

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

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

Docket No. DW 04-048

REPLY TESTIMONY OF ROBERT F. REILLY

May 22, 2006

1 INTRODUCTION AND PURPOSE OF REPLY TESTIMONY

2 Q. Please state your name, business address and by whom you are employed.

3 A. My name is Robert F. Reilly. My business address is 8600 West Bryn Mawr Avenue,
4 Suite 950-N, Chicago, Illinois 60631-3505. I am an appraiser and am employed by
5 Willamette Management Associates (“Willamette”), a private company investment
6 banking firm that provides business valuation, economic analysis and financial advisory
7 services.

8 Q. Did you previously provide testimony in this docket?

9 A. Yes. I was retained by counsel for Pennichuck Water Works, Inc. ("PWW") to estimate
10 the fair market value of the PWW operating assets. In January 2006 I submitted
11 testimony in this docket to present the results of my appraisal to the Commission.

12 Q. What is the purpose of your reply testimony?

13 A. At the request of counsel for PWW, I performed an analysis of the January 12, 2006
14 appraisal report prepared by George E. Sansoucy, P.C., LLC ("the Sansoucy Report")
15 and formed an opinion as to whether the appraisal presented in the Sansoucy Report ("the
16 Sansoucy Appraisal") estimates the fair market value of the PWW operating assets. I
17 prepared a report describing my analysis and the conclusions I reached. A copy of that
18 report, together with appendices and exhibits is attached hereto as Attachment RFR-2.
19 The purpose of my reply testimony is to summarize the results of my analysis of the
20 Sansoucy Report.

21 RESULTS OF ANALYSIS OF SANSOUCY APPRAISAL

22 Q. Did you form an opinion as to whether the Sansoucy Appraisal estimates the fair
23 market value of the PWW operating assets as of December 31, 2004?

1 A. Yes. I concluded that the Sansoucy Appraisal does *not* estimate the fair market value of
2 the PWW operating assets. My analysis revealed several fundamental errors in the
3 Sansoucy Appraisal. As a result of those fundamental errors, the Sansoucy Appraisal
4 fails to provide a reliable indication of the fair market value of the PWW operating assets.

5 **Q. Why did you conclude that the Sansoucy Appraisal does not estimate the fair
6 market value of the PWW operating assets?**

7 A. My analysis of the Sansoucy Report revealed 14 fundamental errors. Those errors are
8 described in detail in my attached report. Each of the three approaches within the
9 Sansoucy Appraisal – the asset-based approach, the sales comparison approach and the
10 income approach – is fundamentally flawed. As a result of these errors, the conclusion
11 reached in the Sansoucy Appraisal is not a reliable indication of the fair market value of
12 the PWW operating assets.

13 **Q. How significant are the errors you discovered?**

14 A. Very significant. It is not uncommon for me to be retained by a client to review an
15 appraisal and form an opinion as to whether the appraisal contains a reasonable value
16 estimate. I have performed numerous reviews in the past, and continue to perform such
17 reviews as a regular part of my appraisal practice. In my experience, it is significant to
18 discover 2 or 3 fundamental errors in an appraisal. My analysis of the Sansoucy
19 Appraisal revealed 14 fundamental errors. I am frequently asked to advise clients as to
20 whether it is possible to correct the errors within the appraisal to reach a reliable value
21 conclusion. Quite often, the presence of 2 or 3 fundamental errors renders the task of
22 correcting the appraisal impossible.

1 The Sansoucy Appraisal is one of the most fundamentally flawed appraisals I have
2 reviewed. It would be impossible to correct the Sansoucy Appraisal, as the number and
3 extent of the errors renders the conclusion totally unreliable. If I were asked by a client,
4 my advice would be that the Sansoucy Appraisal is useless for the purposes of
5 determining the fair market value of the PWW operating assets, and should therefore be
6 discarded in its entirety.

7 **Q. Did you review any materials in addition to the Sansoucy Report?**

8 A. Yes. As part of my analysis, I also reviewed the 1995 appraisal Mr. Sansoucy conducted
9 of the PWW tangible assets (the “1995 Sansoucy Appraisal”), as well as the testimony
10 Mr. Sansoucy submitted in this docket and statements Mr. Sansoucy made to City of
11 Nashua committees regarding the value of the PWW system.

12 **Q. What did you conclude from your review of these materials?**

13 A. These materials indicate that Mr. Sansoucy has an apparent bias that appears to have
14 significantly impacted his analysis and conclusions. It seems that Mr. Sansoucy did not
15 set out to conduct a fair market value appraisal of the PWW operating assets. Instead, as
16 Mr. Sansoucy clearly indicated in numerous statements to the City, his goal was to
17 conclude a value for the PWW assets that would allow the City of Nashua to purchase the
18 system without raising rates.

19 **Q. How did Mr. Sansoucy’s stated goal of concluding a value to allow for City
20 ownership without a rate increase impact his appraisal analysis?**

21 A. Many of the errors in the Sansoucy Appraisal could be explained with reference to Mr.
22 Sansoucy’s stated goal. For example, throughout his analysis Mr. Sansoucy relied on an
23 unstated and incorrect assumption that the pool of hypothetical purchasers for the PWW

1 assets consists only of regulated private companies with the same characteristics of
2 PWW. This is most evident within Mr. Sansoucy's income approach. Although Mr.
3 Sansoucy purported to calculate a weighted average cost of capital ("WACC")
4 representative of "the market," presumably the market of hypothetical purchasers, his
5 "market" consisted only of private regulated water utilities similar to PWW. Despite his
6 stated intention of calculating a "market" WACC, ultimately Mr. Sansoucy discarded the
7 results of his flawed calculations and then compounded his error by substituting the
8 WACC requested by PWW in its last rate case, with adjustments for taxes which brought
9 the number to approximate PWW's rate of return.

10 As Mr. Sansoucy's acknowledged in the 1995 Sansoucy Appraisal, use of the
11 approximate PWW rate of return results in a value conclusion under the Sansoucy
12 income approach that approximates rate base, thus fulfilling Mr. Sansoucy's stated intent
13 to reach a value that would permit transfer to the City without raising rates.

14 **Q. Was Mr. Sansoucy's stated intention to reach a value conclusion to facilitate
15 transfer to City ownership without a rate increase consistent with the errors you
16 discovered within the Sansoucy sales comparison and asset-based approaches?**

17 **A.** Yes. Mr. Sansoucy's goal of reaching a value conclusion that would facilitate sale to the
18 City without a rate increase is consistent with the errors within the Sansoucy Appraisal
19 throughout all three approaches. For example:

- 20 • Within the asset approach, Mr. Sansoucy used a specific cost method (trended
21 original cost) that he described in his the 1995 Sansoucy Appraisal as "unreliable,"
22 due to the lack of accurate data. In addition, in applying that method, Mr.
23 Sansoucy relied on cost and installation date data he knew to be inaccurate. Mr.

1 Sansoucy also failed to conduct any appraisal of the PWW intangible assets or the
2 PWW real property. Had Mr. Sansoucy conducted a valid cost approach analysis,
3 his value conclusion would have been significantly higher and would not have met
4 his stated criteria of facilitating the sale without requiring a rate increase.

- 5 • Within the sales approach, although Mr. Sansoucy purported to rely on 28
6 transactions and numerous comparability factors, in his reconciliation of value Mr.
7 Sansoucy relied on only 9 transactions carved out of the remainder based on one
8 comparability factor alone, that of revenues. None of the 9 transactions are
9 sufficiently similar to subject to be considered comparable to PWW: 4 of the 9
10 transactions are stale; 1 is not a transaction at all, but is instead an offer that did not
11 result in a consummated sale; 3 are part of one multi-state transaction that is not
12 comparable to PWW; and the remaining 1 transaction involved the sale of a
13 combined water/wastewater system regulated in both Texas and Oklahoma that in
14 no way qualifies as a comparable sale. In addition, Mr. Sansoucy applied a stock
15 and debt method, which is a method for valuing stock, not assets, to “confirm” his
16 invalid sales comparison approach results. Had Mr. Sansoucy conducted a valid
17 sales comparison approach analysis, he would not have been able to justify his low
18 value conclusion.

19 **CONCLUSION**

20 **Q. What did you conclude as a result of your analysis and the materials you reviewed?**

21 A. I concluded that Mr. Sansoucy’s stated intent to reach a particular value conclusion for
22 his client, namely, a number that would permit the City of Nashua to purchase the PWW
23 assets without having to raise rates, resulted in the numerous fundamental errors I
24 discovered within the Sansoucy Appraisal. While Mr. Sansoucy may have accomplished

1 his stated goal, he did not estimate the fair market value of the PWW operating assets.
2 The number and nature of the errors within the Sansoucy Appraisal renders the
3 conclusion totally unreliable as an estimate of the fair market value of the PWW
4 operating assets.

5 **Q. Does that conclude your reply testimony?**

6 A. Yes.