Introduction

Q. Mr. Vaughan, please state your full name and business address.

A. My name is Donald J.E. Vaughan. My business address is 37 Northwest Drive, Plainville, Connecticut 06062.

Q. By whom are you employed and in what capacity?

A. I am President and CEO of New England Service Company, Inc. ("NESC"). In that capacity, I am responsible for management oversight of all aspects of the operations of its subsidiaries, namely; Valley Water Systems in Connecticut, Colonial and Plymouth Water Company in Massachusetts, and Abenaki Water Company in New Hampshire. My responsibility also includes management of NESC's non-regulated activities which are detailed in following testimony.

Q. Please describe your educational background and professional experience.

A. I have a Bachelor of Science degree in Civil Engineering from Northeastern University and a Master of Business Administration from Nichols College. From 1976 to 1980, I served as the Director of Water Operations for the City of Worcester. In that capacity, I was involved in all phases of supply and distribution activities. Subsequently, I was employed by Citizen's Utilities as Assistant General Manager for California Water Properties. I also served as President and General Manager of Southbridge Water Supply and as the Superintendent of Supply Operations for Aquarion Water Company with responsibilities primarily in Connecticut. In 1992, I joined Plainville Water Company (now Valley Water Systems, Inc.). In 1996, I managed the formation of New England Service Company which now holds the subsidiaries mentioned in the preceding.

Q. Have you previously testified before the New Hampshire Public Utilities Commission or other regulatory bodies?

A. Yes. I also provided testimony to the Massachusetts Department of Public Utilities, and to the Connecticut Public Utility Regulatory Authority on several prior occasions.

Q. Please describe the purpose of your testimony.

A. My testimony is to provide background information to assist understanding of: (1) Abenaki Water Company's ("the Company") need for a rate adjustment; (2) capital expenditures transacted and operational efficiencies which have and will continue to channel benefits to customers; (3) a proposed five year capital plan designed to realize future optimal operations through prudent investment; (4) strategies intended to maximize the interval between the Company's requests for rate adjustments while also mitigating the amount of future increases; (5) the issue of predictability and funding the City of Laconia's waste water rate step increases to the Lakeland system; and, (6) the benefits of consolidation and rate unification.

Deborah Carson, Treasurer of NESC and the Company, will provide accounting exhibits with explanatory detail as well as describe the Company's customer service features and notable administrative functions that support day to day operations.

Q. What is the test year the Company will be using in this application?

A. The Company is using the twelve months ending December 31, 2014.

Q. When was the Company's last rate adjustment granted?

A. The Company has never had a rate adjustment since it was formed to acquire and operate White Rock Water Company in Bow, and Lakeland Management Company (which also provides waste water service) in Belmont within DW 13-236 and under Order Number

25,621 on January 2014. White Rock's last rate decision was on April 13, 2007 (based on a 2005 test year), DW 16-101, Order Number 24,741. Lakeland's most recent rate decision for both water and waste water was on May 1, 2012, (based on a 2009 test year for service on and after October 1, 2011) DW 10-306, Order Number 25,357.

Q. Why is the Company now requesting an adjustment in rates?

A. As indicated in my direct testimony, beginning in line 21, page 9, of the Joint Petition of Approvals related to the sale of the Utility Assets of the White Rock Water Company, Inc. and Lakeland Management Company, Inc. to Abenaki Water Co., Inc., DW 13-236, the Company planned to operate the two systems for a period of time before seeking rate relief in order to have a better history of the operating costs. Based on that history the Company requests that the Commission allow it to operate the two water systems on a consolidated basis under a single rate structure with monthly billing which was accomplished under DW 14-360, Order Number 25,760. Our experience operating the two systems indicates that the additional costs of operating each system does not benefit customers from either a rate making or operational standpoint.

In addition, the Company's audited 2014 financials and its current course into fiscal year 2015, indicate that the Company has and will continue to experience a return below what would be considered satisfactory financial performance. In order for the Company to maintain its viability, it must be allowed to increase rates which will enable it to carry on efficient day to day operations as well as make future plant investments necessary to optimize system performance that will benefit its customers and ultimately lead to a well designed and cost effective rate structure. The Company requests temporary rates while the Commission evaluates the Company filing and makes its determination on permanent rates.

Q. **What return on equity is the Company seeking?**

A. The Company is seeking a return on equity of 10.75%. The Company makes this request without the assistance of a cost of capital expert whose fees would add significant expense to this proceeding, which the Company is actively trying to minimize. However, it is clear that the Company requires a greater return than present in order to maintain an optimal (in fact preferred) capital structure; maintain experienced management, technical, and financial expertise to underpin operations; and importantly, to attract investors and capital for its two small risky water systems. As explained below, smaller sized systems dramatically increase risk to investors. (Please also see Page 9.)

The risk directly related to the Company is clearly and significantly greater than that of the largest regulated water companies under the Commission's jurisdiction. Accordingly, and rather than taking a one size fits all approach, the Company offers for consideration that the largest water company operating under the Commission's jurisdiction has 37 times the customers and 27 times the revenues as does itself. Given approximately the same return on equity, an investor would unhesitatingly invest one dollar of capital in the larger rather than the smaller utility, all other factors being equal.

In further support of its requested ROE, a look at development of the Company's current capital structure requires a brief review. Prior to acquisition of White Rock Water, that company had no debt and was owned through 100 percent equity by its shareholder. As to the Lakeland system, its capital structure was significantly skewed to equity in its last rate order, for both the water and waste water operations. Consequently, both companies were financed by a very high cost of capital.

Q. How will the requested ROE benefit customers?

A. As part of the acquisition of White Rock and Lakeland, the Company was successful at placing low cost debt (effectively at less than 3.0 percent for 2014) and thereby incorporating it into the capital structure. Therefore, this financing will serve the Company's customers well in terms of moderating rates into the future. That said, we believe the requested return at this point will not have a significant impact on rates, and from a historical perspective, undoubtedly would achieve a lower cost of capital than that sought by previous ownership. Also, because investment seeks higher returns, the requested equity if realized, will drive a prudently and timely designed capital program (Attachment C) to continually improve system operations for customer benefit.

Q. What rates of return do investors realize in other markets?

A. In perspective, the Company's larger sister subsidiaries' authorized return on equity in Massachusetts and Connecticut are 10.5% and 10.05%, respectively. In lieu of retaining expensive cost of capital expert witnesses, and recognizing the risk associated with small systems, the Connecticut and Massachusetts Commissions developed formulaic R.O.E. approaches which address the size premium appropriate for such utilities.

In Massachusetts, the Department of Public Utilities (DPU) issued 220 CMR 31.00 which set the specified floor of 11.5% in order that such companies could attract capital and be comparable to returns on investments of similar risk.

In Connecticut, the Public Utilities Regulatory Authority (PURA), in accordance with its Docket No. 13-01-29, averages the ROE's last granted to its two largest water companies, then adds a 50 basis point size premium. PURA, in its discretion, then can award up to 50 additional basis points based on the small company's standard of performance.

The Company believes it has made prudent investments, all used and useful, during the test year which have benefitted its customers. This improved level of service is noted here and in the testimony of Deborah Carson. Accordingly, the Company asks for the requested return on its test year ending equity, plus 2015 additions where warranted, as indicated in the accompanying exhibits. In summary, the Company is asking for a fair and reasonable opportunity to earn a competitive return on its invested capital. The Company suggests that anything less will disincent capital markets, cause shareholders to look elsewhere, and ultimately leave a larger burden of plant investment to future operators.

Q. How has the Company fared with capital improvements since its acquisition of the White Rock and Lakeland systems and what is its plant investment plan going forward?

A. Evaluating near term Company improvement needs was one of our priorities both before and after the acquisition. A large part of its capital investment had to do with recognition of the need for revenue stability, non-revenue (unaccounted for) water, and minimizing an unacceptable number of estimated and missed meter readings.

Insofar as Commission comments under Section III. A. 5 and 6 of Order Number 24,741, dated April 2007 were concerned regarding White Rock, and relatedly, the status of meter data collection at Lakeland, the Company's first commitment of capital has been directed to meter replacement.

Of the $75,625 of capital investment detailed in Attachment A, notable expenditures have included:

- Installation of radio read meters now completed in over 225 homes. This project is enabling more accurate invoicing, virtual elimination of estimated bills, facilitation of monthly billing, earlier homeowner detection of leaks, the ability to calculate unaccounted for water on a monthly basis, and over the long term, a reduction in operating expenses. For example, future cost mitigation includes a reduction of meter reading to an estimated 3 hours (actual time) per month as opposed to interminable hours (due to an antiquated postcard data collection) per quarter necessary for conventional metering; the ability to introduce paperless bills thereby decreasing postage expense; and the predictability of billing amounts which, although difficult to quantify, has in our experience lessened the administration required in handling customer complaints.
- Installation of a stand-by generator (see Attachment B) in the White Rock system. The much needed addition will ensure the reliability of service by increasing the continuous functioning of the system's operation, pumping, and treatment located at this facility. Prior to this improvement, the system was vulnerable to, and experienced power outages due to heavy snowfall and winds characteristic of the area. Please refer to Deborah Carson's testimony regarding customer comments specific to this improvement as well as improved service derived from other enhancements.

Q. Has the Company developed a Five year Capital Plan?

A. Yes. Based upon the unique operating experience the Company now has with the systems, we have developed a Proposed Five Year Capital Plant Improvement Program, which is included as Attachment C. We believe the considered projects forecasted are prudent and consistent with our experience of owning and managing water systems. Our proposed capital plan is presented with the goal of minimizing the potential for rate shock and importantly, maximizing the interval between needed rate adjustments.

Q. How does the Company plan to fund the Capital Plant Improvement Program?

A. After ongoing evaluation of its annual capital improvement needs, the Company will (and does) prioritize identified system projects that can be completed within the boundaries of its planned capital expenditure budget. Typically, this amount is composed of its expected yearly depreciation, and approximately half of its net income.

Q. What are the issues attendant to small companies and the strategies to maximize the interval between the Company's requests for rate adjustment while also reducing the impact of future rate increases?

A. In general, smaller water systems pose relatively bigger challenges to operate, maintain, and sustain in great part due to the challenges that inadequate infrastructure and increasing regulatory requirements present relative to the systems' size. Frequently, their water rates tend to be higher than their larger counterparts. Smaller systems often lack adequate management and engineering capability as well as the ability to attract capital at reasonably competitive rates. Typically, they cannot afford to hire qualified operators on a full time basis due to their size. As a result, customers do not always receive the same level of service that could be expected from a company with a larger customer base.

To varying degrees with respect to certain aspects of operation, the White Rock and Lakeland systems are examples of ownership transition that has enhanced specific areas of the service level. In particular, demonstrated service reliability at White Rock (new stand-by generator) as well as accurate data collection and payment options including Lakeland have benefited customers in many respects. On the other hand, system infrastructure weaknesses such as the original installation of distribution system nylon connections at White Rock (leading to undetected leaks and unfavorable unaccounted for water ratios) as well as a lack of control valves at both Lakeland and White Rock have been identified by further operating analysis.

These are only a few of the typical operating challenges of small underinvested water systems.

All this said however, prudent and continuous incented investment in the Company's water systems will yield benefits while reducing operating and maintenance costs over the long term. Last winter's power outage at White Rock did not disrupt water service because of stand-by power and, in turn on an ongoing basis, will eliminate the need for overtime labor normally deployed to ensure continuous operation of pump stations. Radio read metering has reduced data collection costs and improved the quality of invoicing all of which dampens the rise of operating costs.

The Company firmly believes the acquisition and synergy of White Rock and Lakeland, as well as future opportunities are ultimately good for the customer, the Commission and the Company. There can be little disagreement that when consolidations of such systems occur, provided the transaction brings competent management, technical ability, and financial strength with it, benefits, particularly accruing from economies of scale take place. These dynamics will lengthen the interval between and reduce the financial impact of future rate decisions.

Q. Please explain the issue of the City of Laconia's waste water rate step increase.

A. A concern the Company has is the City of Laconia's step rate charges to Lakeland which, when occurring outside of a test year, become an unplanned expense that cannot be recovered until the Commission's next rate order.

Deborah Carson, in her pre-filed testimony, proposes the accounting to handle the step rate expenses such that they do not negatively impact the Company's earnings while not also adversely affecting customers. That said, there is undoubtedly agreement that the Company's circumstance of providing the waste water collection system for its customers while the treatment process is performed by others, is somewhat unique.

Q. **What is the Company proposing with respect to the waste water tariff?**

A. The Company believes it would be in the best interest of all to include in its tariff (with the Commission's specific approval) the ability to pass along the subject step increases, at cost, as they occur. The benefit of this methodology would be for customers "to pay as you go" in the same way as the users in Laconia do. Furthermore, the factors (such as these periodic increases) which contribute to "rate shock" can be minimized, as well as having the effect of delaying, or putting off, the necessity for the next rate request.

Q. **Please explain the benefits of consolidation and rate unification to the Company and its customers.**

A. Due to the consolidation of White Rock Water Company and Lakeland Management Company to form Abenaki (Docket DW 13-236) the expense of this rate proceeding, as well as ongoing annual audits and administrative filings have been and will be shared by an increased customer count which will beneficially reduce its exposure to the Company's regulatory costs. Since the cost of rate filings is not necessarily linear to the amount of revenue at stake, then generally the smaller the company, the more financially impactful such filings and proceedings are on a company's customer base. Furthermore, consolidation as previously referenced, typically allows merged companies to gain competitive financing, improved management, and technical expertise, among others. More than at any other time in the past, operational, financial, and compliance hurdles facing the fragmented small company sector going into the future, if they are to be met at all, can be navigated by leveraging consolidation. As an eventual outcome, consolidation with an efficient strategy benefits the customer, the Commission, and the Company through scale.

Through rate consolidation or unification, a pricing methodology that already is significantly common in the electric and gas industries, Abenaki and its customers will benefit over time via more stable rates and mitigated increases influenced by a combination of scale and single tariff pricing.

Even within large single water systems, socialization of prices currently exists when considering the cost of service to supply say, one group of customers benefitting from a pump station, or another which receives water via an unusually long pipe line, over an array of other consumers. Further, exceptionally expensive main breaks or mandated capital improvements can occur in any system or at any location with little or no notice. Rate unification eases the impact of the expense by spreading the cost over the entire customer base rather than directing it to the few.

Q. Does this conclude your testimony?

A. Yes.

LIST OF ATTACHMENTS

ATTACHMENT A Description of Recent Capital Additions

ATTACHMENT B Picture of stand-by generator

ATTACHMENT C Proposed Five Year Capital Plant Improvement Program.