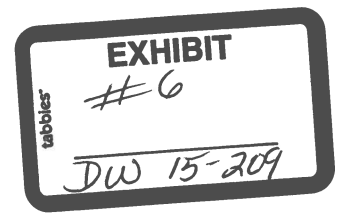


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BEFORE THE NEW HAMPSHIRE
PUBLIC UTILITIES COMMISSION



Lakes Region Water Company

Petition for Rate Increase

Docket No. DW 15 – 209

DIRECT TESTIMONY OF
THOMAS A. MASON

1 **I. BACKGROUND**

2 **Q. What is your name and business address?**

3 A. Thomas A. Mason, 420 Governor Wentworth Highway, PO Box 389,
4 Moultonborough, NH 03254.

5 **Q. What is your role at Lakes Region Water Company?**

6 A. I am president of the Company and serve on its Board of Directors. The
7 Company is owned by a family trust held by my mother, Barbara G. Mason.

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

9 A. The purpose of my testimony is: (1) to explain the Company's overall operations,
10 recent and future capital projects and its need for rate increases; (2) to explain
11 why the Company is requesting a rate of return on equity of 11.6%; and (3) to
12 explain the Company's proposal to transfer the Mt. Roberts from the Company's
13 shareholder to the Company.

14 **II. OPERATIONS & REQUEST FOR A RATE INCREASE**

15 **Q. How would you describe the Company's operational performance?**

16 A. The Company's operational performance of its 17 community water systems
17 serving 1,667 retail customers and one wholesale customer in Moultonborough,
18 Suissevale, remains solid and continues to improve. The Company employs a
19 staff of 8 professionals who specialize in operation of small community water
20 systems. The office staff includes: a Utility Manager; an Office Manager; and 2
21 administrative assistants. Three of the Company's four office staff are certified
22 with a 1A Water Operators Certificate. The Company's field staff includes: a
23 Field Supervisor with a Level 2 Distribution and Level 2 Treatment certification;

1 one Water Operator who has a level 2 Distribution certification; one Water
2 Operator who has a 1A Water Operator certification; and one Water Operator who
3 is in the process of obtaining an 1A Operator certification.

4 The Company and its staff maintain a five year Capital Improvements Plan which
5 it uses to evaluate and prioritize future projects. See Rate Case Schedule 11, Lake
6 Region Water Co., Inc., Capital Projects 2015-2020. This is done with a goal of
7 providing the best possible service using available funds within rates that are
8 reasonable. For example, the Company is in the process of completing a major
9 capital improvement project (total cost of approximately \$200,000) at its Indian
10 Mound System, which includes construction of a new pump house and a new
11 storage tank that will improve service and meet customer demands on the system.
12 The Company is also transitioning to a new financial accounting system (Logics)
13 which will improve its cost tracking, accounting and regulatory reporting in order
14 to reduce administrative, accounting and regulatory costs. These are only two
15 examples of capital improvements projects that the Company evaluates and
16 implements on an on-going basis.

17 **Q. What regulatory issues are outstanding?**

18 A. The Company's only outstanding compliance issue is the long-term ownership of
19 the Mt. Roberts project land and improvements which the Company proposes to
20 acquire in this proceeding.

21 **Q. What is Lakes Region Water Company's business model?**

22 A. The Company specializes in operating very small, challenged water systems that
23 are not financially viable on a stand-alone basis. By consolidating 17 individual

1 community water systems into a single regional company, the Company is able to
2 provide greater technical, financial and administrative expertise to the operation
3 of its systems which has a direct benefit to the Company's customers.

4 **Q. Why are small water systems difficult to operate?**

5 A. There are many reasons. One major factor is that the water utility industry as a
6 whole faces increasing capital costs to comply with drinking water standards
7 using aging infrastructure that does not meet current standards. This is
8 particularly true of the 17 systems operated by the Company because it actively
9 acquired troubled water systems that had been poorly constructed by developers
10 and lacked a substantial business model. The Company acquired these systems,
11 often at the request of the Commission and/or the prior owners, because the
12 systems were too small and too challenging to operate on a stand-alone basis. *See*
13 *Exhibit 1, Troubled Water Systems Acquired by Lakes Region Water Co., Inc.* By
14 consolidating operation of its 17 water systems, the Company is able to
15 professionally manage very small water systems that otherwise would have
16 completely failed, physically and financially, and potentially threatened the public
17 health of customers.

18 **Q. How do Lakes Region's 17 water systems differ from other similar water**
19 **systems in New Hampshire?**

20 A. The Company's 17 water systems are extremely small when compared to other
21 small water systems in New Hampshire. According to the New Hampshire
22 Department of Environmental Services:

23 In 2007 there were 721 community water systems (CWSs) serving a combined
24 resident population of approximately 849,905 (average size: 1,179) (NHDES,

2008a). These include municipalities, apartments and condominiums, mobile home parks, and single family home developments. Ninety-five percent of the CWSs in New Hampshire are small systems serving fewer than 3,300 residents. There are also 36 medium CWSs that each serve between 3,300 and 50,000 people, and two that are classified as large systems serving more than 50,000 each – Manchester Water Works and Pennichuck Water Works in the Nashua area [...].

NHDES Water Resources Primer, Chapter 8, Page 8-4. (Exhibit 2).

As noted above, the NHDES considers a small community water system to be one that serves fewer than 3,300 residents (approximately 912 customers).¹ This is nearly ten times larger than the average size of the community water systems operated by the Company which have an average of 98 customers per system on average (1,667 / 17). By this measure, the Company's 17 water systems should be considered on the extreme end of small, which is consistent with their operational performance prior to acquisition by the Company.

Q. What is it about small water systems that makes operation of these systems financially challenging relative to medium (3,300 – 50,000 residents) or large (> 50,000 residents) systems?

A. The New Hampshire Department of Environmental Services has answered this very question. I agree with the following statement contained in its Water Resources Primer (Exhibit 2):

8.2.2 New Hampshire Has a High Proportion of Struggling Small Community Systems

Even large community water systems find the Safe Drinking Water Act regulations difficult and costly to meet, so it is no surprise that it is much more difficult for small water systems. Figure 8-7 depicts the many challenges that small water systems may encounter as they provide safe

¹ According to the American Water Works Association's 2012 Water and Wastewater Rate Survey: "The median service population per account is 3.62 and 3.70 for water and wastewater, respectively." The Company does not have population data to determine the number of residents are served by its 1,667 service connections and therefore uses this AWWA estimate.

1 drinking water. New Hampshire has a large proportion of small systems
2 which are widely distributed and often impossible to interconnect. Per
3 customer costs may be dramatically different than those associated with
4 large systems. These small stand-alone systems require fairly
5 sophisticated operations, yet they cannot afford to hire full-time staff that
6 specialize in drinking water. Some small municipal water systems may
7 have to share one part-time staff member with the highway department,
8 the fire department and others.

9
10 Conversely, larger systems benefit from economies of scale and can afford
11 to hire highly educated, specialized staff teams with in-depth knowledge
12 of treatment, distribution, and other aspects of drinking water provisions.
13 As a result, customers of the smallest systems often pay the most for the
14 least in services. It is also important to note that providing water supply is
15 a highly capital intensive mission where even the largest systems struggle
16 to maintain and replace their aging infrastructure.
17

18 **Q. How does ownership of small water systems affect regulatory compliance?**

19 A. The New Hampshire Department of Environmental Services reports that: “the
20 highest number of violations, both for health-based standards as well as for
21 monitoring and reporting (failure to sample or provide public notice), are incurred
22 by the very small systems (<250 people).” *See Exhibit 7 Triennial Report to the*
23 *Governor and US EPA with Highlights for FY 2011 on New Hampshire’s*
24 *Capacity Development Program for Public Water Systems* (September 2011),
25 Pages 2-3. This shows that the Company’s water systems, again considered “very
26 small” – fall into the highest risk category for regulatory non-compliance.
27 Despite falling into this high risk category, the Company provided service in
28 compliance with no violation of health based drinking water standards. As noted
29 above, the only outstanding violation of the NHDES’s drinking water standards
30 relates to the need to secure long-term ownership of the Mt. Roberts project,

1 which the Company proposes to resolve in this proceeding. The service provided
2 by the Company is excellent, even outstanding, in light of the challenges it faces.

3 **Q. What effect do the Company's very small water systems have on its financial**
4 **performance?**

5 A. The Company's very small water systems eliminate the ability of its shareholder
6 to realize a return on investment using the same parameters applied to larger
7 utilities such as Pennichuck Water Works which has 25,521 customers in a single
8 system not including P.E.U. & P.A.C., Aquarion which has 9,305 customers in a
9 single system. Because of the nature of the very small water systems the
10 Company operates, the Company is required to spend all of its earnings on
11 improvements needed to maintain service and comply with state and federal
12 drinking water regulations. If the Company were to stop reinvestment of its
13 earnings into on-going capital projects, the quality of its service would deteriorate
14 below acceptable levels. This means that, while the Company earned a return on
15 the shareholder investment during the test year, as reflected in the schedules
16 presented by Stephen St. Cyr, the shareholders realized no return because of the
17 need to reinvest in improvements to maintain its plant in compliance with
18 reasonable standards and safe drinking water regulations. In the last decade, the
19 Company's shareholder(s) have realized essentially no return on investment in the
20 Company's water system.²

21 **Q. How has the Company's financial performance changed since its last rate**
22 **case?**

1 A. The Company's overall financial performance has improved substantially. As the
2 Commission staff is aware, the Company's financial condition was critical when I
3 joined the Company. However, following approval of rate increases in Docket
4 No. DW 10 – 141 on July 13, 2012, the Company has taken steps to improve its
5 financial condition, including:

- 6 ➤ The Company negotiated and refinanced its debts to vendors through loans
7 with CoBank ACB approved in Docket No. DW 13 – 335, which closed in
8 June of 2014.
- 9 ➤ The Company sold surplus real estate at Hidden Valley following
10 Commission approval in DW 13 - 308.
- 11 ➤ The Company worked with its accountant firm of Leone McDowell &
12 Roberts, PA to significantly reduce outstanding federal and state tax liabilities.
13 For example, in DW 14 – 285, the Company obtained approval for financing
14 to replace several vehicles which needed replacement and which allowed the
15 Company to take advantage of depreciation to offset tax liabilities the
16 Company would otherwise have incurred due to vendor discounts offered as a
17 result of CoBank refinancing in DW 13 – 335.
- 18 ➤ The Company limited its reliance on outside consultants for legal, engineering
19 and accounting services.

20 As a result of these and other efforts described in the Company's bi-monthly
21 reports to the Commission in DW 13 - 041, the Company's A/P today are

² As discussed in DW 13 – 041, the Company's returned capital to its shareholder in 2011. This payment was recorded as a return of capital to the shareholder because she had not received any dividends or earnings on investment in the Company.

1 \$146,218 (as of July 17, 2015) which is greatly reduced when compared to A/P of
2 \$584,093 as of December 31, 2013.

3 **Q. What is the Company's financial status today?**

4 A. The Company's financial performance is improved tremendously and has
5 stabilized since 2012. However, the very small water systems that the Company
6 operates and the known financial risks associated with those assets do not allow
7 the Company to attract investment using parameters that are typically applied to
8 larger systems. It is unfair to ask the Company's current shareholder to continue
9 to receive no return on capital investment for over a decade. The Company's risk
10 profile is too great to attract equity investors because of the capital needs of its
11 small systems. This means that income from customer revenues represents the
12 only source of equity for capital projects such as the Indian Mound project. The
13 Company is forced to choose between paying for capital improvements to
14 maintain compliance with drinking water regulations or paying its shareholder a
15 fair return on investment. It cannot do both.

16 **Q. What about debt such as the CoBank financing for the Indian Mound**
17 **project?**

18 A. The Indian Mound project is an excellent example of the Company's positive
19 relationship with CoBank and the limitations of its current rate structure. The
20 financing for the Indian Mound project was possible because the rate increases
21 approved in DW 10 – 141 allowed the Company to secure additional financing
22 and remain in compliance with financial covenants contained in the CoBank loan
23 documents approved by the Commission in DW 13 – 335. The customers

1 received a direct benefit of the Company's use of funds which allowed it to
2 complete the Indian Mound project and improve services to customers.
3 However, the Company's earnings are currently insufficient to allow it to incur
4 additional debt to purchase the land for the Mt. Roberts project or other major
5 capital improvements because it is required to remain in compliance with the
6 financial covenants contained in its CoBank loan documents. The Company's
7 ability to acquire Mt. Roberts and execute future capital projects is limited
8 because its rates are insufficient to attract new debt and equity.

9 **Q. What is needed to address this problem?**

10 A. The Company requests that the Commission approve a rate of return on equity of
11 11.6% used by Stephen St. Cyr which takes into account the increased risks
12 associated with operating very small water systems having an average of fewer
13 than 100 customers per system.
14 It may be that a better regulatory model may be the best solution due to the unique
15 challenges presented by the very small water systems operated by the Company.
16 The Company remains open to suggestions in that regard. However, in the
17 absence of a better regulatory model, it is necessary to recognize the increased
18 risks to investors presented by the Company's very small water systems.

19 **III. REQUEST FOR APPROVAL OF THE MT. ROBERTS PROJECT**

20 **Q. What is the status of the Mt. Roberts project?**

21 A. All of the improvements for the project have been completed and the wells,
22 pumps and related improvements are fully in service. The NHDES approved the
23 project as a small production well on July 7, 2012, subject to certain conditions,

1 including a requirement that the Company obtain permanent ownership and
2 control of the land.

3 **Q. What is the Company's proposal to acquire the Mt. Roberts project?**

4 A. As explained in the testimony of Stephen St. Cyr, the Company requests that the
5 Commission approve the transfer of the wells and other improvements related to
6 the Mt. Roberts project as paid in capital. In addition, the Company intends to
7 request that the Commission approve the financing from CoBank to acquire the
8 real estate for the Mt. Roberts project based on a proposal it has received this day.
9 *See Exhibit 4 CoBank ACB Proposal.*

10 **Q. What is the total cost of the project?**

11 A. The total cost of the Mt. Roberts project includes both direct costs such as the
12 purchase price for land, pumps and equipment as well as an Allowance for Funds
13 Used During Construction (AFUDC) as allowed by the Commission's *Uniform*
14 *System of Accounts*. *See Exhibit 5*. In this testimony, I refer to the direct costs
15 plus AFUDC as the "Cost" of the Mt. Roberts project. As shown in *Exhibits 6*
16 *and 7*, the Cost of Mt. Roberts project land and improvements is \$687,838.99
17 which consists of the following:

18 **Mt. Roberts Improvements:**

- 19 ○ \$216,112.56 Direct costs for wells and related improvements.
- 20 ○ \$55,819.74 AFUDC
- 21 ○ \$271,932.30 Total Cost of Improvements.

22 **Mt. Roberts Land:**

- 23 ○ \$281,782.75 Direct costs for land purchase, taxes, legal, surveys, etc.

- 1 ○ \$134,123.94 AFUDC
- 2 ○ \$415,906.69 Total Cost of Land

3 This results in a total cost for the Mt. Roberts project of \$687,838.99.

4 **Q. How does the Company propose to transfer the Mt. Roberts project to the**
5 **Company?**

6 **A.** The Company requests Commission approval to acquire the Mt. Roberts project
7 in two related transactions: First, the Company has recognized the Cost of
8 improvements related to the Mt. Roberts project such as wells, pipes, pumps and
9 other improvements as paid in capital during the test year for a total of
10 (\$271,932). The Company requests that the Commission approve the transfer as
11 paid in capital which will allow the Company to earn a return on this investment
12 in rates. Second, the Company proposes to purchase the land for the Mt. Roberts
13 project at Cost (\$415,906) in cash by means of a 20 year note from CoBank ACB.
14 *See Exhibit 4.* The Company intends to file a separate petition for review and
15 approval of the financing for this transaction in this proceeding.

16 **Q. Why does the Company propose two related transaction for the Mt. Roberts**
17 **project?**

18 **A.** The Company evaluated and pursued several different options over the last course
19 of two years. No formal ranking system was used. However, the Company's
20 goal was to find a means to acquire the Mt. Roberts project that provided the
21 greatest benefit to the Company's customers, the Company itself, and its owner-
22 shareholder. All three were considered critically and equally important. Any
23 transfer of the Mt. Roberts project that was unfair or unreasonable to the

1 shareholder, the Company or its customers was deemed unacceptable. The
2 Company believes that its proposal represents the greatest reasonable benefits and
3 balance of the interests of the Company, its shareholders and the Company's
4 customers.

5 **Q. Please explain why that is the case?**

6 A. **Land Transfer.** Transferring the land by means of a loan from CoBank at a
7 Cost of \$415,906.69 is the most favorable to customers because the Company will
8 record the transfer as debt which is a pass through to customers in rates. The Cost
9 is below the expected market value of the real estate (\$450,000+) if the property
10 were to be developed in today's real estate market. The interest on debt from a
11 financial institution such as CoBank is expected to be approximately 5.41% less a
12 patronage discount resulting in an interest rate of 4.66% on a 20-year fixed note.
13 This is significantly below the Company's most recent approved rate of return on
14 equity of 9.75%. This approach is also favorable to the Company's owner-
15 shareholder who will be paid at closing and has received no return on investment
16 in the Mt. Roberts project to date.

17 **Transfer of Improvements.** As explained by Stephen St. Cyr, the \$271,932.30
18 Cost for wells and other improvements has been transferred to the Company as
19 paid in capital. This will allow the Company to earn at its allowed rate of return
20 on equity in order to generate future earnings that can be used for capital projects
21 and, critically, to keep the Company in compliance with the finance covenants set
22 forth in its approved loan documents with CoBank ACB. Without an equity
23 component, the Company would not be able to obtain future debt financing for

1 capital improvements that are budgeted in the Company's capital improvements
2 plan and service to customers would ultimately be impaired. It is hoped that this
3 investment will result in the Company's shareholder-owner earning a reasonable
4 return on investment. However, history shows this will not occur unless the
5 Commission approves an increase in the Company's allowed rate of return on
6 equity or changes the regulatory rate model for small water systems.

7 **Q. What is the status of Suissevale's decision to develop its own supply?**

8 A. It is my understanding that Suissevale has made little progress developing its own
9 supply line since announcing its intention to do so. Lakes Region Water
10 Company remains willing to work with Suissevale to pursue whatever option it
11 desires. It is also my understanding that there are continuing problems
12 surrounding water quality, quantity, regulatory compliance, engineering, finance
13 and legal issues remain unresolved.

14 **Q. Would the Mount Roberts Project be a prudent investment even if Suissevale
15 were to overcome these uncertainties and develop its own supply?**

16 A. Absolutely. Well yields in the Company's existing wells have continued to
17 decline. The Company's data show that the Mount Roberts project is needed to
18 meet supply and capacity requirements to serve customers in Balmoral even if
19 Suissevale were entirely separate.

20 In addition, it is important to note that Suissevale has not proposed to leave Lakes
21 Region Water Company's system entirely. To date, it has proposed to develop its
22 own supply in order to reduce consumption. This means that even if Suissevale
23 were to develop its own supply, the Mt. Roberts project remains critical to meet

1 demand in Paradise Shores. Suissevale's consideration of its own supply does
2 raise a question as to how the cost to be available to serve Suissevale during
3 periods of high demand should be recovered under the wholesale contract
4 approved by the Commission. However, there is no doubt that the Mt. Roberts
5 project is required to serve customers, and represents the best option for all
6 customers in terms of cost, water quality and reliability.

7 **V. CONCLUSION**

8 **Q. RSA 378:27 & 28 provide that rates "shall be sufficient to yield not less than**
9 **a reasonable return on the cost of the property of the utility used and useful**
10 **in the public service less accrued depreciation". Please summarize why you**
11 **believe this standard has been met?**

12 A. The Company provides excellent drinking water service to customers of very
13 small, troubled water, systems that could not operate on a stand-alone basis. The
14 Company and its shareholders have invested millions of dollars to serve the public
15 and received effectively no return on their investment due to the nature of the very
16 small water systems the Company operates. The schedules prepared by Stephen
17 St. Cyr show that rate increases are necessary to continue to serve the public and
18 to allow the Company's shareholder an opportunity to earn a reasonable return on
19 investment.

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

21 A. Yes.