

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

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

Docket No. DW 04-048

DIRECT TESTIMONY OF DONALD L. CORRELL

January 12, 2006

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1 **Q. Please state your name and business address.**

2 A. My name is Donald L. Correll. My business address is 25 Manchester Street, Merrimack,
3 New Hampshire.

4 **I. BACKGROUND AND QUALIFICATIONS**

5
6 **Q. What is your position with Pennichuck Water Works?**

7 A. I am the President and Chief Executive Officer of Pennichuck Water Works, Inc. (PWW)
8 and of its parent company, Pennichuck Corporation ("PNNW"). As President and CEO
9 of PNNW, I also have ultimate responsibility for that company's other subsidiaries,
10 Pennichuck East Utility, Inc. ("PEU"), Pittsfield Aqueduct Company, Inc. ("PAC"),
11 Pennichuck Water Service Corporation ("PWSC") and The Southwood Corporation
12 ("Southwood").

13 **Q. Please summarize your professional and educational experience.**

14 A. I have a B.S. in accounting from The Pennsylvania State University and an M.B.A. in
15 Finance from New York University. Prior to joining Pennichuck Corporation in August
16 2003, I served as Chairman, Chief Executive Officer and President of United Water
17 Resources (United Water) from 1991-2001. During my tenure as President of United
18 Water, the company owned and operated water utilities in 14 states and had water and/or
19 wastewater operations in a total of 19 states with water related investments and/or
20 operations in Mexico, Canada and the United Kingdom. Domestically, United Water
21 provided water and/or wastewater services to a population of approximately 7.5 million.
22 Prior to 1991, I served as Sr. Vice President and Chief Financial Officer; Vice President-
23 Finance; Treasurer and Assistant Treasurer for United Water and its predecessor
24 company Hackensack Water Co. beginning in 1976. Throughout this period, I had

1 varying senior management responsibilities including strategic planning, finance,
2 accounting, rates and regulatory relations. Prior to 1976, I worked for Price Waterhouse
3 and Co. in New York City. I maintain a CPA license in New York State.

4 From early 2002, I served as an advisor to numerous water service and investment firms
5 on issues associated with marketing, acquisitions and investments in the water and
6 services sector. In April 2003, I became a Senior Advisor and a member of the Advisory
7 Board of Underground Solutions Inc., a pipe technology and rehabilitation business. I
8 continue to serve as a Commissioner of the New Jersey Water Supply Authority
9 (NJWSA) by appointment of former Governor Christine Whitman. The NJWSA operates
10 three water storage reservoirs, a water canal transmission system and a treatment plant
11 and provides raw and treated water to a population base of more than 3 million. In
12 August 2005, I was appointed to the U.S. Environmental Protection Agency's
13 Environmental Financial Advisory Board. I currently serve on the Board of Directors of
14 HealthSouth Corporation, which I joined in mid-2005.

15 **Q. Please describe prior testimony you have provided before regulatory agencies or**
16 **other governmental entities.**

17 A. I previously submitted prefiled direct and rebuttal testimony to this Commission in
18 Docket DW 04-056, PWW's last general rate case. I have also testified or appeared
19 before numerous utility commissions on various issues on behalf of PNNW or its utility
20 subsidiaries, United Water (or its utility subsidiaries) and their industry trade association,
21 the National Association of Water Companies (NAWC). I have testified before the New
22 Jersey, New York and Pennsylvania public utility regulatory commissions on issues
23 associated with debt and equity financings, rate base, operating expenses, tax issues,

1 capital structure, interim rate relief, phase-in plans, water offset clause (energy
2 adjustment mechanisms) and reorganization as a holding company. On behalf of the
3 industry and the NAWC, I have also testified before the U.S. House Ways and Means
4 Committee on tax proposals; a subcommittee of the Appropriations Committee regarding
5 infrastructure financing issues and EPA funding; and the U.S. Department of Treasury,
6 Internal Revenue Service regarding regulations applicable to Private Activity Bonds and
7 Qualified Management Contracts (i.e. long term water and wastewater management
8 outsourcing agreements). In addition, I have made presentations to the National
9 Association of Regulatory Utility Commissioners and both the Mid-Atlantic and New
10 England Conferences of Public Utilities Commissioners.

11 **Q. What is the purpose of your testimony in this proceeding?**

12 A. My testimony will provide the Commission with an overview of PWW and the
13 Pennichuck family of companies, including a discussion of their interdependence. I will
14 then briefly discuss those companies' history of serving New Hampshire and the benefit
15 that the public has received from the creation of an integrated regional utility system and
16 the harm that is likely to come from taking away the core of that system. Finally, I will
17 describe the likely impact on PWW's affiliates and their customers as well as on the
18 shareholders of PNNW if Nashua is allowed to take PWW's assets by eminent domain.

19 **II. DESCRIPTION OF PENNICHUCK ENTITIES**

20 **Q. Please describe PWW and the other members of the Pennichuck family of**
21 **corporations.**

22 A. As the Commission is aware, Pennichuck Water Works, Inc. is a public utility that serves
23 approximately 24,500 customers in Nashua and 10 other municipalities in Southern and

1 Central New Hampshire. PWW is wholly owned by Pennichuck Corporation, which is a
2 publicly traded holding company listed on the NASDAQ stock exchange. The holding
3 company has a very small market capitalization, and as a result its shares are very thinly
4 traded. As of November 10, 2005, Pennichuck Corporation had approximately 4.2
5 million shares outstanding, with an average daily trading volume of approximately 2,650
6 shares during the preceding 30 days. Pennichuck Corporation has approximately 3,000
7 investors. I should note that on June 1, 2005, Pennichuck Corporation's stock split 4 for
8 3. Prior to that date, the number of shares outstanding was approximately 2.4 million,
9 with average trading volume over the preceding 30 days being approximately 2,400
10 shares. Pennichuck Corporation's sole purpose is to hold the stock of its subsidiaries and
11 provide PWW and its sister companies better access to the capital markets. The
12 following is a summary of each of the subsidiaries of Pennichuck Corporation.

13 **A. Pennichuck Water Works, Inc.**

14 Overview of Business – PWW is a public utility that provides water service to
15 24,485 customers in 11 municipalities in Southern and Central New Hampshire. It is the
16 largest investor owned water utility in New Hampshire.

17 Municipalities Served – PWW currently owns and operates in 11 New Hampshire
18 municipalities three hydraulically connected systems, including the core system, plus 21
19 other non-contiguous water systems. The distribution systems serving the City of Nashua
20 and a small portion of the Towns of Merrimack and Hollis are operated as a single unit
21 and have come to be known as the "core system" because they form a contiguous,
22 hydraulically interconnected water distribution system relying exclusively on the same
23 water sources, treatment plant and network of mains. Except as noted below, all of the

1 water systems operated by PWW outside of Nashua are hydraulically distinct from the
2 Nashua core system and are able to operate independently of that system. The
3 communities in which PWW operates are as follows:

4 Amherst – 760 customers are served by the Amherst Village and Bon Terrain
5 systems, which each have their own wells, plus a backup hydraulic
6 connection through a single pipe to the core system. An additional 181
7 customers in Amherst are served by 2 separate community well systems

8 Bedford – 812 customers are served by 5 systems

9 Derry – 648 customers are served by 5 systems

10 Epping – 78 customers are served by 1 system

11 Hollis – 67 customers, all of whom are served by the core system

12 Merrimack – 222 customers are served by the core system

13 Milford – 119 customers are served by 3 systems

14 Nashua – 21,604 customers, all of whom are served by the core system

15 Newmarket – 87 customers are served by 1 system

16 Plaistow – 194 customers are served by 3 systems

17 Salem – 72 customers are served by 1 system

18 Tyngsboro, MA – 1 customer, which is served by the core system

19 **B. Pennichuck East Utility, Inc.**

20 Business – PEU is a public utility that provides water service to approximately
21 4,900 customers in 12 municipalities in Southern and Central New Hampshire.

1 Municipalities Served – PEU currently owns and operates 31 non-contiguous
2 water systems in 12 municipalities. None of these water systems are connected to the
3 Nashua core system. The communities in which PWW operates are as follows:

4 Atkinson – 5 customers are served by 1 system

5 Bow – 15 customers are served by 1 system

6 Derry – 218 customers are served by 2 systems

7 Hooksett – 92 customers are served by 2 systems

8 Lee – 34 customers are served by 1 system

9 Litchfield – 1,641 customers are served by 1 system

10 Londonderry – 1,667 customers are served by 9 systems

11 Pelham – 302 customers are served by 3 systems

12 Plaistow – 20 customers are served by 1 system

13 Raymond – 307 customers are served by 2 systems

14 Sandown – 11 customers are served by 1 system

15 Windham – 625 customers are served by 7 systems

16 **C. Pittsfield Aqueduct Company, Inc.**

17 Business – PAC is a public utility that currently provides water service in the
18 Town of Pittsfield.

19 Municipalities Served – Although PAC currently provides service in the Town of
20 Pittsfield only, if its petition to operate several additional troubled water systems in
21 Central and Northern New Hampshire is approved in Docket DW 05-132, its service
22 territory will expand to include the Towns of North Conway, Middleton and Barnstead.

1 The number of customers for each system that is operated or proposed to be operated by
2 PAC is as follows:

3 Barnstead – 755 customers

4 Middleton – 83 customers

5 North Conway – 207 customers

6 Pittsfield – 640 customers

7 **D. Pennichuck Water Service Corporation**

8 Business – PWSC operates municipal and developer and other privately owned
9 water systems in New Hampshire and Massachusetts under contracts with over 80
10 owners of those systems. Currently, PWSC operates the municipal systems in Hudson,
11 New Hampshire and Salisbury, Massachusetts. It also recently was awarded the contract
12 to operate the municipal system in Barnstable, Massachusetts. In addition, PWSC is the
13 certified operator for many non-community water systems, providing laboratory testing,
14 monitoring and consulting services.

15 Municipalities Served –

16 Hudson – PWSC serves 5,300 customers in the Hudson municipal water system.

17 Barnstable—Beginning February 1, 2006, PWSC will serve approximately 7,300
18 customers in the Barnstable, Mass. municipal water system.

19 Salisbury – PWSC serves 3,234 customers in the Salisbury, Mass. municipal
20 water system.

21 **E. The Southwood Corporation**

22 Business – Southwood is a developer of commercial and residential real estate.
23 Southwood’s holdings include over 500 acres of developable land located in Southern

1 New Hampshire, as well as a portfolio of multi-tenant office buildings. Southwood's
2 activities include land planning, land development and sales, as well as developmental
3 joint ventures, acquisitions of income properties, and asset management.

4 **Q. What is the relationship between PNNW, PWW and the other subsidiaries of**
5 **PNNW in terms of their financial and managerial interdependence?**

6 **A.** PNNW does not have any employees, nor do any of its subsidiaries other than PWW and
7 Southwood. Southwood has only two employees. PWW, on the other hand, employs 93
8 individuals. Although they work primarily for PWW, the cost associated with those
9 employees is allocated to PWW's affiliates in accordance with a cost allocation
10 agreement between the companies, a copy of which is included with this testimony as
11 Attachment DLC-1. Similarly, many of the assets associated with the operation of each
12 company are actually owned by PWW and shared with its affiliates. PAC and PEU each
13 own the pipes, water resources and other assets that are actually located in their service
14 territories, and Southwood holds the real estate interests that constitute its business, but
15 otherwise almost every other asset needed to operate any of the Pennichuck entities and
16 their businesses is owned by PWW and shared with those other entities. Again, under the
17 cost allocation agreement, the cost of those assets is shared by the other entities, which
18 enables PWW to reduce the cost to serve its customers and similarly reduces the cost that
19 PEU, PAC and PWSC would have incurred if they had been required to acquire such
20 assets for their own use. Similarly, PEU and PAC are able to take advantage of better
21 short term debt rates by relying entirely on PNNW for their short term borrowings. In the
22 absence of PWW, the terms of that debt could be expected to be substantially less
23 favorable. Short term lending between PNNW and its subsidiaries is largely done

1 pursuant to the Pennichuck companies' Money Pool Agreement, a copy of which is
2 included as Attachment DLC-2 to this testimony.

3 **Q. What assets are you referring to when you say that PEU, PAC, PWW and PWSC**
4 **rely on a common set of assets?**

5 A. Mr. Ware will discuss this issue in more detail, but I am referring to assets such as
6 computer systems, offices, vehicles, inventory and supplies, and almost anything that is
7 needed to operate a utility but is not located on site at a specific water system.

8 **III. BENEFITS THAT PENNICHUCK BRINGS TO NEW HAMPSHIRE**
9

10 **Q. You mentioned earlier that PWW is the largest investor owned water utility in New**
11 **Hampshire. What is the significance of that fact?**

12 A. The capabilities, asset base, capital raising ability, management and field personnel of
13 PWW, which are shared with its sister companies--PEU, PAC and PWSC--make it
14 possible for the Pennichuck companies to acquire and operate other drinking water
15 systems in New Hampshire. Presently the Pennichuck companies own or provide
16 operational services for over 130 such water systems. This benefits the Pennichuck
17 companies' existing customers by spreading their cost structure across a larger customer
18 base. Of equal importance, it creates a tool by which the Commission and others in the
19 state can address the problems associated with the many troubled water systems in New
20 Hampshire. These problems arise from various sources, but most frequently result from
21 undercapitalized public utilities, developer or owner operated systems, and systems that
22 face technical challenges associated with a lack of supply sources or increased
23 environmental requirements that are difficult and expensive to meet. While in some
24 cases PWW has been the entity that actually acquired troubled systems, the ability of

1 PEU and PAC to do so has been entirely dependent on the resources—both capital and
2 operational—of PWW. Without PWW and its assets and personnel, PEU and PAC
3 would effectively be incapable of acquiring other troubled systems. I will address this
4 concern in more detail later in my testimony. In addition, PWW's Senior Vice President
5 for Operations, Mr. Donald Ware, and former PUC Chairman Douglas Patch will discuss
6 in more detail the role that the Pennichuck companies have played over the years in
7 helping to address the issue of troubled water systems in New Hampshire.

8 **Q. Why have the Pennichuck utilities acquired other water systems over the years?**

9 A. Since Pennichuck was first granted the franchise 156 years ago to create a water system
10 for the geographic area that later became the City of Nashua, building and investing in
11 water systems has been our core business. As I mentioned earlier, careful expansion of
12 our system benefits our existing customers because it enables us to spread ongoing
13 operating costs across a larger customer base. In addition, where additional capital
14 investment is needed to rectify existing problems in systems that the Pennichuck
15 companies acquire, the expansion provides Pennichuck with an opportunity to increase its
16 earnings based on appropriate rate relief after review of the investments by the
17 Commission. It is hard to imagine a municipal utility regularly taking on the challenge of
18 troubled water systems outside of its municipal boundaries (whether that be a single city
19 or a group of municipalities operating in the form of a district) if that expansion required
20 a commitment of additional capital. Obviously, a governmentally owned utility has no
21 profit motive to pursue such an expansion, and it is inconceivable that a political body
22 would take on such a burden and the associated risks in order to help people outside of
23 their political boundaries.

1 This was well illustrated by Nashua's mayor, who stated succinctly the municipal
2 disinterest in expansion, when he replied in answer to a question about PWW systems in
3 Epping and Newmarket, "I'm not concerned about Epping or Newmarket." As to
4 potential water system acquisitions in communities like Gilford or Tilton, he stated that
5 we would not actively look for such acquisitions, because he is the mayor of *Nashua*.
6 See Bernard A Streeter deposition excerpts, attached hereto as Attachment DLC-3.

7 **Q. Earlier, you mentioned PWSC as well when you were discussing the benefit to New**
8 **Hampshire that would be lost if the resources of PWW were not available to assist**
9 **customers of water systems not currently owned by the Pennichuck entities. How**
10 **does PWSC fit into that consideration?**

11 A. In some instances, the troubled water systems that I spoke of are either municipally
12 owned or are owned by private parties who do not wish to sell their system. In these
13 instances, PWSC is available to work with the system owner to address their operational
14 or supply problems. In some cases, that assistance comes in the form of an ongoing
15 relationship. In others, PWSC may perform discrete services for the owner to assist them
16 with a particular problem. Again, because PWSC is entirely dependent on resources that
17 are owned or controlled by PWW, PWSC's ability to continue in such a role after an
18 eminent domain taking is highly doubtful.

19 **Q. Does PWW itself also provide benefits to systems that are not owned by the**
20 **Pennichuck companies?**

21 A. Yes. In addition to the contract services that PWSC provides through its allocated use of
22 PWW employees and assets, PWW itself sells water at wholesale directly to other
23 municipalities such as Hudson, Milford and Merrimack. Needless to say, it is likely that

1 renewal of those wholesale supply relationships (and the terms on which such
2 relationships would exist) would be more at risk if Hudson, Milford and Merrimack were
3 reliant on the City of Nashua for such arrangements. In that case, the usual inter-
4 municipal jealousies would likely interfere with the relationship. Moreover, the
5 communities to which PWW sells water would also lose the protection of PUC oversight
6 of those relationships. There have been many cases in New Hampshire, as well as
7 elsewhere in the region and throughout the country, where municipalities with available
8 water resources have been unwilling to share those resources with other communities
9 because of concerns about supporting development in those other towns and other
10 competitive reasons. Given the nature of local politics, Pennichuck's own experience and
11 reports from other communities, there's good reason to believe that Nashua would act no
12 differently.

13 **Q. Do you have any reason to believe that the municipalities affected by the proposed**
14 **PWW condemnation could overcome local politics and that Nashua could gain the**
15 **confidence of the other communities in which Pennichuck operates?**

16 **A.** I do not see any such indication. I spoke previously about Nashua's disinterest in two
17 current PWW communities and its lack of enthusiasm for further expansion. Other towns
18 are leery of Nashua as well. Leaders of towns previously supporting Nashua's efforts
19 have expressed concerns with its lack of consensus building. A town councilor in
20 Bedford, also the chair of the Merrimack Valley Regional Water District, stated in his
21 deposition that "I do not believe that Bedford is well served by being a customer of the
22 City of Nashua." Excerpts from the deposition of Michael J. Scanlon are attached hereto
23 as Attachment DLC-4.

1 **IV. HARM ARISING FROM TAKING BY NASHUA**

2
3 **Q. If most or all of PWW's assets were taken by eminent domain, what impact would**
4 **that have on the ability of PNNW and its remaining subsidiaries to continue in**
5 **business in their current form?**

6 A. In considering that question, it is critical to bear in mind that PWW constitutes
7 approximately 75% of the asset base of PNNW. In the absence of the water systems
8 owned and operated by PWW, PNNW's two remaining utility subsidiaries would have
9 approximately 5,500 customers. PNNW, either on its own or through one of its
10 remaining subsidiaries, would have to acquire the computer systems, vehicles and other
11 assets that were formerly owned by PWW, but would have only a fraction of the previous
12 customer base over which to spread those costs. Similarly, although it would obviously
13 take fewer employees to operate such a system, significant economies of scale would be
14 lost. As a result, rates for PEU and PAC customers would be seriously adversely
15 affected. The shrunken size of the Pennichuck family of companies would also be certain
16 to result in a lower level of customer service by PEU and PAC. Those companies
17 currently rely heavily on the systems and support that are associated with the larger
18 PWW customer base, and a similar level of staffing and investment would be impossible
19 to justify for the remainder of the Pennichuck system.

20 For PWSC, the effect would almost certainly be even more devastating than for PEU and
21 PAC. That is because PWSC operates under contract with its customers. It cannot seek
22 rate relief during the term of a contract, so to the extent that its operating costs increased,
23 it would simply lose money on its existing contractual arrangements. If it was able to
24 survive until the expiration of those contracts, it would then face the challenge of

1 obtaining contract renewals at significantly increased prices. If the municipalities that
2 PWSC currently serves were unwilling to pay such increases, it is likely that PWSC
3 would have to close down. The loss of the PWSC customer base would have a further
4 significant adverse impact on PEU and PAC because of the additional lost economies of
5 scale and cost sharing. As you can see, there is likely to be a kind of negative spiral that
6 would threaten the ability of these companies to continue in business in any financially
7 viable form. At the same time, a company that faces these types of challenges and is
8 essentially a shrunken, debilitated version of its former self would have an extremely
9 difficult, if not impossible time, hiring and retaining talented management personnel,
10 further posing challenges for the business and risks to its ability to provide customer
11 service.

12 **Q. Is there likely to be an impact on the ability of the Pennichuck companies to access**
13 **the capital markets in the event PWW is taken by eminent domain?**

14 A. As for their access to the debt markets, the impact would be immediate. PNNW provides
15 all of the short term debt financing for the Pennichuck companies through a \$16 million
16 line of credit with Bank of America. In addition, PNNW currently provides PAC's long
17 term debt as well. As for PEU, PNNW is a coborrower on all of that company's long
18 term debt. All of the debt instruments to which PNNW is a party have acceleration
19 provisions that specifically require them to be paid in full if the assets of PWW are
20 transferred. (A copy of the applicable provisions from the loan agreements for PNNW
21 and PEU are included with this testimony as Attachment DLC-5.) Thus, if PWW were
22 taken by eminent domain, PEU, PAC and PNNW's existing debt capital would disappear
23 overnight. The companies would then have to seek new debt financing, which, if

1 available, could only be obtained on much less desirable terms (particularly interest rates)
2 than the current debt because of the much higher risk profile presented by the remaining
3 companies. I cannot quantify the impact in dollar terms at this time, but this additional
4 cost would likely be quite significant and then would have to be recognized through the
5 ratemaking process in the form of a higher allowed cost of capital and the higher rates
6 that would be commensurate with the increased cost of capital.

7 **Q. What about the impact on the Pennichuck companies' access to the equity capital**
8 **markets?**

9 A. It is harder to predict the impact on PNNW's access to the equity markets. The most
10 likely impact would be that PNNW would not last long as a stand-alone company, and
11 that it would need to be acquired by a larger utility holding company. Because PWW
12 represents such a large portion of PNNW's business, after paying applicable income taxes
13 from the sale of the PWW assets, PNNW's board would likely have to examine its
14 strategic options and, among other things, would need to consider using the cash from the
15 eminent domain taking in a so-called self tender offer (i.e., to buy back its stock from
16 shareholders). The reason for this is that PNNW shareholders have invested in a water
17 company, and not a speculative or more risky company that might seek to use cash from
18 a taking by Nashua to begin buying other businesses. Either before or after shares were
19 repurchased from existing investors, it is likely that the company's board would also have
20 to consider entertaining purchase offers from other companies in order to avoid the fate I
21 described earlier. The reality is that, as a stand-alone company, a shrunken Pennichuck
22 Corporation would have very limited, if any, access to equity capital, and the most likely
23 way to address that problem would be through a sale to a larger company. Ironically, that

1 is the very result that Nashua was seeking to avoid when it began the eminent domain
2 process, and which an eminent domain taking would effectively ensure would come to
3 pass for customers outside of Nashua.

4 **Q. Why couldn't PNNW simply use the cash to begin buying other water companies?**

5 A. There simply aren't sufficient opportunities to buy water companies in the geographic
6 area where PNNW has experience doing business. To provide some perspective, the
7 combined purchase price for all of the other water systems purchased by the Pennichuck
8 Companies in the last twenty years is less than \$10 million. The idea that practically
9 overnight the company could effectively and efficiently spend \$200 million or more (or
10 even \$100 million, if Nashua is to be believed) to buy other water systems in New
11 Hampshire and nearby areas is simply unrealistic.

12 Certainly, what PNNW does with the proceeds of an eminent domain taking is a matter
13 that the board of directors would have a fiduciary duty to address. At that point, any use
14 of the proceeds would have to be in the best interests of the company's shareholders.
15 Given the significantly changed outlook for the company, the board would have to
16 seriously consider a liquidation of the balance of the company, depending on shareholder
17 response to any stock buyback offer. For over 150 years, investors have supported
18 Pennichuck, first as a company with a central urban core system and more recently as a
19 core system operating in conjunction with smaller satellite systems throughout New
20 Hampshire. It cannot be assumed that shareholders would want to continue to invest in a
21 much smaller company with a far riskier business outlook. Nashua's suggestion that
22 PNNW could suddenly take the huge amount of proceeds of an eminent domain taking
23 and simply redeploy them in other water systems in New Hampshire, or even the New

1 England region, in any reasonable period of time is simply unfounded, defies logic and
2 demonstrates a lack of understanding of corporate governance.

3 **Q. What taxes are paid by PWW that would be lost to the State of New Hampshire if**
4 **its assets were taken by Nashua?**

5 A. If PWW's assets were taken by Nashua, approximately half a million dollars of tax
6 revenues from PWW's business would be lost to the State of New Hampshire. This
7 includes the business enterprise tax (\$51,853 in 2004), the statewide utility property tax
8 (\$208,825 in 2004) and the PUC's annual assessment (\$41,465 in 2004). In addition, the
9 business profits tax normally attributable to PWW would be lost as well. Prior to the
10 onset of eminent domain litigation, PNNW's annual business profits tax bill was
11 approximately \$200,000, the vast majority of which was based on PWW's net income.
12 These taxes would be lost to the state even assuming for the moment that Nashua decided
13 to collect a payment in lieu of taxes with regard to its own local real estate taxes and
14 pledged to pay any taxes imposed on property held in other municipalities. In addition, it
15 is reasonable to anticipate that the annual revenues from PWW for these taxes would be
16 likely to increase over the years, but under ownership of the assets by Nashua they would
17 be completely lost to the state. In order for the State of New Hampshire to balance its
18 budgets in coming years, these lost revenues will either have to be collected from other
19 taxpayers in the form of higher taxes or the state will need to reduce its spending
20 incrementally. Similarly, the PUC's annual assessment to other utilities will need to be
21 increased in order to make up for the lost revenues from PWW's share of the annual
22 assessment, unless the Commission is able to reduce its own expenditures through
23 staffing reductions or other cost saving measures.

1 **Q. What would be the tax impact on PNNW if Nashua were allowed to acquire PWW's**
2 **assets?**

3 A. If Nashua were to take PWW's assets, the most significant tax impact would be the
4 imposition of state and federal income taxes totaling approximately 39% on the
5 difference between the purchase price and the original cost less depreciation of the assets.
6 Because a large portion of PWW's assets are of a fairly old vintage, this differential
7 would be substantial and the income tax burden would certainly run into the many tens of
8 millions of dollars. This income tax burden on PNNW would be in addition to the capital
9 gains tax that would be incurred by shareholders receiving cash for their shares in the
10 liquidation scenario I described earlier.

11 Nashua has consistently sought to mislead the public as to the extent of the tax burden
12 that would be borne by PWW and the shareholders of PNNW, as part of its campaign to
13 convince the public that the cost of acquiring PWW and its affiliates would be minimal.
14 This effort included public statements by city officials as part of the city's hostile tender
15 offer in November 2003, when city officials misrepresented that the city's offer for all of
16 PNNW's assets was equivalent to the value offered by the stock for stock transfer
17 proposed by Philadelphia Suburban Corporation ("PSC"). The statements by city
18 officials were not only inaccurate, they also resulted in NASDAQ's halting trading in
19 PNNW's stock and led to an inquiry by the NASD.

20 The tax expenses are costs that Nashua has assumed should be borne by the company and
21 by shareholders, despite the fact that they would not have arisen under any realistic
22 scenario in the absence of eminent domain. It would be an extraordinary financial harm

1 to inflict on utility investors, particularly given the Pennichuck companies' history of
2 supporting growth in New Hampshire through capital investment.

3 **Q. During the last two years or so, Pennichuck Corporation has announced the**
4 **acquisition of a number of smaller water systems in New Hampshire, has extended**
5 **service to new service territories and has undertaken the operation of an additional**
6 **municipal water system in Massachusetts. What is the purpose of these**
7 **acquisitions, and what is the likelihood that transactions like these will occur if**
8 **Nashua is allowed to take PWW?**

9 A. These transactions have been part of PNNW's continuing strategy to increase its overall
10 customer base and continue to spread its fixed costs over that larger base. This strategy
11 benefits existing customers by managing the cost of service more efficiently than can be
12 done with a smaller customer base and benefits shareholders by diversifying PNNW's
13 service territories. If PWW were not part of PNNW, however, there is simply no way
14 that the company would have the capital, technical or managerial resources to undertake
15 this type of effort. The result would be a direct and immediate harm to both PNNW's
16 shareholders and the customers of PEU and PAC.

17 **Q. You have stated in other forums that the eminent domain process was undertaken**
18 **by Nashua with the intention of disrupting the proposed merger between**
19 **Pennichuck Corporation and PSC. Is it your position that Nashua was never really**
20 **serious about completing an eminent domain taking?**

21 A. Yes. I am confident that Nashua undertook this process with the intention of interfering
22 with the proposed PSC/PNNW transaction, regardless of whether customers would have
23 benefited from it and without first seriously studying the claimed benefits of

1 municipalization of utility service. After the city succeeded in killing the PSC
2 transaction, it appears that political pressures and the fear of potential liability to PNNW
3 made it impossible or at least unacceptable for the city to simply call an end to the
4 threatened taking. I know from information obtained by company representatives that,
5 when it became apparent that the strategic goals of the city were not going to be satisfied
6 by having Nashua's own professional public works staff study the issues surrounding a
7 takeover of the water system, the Department of Public Works was largely cut out of the
8 process and the matter was handed over instead to outside consultants. These consultants
9 apparently were willing to develop a more aggressive strategy that wasn't based on
10 examining the kinds of issues that would normally be considered before proceeding with
11 an eminent domain taking and establishment of a municipal water system.

12 Another reason for my belief is that this is not the first time that Nashua has threatened
13 Pennichuck Water Works with eminent domain. On each prior occasion the city has
14 ultimately walked away from the process. The city's last aborted attempt at eminent
15 domain occurred in the late 1950's. Before that, Nashua explored the process in 1911
16 because Pennichuck Water Works was considering extending service to Hudson. Both
17 times, Nashua dropped its plans for a taking. Ironically, at the outset of the current effort,
18 Nashua's chief argument to its citizens was that PNNW was proposing to merge with a
19 company that had a minority shareholder that was French owned. Of course, as the
20 Commission is aware from prior pleadings and public reports, that company is no longer
21 a PSC (now known as Aqua America) shareholder, but incredibly Nashua has identified
22 that same company's French owned operating subsidiary as its intended operator for the
23 PWW system if Nashua were to complete a taking. All of this demonstrates that Nashua

1 was willing to do and say whatever it took at the time to kill the PSC transaction, and that
2 this proceeding was never really about a genuine desire on the part of Nashua to own the
3 water system.

4 Additional evidence that Nashua is not serious about completing a taking is reflected in
5 the public discussions between Nashua's aldermen and the city's consultants. Those
6 consultants have consistently advised the city that it can use the eminent domain process
7 as a means of increasing city tax revenues and simply walk away from that process
8 without cost after obtaining a PUC determination of value. I have included Attachment
9 DLC-6, which gives one example of such advice. In addition, I know that the city has
10 again been given that advice, most recently at a November 28, 2005 meeting in response
11 to a question from Alderman Johnson, who was told that, at the end of the PUC process,
12 the city can simply walk away from eminent domain and increase PWW's taxes based on
13 an asset value determined by the PUC.

14 **Q. What has been the impact to date on PNNW and its subsidiaries of Nashua's**
15 **actions?**

16 A. The result of Nashua's tactics has been hugely damaging not just to PNNW and its
17 subsidiaries, but also to PNNW's shareholders as well as to the customers of PNNW's
18 subsidiaries. I want to stress that this harm is in addition to the prospective harm that
19 would occur if a taking were actually authorized.

20 When considering the harm that Nashua has caused through the eminent domain process,
21 it is worth considering that, had the proposed merger with PSC been completed, the
22 shares of PNNW shareholders at the time would be worth approximately \$145,800,000
23 today. Instead, those shares are worth a combined total of approximately \$63,600,000, a

1 difference of 82,200,000. In addition to the huge loss that PNNW's shareholders have
2 suffered directly, PNNW has incurred \$2.2 million in merger termination expenses as
3 well as what has been and will almost certainly continue to be millions of dollars in
4 expense to litigate eminent domain issues.

5 Of equal significance, as the Commission is aware, the Pennichuck Companies are
6 relatively small by comparison to many utilities, and they have a very limited
7 management staff. This proceeding has been an immense burden on them because,
8 unlike the City of Nashua, the company must rely on its own personnel—people like Don
9 Ware, Bonnie Hartley, Dan Incropera (our controller) and their colleagues—who must
10 spend many dozens of hours a week over a period of many months or years working on
11 this case to answer data requests and gather information to assist the company and its
12 attorneys. It is hard to describe the enormity of the effort involved and the personal and
13 professional toll it can take. At the same time, these individuals are responsible for
14 running the Pennichuck companies—dealing with customer related issues, capital
15 planning, regulatory filings, financings, PNNW's recent equity offering, budgeting, and
16 on and on. Those responsibilities don't simply go away because PWW is trying to
17 defend itself against a taking by Nashua. This extraordinary burden takes a toll over time
18 and has the potential to interfere with the company's core business and long term growth
19 and mission. That type of interference with our business and our service to our customers
20 is plainly not in the public interest and, frankly, is deeply offensive to me and I believe
21 should be deeply troubling to the Commission. Even though the immediate adverse
22 impact of these types of issues is hard to quantify, I truly believe it is important to

1 understand and weigh the very human element to the damage that Nashua has done and is
2 doing, and the significance of that impact on customers and investors alike.

3 **Q. What relevance do these concerns have to the Commission's public interest**
4 **analysis?**

5 A. I certainly believe that the considerable adverse impact I have described with regard to
6 the customers of PEU, PAC, PWSC and PWW should be given extremely heavy weight
7 by the Commission in its consideration of this case. But I also believe that the
8 Commission must consider the significant adverse impact that has been and will be
9 suffered by PNNW, as the shareholder of those entities, and by PNNW's shareholders. In
10 considering both the public interest and valuation aspects of this case, I believe the
11 Commission should take into account the enormity of the lost investment and business
12 opportunity and other damages that Nashua has already inflicted on shareholders. To do
13 otherwise would be to reward Nashua for its bad faith tactics and calculated efforts over
14 the last several years.

15 **Q. What message would a taking by Nashua send to owners of other investor owned**
16 **utilities in New Hampshire?**

17 A. I believe that investors and potential investors in other utilities in New Hampshire,
18 particularly water utilities, would receive a very negative message if this were to occur.
19 It would tell them that in New Hampshire the interests of investors are given little or no
20 weight by regulators. That has not been my experience to date, and it would be a very
21 dangerous road to embark on.

1 **Q Nashua has said that it intends to contract with a qualified third party for the**
2 **operation of the water utility. If it does that, do you still foresee service quality**
3 **problems that are posed by City ownership of the utility?**

4 A. Yes, even if Nashua were to contract with an outside operator that arguably has the
5 technical ability to operate the utility, the City's internal political struggles are still likely
6 to be a major obstacle to the successful operation of the utility. Capital budgeting and
7 investment as well as environmental compliance are ultimately the responsibility of the
8 system owner, not the operator. Nashua, like other municipal owners, will need to
9 balance local political concerns and budgetary pressures when making these investment
10 determinations. This will pose a substantial risk to ensuring that proper long term
11 planning and investment occur, which should be of significant concern for a major city
12 service such as a drinking water system. I have included with my testimony as
13 Attachment DLC-7 several newspaper articles from the last six months that illustrate
14 some of the types of pressures and disputes that can arise as a result of the political
15 budgetary process.

16 **V. CONCLUSION**

17
18 **Q. What is your conclusion as to whether it is in the public interest for Nashua to be**
19 **authorized to take the assets of PWW by eminent domain?**

20 A. I do not believe that such a taking is in the public interest. It would cause significant
21 harm to the customers of PWW as well as those of PEU, PAC and PWSC. It would also
22 do substantial harm to the efforts of this Commission to address the problem of troubled
23 water systems in New Hampshire and would result in direct financial harm to the State of
24 New Hampshire. It would also send a negative message to investors considering whether

1 to in invest in New Hampshire utilities or their parent companies. Finally, an eminent
2 domain taking would have an enormously harmful impact on PNNW, as the shareholder
3 of PWW, and in turn on the shareholders of PNNW. Inflicting a major economic loss on
4 investors who have supported the growth and operations of an extremely well run utility
5 would be wrong and would be contrary to the interests of the people of this state.

6 **Q. Does that conclude your direct testimony?**

7 **A.** Yes, it does.