

**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 JOHN F. GUASTELLA

January 12, 2006

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

2 A. John F. Guastella, Guastella Associates, Inc., 6 Beacon Street, Suite 325, Boston, MA
3 02108.

4 **Q. Please describe Guastella Associates, Inc.**

5 A. Guastella Associates, Inc. provides utility management, valuation and rate consulting
6 services to both regulated and unregulated utilities.

7 **Q. Please describe your educational, professional and business background and
8 experience.**

9 A. I graduated from Stevens Institute of Technology in June of 1962, receiving a degree in
10 Mechanical Engineering, and I am a licensed professional engineer. I have completed
11 courses in utility regulation sponsored by the National Association of Regulatory Utility
12 Commissioners ("NARUC") and conducted by the University of Colorado, the
13 University of South Florida, Florida Atlantic University, the University of Utah, Florida
14 State University, the University of Florida, and Michigan State University.

15 I was employed by the New York State Public Service Commission for sixteen
16 years from 1962 to 1978. With the exception of two years in which I was involved in the
17 regulation of electric and gas utilities, my time with the New York Commission was
18 devoted to the regulation of water utilities. After a series of promotions during the years
19 1962 to 1970, attained through competitive examinations, I was promoted to Chief of
20 Rates and Finance in the Commission's Water Division. In 1972, I was made Assistant
21 Director of the Water Division. In 1974, I was appointed by the Chairman of the
22 Commission as Director of the Water Division, a position I held until my resignation
23 from the Commission in August of 1978.

1 My duties with the Commission included the performance and supervision of
2 various engineering and economic studies concerning valuation of utility property,
3 financing, rates and service of electric, gas and water utilities. While in the Water
4 Division, I either examined or supervised the examination of the books and records of
5 literally hundreds of water utilities.

6 As Director of the Water Division, I was responsible for the regulation of more
7 than 450 water companies in New York State, heading a professional staff consisting of
8 32 engineers and three technicians. One of my primary duties was to advise the
9 Commission during its adjudication of formal proceedings, as well as other matters. In
10 the course of those deliberations, testimony, exhibits and briefs submitted in formal
11 proceedings were reviewed and analyzed. My duties and responsibilities covered such
12 subjects as the reasonableness of investments in utility plant, appropriate depreciation,
13 contributions in aid of construction, advances in aid of construction, construction work in
14 progress, working capital, amortizations, rate base, revenue level, operation and
15 maintenance expenses, taxes, cost of capital, fundable capital, financing, capital structure,
16 rate of return, rate design, rate structure, quality of service and, in general, all aspects of
17 utility valuation, rate setting and service.

18 Another major responsibility was the review of all proposed legislation affecting
19 water utilities in New York and the subsequent preparation of recommendations for use
20 by the governor or the legislature in considering such legislation. I also made legislative
21 proposals and participated directly in drafting bills that were enacted: one expanded the
22 New York Commission's jurisdiction with respect to the regulation of the service
23 provided by small water companies and another dealt specifically with rate regulation and

1 financing of developer-related water systems. During my employment with the New
2 York Commission, I handled or supervised the handling of thousands of consumer
3 complaints by individuals, corporations and municipal, governmental and political
4 officials.

5 In 1978, I formed Guastella Associates, Inc. Concurrently with my position as
6 President of Guastella Associates, Inc., I served as President of Country Knolls Water
7 Works, Inc. from 1987 to 1991, directing the management and operation of this utility
8 which served some 5,000 customers.

9 I have prepared rate analyses, cost allocation and rate design studies, depreciation
10 studies, appraisals and valuations of utility property, and management and financial
11 analyses. I have provided consulting services for municipal and investor-owned water
12 and sewer utilities, as well as gas utilities and solid waste collection and disposal
13 companies.

14 **Q. Have you previously presented expert testimony in proceedings involving regulatory**
15 **agencies, municipal jurisdictions and court cases with respect to utility matters?**

16 A. Yes.

17 **Q. In what states were the utilities or regulatory agencies located?**

18 A. My testimony was presented on behalf of utilities or regulatory agencies in the states of
19 Alaska, California, Connecticut, Delaware, Florida, Georgia, Illinois, Indiana, Maryland,
20 Massachusetts, Missouri, Montana, Nevada, New Hampshire, New Jersey, New Mexico,
21 New York, North Dakota, Ohio, Pennsylvania, Rhode Island, South Carolina, Texas and
22 Virginia.

1 **Q. Briefly state your activities in connection with professional organizations and**
2 **associations.**

3 A. I served as Vice-Chairman of the Staff-Committee on Water of NARUC. While on that
4 committee, I prepared a 95-page instruction manual entitled, "Model Record-Keeping
5 Manual for Small Water Companies," which was published by NARUC. The manual
6 describes in detail the kinds of operating and accounting records that should be kept by
7 small water utilities, with instructions on how to use those records in order to properly
8 operate a water system and properly keep account of the cost of providing service.

9 Since 1974, I have prepared the rate case study material, assisted in the
10 coordination of the program and served as an instructor at the Annual Fall Seminar on
11 Water Rate Regulation sponsored by NARUC and conducted by the University of South
12 Florida, Florida Atlantic University, the University of Utah, Florida State University, the
13 University of Florida, and currently Michigan State University. This seminar is
14 recognized as being one of the best in the country for teaching rate-setting principles and
15 methodology. It is attended by representatives of regulatory agencies, utilities, and
16 engineering, accounting, economic and law firms throughout the country. In 1980, as a
17 special consultant to NARUC, I assisted in the establishment of another similar seminar,
18 which has been held annually in the spring in the western United States.

19 I served as an instructor and panelist in a seminar on water and wastewater
20 regulation conducted by the Independent Water and Sewer Companies of Texas. In
21 1998, I prepared and conducted a rate regulation seminar in Maine on behalf of the New
22 England Chapter of the National Association of Water Companies ("NAWC"). In 2000
23 and 2001, I prepared and conducted a seminar for developer related and small water and

1 sewer utilities in conjunction with Florida State University, and again in 2003 in
2 conjunction with the University of Florida. This seminar provided instruction as to the
3 financial structuring of utilities, rate setting, financing and valuation for market value
4 determinations in preparation for negotiated sales or condemnations. It also identified the
5 various problems faced by small utilities, the impact on their operations and potential
6 solutions. In 2004, I prepared and conducted a utility regulation and rate seminar for the
7 newly formed Office of Regulatory Staff in South Carolina.

8 As a member of the NAWC, I served on its Rates and Revenue Committee and
9 Small Company Committee. I am a lifetime member of the New England Water Works
10 Association. I am a lifetime member of the American Water Works Association
11 (“AWWA”) and served on its Water Rates Committee, assisting in the preparation of the
12 AWWA Rates Manual, Third Edition. I have also served on a joint committee on rate
13 design composed of staff members of NARUC and NAWC. In connection with my
14 serving on these committees, and in connection with cost allocation and rate design
15 studies I have performed in the course of my work, I have participated in decisional
16 meetings to determine proper engineering and construction criteria in relation to costs in
17 the design of water and sewer systems.

18 I have prepared and presented papers at a number of meetings of NARUC,
19 NAWC, the New England Conference of Public Utilities Commissioners, the Mid-
20 America Regulatory Conference, and at meetings of the Public Utility Law Section of the
21 New Jersey Bar Association, the Pennsylvania Environmental Council, the Southeastern
22 Association of Regulatory Utility Commissioners, the New Jersey Chapter of the

1 American Water Works Association, the Nassau County Water District Commissioners,
2 and the Florida, New England, New Jersey and New York chapters of NAWC.

3 **Q. What is the nature of your involvement in this proceeding?**

4 A. Guastella Associates, Inc. has been retained to prepare a rate analysis on behalf of
5 Pennichuck Water Works, Inc. ("PWW" or "Company") in connection with the pending
6 condemnation action by the City of Nashua.

7 **Q. What type of rate analysis were you asked to prepare?**

8 A. I was asked to estimate the revenue requirement that would be necessary under the
9 assumption that the City of Nashua acquired the PWW water systems, including the
10 Pennichuck "core" system and the "community" water systems, at the market value
11 determined by PWW's valuation experts. I have also been asked to estimate the rate
12 impact of such an acquisition on the other utility subsidiaries of Pennichuck Corporation,
13 Pittsfield Aqueduct Company, Inc. and Pennichuck East Utility, Inc.

14 **Q. What was your approach in estimating the revenue requirement under an assumed
15 acquisition by the City?**

16 A. On the basis of discussions with the Company's attorneys, it was determined that if the
17 acquisition takes place, it would not likely close prior to 2008. Accordingly, my
18 approach was to project a municipal operation (ownership by the City) beginning in
19 2008. In order to do so, I first projected PWW's operations, including revenues,
20 expenses and capital assets, beginning with actual information and projecting 2006
21 through 2015. I then converted the investor-owned operation into a municipal operation
22 for the years 2008 through 2015, eliminating such major costs as depreciation, income

1 taxes, a portion of real estate taxes, expenses related to economic regulation, cost of
2 capital, and adjustments to certain revenues and operating expenses.

3 **Q. What was the source of information that you relied on for your analysis?**

4 A. I obtained the Company's historical as well as projected financial, operational and billing
5 information. The financial information included projections of revenues, capital
6 additions and operating expenses for a 5 year period from 2005 to 2009.

7 **Q. Have you prepared an attachment that summarizes the results of your study?**

8 A. Yes. I have prepared Attachment JFG-1 entitled "Revenue Requirement Analysis" that
9 contains a summary of my study.

10 **Q. Would you please describe Attachment JFG-1?**

11 A. Yes. This contains four schedules (A, B, C and D) that show my estimate of the
12 projected operations under the assumed ownership of the City of Nashua from 2008
13 through 2015, along with supporting summary information. Schedule A sets forth the
14 results of my revenue projections, comparing the projected revenues under PWW
15 ownership and under the City's ownership. As shown, if the City acquired PWW's
16 systems at the market value of \$248,400,000, as determined by PWW's valuation expert,
17 it would essentially need the same revenues as PWW would need over the same period
18 based on a projection of the revenues PWW would require to cover its cost of providing
19 service during that period. The only difference of any note would be a rate increase in
20 2014 that would bring the City's revenue requirement to a level that is 4.1% higher than
21 PWW's projected revenues at that point in time. I would note that there are minor
22 differences of about 0.3% in each of the other years because it is estimated that there will

1 be slightly less growth under the City's operation and no revenues related to sewer billing
2 data that PWW collects.

3 A summary of the "Projected Operations Under PWW Ownership" is contained in
4 Schedule B. PWW's revenues are projected to reflect rate increases that cover increases
5 in operating expenses and the return requirement related to anticipated increases in
6 capital assets. A summary of the "Projected Operations Under Municipal Ownership" is
7 contained on Schedule C. For the municipal operation, operating expenses do not include
8 depreciation, costs related to rate regulation and income taxes; and other adjustments are
9 made for such items as capitalized labor and administrative costs. I would note that the
10 real estate taxes were adjusted to include a Payment in Lieu of Taxes for the core system
11 in the City of Nashua and for community systems in other municipalities, reduced to
12 reflect an estimate of real estate taxes only on land. Instead of depreciation and return on
13 investment, debt service has been included to cover the financing of the acquisition price
14 and projected major capital improvements, and debt service coverage of 1.15 times the
15 projected annual debt service. My projections assume that the municipal financing would
16 include an initial issuance of Revenue Anticipation Notes and then Long Term Bonds
17 issued after three years, with a 20 year term and a 4.6% interest rate, as summarized on
18 Schedule D. This schedule also shows the accumulation and use of surplus as a
19 "revenue stabilization fund" that is typically available under municipal utility operations
20 in order to maintain the coverage requirement.

21 **Q. Why do your projections extend to 2015?**

22 A. The projections under PWW's operations include major capital asset additions over a 5
23 year period, which will have a significant impact on the rates necessary to provide

1 adequate service to the customers under any ownership scenario. Assuming ownership
2 by the City beginning in 2008, the projection through 2015 provides enough time for
3 reviewing the revenue impact of the initial financing with Revenue Anticipation Notes
4 for the first three years as well as the impact of a long term financing after the third year.
5 This period also allows for a more comprehensive review of the revenue impact after
6 asset additions become routine and the revenue requirement stabilizes.

7 **Q. What is your opinion with respect to the revenue requirement under an assumed**
8 **acquisition by the City of Nashua at a market value of \$248,400,000?**

9 A. My analysis produces a revenue difference of 4.1% in the 7th year of the eight year
10 period. Given the magnitude of the overall revenues and the potential variances that
11 should be expected in any projections, I conclude that there would essentially be no
12 significant difference in terms of revenues under continued ownership by PWW or an
13 acquisition by the City of Nashua.

14 **Q. Have you estimated the rate impact of such an acquisition on the remaining**
15 **Pittsfield Aqueduct Company, Inc. and Pennichuck East Utility, Inc.?**

16 A. Not at this time. In order to complete that analysis I would need information with respect
17 to any common tangible and intangible assets that are evaluated as part of the appraisal
18 undertaken by other expert witnesses who will be submitting testimony simultaneously
19 with this testimony. Because that information is being prepared contemporaneously with
20 this testimony, the information necessary to complete such an analysis is not yet
21 available.

22 **Q. Does that conclude your testimony at this time?**

23 A. Yes.