OCA Exhibit 1

BEFORE THE STATE OF NEW HAMPSHIRE

PUBLIC UTILITIES COMMISSION

In the matter of:

Aquarion Water Company of New Hampshire, Inc.	)
DW 12-085	)
Permanent Rate Case	)

Direct Prefiled Testimony

Of

Donna L. McFarland
On behalf of the NH Office of the Consumer Advocate

Dated: **January 11, 2013**

I. Introduction

Q. Please state your name and business address.

A. My name is Donna L. McFarland. I am employed by the New Hampshire Office of Consumer Advocate (OCA) as the Finance Director. My business address is 21 South Fruit Street, Suite 18, Concord, New Hampshire.

Q. Please describe your duties as Finance Director and provide information about your professional experience and education.

A. I am responsible for participating in proceedings at the New Hampshire Public Utilities Commission (Commission), including performing analysis of utility filings. In this context, I identify and investigate financial and ratemaking issues, and draft discovery and testimony. I joined the OCA in 2011, and this is the first time that I have testified before the Commission. I have actively participated in all other phases of adjudication in many dockets at the commission.

Prior to the OCA, from 2007 through 2011, I was employed as a Financial Auditor with the New Hampshire Legislative Budget Assistant – Audit Division. My duties involved auditing the financial statements of New Hampshire agencies, boards, and commissions in accordance with Government Auditing Standards. In 2006, I graduated from Southern New Hampshire University with a Bachelor of Science degree in Accounting. During the course of my career, I have obtained numerous continuing education credits in accounting, auditing, and finance. For example, I attended the National Association of Regulatory Utility Commissioners Annual Regulatory Studies

Program sponsored by New Mexico State University in 2011. DLM-1 contains a more detailed summary of my education and experience.

II. Purpose of Testimony

Q. What is the purpose of your testimony in this case?

A. The purpose of my testimony is to provide information and the OCA's recommendations related to the costs of employee compensation and benefits included in the permanent revenue requirement proposed by Aquarion Water Company of New Hampshire (Company); and the costs of services provided by an employee of a Company affiliate. In addition, I provide the OCA's recommendation for the filing of a cost of service study in the Company's next rate case.

Q. Did you review the testimony and exhibits filed by the Company in this proceeding?

A. Yes. I also reviewed numerous responses to discovery requests and other documents related to the Company, its affiliates and proceedings in other jurisdictions.

Q. Please summarize your conclusions.

A. My conclusions are summarized as follows:

- Since its last rate case, the Company has increased employee wages by an unjust and unreasonable amount. The costs associated with these unsupported wage increases, as well as a number of other employee benefits, are included in the Company's proposed revenue requirement for recovery from customers. During the time of these significant wage increases, the Company's customers lived through financial crises and economic recession. These circumstances along with the information provided by the Company about these wage increases do not support a conclusion that the wage increases proposed by the Company – as well as the proposed rates resulting from including the costs of the wage increases – are just and reasonable. Therefore, the Commission should permit the Company to recover through customers' rates only 50% of the total costs associated with the unsupported wage increases.

- The Company does not have an affiliate agreement with its Massachusetts affiliate, yet the Company included within its proposed revenue requirement the costs associated with a Massachusetts affiliate employee. These costs should not be recovered from customers absent an approved affiliate agreement between the Company and its Massachusetts affiliate.

- The Company has not analyzed its cost of service and rate design since 2005. Given the passage of time and other considerations, the Commission should require the Company to prepare and file a cost of service study in its next rate case.

III. The Company and its Permanent Rate Proposals

Q. Please describe the Company and its permanent rate proposal.

A. The Company is a regulated utility and a wholly-owned subsidiary of the Aquarion Water Company. The Aquarion Water Company, based in Connecticut, is wholly-owned by the Aquarion Company, which is owned by Macquarie Utilities, Inc. Aquarion Water Company also owns water utilities in Connecticut and Massachusetts. Testimony of Troy M. Dixon, Bates p. 81, lines 1 through 6, dated May 14, 2012.

The Company provides water service to approximately 9,100 New Hampshire customers in the towns of Hampton, North Hampton, and Rye, with 137 miles of water mains. Testimony of Carl McMorran, Bates p. 53, line 23, dated May 14, 2012. For the year ended December 31, 2011, the Company reported $5,969,630 million in revenues. Testimony of Dixon, Schedule 1, line 5. The Company has $26,383,788 in net utility plant. Testimony of Dixon, Schedule 3, p. 1.

The Company's last rate case concluded in September, 2009, with an increase of 18.14% to residential customer rates. Settlement Agreement (July 10, 2009), DW 08-098, Attachment A, p. 1. Since that time, through the Water Infrastructure and Conservation Adjustment (WICA) pilot program, these rates have increased by an additional 3.7269%. Order No. 25,311 (December 30, 2011), DW 11-328.

On May 14, 2012, the Company filed proposed changes to its rates based upon a twelve-month test year ending December 31, 2011. Testimony of Dixon, Schedule 1, line 5 (May 14, 2012). The Company originally proposed a permanent overall rate increase of 18.3%. Following discovery, the Company decreased the proposal to 17.71%. Staff 3-11, Attachment A (DLM-2) (excerpts only).

In addition, the Company requests Commission approval of the WICA pilot program as a permanent surcharge mechanism. The WICA proposal and other proposed changes to the Company's tariff are addressed in the separate testimony of Scott J. Rubin, filed on behalf of the OCA.

IV. Employee Wages

Q. Your first conclusion, stated above, relates to the just and reasonableness of the employee wage costs proposed by the Company. Before turning to the specific details of this conclusion, please describe the wage-related and other benefits available to the Company's employees.

A. The Company currently offers the following benefits and incentives to employees, in addition to wages:

- Wage Increases: Non-union employees are eligible for an increase on April 1st each year. See response to OCA 2-11 (DLM-3).[1] According to the Company wage increases are based on merit and cost of living increases. Id. Under the current contract, union employees were eligible for wage increases on December 1, 2011 (3%) and on December 1, 2012 (3.5%). According to the

[1] DLM-3 includes the Company's redacted response to OCA 2-11 and excerpts from the redacted version of OCA 2-11 Attachment B.

Company's response to OCA 2-13 (DLM-4),[2] the union contract expires on November 30, 2013.

- Vacation and Sick Days: Union employees, both full-time and part-time, are eligible for paid vacation and sick days after six months of service. Id.
- Employee Incentive Compensation: Non-union employees earn employee incentive compensation. OCA 2-10 (DLM-5). "The objectives of the Employee Incentive Plan are to incentivize employee behavior toward improving customer service and business performance goals and to attract and retain employees." Id. For employees meeting individual and team performance goals and measures, bonus amounts are based on a percentage of the employee's annual salary. See OCA 2-10 Attachment A (DLM-5), p. 3.
- Pension and 401k Plans: These plans are available to all employees based on their hire date.
    - Pension plans are only available to non-union employees hired prior to October 1, 2009, and union employees hired prior to January 1, 2011. OCA 3-20 (DLM-7).
    - The 401k plans are available to all employees. OCA 3-19 (DLM-6). However, the Company's matching percentage is different based on hire date. Id. Non-union employees hired prior to October 1, 2009, and Union employees hired prior to January 1, 2011, are matched at 75% of their contribution up to 6% of their annual salary. Id. For

[2] DLM-4 includes the Company's response to OCA 2-13 and excerpts from OCA 2-13 Attachment A.

employees hired after October 1, 2009 (for non-union employees) and January 1, 2011 (for union employees), the Company's matching percentage increases to 100% of the employee's contributions up to 6% of their annual salary. Id.

- Life Insurance and Long Term Disability: According to the response to OCA 2-26 (DLM-8), the Company pays 100% of the cost of benefits for all employees.
- Medical, Dental, Vision Plan Insurance: The Company covers approximately 90% of the costs associated with these benefits for all employees. See DLM-4.
- Union Contract Benefits: In addition to the benefits described above, the Company provides the following benefits only to its union employees:
  - Certification Incentive Compensation: union employees receive $100 incentive upon obtaining and renewing their Backflow Device Tester License. The Company pays for the certification exam, renewal fees, and educational/training fees.
  - Physical Fitness Reimbursement: The Company reimburses employees for 75% of the cost of physical fitness activities, up to $200 per calendar year.
  - Educational Reimbursement: Employees receive a reimbursement match of $2,500 per calendar year for educational costs regardless of grade(s) received.

- Educational Assistance Program: Employees maintaining a "C" grade or better are eligible to be reimbursed 100% of the first $3,000 and 80% of the second $3,000 in educational costs per calendar year.

See DLM-4.

Q. Turning to your conclusion about wage increases, what is the basis of your understanding?

A. My wage increase conclusions are derived from analyses of the Company's Salary and Wage Schedules No. 1C, filed in both this proceeding and the Company's last rate case. DLM-9.

Q. You concluded from your investigation that the Company's wages have increased by approximately 16%, for union employees in the four years since its last rate case. What is the dollar value of these wage increases?

A. The approximate 16% wage increase level equates to $61,749.[3] (DLM-9.)

Q. Please describe the basis of these union wage increases.

A. The approximate 16% increase results from the 3 to 3.5% annual increments union employees have received since the last rate case. The most recent of these annual wage increases for union employees occurred in December 2012.

[3] The $61,749 is the total of the Union employee wages ($58,814) and wage increase ($2,935) difference calculated in DLM-9 column C.

Q. **You concluded from your investigation that the Company's wages for non-exempt, non-union have increased by approximately 24% in the four years since its last rate case. What is the dollar value of these wage increases?**

A. The approximate 24% wage increase level equates to $17,229. (DLM-9)

Q. Please describe the basis for the non-exempt, non-union wage increases.

A. Similar to the increase for union employees, the wage increases for non-exempt, non-union employees is the culmination of the 3% annual increments received by these employees since the last rate case. The most recent of these annual wage increases for non-exempt, non-union employees occurred in April 2012.

Q. You concluded from your investigation that the Company's wages for officer and exempt, non-union decreased by 4.18% since its last rate case. What is the dollar value of this reduction in wage costs?

A. The 4.18% reduction in officer and exempt, non-union wage costs equates to $8,579. (DLM-9)

Q. **Please describe the basis of this reduction in these wage costs.**

A. The OCA is uncertain about the basis of the reduced officer and exempt, non-union wage costs. The Company did not provide detail in its filing to substantiate these costs.

However, in light of changes in officer personnel since the last rate case,[4] the OCA posits that the decrease may be in part due to the differences in the salaries paid to these individuals and the timing of the personnel changes in relation to the test year.

Q. If you are not certain about the basis of these exempt, non-union wage decreases, why did you consider them in formulating your recommendation on wage cost recovery?

A. We included these wage decreases, notwithstanding our uncertainty about their validity, in the interest of providing the Commission a complete picture of the change in employee wages since the last rate case.

Q. In addition to the cost of these wage increases, does the Company's proposed revenue requirement include incentive compensation for officers and non-union employees?

A. Yes. The Company includes a pro forma test year amount of $17,593 associated with bonuses paid to officers and non-union employees. Staff 3-11, Schedule No. 1E, p. 14 of 68 (DLM-2).

Q. You referred to the troubled state of the nation's economy during the period of time since the last rate case. What is the basis of your understanding?

[4] For example, the rates charged customers since the last rate case have included the costs associated with the Company's then-new Vice President of Operations, Harry Hibbard. Mr. Hibbard left the Company and John Walsh assumed his position in 2012.

A. The OCA relies upon testimony by J. Randall Woolridge, Ph.D., recently filed at the Federal Energy Regulatory Commission (FERC). Although this FERC proceeding concerns the return on equity earned by transmission owners in the electric market, Dr. Woolridge's testimony contains some general information about, and a chronology of, the recent financial crises and recession experienced during the same time that the Company was giving its employees annual raises and bonuses. Testimony of J. Randall Woolridge, Ph.D., (October 1, 2012), FERC Docket Nos. EL 11-66-000 and EL 11-66-001, excerpt only, pp. 8-10 (DLM-10).

As described by Dr. Woolridge, since 2008, "the mortgage crisis, subprime crisis, credit crisis, economic recession and the restructuring of financial institutions have had tremendous global economic implications." Id. at p. 8, lines 22-24. These impacts have included the failures of several large financial institutions, the federal government's spending of billions to buy-out, bail-out or takeover other financial institutions, and the spending of billions more aimed at creating jobs and turning around the economy. Id. at pp. 8-9. Dr. Woolridge concludes, even at this time, "...the U.S. is still saddled with relatively high unemployment, large government budget deficits, continued housing market issues, and uncertainty about future economic growth." Id. at p. 9, line 22-24.

Q. You previously referred to the information provided by the Company to support the wage increases and bonuses paid to employees. What information did the Company provide?

A. During discovery the OCA propounded several requests to the Company regarding how salaries and wages are determined. According to the Company, it bases its union and non-union wages upon studies or surveys conducted by outside consultants. DLM-3. The Company also provided under the claim of confidentiality "the results of the studies related to New Hampshire [non-union] employees." Id.

Q. What observations do you have to offer about this Company-provided information?

A. I offer the following observations about the information provided by the Company:

- Non-union Compensation
  - Exempt Non-union

    To set compensation for "higher level Managers and Director positions," referred to herein as exempt non-union, Aquarion relied upon a survey conducted by Saje Consulting Group, Inc., in 2012. DLM-3. Saje sent the survey instrument to 11 companies which possess an ownership interest in one or more water utilities. OCA Tech 1-3 (DLM-11). Only eight companies responded to the survey. DLM-3 (Attachment B, p.1) and DLM-11. Six of the participants own multiple regulated and unregulated entities. DLM-3 (Attachment B, p.4). Five of the participants have annual regulated revenues greater than $51 million. Id. at p.5. Five of the participants have more than 100,000 customers. Id. at p.7. Five participants have more than $301 million in net utility plant. Id. at p.7. The average number of non-union employees employed by the survey participants was 430. Id. at p. 8. Five participants have more than 200 employees total. Id. at p. 9.

- Non-exempt Non-union

The Company also identified Executive Resource Group (ERG), an "independent compensation consultant, as the source of "marketplace" information about employee compensation. OCA Tech 1-1 (DLM-12). The Company provided the "results of the studies related to New Hampshire employees" but did not provide a copy of the study. According to the Company, the "2011/2012 Comparator Group" used by ERG totaled 32 in number and included the following companies: General Electric, International Paper, New York ISO, Philip Morris USA and Verizon Communications. DLM-12 (and Attachment A). In fact, it appears that most of the "Comparables" are not public water utilities. Id.

- Union Compensation

Although the Company asserted that it relies on "survey data and relevant market indexes to establish a basis for negotiating the hourly [wages] for the union employees," DLM-3, the Company did not provide union-compensation survey results in response to discovery.

Q. Did you consider other information in addition to the Company-provided information?

A. Yes. I reviewed the recent wage policies of the State of New Hampshire for its employees as well as information provided by the New Hampshire Department of Employment Security.

Q. What did you learn?

A. The State of New Hampshire eliminated 250 positions during fiscal years 2010 and 2011. It froze wage increases for fiscal years 2011, 2012, and part of 2013.[5] Retirees on the New Hampshire Retirement System received a 1.5% cost-of-living increase for years 2008 to 2010 and none for years 2011 and 2012.

In addition, according to the New Hampshire Employment Security publication "New Hampshire Economic Conditions" dated September 2012, between 2008 and 2009, the period when the recession took hold, there was a 2.4% reduction (17,000) of the average number of New Hampshire residents working. The number of employed individuals increased by only 4,000 by 2011 with only 78.6% of the average number of residents employed working full time.

Q. During the time since the Company's last rate case, what were the cost-of-living adjustments for persons on Social Security?

A. Recipients of Social Security did not receive benefit increases in 2009 and 2010. They received a 3.6% increase for 2011 and a 1.7% increase for 2012. See Social Security

[5] Executive Orders 2011-5 and 2011-6 issued by Governor Lynch instituted pay freezes for State of NH government employees.

Administration website, Cost-of-Living Adjustments, available at http://www.ssa.gov/oact/cola/colaseries.html.

Q. What do you conclude from the information that you reviewed?

A. I reached the following conclusions based upon the information that I reviewed:

- The Saje compensation study relied upon by the Company to set non-union wages does not form a reasonable and reliable basis to support the Company's wage increases. Only eight companies participated in the survey, and most of the participants in the survey are much larger than the Company and are otherwise not comparable.

- The ERG compensation analysis is flawed and unreliable for the same reason, to an even greater extent. Although there were 32 "Comparables" included in the ERG analysis, this group includes huge companies with global markets.

- The Company offers its employees generous benefits in addition to wages. Also, New Hampshire may differ – in terms of economic circumstances and opportunities – from the geographic areas in which the comparison companies operate. If the Company relied upon the external market information provided by Saje and ERG without considering the value of these Company's benefits and the economic differences associated with geographic location, the results may be skewed to the detriment of customers.

Q. What do you recommend?

A. On behalf of the OCA, I recommend that the Commission limit customer recovery to an equitable portion of the total amount of wage increases since the last rate case. In addition, I recommend that the Commission similarly limit recovery from customers of the annual incentive compensation costs built into the Company's proposed revenue requirement. The Company has failed to show that these costs are just and reasonable, and the Company's customers should not be required to compensate the Company for these costs without such support. Specifically, the OCA recommends that the Commission authorize the Company to recover 50% of these costs.

Q. Upon what basis is the recommended 50/50 split of these costs between customers and the Company's shareholders?

A. The OCA's allocation proposal is based simply on the principles of equity and fairness. Dividing the costs of the unsupported wage increases seemed a reasonable solution. Balancing the interests of customers and shareholders is also consistent with the Commission's statutory duty to balance the interests of customers and shareholders. RSA 363:17-b. Lastly, the OCA strives to operate within budgetary limits and to keep litigation costs, which are recovered from customers through utility bills, as low as possible. Consistent with these goals, we did not hire a compensation expert for this proceeding. Given these circumstances, recommending a simple allocation formula seemed in the best interests of customers.

Q. What is the impact on the Company's proposed revenue requirement of this OCA recommendation?

A. The OCA's recommendation results in a total reduction in recovery from customers of $43,996, which total reduction is comprised of $35,199 related to wage costs and $8,797 related to incentive compensation costs. (DLM-9)

Q. With the OCA's recommended level of wage-cost recovery, what is the average wage increase that you recommend the Company recover from customers?

A. As can be seen on Attachment DLM-9, sharing the Company's wage increase equally between shareholders and customers results the Company's recovery from customers of a 5.31% wage increase over the wages included in the DW 08-098 rate case.

Q. Your second conclusion concerned the costs of services provided to the Company by its Massachusetts affiliate without an approved affiliate agreement on file with the Commission. Please describe the services provided by the Company's affiliate

A. Late in the discovery period, the Company first revealed that there was an employee of the Massachusetts Aquarion Water Company providing services to the Company. OCA 3-12 (DLM-13) and OCA Tech 1-5 (DLM-14). According to the Company, this employee provides administrative and technical support to the Vice President of Operations (for both Aquarion Massachusetts and the Company). DLM-14)

Q. How are the costs of these services recovered from the Company from its Massachusetts affiliate?

A. Based upon the information provided by the Company, the costs for this Aquarion Massachusetts' employee's services are (and have been) directly charged to the Company.

Q. What is the annual cost to the Company for these affiliate services?

A. The Company quantified the annual costs of this employee as $18,000. DLM-14

Q. What is the basis for your conclusion that the Company does not have an approved affiliate agreement with its Massachusetts affiliate on file with the Commission?

A. The Company acknowledged in discovery that it does not have an affiliate agreement with its Massachusetts affiliate. Id p.2

Q. Was this information provided by the Company in its original filing in this proceeding?

A. Not that I am aware of. I learned of this information late in the discovery period. Consequently, the OCA was unable to gather additional information about this employee, the services she provides to the Company or the nature of the informal agreement between the affiliates which guides her work and the billing of the Company for these services.

Q. What do you recommend the Commission do with regard to these unauthorized affiliate costs?

A. On behalf of the OCA, I recommend, based upon the information available, that the Commission disallow the recovery of these costs from the Company's customers because the Company does not have an approved affiliate service agreement with Aquarion Massachusetts, outlining the services to be provided or how the costs are charged to the Company. This recommendation will result in a reduction to the Company's revenue requirement of $18,000. Also, I recommend that the Commission require the Company to 1) file an affiliate agreement (with its Massachusetts affiliate) for review; and 2) expressly disclose the existence of any Massachusetts affiliate costs included in future proposed revenue requirements, in its original filing for such cases (e.g., in the Salaries and Wages Schedule No. 1C).

Q. Your third conclusion is that the Company should prepare and file a cost of service study in its next rate case. Please explain the rational underlying this conclusion.

A. Cost of service studies are used in utility ratemaking to guide the allocation of a company's required revenue requirement to the different categories or classes of customers. The results of a cost of service study are based on an analysis of how each class of customers cause costs to be incurred by the Company in providing service to these customers. Over time, inputs required for such a study may vary and change, which changes may affect, and need to be reflected, in a company's revenue requirement allocations in order to assure that customers pay just and reasonable rates.

According to the Company's response to OCA 2-42 (DLM-15), the Company last conducted a cost of service study in 2005, before the 2006 acquisition of the Company by

Macquarie. See Order 24,691 (October 31, 2006), DW 06-094. Since that time, the Company was acquired by Macquarie, see Order 24,691 (October 31, 2006), DW 06-094; the Company has filed two rate cases and received WICA rate increases; Aquarion has invested more millions of dollars in capital improvements, and the Company has observed changes in consumption. See, e.g., Testimony of Dixon, Bates p. 69, line 31, and p. 70, lines 1-2; Staff 2-24 (DLM-16) (attachments not included); and Staff 2-25 (DLM-17). In light of these circumstances, it is reasonable for the Commission to require the Company to conduct a cost of service study prior to, for filing in, the next base rate case.

Q. Before concluding your testimony, please summarize your recommendations on behalf of the OCA.

A. The OCA recommends that the Commission reduce the Company's revenue requirement by $61,996: $35,199 related to unsubstantiated wage costs; $8,797 related to unsubstantiated incentive compensation costs; and $18,000 related to unauthorized affiliate costs. In addition, the OCA recommends that the Commission require the Company to prepare and file a cost of service study at the time of its next base rate case.

Q. Does this conclude your testimony?

A. Yes.