead to numerous service
17 quality problems and a very high level of customer dissatisfaction, not just in their
18 satellite systems but in their urban core system as well. Pennichuck, by comparison, has
19 had a very successful track record of operating satellite systems, including the former
20 Consumers New Hampshire systems. It should be apparent that the mere fact that Veolia
21 is a large company with some prior experience in managing water systems provides no
22 assurance that it will be able to successfully operate the many community water systems
23 owned by PWW. When one adds the complicated intertwining nature of the relationships

1 among Nashua, Veolia, Beck, Tetra Tech, Dufresne-Henry and possibly a sixth party who
2 would conduct billing and collection services in the future, it does not bode well for
3 meeting this challenge as efficiently and effectively as Pennichuck has done.

4 **Q. What can you tell us about the experience of the identified staff of R.W. Beck with**
5 **respect to the oversight of water systems?**

6 A. The three individuals who provided testimony on behalf of R.W. Beck--Stephen R.
7 Gates, Paul B. Doran and Jack M. Henderson--and who would be assigned to the Nashua
8 contract, all have no prior experience with the oversight of a third party drinking water
9 system contractor. Mr. Henderson only joined Tetra Tech in July 2004; Mr. Doran joined
10 Beck in December 2004 and Mr. Gates joined Beck in mid-2005. From their testimony,
11 it certainly appears that they do not have the insight into the types of problems likely to
12 be encountered in the treatment and distribution of water in a system as complex as that
13 of PWW. Also, based upon the response to Pennichuck's Data Request 3-2 to Nashua,
14 which is attached as DLW-5, Beck has no experience company-wide in providing
15 oversight to another private contractor for the operation of an entire public water supply
16 system (i.e. including distribution), and it has no experience in providing oversight to a
17 public operator of an entire public water supply system (i.e. including distribution).

18 **Q. What other concerns do you have about the City's proposed relationship with**
19 **Veolia?**

20 A. It is worth noting that Nashua has not entered into a legally binding relationship with
21 Veolia or any of its other contractors. In fact, although the City claims that its ability to
22 operate the water system should be judged based on the abilities of the four contractors it
23 has now identified, all of those relationships can be changed at any time and there is

1 absolutely no assurance that those contractors will be the ones that the City ultimately
2 engages. In fact, there is nothing to stop the City from deciding not to use a contractor at
3 all and operating the water system itself even though it has told the PUC that it will not
4 do so. At this point, the City does not have a binding contract with Veolia, but rather just
5 a form of agreement that presents an initial proposal of sorts. Aside from their ability to
6 change provisions that are set forth in the contract that has been submitted to the
7 Commission, there remain unfilled terms in the draft contract for items such as unit costs
8 and job task times. (See, for example, the Veolia contract included as Attachment B to
9 the testimony of Philip G. Ashcroft et al, Appendices E and H, submitted by Nashua on
10 January 12, 2006 and the excerpt from the deposition of Paul Doran attached as DLW-5D
11 – previously DLC-11) As a result, PWW and the other parties to this proceeding have
12 been put in the position of having to respond to a moving target. The fact that PWW and
13 the Commission must analyze a moving target was further confirmed by Nashua just last
14 week at the February 21 technical session, where Nashua's representatives stated that
15 they believe they are free to change their proposal as the case goes forward to respond to
16 failings that are identified by PWW or other parties. This further confirms what PWW
17 has said since the beginning of this proceeding, which is that Nashua is undertaking this
18 proceeding as a means of "kicking the tires," rather than because it has a well thought out
19 plan for operating the utility.

20 **Q. Have you conducted an independent investigation of Veolia's track record in other**
21 **communities?**

1 A. At the request of PWV, research was conducted regarding Veolia's record throughout
2 the United States. Some disturbing themes arose, which I think are worth sharing with
3 the Commission.

4 **Q. What were those themes?**

5 A. One is that, in order to do business with governmental entities, Veolia necessarily has to
6 look for ways to gain as much access as possible to the governmental officials making the
7 procurement/contracting decisions. Unlike what happens with operation of a water
8 system by an investor owned utility, an outside contractor such as Veolia needs to focus
9 extremely heavily on a governmental relations effort as part of its plan to obtain and
10 maintain its position as an outside contractor. Often this is likely to mean sending many
11 individuals into a community to build relationships with officials. That type of
12 relationship can create many risks if the contractor does not practice the highest level of
13 business ethics. In such cases, the potential for improper conduct and relationships,
14 rather than making decisions strictly on the merits, is great. In at least two cases we have
15 found to date in the U.S.—Bridgeport, Connecticut and New Orleans—Veolia employees
16 were convicted of making illegal payments to government officials. (The criminal
17 conduct in Bridgeport involved an employee of Professional Services Group, a prior
18 name for VVNA's current business.) In addition, in Rockland, Massachusetts, a town
19 employee and a Veolia employee jointly pilfered cash set aside for capital improvements
20 to the sewer treatment plant which Veolia operated for the town. Included with my
21 testimony as Attachment DLW-5E (previously DLC-12) is some of the supporting
22 information that we have found to date regarding such situations.

Another theme we found was that of troubled relations with employees. Such problems are not surprising given the pressure that Veolia frequently faces to meet the cost projections and contractual fee arrangements it must agree to in order to win municipal contracts. Examples of labor issues at Veolia water systems that we have found to date are those in Indianapolis and in New Bedford, Massachusetts. On a related and perhaps more troubling note, we found that the City of Angleton, Texas terminated its contract with Veolia because of lack of performance and sued the company for breach of contract. The City claimed that Veolia had failed to maintain adequate staffing levels, did not submit annual capital budget reports as required, and improperly charged expenses to the maintenance and repair budget that was funded by the City. (Attachment DLW-5F, which was previously DLC-13, provides some of the documents that we found that refer to these situations, all of which involve underlying labor problems.) Interestingly, based on the contract submitted by Nashua in this case, it is clear that the City has failed to negotiate with Veolia to ensure even minimal protections for the 30 to 40 PWW workers that Veolia has indicated it wants to hire. Unlike in Indianapolis, where the city required that Veolia not lay off workers for two years, that it recognize the current labor union and that it assume the existing labor contract, here Veolia has made no promises to the many PWW unionized workers who enjoy hard-earned health insurance, pensions and retirement health benefits and whose assistance both the City and Veolia claim is so critical to a successful transition. The types of protections extended in Indianapolis are common practice in private operation procurement relationships. (I have included with this testimony as Attachment DLW-5G, a copy of Section 4.02 of the Veolia contract with Indianapolis, which was previously DLC-14.) In fact, Veolia has stated that if

PWW employees wish to join Veolia, it will offer them much less: no pension, no retirement health benefit and other cuts in an effort to “streamline” employee pay and benefits. (See the response to Data Request Staff DR 3-23 to Nashua attached as Attachment DLW-5H, which was previously DLC-15.) This would result not only in these employees receiving lower pay and benefits than do current PWW staff, but also less than the benefits of Nashua city employees. We have to assume that one result of a Nashua/Veolia takeover therefore could well be labor unrest in Nashua’s drinking water system.

A third theme we found was a lack of candor about quality of service issues in systems operated by Veolia. Problems in this regard have arisen in particular in Indianapolis, where (i) the labor union has alleged that Veolia management is not trustworthy, (ii) a number of non-union employees have brought suit alleging first amendment violations, (iii) the U.S. Attorney's Office is conducting an investigation into possible falsification of water documents, and (iv) an employee has brought suit claiming that he was fired in retaliation for speaking out on matters of public safety. Copies of documents relating to these matters are included with this testimony as Attachment DLW-5I (previously DLC-16), although I would note that to date Nashua and Veolia have refused to produce documents relating to some of these matters.

Q. Does that complete your testimony?

A. It does at this time. However, I should note that because of the extremely short timeframe that we have had to conduct discovery regarding Nashua's proposal to contract out the operation of the water system, the fact that there are still numerous depositions to be taken, including those of Nashua staff concerning its proposed operation of water

1 billing and collections, and the fact that we are still awaiting responses to various
2 requests for information, I expect to supplement this testimony at a later date. In
3 addition, as we obtain additional information from Veolia and Nashua in response to our
4 discovery requests and we are able to conduct our own investigation of the problems
5 Veolia has had in other parts of the country, I may supplement this testimony with
6 additional information.