
THE STATE OF NEW HAMPSHIRE
SUPREME COURT

No. 2009-0274

**Appeal of City of Nashua
Appeal of Pennichuck Water Works, Inc.,
Pennichuck Corporation, Pennichuck East Utility, Inc.,
Pennichuck Water Service Corporation, Pittsfield Aqueduct Company, Inc.**

Appeal by Petition Pursuant to RSA 541:6
from Final Order of New Hampshire Public Utilities Commission

APPENDIX TO BRIEF OF CROSS-APPELLANTS

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Pennichuck Water Service Corporation, Pittsfield Aqueduct Company, Inc.

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UNITED STATES CONSTITUTION

Fifth Amendment

No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a grand jury, except in cases arising in the land or naval forces, or in the militia, when in actual service in time of war or public danger; nor shall any person be subject for the same offense to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

Fourteenth Amendment

Section 1. All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the state wherein they reside. No state shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any state deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

NEW HAMPSHIRE CONSTITUTION

Part 1

[Art.] 2. [Natural Rights.] All men have certain natural, essential, and inherent rights - among which are, the enjoying and defending life and liberty; acquiring, possessing, and protecting, property; and, in a word, of seeking and obtaining happiness. Equality of rights under the law shall not be denied or abridged by this state on account of race, creed, color, sex or national origin.

[Art.] 12. [Protection and Taxation Reciprocal.] Every member of the community has a right to be protected by it, in the enjoyment of his life, liberty, and property; he is therefore bound to contribute his share in the expense of such protection, and to yield his personal service when necessary. But no part of a man's property shall be taken from him, or applied to public uses, without his own consent, or that of the representative body of the people. Nor are the inhabitants of this state controllable by any other laws than those to which they, or their representative body, have given their consent.

[Art.] 14. [Legal Remedies to be Free, Complete, and Prompt.] Every subject of this state is entitled to a certain remedy, by having recourse to the laws, for all injuries he may receive in his person, property, or character; to obtain right and justice freely, without being obliged to purchase it; completely, and without any denial; promptly, and without delay; conformably to the laws.

Art.] 15. [Right of Accused.] No subject shall be held to answer for any crime, or offense, until the same is fully and plainly, substantially and formally, described to him; or

be compelled to accuse or furnish evidence against himself. Every subject shall have a right to produce all proofs that may be favorable to himself; to meet the witnesses against him face to face, and to be fully heard in his defense, by himself, and counsel. No subject shall be arrested, imprisoned, despoiled, or deprived of his property, immunities, or privileges, put out of the protection of the law, exiled or deprived of his life, liberty, or estate, but by the judgment of his peers, or the law of the land; provided that, in any proceeding to commit a person acquitted of a criminal charge by reason of insanity, due process shall require that clear and convincing evidence that the person is potentially dangerous to himself or to others and that the person suffers from a mental disorder must be established. Every person held to answer in any crime or offense punishable by deprivation of liberty shall have the right to counsel at the expense of the state if need is shown; this right he is at liberty to waive, but only after the matter has been thoroughly explained by the court.

Part 2

[Art.] 83. [Encouragement of Literature, etc.; Control of Corporations, Monopolies, etc.] Knowledge and learning, generally diffused through a community, being essential to the preservation of a free government; and spreading the opportunities and advantages of education through the various parts of the country, being highly conducive to promote this end; it shall be the duty of the legislators and magistrates, in all future periods of this government, to cherish the interest of literature and the sciences, and all seminaries and public schools, to encourage private and public institutions, rewards, and immunities for the promotion of agriculture, arts, sciences, commerce, trades, manufactures, and natural history of the country; to countenance and inculcate the principles of humanity and general benevolence, public and private charity, industry and economy, honesty and punctuality, sincerity, sobriety, and all social affections, and generous sentiments, among the people: Provided, nevertheless, that no money raised by taxation shall ever be granted or applied for the use of the schools of institutions of any religious sect or denomination. Free and fair competition in the trades and industries is an inherent and essential right of the people and should be protected against all monopolies and conspiracies which tend to hinder or destroy it. The size and functions of all corporations should be so limited and regulated as to prohibit fictitious capitalization and provision should be made for the supervision and government thereof. Therefore, all just power possessed by the state is hereby granted to the general court to enact laws to prevent the operations within the state of all persons and associations, and all trusts and corporations, foreign or domestic, and the officers thereof, who endeavor to raise the price of any article of commerce or to destroy free and fair competition in the trades and industries through combination, conspiracy, monopoly, or any other unfair means; to control and regulate the acts of all such persons, associations, corporations, trusts, and officials doing business within the state; to prevent fictitious capitalization; and to authorize civil and criminal proceedings in respect to all the wrongs herein declared against.

REVISED STATUTES ANNOTATED

38:1 Definitions. – In this chapter:

I. "'Commission" means the public utilities commission, unless the context otherwise indicates.

II. "'Utility" means any public utility engaged in the manufacture, generation, distribution, or sale of electricity, gas, or water in the state.

III. "'Municipality" means any city, town, unincorporated town, unorganized place, or village district within the state.

IV. "'Municipal water company" means any water distribution system or water supply utility, owned or operated by a municipality, whether as a municipal department, separate company, or otherwise.

V. "'Regional water district" means any regional water district formed pursuant to RSA 53-A, for the purpose of providing and assuring the provision of an adequate and sustainable supply of clean water.

38:2 Establishment, Acquisition, and Expansion of Plants. – Any municipality may:

I. Establish, expand, take, purchase, lease, or otherwise acquire and maintain and operate in accordance with the provisions of this chapter, one or more suitable plants for the manufacture and distribution of electricity, gas, or water for municipal use, for the use of its inhabitants and others, and for such other purposes as may be permitted, authorized, or directed by the commission.

II. For these purposes, take, purchase, and hold in fee simple or otherwise lease or otherwise acquire and maintain any real or personal estate and any rights therein, including water rights.

III. Do all other things necessary for carrying into effect the purposes of this chapter.

IV. Excavate and dig conduits and ditches in any highway or other land or place, and erect poles, place wires, and lay pipes for the transmission and distribution of electricity, gas, and water in such places as may be deemed necessary and proper.

V. Change, enlarge, and extend the same from time to time when the municipality shall deem necessary, and maintain the same, having due regard for the safety and welfare of its citizens and security of the public travel.

38:2-a Establishment, Acquisition, and Expansion of Plants; Regional Water Districts. – Any regional water district may:

I. Establish, expand, purchase, lease, or otherwise acquire and maintain and operate in accordance with the provisions of this chapter, one or more suitable plants for the manufacture and distribution of water for the use of municipalities that are members of the regional water district and for such other purposes as may be permitted, authorized, or directed by the commission.

II. For these purposes, purchase and hold in fee simple or otherwise lease or otherwise acquire and maintain any real or personal estate and any rights therein, including water rights.

III. Do all other things necessary for carrying into effect the purposes of this chapter.

IV. Excavate and dig conduits and ditches in any highway or other land or place, and erect poles, place wires, and lay pipes for the distribution of water in such places as may be deemed necessary and proper.

V. Change, enlarge, and extend the same from time to time when the regional water district

shall deem necessary, and maintain the same, having due regard for the safety and welfare of the citizens of the member municipalities and security of the public travel.

VI. No regional water district shall have the authority to take property by eminent domain.

38:3 By Cities. – Any city may initially establish such a plant after 2/3 of the members of the governing body shall have voted, subject to the veto power of the mayor as provided by law, that it is expedient to do so, and after such action by the city council shall have been confirmed by a majority of the qualified voters at a regular election or at a special meeting duly warned in either case. Such confirming vote shall be had within one year from the date of the vote to establish such a plant, and if favorable, shall create a rebuttable presumption that such action is in the public interest. If the vote is unfavorable, the question shall not be again submitted to the voters within 2 years thereafter.

38:3-a By Regional Water Districts. – Any regional water district may initially establish such a plant after 2/3 of the members of the governing body of the district shall have voted affirmatively, and a majority of the constituent municipalities of the district by a majority vote of their legislative bodies have confirmed that vote. Such confirming vote shall create a rebuttable presumption that such action is in the public interest. If the vote is unfavorable, the question shall not be again submitted to the constituent municipalities within 2 years thereafter.

38:4 By Towns or Village Districts. – Any town or village district may initially establish such a plant after 2/3 of all the voters present and voting at an annual or special meeting, duly warned in either case, have voted by ballot with the use of the checklist that it is expedient to do so. A favorable vote to establish such a plant shall create a rebuttable presumption that such action is in the public interest. If such vote is unfavorable, the question shall not be again submitted to the voters within 2 years thereafter.

38:5 By Unincorporated Towns and Unorganized Places. – Any unincorporated town or unorganized place may initially establish such a plant after 2/3 of the members of the county convention shall have voted that it is expedient to do so, and, if there are any registered voters in that unincorporated town or unorganized place, after such action by the county convention shall have been confirmed by a majority of the qualified votes in that unincorporated town or unorganized place at a regular election or at a special meeting duly warned in either case. Such confirming vote shall be had within one year from the date of the vote to establish such a plant, and if favorable, shall create a rebuttable presumption that such action is in the public interest. If the vote is unfavorable, the question shall not be again submitted to the voters within 2 years thereafter.

38:6 Notice to Utility. – Within 30 days after the confirming vote provided for in RSA 38:3, 38:4, or 38:5 the governing body shall notify in writing any utility engaged, at the time of the vote, in generating or distributing electricity, gas, or water for sale in the municipality, of the vote. The municipality notifying any utility in such manner may purchase all or such portion of the utility's plant and property located within such municipality that the governing body determines to be necessary for the municipal utility service, and shall purchase that portion, if any, lying without the municipality which the public interest may require, pursuant to RSA 38:11 as determined by the commission. The notice to such utility shall include an inquiry as to whether the utility elects to sell, in the manner hereinafter provided, that portion of its plant and

property located within or without the municipality which the municipality has identified as being necessary for the municipal utility service.

38:7 Reply by Utility. – The utility shall reply to the inquiry provided for in RSA 38:6 by delivering its answer in writing to the governing body within 60 days of the receipt of the inquiry. If the reply is in the negative, or if the reply is not made within the 60 days, the utility thereby forfeits any right it may have had to require the purchase of its plant and property by the municipality, and the municipality may proceed to acquire the plant as provided in RSA 38:10. If the reply is in the affirmative, the utility shall submit the price and terms it is willing to accept for all of its plant and property identified by the municipality in its inquiry, together with a detailed schedule of such plant and property with proper evidence of title. All of the plant and property identified by the municipality shall at all reasonable times thereafter be open to the examination of the officers and agents of the municipality and others charged with the duty of determining the fair value of the property.

38:8 By Agreement. – The governing body of a municipality may negotiate and agree with the utility upon the price to be paid for such plant and property; provided, however, that such agreement shall not be binding upon the municipality until ratified pursuant to RSA 38:13.

38:9 Valuation. –

I. If the municipality and the utility fail to agree upon a price, or if it cannot be agreed as to how much, if any, of the plant and property lying within or without the municipality the public interest requires the municipality to purchase, or if the schedules of property submitted in accordance with RSA 38:7 are not satisfactory, either the municipality or the utility may petition the commission for a determination of these questions.

II. The commission, after proper notice and hearing, shall decide the matters in dispute.

III. When required to fix the price to be paid for such plant and property, the commission shall determine the amount of damages, if any, caused by the severance of the plant and property proposed to be purchased from the other plant and property of the owner. In the case of electric utilities, such amount shall be limited to the value of such plant and property and the cost of direct remedial requirements, such as new through-connections in transmission lines, and shall exclude consequential damages such as stranded investment in generation, storage, or supply arrangements which shall be determined as provided in RSA 38:33.

IV. The expense to the commission for the investigation of the matters covered by the petition, including the amounts expended for experts, accountants, or other assistants, and salaries and expenses of all employees of the commission for the time actually devoted to the investigation, but not including any part of the salaries of the commissioners, shall be paid by the parties involved, in the manner fixed by the commission.

38:10 Construction or Condemnation. – If the utility shall have replied to the inquiry provided for in RSA 38:7 in the negative or if it shall have failed to reply within the time prescribed in RSA 38:7, the municipality, in the event that it shall have passed the vote or votes required in RSA 38:3, 38:4, and 38:5 and after the commission upon proper notice and hearing has determined that it is in the public interest to do so, may construct a municipal plant or may take all or any portion of such private plant and property by condemnation, paying therefor just compensation determined in the manner provided in RSA 38:9.

38:11 Public Interest Determination by Commission. – When making a determination as to whether the purchase or taking of utility plant or property is in the public interest under this chapter, the commission may set conditions and issue orders to satisfy the public interest. The commission need not make any public interest determinations when the municipality and utility agree upon the sale of utility plant and property.

38:12 Expansion of Existing Municipals. – A municipality that has an existing municipal plant may expand such plant or may purchase or take, in the manner prescribed in RSA 38:6-11 and RSA 38:33, all or a portion of such plant owned by a utility which is necessary for expanded municipal utility service. Such action shall not require any further vote under RSA 38:3, 38:4, or 38:5.

38:13 Ratification. – Within 90 days of the final determination of the price to be paid for the plant and property to be acquired under the provisions of RSA 38:8, 38:9 or 38:10 and any consequential damages under RSA 38:33, the municipality shall decide whether or not to acquire the plant and property at such price by a vote to issue bonds and notes pursuant to RSA 33-B as may be necessary and expedient for the purpose of defraying the cost of purchasing or taking the plant, property, or facilities of the utility which the municipality may thus acquire. The municipality is authorized to hold a special meeting, if necessary, to take such vote without having to petition the superior court for permission to do so. An affirmative vote under RSA 33-B shall constitute ratification on the part of the municipality of the final determination of the price to be paid for the plant and property under the provisions of RSA 38:8, 38:9, or 38:10 and any consequential damages under RSA 38:33. If the money is so raised it shall immediately be paid to the utility, which shall thereupon execute a proper conveyance and surrender the plant and property to the municipality. If the ratifying vote provided for in this section shall be in the negative, no other action under this chapter shall be had during the ensuing period of 2 years.

38:13-a Aggregate Municipal Revenue Bonds. – If the commission orders divestiture of generation facilities in the implementation of electric utility restructuring under RSA 374-F, any municipality which has voted to acquire a hydro-electric facility as provided in RSA 38 may jointly issue with any other municipality which has also voted to acquire a hydro-electric facility as provided in RSA 38 municipal revenue bonds and notes pursuant to RSA 33-B as may be necessary and expedient for the purpose of defraying the cost of purchasing or taking such hydro-electric generation facilities. Such municipal revenue bonds or notes may be in the aggregate of the total cost of purchasing or taking such generation facilities as set forth in RSA 33-B:3 and may be issued in the joint names of any such municipalities in accordance with their respective interests therein. In all other respects, the provisions of RSA 33-B shall apply to the issuance of such municipal revenue bonds and notes.

38:14 Operation of Plant. – A municipality, which has so acquired the plant, property, or facilities of a public utility in any other municipality, may operate within such other municipality as a public utility with the same rights and franchises which the owners of such outlying plant, as purchased, would have had such purchase not been made. The operation by a municipality outside its own limits shall be subject to the jurisdiction of the commission except as provided in RSA 362. If the outlying municipality shall itself vote to establish a municipal plant all the provisions of this chapter shall be binding as to such determination.

362:4 Water Companies, When Public Utilities. –

I. Every corporation, company, association, joint stock association, partnership, or person shall be deemed to be a public utility by reason of the ownership or operation of any water or sewage disposal system or part thereof. If the whole of such water or sewage disposal system shall supply a less number of consumers than 75, each family, tenement, store, or other establishment being considered a single consumer, the commission may exempt any such water or sewer company from any and all provisions of this title whenever the commission may find such exemption consistent with the public good.

II. A municipal corporation furnishing water or sewage disposal services outside its municipal boundaries shall not be considered a public utility under this title for the purpose of accounting, reporting, or auditing functions with respect to said service.

III. A municipal corporation furnishing sewage disposal services shall not be considered a public utility under this title:

(a) If it serves customers outside its municipal boundaries, charging such customers a rate no higher than that charged to its customers within the municipality, and serves those customers a level of sewage disposal service equal to that served to customers within the municipality. Nothing in this section shall exempt a municipal corporation from the franchise application requirements of RSA 374.

(b) If it supplies bulk sewage disposal services pursuant to a wholesale rate or contract to another municipality, village district, or water precinct.

III-a. (a) A municipal corporation furnishing water services shall not be considered a public utility under this title:

(1) If it serves new customers outside its municipal boundaries, charging such customers a rate no higher than 15 percent above that charged to its municipal customers, including current per-household debt service costs for water system improvements, within the municipality, and serves those customers a quantity and quality of water or a level of water service equal to that served to customers within the municipality. Nothing in this paragraph shall exempt a municipal corporation from the franchise application requirements of RSA 374.

(2) If it supplies bulk water pursuant to a wholesale rate or contract to another municipality, village district, or water precinct. This subparagraph shall not apply to bulk water contracts which were in effect before July 23, 1989, or to the renewal of said bulk water contracts.

(b) The commission may exempt a municipal corporation from any and all provisions of this title except the franchise application requirements of RSA 374, and may authorize a municipal corporation to charge new customers outside its municipal boundaries a rate higher than 15 percent above that charged to its municipal customers, if after notice and hearing, the commission finds such exemption and authorization to be consistent with the public good. The commission may not authorize a municipal corporation to charge existing customers outside its municipal boundaries a rate higher than 15 percent above that charged to its municipal customers until any rate agreements in effect for those customers on May 13, 2002 shall have expired.

(c) A municipal corporation's authority to charge higher rates for new customers outside of its municipal boundaries shall be applied prospectively to new customers taking water service provided by means of a main extension or an expansion of the municipal corporation's system after the effective date of this paragraph.

(d) A municipal corporation's authority to charge higher rates for existing customers outside of its municipal boundaries shall not become effective until any rate agreements in effect on May 13, 2002 have expired.

(e) A municipal corporation serving customers outside of its municipal boundaries and charging a rate no higher than 15 percent above that charged to its municipal customers prior to July 1, 2002, may also be exempted from regulation as a public utility, except for the franchise application requirements of RSA 374, if after notice and hearing, the commission finds such exemption and authorization to be consistent with the public good.

IV. (a) Any customer of a water utility shall have the right to terminate water service and secure water from an alternate source, if the customer can demonstrate the ability to comply with the requirements of RSA 485-A:29 and RSA 485-A:30-b, and the administrative rules adopted to implement these sections.

(b) Any covenant in a deed or contract that restricts the right to terminate water service from a water utility or in any way limits that right, shall be void as against public policy.

V. No property owner shall be required to connect to a municipal corporation furnishing water, provided such property owner can demonstrate the ability to comply with the requirements of RSA 485-A:29 and RSA 485-A:30-b.

VI. (a) For purposes of this chapter, a municipal corporation shall include a regional water district.

(b) During the initial 4 years of its operation, if a regional water district seeks to alter rates other than in a manner that uniformly impacts all customers within the district, any municipality that is a member of the regional water district may seek commission review of the proposed rate change. In order for the proposed rate change to take effect, the commission must determine that the proposed rates are cost-based and that they are not unduly discriminatory.

(c) A regional water district shall adopt and enforce quality of water service standards consistent with the commission's administrative rules.

(d) With respect to regional water districts, the 15 percent benchmark employed in this section shall be calculated in relation to an average of the regional water district's relevant rates as determined by the public utilities commission.

VII. (a) A homeowners association, including but not limited to a condominium unit owners association, shall not be considered a public utility under this title by virtue of providing water service if:

(1) The service is furnished only to members of the association or the occupants of their residential units; and

(2) The association is organized on a not-for-profit basis and is democratically controlled by the owners of the residential units and not the developer or subdivider thereof.

(b) Such a homeowners association is one consumer for purposes of paragraph I, and its individual members or their lessees shall not be treated as individual consumers.

363:17-b Final Orders. – The commission shall issue a final order on all matters presented to it. The transcript or minutes of oral deliberations shall not constitute a final order. A final order shall include, but not be limited to:

I. The identity of all parties;

II. The positions of each party on each issue;

III. A decision on each issue including the reasoning behind the decision; and

IV. The concurrence or dissent of each commissioner participating in the decision.

374:22 Other Public Utilities. –

I. No person or business entity shall commence business as a public utility within this state, or shall engage in such business, or begin the construction of a plant, line, main or other apparatus

or appliance to be used therein, in any town in which it shall not already be engaged in such business, or shall exercise any right or privilege under any franchise not theretofore actually exercised in such town, without first having obtained the permission and approval of the commission.

II. No permission or approval under this section shall be required to be obtained by a foreign electric utility as defined in RSA 374-A:1 in connection with its participation in an electric power facility as defined in said section where the electric utility having the largest financial interest therein and the utility or utilities having primary responsibility for the construction or operation of the facility are domestic electric utilities as defined in said section or have obtained such permission.

III. No water company shall obtain the permission or approval of the commission to operate as a public utility without first satisfying any requirements of the department of environmental services concerning the suitability and availability of water for the applicant's proposed water utility.

374:26 Permission. – The commission shall grant such permission whenever it shall, after due hearing, find that such engaging in business, construction or exercise of right, privilege or franchise would be for the public good, and not otherwise; and may prescribe such terms and conditions for the exercise of the privilege granted under such permission as it shall consider for the public interest. Such permission may be granted without hearing when all interested parties are in agreement.

541:3 Motion for Rehearing. – Within 30 days after any order or decision has been made by the commission, any party to the action or proceeding before the commission, or any person directly affected thereby, may apply for a rehearing in respect to any matter determined in the action or proceeding, or covered or included in the order, specifying in the motion all grounds for rehearing, and the commission may grant such rehearing if in its opinion good reason for the rehearing is stated in the motion.

541:4 Specifications. – Such motion shall set forth fully every ground upon which it is claimed that the decision or order complained of is unlawful or unreasonable. No appeal from any order or decision of the commission shall be taken unless the appellant shall have made application for rehearing as herein provided, and when such application shall have been made, no ground not set forth therein shall be urged, relied on, or given any consideration by the court, unless the court for good cause shown shall allow the appellant to specify additional grounds.

541:13 Burden of Proof. – Upon the hearing the burden of proof shall be upon the party seeking to set aside any order or decision of the commission to show that the same is clearly unreasonable or unlawful, and all findings of the commission upon all questions of fact properly before it shall be deemed to be prima facie lawful and reasonable; and the order or decision appealed from shall not be set aside or vacated except for errors of law, unless the court is satisfied, by a clear preponderance of the evidence before it, that such order is unjust or unreasonable.

[1]
**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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Q. Please state 1 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

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

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

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

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

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capital structure, interim rate relief, phase-in plans, water 1 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

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

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water systems operated by PWW outside of Nashua are hydraulically 1 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.

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Municipalities Served – PEU currently owns and operates 131 non-contiguous water systems in 12 municipalities. None of these water systems are connected to the Nashua core system. The communities in which PWW operates are as follows:

Atkinson – 5 customers are served by 1 system

Bow – 15 customers are served by 1 system

Derry – 218 customers are served by 2 systems

Hooksett – 92 customers are served by 2 systems

Lee – 34 customers are served by 1 system

Litchfield – 1,641 customers are served by 1 system

Londonderry – 1,667 customers are served by 9 systems

Pelham – 302 customers are served by 3 systems

Plaistow – 20 customers are served by 1 system

Raymond – 307 customers are served by 2 systems

Sandown – 11 customers are served by 1 system

Windham – 625 customers are served by 7 systems

16 C. Pittsfield Aqueduct Company, Inc.

Business – PAC is a public utility that currently provides water service in the

Town of Pittsfield.

Municipalities Served – Although PAC currently provides service in the Town of

Pittsfield only, if its petition to operate several additional troubled water systems in

Central and Northern New Hampshire is approved in Docket DW 05-132, its service

territory will expand to include the Towns of North Conway, Middleton and Barnstead.

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

Barnstead – 755 customers

Middleton – 83 customers

North Conway – 207 customers

Pittsfield – 640 customers

D. Pennichuck Water Service Corporation

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

Municipalities Served –

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

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

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

E. The Southwood Corporation

Business – Southwood is a developer of commercial and residential real estate.

Southwood's holdings include over 500 acres of developable land located in Southern

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

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

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

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pursuant to the Pennichuck companies' Money Pool Agreement, 1 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

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PEU and PAC to do so has been entirely dependent on the resources—1 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.

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This was well illustrated by Nashua's mayor, who stated succinctly 1 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

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

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

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

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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 shrunk 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

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obtaining contract renewals at significantly increased prices. If the 1 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

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available, could only be obtained on much less desirable terms (particularly 1 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

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is the very result that Nashua was seeking to avoid when it began the eminent domain process, and which an eminent domain taking would effectively ensure would come to 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 area where PNNW has experience doing business. To provide some perspective, the combined purchase price for all of the other water systems purchased by the Pennichuck Companies in the last twenty years is less than \$10 million. The idea that practically overnight the company could effectively and efficiently spend \$200 million or more (or even \$100 million, if Nashua is to be believed) to buy other water systems in New Hampshire and nearby areas is simply unrealistic.

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

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England region, in any reasonable period of time is simply unfounded, 1 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.

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

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

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

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

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

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

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

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

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

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municipalization of utility service. After the city 1 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

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was willing to do and say whatever it took at the time to kill the 1 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

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

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

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understand and weigh the very human element to the damage that 1 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.

[- 26 -]

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

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

V. CONCLUSION

17

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

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

[- 27 -]

to in invest in New Hampshire utilities or their parent companies. 1 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.

[1]

**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 DOUGLAS L. PATCH
January 12, 2006**

[2]
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[3]

Q. Please state 1 your name and business address.

2 A. My name is Douglas L. Patch. My business address is One Eagle Square,
3 Concord, NH 03302.

4 I. BACKGROUND AND PURPOSE OF TESTIMONY

5

6 Q. Who is your current employer and what position do you hold?

7 A. I am employed by Orr & Reno, Professional Association where I am a
8 Director/Shareholder.

9 Q. What is your background?

10 A. I have been with Orr & Reno since November of 2001. Prior to that I was the
11 Chairman of the New Hampshire Public Utilities Commission from March of
12 1992 until October of 2001. A more complete description of my education and
13 experience is included as Attachment DLP-1.

14 Q. What is the purpose of your testimony?

15 A. The purpose of my testimony is to provide my direct experience in dealing with
16 Pennichuck Water Works (PWW, Pennichuck, or the Company) and its affiliates
17 and to give my opinion on the City of Nashua's proposed eminent domain taking
18 of the assets of PWW based on my familiarity with PWW and the important role
19 that PWW plays in providing water in New Hampshire, as well as my knowledge
20 of the water and utility industry in New Hampshire.

21 II. PENNICHUCK'S EXPERTISE AND REPUTATION

22

23 Q. Are you familiar with Pennichuck Water Works?

24 A. Yes, I am. During the nine and one-half years I was the Chairman of the
25 Commission I presided over a number of adjudicative and public hearings

[4]

involving PWW and was a member of the Commission 1 that issued a number of
2 orders concerning PWW. A complete list of the orders involving PWW issued
3 while I was on the Commission is included as Attachment DLP-2. During the
4 time I was on the Commission I also visited PWW's facilities and talked with
5 PWW managers on a number of occasions as part of fulfilling my duty to keep
6 informed under RSA 374:4. During that time I also had discussions with
7 Commission Staff about issues related to PWW's operations.

8 Q. What is your opinion of PWW's qualifications as a public utility?

9 A. My opinion is that PWW has excellent qualifications to own and operate a public
10 utility. It clearly fulfills the obligation that all utilities have under New
11 Hampshire law to provide "such service and facilities as shall be reasonably safe
12 and adequate and in all other respects just and reasonable." RSA 374:1.

13 Q. On what information do you base your opinion?

14 A. My opinion is based on the knowledge I gained of PWW while I was a member of
15 the Commission which included my observations of the Company's officers and
16 employees, the witnesses who testified on behalf of the Company, attendance at
17 public hearings in Nashua, visits to the Company's facilities, and conversations
18 with Staff members who worked with the Company and had more frequent and
19 less formal contact with the Company than I did as a member of the Commission.
20 It is also based on a comparison of PWW's qualifications to those of other water
21 utilities in New Hampshire. My opinion is also based on my knowledge of water
22 utilities gained through my experience as a member of the National Association of
23 Regulatory Utility Commissioners and as a member of the New England

[5]

Conference of Public Utility Commissioners, both of 1 which organizations hold
2 periodic meetings and conferences to share information and discuss utility-related
3 issues, as well as on my experience since I have been in the private practice of
4 law.

5 **Q. Please provide examples that demonstrate the Commission's recognition of**
6 **the expertise and reputation of PWW and related entities for providing**
7 **reliable and efficient service.**

8 A. There are numerous instances where the Commission has recognized PWW's
9 expertise and reputation for reliable and efficient service to the public. In Order
10 No. 20,610, 77 NH PUC 559 (1992) the Commission approved petitions from
11 Pennichuck for franchises in Great Brook Condominium in Milford and Redfield
12 Estates in Derry. The settlement agreement cited in the order refers to
13 Pennichuck's "reputation for reliable and efficient service to the public." 77 NH
14 PUC at 561. The Commission analysis says: "The record amply demonstrates
15 that Pennichuck is financially, managerially, and technically able to provide the
16 requested service." 77 NH PUC at 563. In Order No. 20,808, 78 NH PUC 218
17 (1993) the Commission granted franchises to Pennichuck for Maple Haven in
18 Epping and Glen Woodlands in Derry. In doing so the Commission said it had
19 "consistently held that Pennichuck has the managerial, financial, and technical
20 expertise to operate as a public utility." 78 NH PUC at 219. In Order No. 21,026,
21 78 NH PUC 621, 623 (1993) which granted PWW a permanent rate increase, the
22 Commission said "Pennichuck presents a strong, stable and attractive opportunity
23 for investment." *See also* Order No. 22,054, 81 NH PUC 191 (1996), authorizing

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Pennichuck to extend service in Bedford; 1 Order No. 22,532, 82 NH PUC 292
2 (1997) authorizing Pennichuck to extend service into Salem; Order No. 22,792,
3 82 NH PUC 814, 816 (1997) approving the transfer of assets of Consumers New
4 Hampshire Water Company outside Hudson to Pennichuck Corporation which
5 refers to Staff's support "in light of Pennichuck's [PWW's] overall competence
6 and experience with both core and small community water systems"; Order No.
7 22,843, 83 NH PUC 44, 45 (1998) approving Pennichuck Corporation's
8 acquisition of Pittsfield Aqueduct, in which the Commission noted that it had
9 "recognized the financial, managerial and technical expertise of Pennichuck
10 [PWW] to operate a water utility on numerous occasions"; Order No. 23,044, 83
11 NH PUC 575, 577 (1998) authorizing Pennichuck to acquire the assets of Great
12 Bay Water Company, Inc., where the Commission said Pennichuck "has a history
13 of competent and reliable service"; Order No. 23,670, DW 00-285, issued April 2,
14 2001, approving PWW's franchise expansion in Milford; Order No. 24,264, DW
15 03-023, issued January 9, 2004, approving Pennichuck East Utility, Inc.'s (PEU)
16 acquisition of the water system of White Rock Senior Living Community in Bow
17 and authority to provide water service to White Rock; Order No. 24,370, DW 04-
18 129, issued September 10, 2004, approving PEU's franchise petition to serve the
19 Pines of Bow; Order No. 24,413, DW 04-120, issued December 22, 2004,
20 approving franchise rights for PEU in a limited area in the Town of Lee. To the
21 extent that some of the more recent orders cited above refer to PEU or Pittsfield
22 Aqueduct Company, Inc. (PAC), not PWW, it is important to note that these
23 companies are heavily reliant on the skill, expertise and assets of PWW, and in

[7]

fact there is a management agreement that provides for 1 the allocation of PWW's
2 assets and expertise to these utilities.

3 Q. What is PWW's reputation in the state?

4 A. PWW is generally known as a well-run, highly qualified utility. In my opinion it
5 is the premier water utility in the state. The Company has been providing water
6 service to customers since 1852. It has grown from a privately held company to a
7 publicly traded company. The growth that PWW has made in recent years has, in
8 my opinion, been done carefully and responsibly. PWW expanded its operations
9 to provide more customers with excellent service while not putting shareholders
10 or the existing customers of the Company at risk. PWW also enjoys a very good
11 reputation for being a good corporate citizen by virtue of its contributions to
12 numerous organizations and programs in the communities in which it operates.

13 Q. How has PWW served the public good as a public utility?

14 A. In addition to the high quality of service it has brought to its customers, PWW has
15 made a significant contribution to the public good in New Hampshire through its
16 willingness to expand its operations in the state. PWW has taken over a number
17 of smaller water systems and provided good quality water at reasonable rates to
18 customers of those systems. In many cases, without PWW's intervention, service
19 to customers in these smaller, satellite systems would have further deteriorated
20 and/or their rates would have been much higher to provide comparable service.
21 One example of this is Order No. 20,808, 78 NH PUC 218 (1993), cited above,
22 where the Commission granted franchises to Pennichuck for Maple Haven in
23 Epping and Glen Woodlands in Derry. In doing so the Commission noted that the

[8]

New Hampshire Department of Environmental Services 1 and the United States
2 Environmental Protection Agency “in recognition of the substantial costs of
3 monitoring and treatment under the Safe Drinking Water Act, have encouraged
4 the acquisition of developer owned water distribution systems by established and
5 competent water utilities.” 78 NH PUC at 220.

**6 III. THE NEGATIVE IMPACT OF AN EMINENT DOMAIN TAKING ON
7 PENNICHUCK, ITS AFFILIATES AND CUSTOMERS**

8

**9 Q. What is your opinion generally of the impact that an eminent domain taking
10 of PWW by the City of Nashua would have?**

11 A. I believe an eminent domain taking of PWW by the City of Nashua would have a
12 number of negative effects on the ratepayers of various Pennichuck systems, both
13 within and outside the borders of Nashua, on the state of New Hampshire, on the
14 regulatory environment in the state, and ultimately on the public interest in New
15 Hampshire. It would also have a negative impact on investors and shareholders.

**16 Q. What is your opinion of the impact such a taking would have on
17 Pennichuck’s ratepayers?**

18 A. The answer to this question falls into three parts: the impact on ratepayers in
19 Nashua, the impact on PWW customers in municipalities other than Nashua, and
20 the impact on ratepayers in other towns who are part of PAC and PEU. It is my
21 understanding that there are approximately 24,500 customers of PWW, 4,900
22 customers of PEU, and 640 customers of PAC. Economies of scope and scale
23 currently inure to the benefit of all of the Company’s customers regardless of their
24 location. These economies will be reduced if there are fewer ratepayers from
25 whom fixed costs can be collected. Thus all of PWW’s current customers would

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be at risk of having their rates rise to a higher level than would otherwise be the case if PWW continues to own and operate the entire system.

PWW customers also stand to lose other benefits that accrue to them as customers of PWW. I am not convinced that the City of Nashua (Nashua or the City) and the operator it intends to hire, if it succeeds in the taking, can run the system as well and as economically as PWW has. I have attached two articles by Dr. Janice A. Beecher, the Director of the Institute of Public Utilities at Michigan State University, an expert in the water industry who has testified before this Commission. "Options for Water Company Ownership" Indianapolis Star, October 12, 2000, attached as Attachment DLP-3; "The Rationale for Regulating Municipal Contract Services" PWFinancing, November 2000, attached as Attachment DLP-4. As her articles indicate, when a local government retains ownership of a system and hires a private operator that has responsibility for operations there are often problems that develop. Some of the problems that Dr. Beecher points to are with the deployment of capital and operating resources. There is also often confusion as to accountability, in other words, which entity is responsible for environmental compliance, which is responsible for resolving service complaints, and which is responsible for planning to meet future needs. In short municipalization combined with the outsourcing of operational responsibility often leads to fragmentation.

Contrast this with investor-owned utilities, where regulation brings a reasonably predictable system of accountability and incentives. Regulation also balances the interests of shareholders and ratepayers, as reflected in the most

[10]

fundamental responsibility required of the 1 Commission in RSA 363:17-a.

2 Regulation also typically seeks long term solutions that are in the public interest,

3 *see* Order No. 22,462, *Re Least-cost Planning for Water Utilities*, 81 NH PUC

4 1037 (1996), and insures the prudence of investments and expenditures. Before a

5 regulated utility can recover investments it must show that the investments were

6 prudent, i.e. that they were reasonable at the time they were made. As the

7 Commission noted in Order No. 24,276, *Public Service Company of New*

8 *Hampshire, Petition for Authority to Modify Schiller Station*, February 6, 2004:

9 “A prudence review, as we understand the concept, involves an after-the-fact

10 review of investment decisions, in light of actual performance, but limited to what

11 was reasonably foreseeable at the time of the decisions.” Regulators also look at

12 the justness of prices. Investor-owned companies, not bound by geopolitical

13 boundaries, are better able to achieve regional economies of scale. Although it is

14 not perfect, regulation also provides a mechanism for the timely resolution of

15 disputes and it tends to depoliticize the provision of water services, particularly

16 the investment and pricing decisions.

17 Municipalization, on the other hand, imposes an added oversight burden

18 on the local government. Although a municipality and/or an operator hired to run

19 a municipally-owned system may promise savings to customers, there is no

20 assurance that utility customers will realize the promised savings as there will no

21 longer be a regulatory body with the responsibility for deciding whether any

22 savings should be passed on to customers. This concept is of particular relevance

23 to the situation at hand in that Nashua intends to take assets outside of its

[11]

boundaries, assets that are located as far away as 1 Newmarket and Epping. If
2 Nashua is successful, customers in these towns will be subject to the whims of
3 Nashua officials. I am not aware of anything that Nashua has proposed, or could
4 propose to assure the Commission that the interests of these customers would be
5 adequately protected. A municipal utility, unlike an investor-owned public utility,
6 would have to recover all investments, even imprudent ones, from ratepayers. In
7 addition a municipal water utility would have no incentive to invest in water
8 systems outside of its boundaries, it would have no independent review like that
9 conducted of an investor-owned water utility by regulators in a rate case, no
10 periodic independent audit of the utility like what the Commission does, and no
11 disallowance of unjustified or imprudent costs. Although a municipal utility
12 would not have the added obligation of local taxes, which investor-owned utilities
13 are allowed to recover through rates, there is no guarantee that the City will lower
14 rates to take into account the elimination of this expense from the rate calculation.

**15 Q. What is your opinion of the impact such a taking would have on PAC and
16 PEU ratepayers?**

17 A. In so far as the customers outside the PWW system are concerned it seems likely
18 that their rates would rise faster or the quality of their service would suffer
19 because there would not be as large a base of customers over which to spread the
20 costs of purchasing assets and running the system. The Commission has
21 recognized this in many orders, such as Order No. 21,713, 80 NH PUC 394, 398
22 (1995) where it said: "The addition of new customers spreads the cost of system
23 improvements among a larger customer base, and the public is better served by a

[12]

water source which is continually monitored for quality and 1 safety problems.”
2 There is also a significant difference between smaller water utilities and larger
3 water utilities in their ability to pay for the costs of meeting environmental
4 requirements. In Order No. 22,883, 83 NH PUC 197, 201 (1998), approving a
5 rate increase for Pennichuck and allowing it to consolidate core and community
6 water services for rate-making purposes, the Commission said: “Most of the
7 community systems are simply too small to absorb the magnitude of investments
8 mandated by environmental enactments.” Similarly, in Order No. 21,219, 79 NH
9 PUC 264, 268 (1994), approving a sale of the water utility assets in Springwood
10 Hills to Southern NH Water Co. and rejecting an alternative proposal by an
11 association of homeowners, the Commission noted the high cost of complying
12 with the Safe Drinking Water Act and other federal and state requirements, as
13 well as the need for resources to finance “significant capital expenditures that
14 might be encountered in the future as a result of federal or state requirements or
15 an emergency that might occur.” *See also* Order No. 20,808, 78 NH PUC 218,
16 220 (1993), cited above. If the City succeeds in this eminent domain taking, the
17 reduced size of the remaining company will make it difficult to maintain the
18 expertise that it currently has and to afford the purchase of new assets. Without a
19 larger investor-owned company, there is not likely to be the consolidation of
20 smaller and mid-size systems to achieve economies of scale as there has been. I
21 believe there is also a significant risk that the pace of modernization under a
22 smaller company would be slower because of insufficient capital.

[13]

As Dr. Beecher points out, investor-owned companies have clearer incentives for efficiency in investment, operations, service and pricing. In the case of municipally-owned systems, cost savings are not necessarily reinvested in the system or returned to ratepayers.

5 Q. Please explain your answer in more detail as it pertains to customers in Nashua.

6 A. While the City might be able to lower rates somewhat in the short term if it takes over the PWW system, as the report from Maine included as Attachment DLP-5 points out, it is important to consider more than just the impact on rates. The Maine report, "Review Necessary to Determine the Benefits of Ownership Changes for Public Water Utilities, Developed by the Maine Public Utilities Commission, June 2005 at the Request of the Utilities and Energy Committee", evaluates "what review should be undertaken by a municipality or water utility before a decision is made to change the ownership structure of a public water utility." The report says that such a review should determine the costs and benefits of an ownership change. The report also says that the "determining factor should be what is best for the ratepayers of the water utility." The report notes: "While cost of operation is important, the ability to provide a safe, adequate and reliable source of water, now and in the future, should be the primary consideration of any utility. When looking at the choices of ownership, the question should be what entity will best be able to achieve this end." The first priority of any entity serving water customers should be to provide them with safe and adequate service. Pennichuck has repeatedly and

[14]

consistently proven that it can provide such service. The City and its potential operator have no track record with this Commission regarding their ability to own and operate a water system in New Hampshire. Thus there is a real risk that the quality of service provided to Nashua customers will decline. If there had been concerns about PWW's qualifications to serve customers it might make sense to take such a risk. However, past experience has been just the opposite. In the absence of any such issue or question, there seems to be no benefit to PWW's customers of making such a change; in fact there is a significant risk of harm to the customers.

Over the years the Commission has encountered situations where municipal systems were not willing to provide service to customers even within their own municipal boundaries. *Re Beaver Village Realty Trust*, 80 NH PUC 31 (1995) is one such example, where a community water system serving 80 customers had been put into receivership by the Commission because of an imminent threat to the health and welfare of customers. The Town of Salem was approached to see if it would provide water to the customers of Beaver Village Realty Trust who were residents of Salem, but who were being served by the private water system that had been put into receivership. Because the town refused to serve those customers, the system had to be abandoned and the customers had to drill their own wells. If Salem had been served by an investor owned public utility instead of a municipal water system, the utility would have had an economic incentive to work with the Commission to address this problem because the expansion would have presented an investment opportunity for it.

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Moreover, the Commission would have had the authority 1 (under RSA 374:7) to
2 order the utility to serve those customers and the utility would have had an
3 obligation to serve the customers. There is no such requirement for a municipal
4 utility to serve customers who reside within the boundaries of the municipality.
5 In 2005 a bill was introduced to the New Hampshire Legislature, HB 318, which
6 would have required that any municipal water company provide service to any
7 person within the municipality's boundaries. The bill did not pass. The fact that
8 such a bill was introduced, however, points out that this is a problem and the
9 experience in Salem demonstrates the reality of the problem. This also highlights
10 one of the limitations of switching to a publicly-owned system: the
11 responsibilities and obligations of a municipal system are more limited than an
12 investor-owned public utility.

**13 Q. Please explain your answer in more detail as it pertains to customers outside
14 of Nashua who are part of the PWW system.**

15 A. I believe there is also a serious concern about what will happen to other customers
16 of PWW who reside outside the boundaries of Nashua. The Report to the New
17 Hampshire Legislature Prepared by the Department of Environmental Services
18 and the Commission in 2001, "Regulatory Barriers to Water Supply Regional
19 Cooperation and Conservation in New Hampshire", a copy of which is attached as
20 Attachment DLP-6, recognized that there are limitations that result from
21 municipal ownership: "Many municipal water suppliers have a parochial view of
22 their current water supplies and will not readily extend service beyond municipal
23 borders even when this might be part of the 'optimum' alternative from a regional

[16]

perspective. For example, some municipal water suppliers have refused to serve customers beyond their boundaries even to address relatively small, localized water storage or quality problems in neighboring municipalities; other municipalities have contested development within their boundaries by public utilities and others. These decisions are frequently driven by (1) the desire to ensure that water is available for future growth within a municipality with existing surplus supply and (2) the competitive advantage that ample water supply provides to attract future industrial and commercial development to communities with surplus capacity.” Report at 9.

Furthermore, under RSA 362:4, Nashua could raise rates for customers outside of Nashua to a rate that is substantially higher than customers inside Nashua without the approval of the Commission or any other authority. These concerns are in addition to those pointed out previously about the City’s inability or lack of incentive to adequately meet the needs of customers outside of Nashua.

IV. THE DIFFERENCES BETWEEN A MUNICIPALLY-OWNED AND INVESTOR-OWNED UTILITY

17

Q. How does a municipally-owned water utility compare to an investor-owned public utility?

A. There is a much different dynamic when you have a municipally-owned and run water system than an investor-owned, regulated public utility. In *Blair v. Manchester Water Works*, 103 N.H. 505 (1961) the NH Supreme Court said that the Commission does not have authority to compel a municipal utility that extends its service to a small area in an adjoining town to extend its service over the entire area of the adjoining town. In other words the Commission has little authority

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over municipal systems operating outside their boundaries. 1 In the case of a public
2 utility the Commission has the authority under RSA 374:26 to “prescribe such
3 terms and conditions for the exercise of the privilege granted under such
4 permission as it shall consider for the public interest.” The Commission also has
5 the power of “general supervision of all public utilities” under RSA 374:3. Under
6 RSA 374:7 the Commission has the power to order extensions of service if it
7 believes that it is necessary to do so to protect customers who otherwise may not
8 have options available to them. The Commission has no such authority over
9 municipal water systems, which means that there is a distinct possibility that
10 water customers who would otherwise benefit from service from a public utility
11 may not be served by a municipal water system. As the Court noted in the *Blair*
12 case: “There is indication that the statutes regulating municipally-owned water
13 works were intended to place a primary duty to furnish water to the residents of
14 the municipality and that any right to furnish water to nonresidents in adjoining
15 towns and districts is secondary.” *Blair*, 103 N.H. at 507.
16 RSA 362:4 was amended in 2003 to even further reduce the Commission’s
17 authority over municipal systems. Under this law, a municipal corporation
18 furnishing water services is not considered a public utility if it serves new
19 customers outside its municipal boundaries, charging such customers a rate no
20 higher than 15 percent above that charged to its municipal customers and it serves
21 those customers a quantity and quality of water or a level of water service equal to
22 that served to customers within the municipality. A municipal corporation
23 serving customers outside of its municipal boundaries and charging a rate no

[18]

higher than 15 percent above that charged to its municipal customers prior to July 1, 2002, may also ask the Commission for an exemption from regulation as a public utility if it finds such an exemption to be consistent with the public good. Thus, while the Commission has remedies available to it to order public utilities to take certain steps to meet the needs of distressed customers, as well as the authority over rates, as noted above, when the entity providing service is a municipal corporation, those remedies are not available and the public is likely to suffer because of this difference. I believe this should be a concern to the state in these situations and thus to the Commission when it is looking at whether a municipal taking by eminent domain is in the public interest. If the taking were to move forward, the system would be under the control of elected officials in Nashua who would have little incentive to provide low rates and good quality service to customers outside of the municipal boundaries. There would also be little or no incentive for the municipal utility to take on problem systems outside its existing service territory. Furthermore, as the Maine report cited above notes: "If the water utility serves many customers in a number of municipalities, it may be difficult for a department of one of those municipalities to effectively meet the needs of all those customers equally."

There are other important differences between municipally-owned water systems and public utilities. The "anti-cwip" statute, RSA 378:30-a, protects utility customers from paying for construction work in progress. There is no similar statutory protection for municipal customers. Thus if the City of Nashua takes over the Pennichuck system, the City can raise rates to recover costs

[19]

associated with some projects before the projects have been completed and are providing service to customers. Moreover, there is nothing that would prohibit the municipality from charging its customers for a construction project that was abandoned or otherwise ends up not providing service to the public. Furthermore, there would be no regulatory review of whether any construction costs were appropriate or prudently incurred, regardless of whether the project was placed into service. Yet the costs would be passed on directly to ratepayers. This aspect of municipal ownership is clearly a disadvantage for customers.

One of the important functions of a water utility is its ability to develop new sources of water. Pennichuck has shown its expertise in this area over the 11 years. *See* Order No. 23,619, in DW 00-222, issued on January 10, 2001. Because Nashua has no history of providing water to customers and therefore no need to have developed new water sources in the past, there is a serious question whether Nashua has this important expertise.

In so far as consumer protection is concerned, in the case of a public utility the Commission acts as a forum for the redress of customer complaints. If Nashua were to take over the system, there would be no forum for complaints for Nashua customers (other than to Nashua itself, which would be akin to a utility resolving its own complaints) and perhaps even more importantly for customers of the system who reside outside of Nashua.

One other difference between an investor-owned utility and a municipally owned utility is in the area of charitable contributions. Pennichuck has an excellent record of contributing to various organizations and events in the Nashua

[20]

area and throughout its service areas. If the petition 1 is approved and the City
2 takes over the assets, this will remove Pennichuck as a source of contributions to
3 civic and charitable events and organizations in the area.

4 **V. THE NEGATIVE EFFECT OF AN EMINENT DOMAIN TAKING ON**
5 **TROUBLED WATER SYSTEMS AND OTHER UTILITIES IN NEW**
6 **HAMPSHIRE**

7

8 **Q. What effect would an eminent domain taking of PWW by the City of Nashua**
9 **have on other water utility customers in the state?**

10 A. My opinion is that the taking by eminent domain would have a negative effect on
11 customers of other water utilities and privately-owned systems such as those in
12 small developments throughout the state. I say this because PWW has purchased
13 many troubled water systems over the years, as noted above, and has provided
14 much higher quality service at more reasonable rates to many of these customers.
15 The customers of these water systems in many instances had to worry about
16 whether they would be able to receive reliable service at a reasonable rate; once
17 PWW or its affiliates took over the system many of these concerns evaporated. If
18 PWW's size is significantly reduced or PWW is in fact eliminated, the surviving
19 Pennichuck companies will most likely not be in the position to take over troubled
20 water systems. Thus customers in marginal water systems around the state will
21 have few options. In fact I am not aware of any other company currently in the
22 state that has anywhere near the record that PWW and its affiliates have in this
23 respect in recent years. The absence of PWW as a regional water utility would be
24 a big blow to the water industry in New Hampshire and, importantly, to the
25 customers served by that industry. In the *Springwood Hills* case, the Commission

[21]

recognized the benefit of a company's willingness 1 to take on troubled waters
2 systems stating: "We find the Company's willingness to provide service to
3 customers in stand-alone systems which are often fraught with problems to be of
4 assistance in resolving difficult situations and we do not want to discourage that
5 willingness." *Springwood Hills*, 79 NH PUC at 268. Though some might argue
6 that the other Pennichuck systems, PAC and PEU, will still be there even if the
7 Nashua system is gone, the remaining systems would be far more limited in size
8 and resources. Companies that acquire troubled water systems often apply for
9 Community Development Block Grants to rehabilitate the distribution system.
10 The Commission recognized the value of having a larger, investor-owned water
11 company in Order No. 22,843, 83 NH PUC 44 (1998), where it approved
12 Pennichuck's acquisition of Pittsfield Aqueduct. In its order, the Commission
13 cited Pennichuck's greater access to financial markets and to the State Revolving
14 Fund for low interest loans and grants as a factor supporting the acquisition. 83
15 NH PUC at 45. Thus, if Pennichuck is reduced to a substantially smaller utility, it
16 is unlikely that it will have the resources to be able to respond to these critical
17 situations as it has in the past. For example, if the Company exists as a smaller
18 utility, it may not have the same access to capital as the larger company now has.
19 Thus, even if the surviving company has the same desire to commit to smaller
20 systems, it may not have the option financially.
21 There is also a question of whether a smaller utility would be in a position
22 to help in other emergency situations that might arise. One such example
23 occurred in 1990 when Pennichuck made an emergency interconnection from its

[22]

system to the Merrimack Village District so that it could 1 furnish the village
2 district with water when its water supply was lost because of industrial
3 contamination. Having a company that is as large, deeply experienced and
4 competent as PWW is very much in the public interest.

5 Q. Are there other concerns raised by the elimination of PWW as a company?

6 A. There would also be a concern about whether the Pennichuck companies that
7 would remain could maintain the expertise that PWW has and could afford the
8 assets that PWW has, both of which are very useful to providing water and
9 services to the systems that are now part of the Pennichuck family. A new,
10 smaller company would have a far smaller base of customers over which to
11 spread its costs. This could result in a diminution of services and/or the quality of
12 services or a failure to modernize operations as quickly as would otherwise
13 happen unless there were what could amount to a significant rate increase. Over
14 the years, I have observed many troubled water systems in the state and attended
15 many public hearings where customers were desperate for better service and more
16 reasonable rates. Without PWW to help in at least some of these situations, I
17 believe many water customers would have to continue to suffer poor service and
18 high rates. Smaller systems tend to have higher rates and more problems with
19 water quality and quality of service. The economics of a smaller system often do
20 not support the ability to run a high quality system. It is unlikely that a pared
21 down Pennichuck could offer customers the same level of service without
22 increasing rates.

[23]

One additional consequence of a taking of 1 the Pennichuck assets by
2 Nashua would be a loss of state revenues from the statewide property utility tax,
3 the business profits tax, and business enterprise tax. Obviously because a
4 municipal utility would not be liable for such taxes, the revenue would be lost to
5 the state.

**6 Q. What is your opinion of the impact an eminent domain taking would have on
7 the public utility industry in the state of New Hampshire?**

8 A. My opinion is that a Commission-ordered taking of PWW's assets by the City of
9 Nashua would have a chilling effect on the investor-owned utility industry in New
10 Hampshire. Such a decision would not be looked on favorably in the utility
11 industry in New Hampshire or by the community outside of New Hampshire. For
12 the Commission to approve the eminent domain taking of the premier water utility
13 in the state, an otherwise successful, well-run, growth-oriented company, against
14 its wishes would send an unfavorable message about investor-owned utilities and
15 the regulatory community in New Hampshire. Other utilities might be seen as
16 being at risk of similar takings by eminent domain. Commission approval of this
17 taking would send the message that the Commission puts little weight on the
18 interests of investors of a utility that provides excellent service to customers.
19 Such an action could also send a negative message to the financial community
20 and could potentially drive up the cost of borrowing money to other New
21 Hampshire utilities. One of the other consequences of such a decision might be
22 that individual or institutional investors would be less willing to invest in NH
23 utilities. Such a decision would not be good for the regulatory industry across the

[24]

board. There could also be a ripple effect from such a decision: 1 municipalities in
2 the state might start to look seriously at taking over utility assets in their
3 communities and outside of their communities, like what Nashua is proposing to
4 do here. I believe the Commission needs to be very concerned about the impact
5 such a decision would have on the industry and the precedent it would set.

**6 VI. THE PROPOSED TAKING OF PWW'S ASSETS IS NOT IN THE PUBLIC
7 INTEREST**

8

**9 Q. Do you think it would be consistent with good public policy for the
10 Commission to approve the eminent domain taking of PWW's assets by the
11 City of Nashua?**

12 A. No, I do not. Our state has a history of encouraging free enterprise and of
13 avoiding government intervention in and government operation of what are
14 traditionally private functions unless it is absolutely necessary. This philosophy is
15 reflected in the New Hampshire Constitution, Part II, Article 83, which the New
16 Hampshire Supreme Court has said "declares our fundamental preference for free
17 enterprise." *Appeal of Omni Communications, Inc.* 122 N.H. 860, 862 (1982). As
18 the Omni court noted, referring to the Commission: "The role and duty of such a
19 commission is to oversee and regulate those few necessary monopolies so that the
20 *constitutional rights of free trade and private enterprise* are disrupted as little as
21 possible." [emphasis added] 122 N.H. at 862, 863. Giving the City of Nashua the
22 approval to take the assets of an investor-owned water utility that operates not
23 only within, but also outside the borders of the city, is clearly not necessary "to
24 protect the health, safety and general welfare of the public", which the New
25 Hampshire Supreme Court, in an eminent domain case, recognized as the

[25]

fundamental purpose of government. *Leary 1 v. Manchester*, 91 N.H. 442, 445
2 (1941), quoting *New York &c. Authority v. Muller*, 270 N.Y.333. In this instance,
3 there is no “menace to the public health, safety or general welfare” like what the
4 *Leary* court noted should be a basis for the exercise of eminent domain powers.
5 What we have here is an excellent public utility that provides all of the benefits
6 and services that it is asked to provide at reasonable rates and that provides
7 services to its customers and the state above and beyond what is required to
8 maintain its status as a public utility. I have a difficult time envisioning a state
9 approved taking of a public utility that would be any less in the public interest and
10 more troubling than this one. To take the largest and best privately-owned water
11 company in the state and dismantle it is not in the public interest.
12 The extent of eminent domain powers and how they are exercised by the
13 government is currently being reevaluated in our state, and throughout the
14 country, as a result of the United States Supreme Court decision in *Kelo v. City of*
15 *New London and New London Development Corporation*. Since the *Kelo*
16 decision the underlying power of the government to take privately-owned
17 property has become a major issue for the New Hampshire Legislature and
18 legislatures throughout the country. Our Legislature is carefully scrutinizing any
19 exercise of eminent domain powers that could be viewed as overstepping the
20 bounds of reasonableness. Approval of Nashua’s acquisition of Pennichuck’s
21 property within Nashua and in other municipalities, given the reputation that
22 PWW has and the overall circumstances in Nashua and the other towns served by
23 Pennichuck, could provoke an adverse response. There is already public

[26]

sentiment for changing the burden of proof that a municipality must meet to authorize a taking. See Attachment DLP-7, Union Leader editorial dated 11/18/05. It seems inconsistent with the free enterprise philosophy in this state (see Attachment DLP-8, "The End of Free Enterprise in New Hampshire" by Charles M. Arlinghaus), the desire to encourage the development of a healthy water industry, and a judicious exercise of eminent domain powers to find that such a taking is in the public interest given the totality of the circumstances.

Q. Overall do you believe it would be in the public interest for the Commission to approve the City's petition?

A. No, I do not. As the New Hampshire Supreme Court said in *Waste Control Systems, Inc. v. State*, 144 N.H. 21 (1974), the Court has given a broad definition to "public good", which this Commission has determined is analogous to "public interest". Order No. 20,668, 77 NH PUC 708, 712 (1992). According to the Court in *Waste Control Systems, Inc.* the public good includes not only the needs of particular persons who are directly affected, but also "the needs of the public at large and the general welfare of the utility involved." 144 N.H. at 24. When the Commission looks closely at the needs of ratepayers, the needs of the public at large, and the general welfare of the utility itself, it is clear that there would be significant harm to the public interest if the taking were approved and this harm clearly outweighs any potential benefits from such a taking.

Q. Does this conclude your testimony?

A. Yes.

[1]

STATE OF NEW HAMPSHIRE
PUBLIC UTILITIES COMMISSION

September 12, 2007 - 9:13 a.m. DAY VIII
21 South Fruit Street
Concord, New Hampshire

RE: DW 04-048
CITY OF NASHUA, NEW HAMPSHIRE:
Petition for valuation pursuant to RSA 38:9

BEFORE: Chairman Thomas B. Getz, Presiding
Commissioner Graham J. Morrison
Commissioner Clifton C. Below

Connie Fillion, Clerk
Sandy Deno, Clerk

APPEARANCES

Representing the City of Nashua, NH:
Robert Upton, II, Esq.
Justin C. Richardson, Esq.
Linda Regan, paralegal

Representing Pennichuck Water Works, Pennichuck
East Utilities & Pittsfield Aqueduct Co.:
Steven V. Camerino, Esq.
Sarah B. Knowlton, Esq.
Joe Conner, Esq.

Court Reporter:
Pamela Carle, CCR, RPR
New Hampshire CCR No. 98

[6]

1 Q. Gentlemen, could you each please
2 introduce yourselves, and then I'll ask you about
3 your testimony.

4 A. (By Mr. Reilly) My name is Robert
5 Reilly, R-E-I-L-L-Y.

6 A. (By Mr. Riethmiller) My name is
7 Richard Riethmiller, R-I-E-T-H-M-I-L-L-E-R.

8 Q. Mr. Reilly, I'll direct your attention
9 to your direct testimony that's been filed in this
10 case on January 12, 2006. It's been marked trial
11 Exhibit 3007, 3007A, and then 3007X, that's the
12 confidential section, as well as your reply
13 testimony that is dated May 22, 2006, trial
14 Exhibit 3017, and 3017A.

15 Then your limited update testimony,
16 Mr. Reilly, which was filed on November 14, 2006,
17 which is trial Exhibit 3021, 3021A, that is your
18 update valuation of \$273,400,000, and 3021B is
19 your further critique of the Sansoucy and Walker
20 report, and 3021X, which is the confidential
21 section.

22 Can you confirm that's your testimony
23 that's been filed in this case?

[7]

1 A. (By Mr. Reilly) Yes, it is.

2 Q. Do you have any changes or revisions to
3 make to that testimony?

4 A. (By Mr. Reilly) No, I do not.

5 Q. Do you adopt that testimony as your
6 testimony today?

7 A. (By Mr. Reilly) Yes, I do.

8 Q. Mr. Riethmiller, same questions, not as
9 much testimony. On January 12th, 2006 you filed
10 direct testimony, trial Exhibit 3008, 3008A. Then
11 on May 22, 2006 you filed reply testimony, which
12 is trial Exhibit 3018, is that correct?

13 A. (By Mr. Riethmiller) That's correct.

14 Q. Do you have any changes or revisions to
15 make to that testimony?

16 A. (By Mr. Riethmiller) I do not.

17 Q. Do you adopt that testimony as your
18 testimony today?

19 A. (By Mr. Reilly) I do.

20 MR. CONNER: Mr. Chairman, at this time
21 I'd also like to go ahead -- I think we may have
22 done this, but I want to make sure we have for the
23 record -- Mr. Harold Walker also participated in...

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1 Q. And did you get your understanding from
2 the same way that you got your understanding about
3 municipalities?

4 A. (By Mr. Reilly) Well, when you say --
5 what understanding about municipalities?

6 Q. That any New Hampshire city or town
7 could acquire the assets of Pennichuck Water Works
8 -- Water Company?

9 A. (By Mr. Reilly) It ultimately came
10 through the attorneys in this case. I don't
11 remember exactly the method of communication.

12 Q. Now, you chose public entities as
13 likely hypothetical buyers because of the
14 synergies they have, is that one of the reasons?

15 A. (By Mr. Reilly) Well, this is a
16 misstatement of what I -- what I did.

17 Q. Well, is that one of the reasons you
18 think that they're the most likely buyers?

19 A. (By Mr. Reilly) That is a misstatement
20 of my conclusion.

21 Q. Okay. Okay, you tell me what the
22 conclusion is, then?

23 A. (By Mr. Reilly) My conclusion is that

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1 public entities should be included in the
2 population of hypothetical willing buyers.

3 Q. Do you agree that public entities have
4 synergies that allow them to pay more than an IOU
5 could pay?

6 A. (By Mr. Reilly) Yes, I do.

7 Q. And do you agree that ability to pay is
8 not the same as fair market value?

9 A. (By Mr. Reilly) Yes, I do.

10 Q. The synergies that a public entity has
11 aren't just known to somebody like you, are they?

12 A. (By Mr. Reilly) You mean a short
13 person?

14 Q. Or a red-headed person like me? You
15 don't have to be an appraiser with all the letters
16 after your name to know that there are synergies
17 for a municipality?

18 A. (By Mr. Reilly) No, I would think
19 that's true. I would say it's probably -- it is
20 widely known in the water service industry, which
21 is why 80 percent of all water utilities in the
22 United States are owned by municipalities.

23 Q. The synergies -- I guess what I was...

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1 to earn whatever their allowed rate of return is,
2 I think it's something approaching 9 percent, but
3 if a buyer, particularly a municipal buyer says I
4 can finance this deal at four and a half or five
5 or five and a half percent, then you'd pay that
6 premium -- you'd pay a premium for that.

7 I'm going to be allowed to earn
8 8 percent, eight and a half, 9 percent, but I can
9 finance this deal at four and a half percent,
10 five, five and a half percent, I'll pay a premium
11 above rate base because I'll save it on my
12 interest expense.

13 COMMISSIONER BELOW: In your testimony
14 you indicated that you had done fair market value
15 appraisals of about five or six water companies in
16 the context of a voluntary sale.

17 MR. REILLY: Yes, sir.

18 COMMISSIONER BELOW: Do you know if
19 any -- in any of those appraisals you included in
20 the population of the hypothetical willing buyers
21 nonprofit entities?

22 MR. REILLY: I've been asked that in
23 other litigation proceedings like this, I've gone

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1 back to check. Not in every single case, but in
2 most cases I have. And it all depends on who is
3 surrounding -- I mean, literally, who is
4 surrounding the subject system.

5 If the subject system was surrounded by
6 other IOU utilities, we assumed the buyer would be
7 an IOU utility. Basically, if the subject system
8 is surrounded by municipalities, we assume the
9 buyer is going to be -- if not a municipality, at
10 least will be influenced by a municipality.

11 COMMISSIONER BELOW: You've also stated
12 that you've done five appraisals -- maybe that's
13 increased by one more recently -- for water
14 companies in the context of a forced sale or
15 condemnation?

16 MR. REILLY: Yes, sir.

17 COMMISSIONER BELOW: In those
18 appraisals, do you know how many times you used a
19 population -- included in the population of
20 hypothetical willing buyers nonprofits?

21 MR. REILLY: I want to say every time
22 except one. Typically in many of those cases --
23 there hasn't been that many, between one or two

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1 handful, we worked for the condemning authority,
2 in other words we worked for the county or for the
3 city. In some of the cases like this case we
4 worked for the company.

5 But in those cases where there have
6 been condemnations, typically when you look at who
7 really is surrounding the subject utility, the
8 surrounding utilities are owned by
9 municipalities -- municipalities, so we assume
10 municipalities will at least be included in the
11 group of possible willing buyers.

12 COMMISSIONER BELOW: Back to rate base
13 for a moment. All other things being equal in
14 looking at a particular situation for income
15 valuation, if the rate base is more or less, would
16 you expect the fair market value to be more or
17 less?

18 MR. REILLY: Oh, I think there's a
19 direct relationship. If the rate base is higher,
20 the fair market value would be higher; if the rate
21 base is lower, the fair market value would be
22 lower.

23 But my only point is the relationship

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1 is, you know -- depending on the actual
2 transactions, we can look it up in the Peoria case
3 where I actually looked at those -- you know, the
4 rate base -- the fair market value based on actual
5 closed deals may be three, three and a half, four
6 times rate base, but it would be a linear
7 relationship.

8 COMMISSIONER BELOW: So that multiplier
9 is going to create a ratio relationship, and that
10 ratio itself might be influenced by other factors
11 such as the regulatory environment or things of
12 that sort.

13 MR. REILLY: That's exactly right. Why
14 does one company pay two and a half times rate
15 base and another acquirer, they pay 4.2 times rate
16 base, that will be location and growth
17 and consumption and so forth, but --

18 COMMISSIONER BELOW: And the particular
19 synergy opportunities for the particular buyer.

20 MR. REILLY: Exactly right. Exactly
21 right.

22 COMMISSIONER BELOW: That's all.

23 CHAIRMAN GETZ: I have some questions,

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1 but before I want to address one procedural issue.

2 I raised the question yesterday of
3 trying to possibly get to Ms. Hartley today. I
4 should probably addressed that before lunch. I
5 think it's a little late in the day, but to the
6 extent that she's standing by, you can, I guess,
7 notify her she can stand down.

8 MS. KNOWLTON: Thank you.

9 CHAIRMAN GETZ: Good afternoon,
10 Mr. Reilly. A few areas I want to try to get some
11 understanding of.

12 First I was looking at your testimony
13 in your January 12 filing, it's Exhibit 3007, and
14 it's this whole notion of hypothetical willing
15 buyers, and the discussion begins on page 12 of
16 your testimony.

17 And my understanding -- the basic
18 understanding that's been covered is that you,
19 based on a legal opinion of counsel who indicated
20 that other municipalities could buy, you've
21 included them in your universe of hypothetical
22 willing buyers.

23 What I'm curious about is if the

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1 opinion of counsel had been that they could not be
2 included in that universe, how would that have --
3 do you expect that would have played out in your
4 fair market value valuation of the \$248 million?

5 MR. REILLY: Oh, sure. And I have
6 encountered that where in a certain -- either for
7 a certain purpose -- maybe not for condemnation,
8 for other purposes -- or in a certain
9 jurisdiction, the legal counsel has said, you
10 know, assume away municipal buyers. In this
11 jurisdiction for this purpose, you know, municipal
12 buyers doesn't have a legal right to enter into an
13 arms length negotiation.

14 And once that assumption is given to me
15 basically as an instruction, I would assume that
16 all the buyers are IOU buyers, and they're not
17 going to be concerned about outbidding a municipal
18 buyer, and then, frankly, what happens is the
19 values go down because we assume away low cost
20 financing, we -- you know, that's not in the
21 picture, and we assume that all operating expenses
22 are in place.

23 In other words, we don't take out

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1 income tax, and we don't take out property tax,
2 and we don't take out regulatory expense. We
3 leave those in, and in all three approaches the
4 value comes down.

5 So to assume that the marketplace is
6 influenced by municipal buyers, we don't need a
7 hundred municipal buyers, we don't even need ten,
8 but we need one or two. You would need to assume
9 there are at least one or two municipal buyers who
10 would get into the fray and compete with the
11 investor owned utility buyers, and they would all
12 start bidding up to the point where the -- the
13 highest bid wins.

14 CHAIRMAN GETZ: But getting back to my
15 question, if there were no possibility or it
16 wasn't legally permissible for municipalities or
17 other not for profits to actually acquire in this
18 case, I'd just ask for like an order of magnitude
19 or some qualitative opinion on your -- on your
20 part of what -- would the \$248 million have been
21 slightly smaller, significantly smaller? Can
22 you --

23 MR. REILLY: I could actually go back

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1 and quantify it, but just as I'm sitting here, it
2 would be significant. I don't want to -- I mean,
3 this is just based on cases where I've been
4 instructed, you know, assume away, assume there
5 are no municipal buyers.

6 Typically it may be in order of a
7 third. In other words, the value could come down
8 by a third if you assume the only buyers in the
9 market are investor owned utilities as opposed to
10 saying the buyers in the market include investor
11 owned utilities and municipal funds. So it's not
12 a trivial adjustment.

13 CHAIRMAN GETZ: So in the case at hand
14 where you have given the opinion that other
15 municipalities and not for profits could be an
16 acquirer, my understanding of -- of the
17 appraiser's obligation, and then which I presume
18 you would contend then become an obligation of the
19 commission in trying to assess what fair market
20 value would be, that we would only be looking at
21 the possibility that others could -- could buy and
22 not making any judgment about the likelihood that
23 they would buy, is that a fair characterization?

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1 MR. REILLY: I think that's right. My
2 premise is not -- and in any appraisal that I've
3 performed like this, it's not that not for profit
4 will be the buyer, it's just that in the way I
5 always think about it internally or tell my staff,
6 if you assume that the company, Pennichuck
7 Corporation, put a for sale sign on Pennichuck
8 Water Works and they sent out bids, and they sent
9 out bids to municipal buyers and to IOU buyers and
10 they got back ten bids, and at least a couple of
11 those were municipal buyers, and even seven or
12 eight of them may be IOU buyers, but everyone
13 knows who the other bidders are, then the IOU
14 buyers in their bidding process -- and no one gets
15 a last look, and no one gets a second bid, you
16 know, they give you one sealed bid and that's it,
17 the IOU buyers are going to say, well, what's the
18 next guy going to bid?

19 If I need to win, I need to outbid the
20 next guy by a dollar. But they each go -- they
21 start going in dollar increments -- now it's going
22 to take a long time because we're talking about
23 hundreds of millions of dollars -- but each buyer

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1 looks around and says if I want to win, I've got
2 to outbid everyone at this table. And if one or
3 two or three people at the table are municipal
4 buyers, then I've got to bid at least what they're
5 going to bid.

6 Now, the ultimate winner may well be an
7 investor owned utility. All I'm saying is that
8 investor owned utility is going to have to pay
9 what he thinks the municipal buyer is going to
10 pay, otherwise he'll never be the winner in the
11 bidding process.

12 CHAIRMAN GETZ: Some of this actually
13 seems to be going to the type of sales process or
14 auction. Are you presuming that it's -- here it's
15 known who else is bidding, but it seems to me
16 you're also saying if it's in the mind of some IOU
17 who might bid to think that some municipality
18 might bid, and there is only one that might bid
19 out in that universe, that's enough?

20 MR. REILLY: It is. At least according
21 to some of the transactional data that we've seen.
22 And you look at this transactional data, and you
23 see wide variations in multiples of revenue, in

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1 multiples of net utility plant, multiples of EBIT,
2 EBIDTA, net income, and why are there wide
3 variations.

4 Well, there are a lot of reasons, but
5 in some of the cases the explanation is once one
6 or two municipal buyers have entered into the
7 bidding -- and typically my experience is in a
8 transaction of this size -- this would not be a
9 trivial transaction -- that the other buyers may
10 not know everyone at the table, but they have a
11 pretty good feel for the other types of buyers at
12 the bidding table.

13 If the other buyers -- in my example,
14 the other six or seven buyers are all investment
15 owned utilities but they're pretty -- they believe
16 that there's going to be one or two municipals at
17 the table who are serious about this, whoever
18 wants to win the acquisition has to pay the
19 highest price.

20 And if everyone thinks that the other
21 person's going to bid one dollar more, they'll
22 keep the bidding going up until they get to the
23 price that's dictated by the -- by the investor

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1 owned utility -- I'm sorry, by the municipal
2 buyer.

3 CHAIRMAN GETZ: I guess the trouble I'm
4 having is -- on a theoretical level it's
5 understandable, then it's a question of how much
6 do you apply the facts of New Hampshire and the
7 facts of who might buy, what their history is, and
8 it seems to me it's almost like a second order
9 thing, the issue of whether you as an appraiser or
10 us as a commission is how much are we going to
11 read into the minds of IOU to make a judgment
12 about what particular entities in New Hampshire
13 may or may not do.

14 MR. REILLY: Well, that's right. And
15 that really is -- you know, that's why you have a
16 harder job than I have. But I can tell you this.
17 I don't think anyone in this trial will disagree
18 with this, and you can see this again from looking
19 at our Peoria report because we delineated some
20 market approach analysis in there, I broke out the
21 investor owned utility purchases compared to
22 municipal utility purchases, and across the board
23 the municipalities paid much higher multiples,

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1 materially, significantly, obviously higher
2 multiples than the investor owned utilities paid.

3 So in cases where the municipals go to
4 the bidding table, they can often win out because
5 they have the low cost financing and so forth. So
6 when they're in the game, they often win.

7 Your question, sir, which is a good
8 question, is how do you know they're going to be
9 in the game. Well, that becomes the assumption.
10 Is it fair to assume that they're not going to be
11 in the game when, you know, we know they're -- the
12 question is how many municipals have the right to
13 own Pennichuck assets.

14 I mean, it may be a question about
15 whether it's ten or 12 or 15 or what the number
16 is, but it's more than one. And once that type of
17 buyer enters into the bidding process, it affects
18 the whole process.

19 Again, the analogy that I use -- and
20 this is not to trivialize it, but I think this is
21 really a good analogy -- I tell my staff, if --
22 you know, when things get complex, go back to
23 basic real estate appraisal 101....

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1 becomes harder to estimate what's going to happen.
2 And maybe -- and just to volunteer something, this
3 isn't helpful to your problem solving, but it may
4 be helpful for you to sleep at night -- this is
5 not a problem that's at all unique to your
6 decision and to water companies.

7 Our firm is probably best known for the
8 work we do on healthcare. We do a lot of
9 healthcare valuations; we do literally hundreds a
10 year. This phenomenon is replete throughout
11 almost every healthcare valuation that we do
12 because that industry has the for profit sector
13 and the not for profit sector.

14 So when we're valuing clinics, we're
15 valuing hospitals, we're valuing MRI centers,
16 we're valuing, you know, urgent care centers,
17 whatever it is, this decision of who's going to be
18 in the marketplace, not for profits only, for
19 profits only, or both, affects every healthcare
20 valuation that I think every valuation firm in the
21 country does. I mean, this is not an issue that
22 is just specific to your decision.

23 COMMISSIONER BELOW: When you're

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1 looking at comparables in, say, a sales comparison
2 approach and you have knowledge that a particular
3 buyer had some sentimental or emotional interest
4 in a property, would you tend to discard that
5 transaction?

6 MR. REILLY: Typically, we do. If we
7 find that there's anything other than an arm's
8 length transaction, whether the buyer or the
9 seller is selling -- you know, go back to the
10 simple real estate example.

11 The buyer comes in, it turns out that
12 he's buying grandma's house because he wants his
13 children to grow up in the same house he grew up
14 in. You know, often you can't use that as a
15 comparable sale because people will pay more than
16 fair market value, or they'll hold onto a house
17 and they'll say, look, I just won't sell it to you
18 because this is the house I got married in, until
19 someone comes in and offers an outrageous price.
20 So typically we try to take those out of the
21 comparable sales.

22 COMMISSIONER BELOW: On page 14 of your
23 testimony you discuss that if a hypothetical

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1 what-if, other than the city of Nashua there were
2 no other municipality that was a potential
3 purchaser -- well, it actually says any stated
4 interested purchaser -- and I think you talk a bit
5 about that you would never do an appraisal based
6 on one party's or person's interest in a property,
7 it has to be sort of more abstract than that.
8 Could you elaborate?

9 MR. REILLY: Sure. What we don't want
10 to do, at least in a fair market value appraisal,
11 is conclude what's the value of, in this case
12 Pennichuck, to the city of Nashua, or to any one
13 other -- you know, we try to ignore the specific
14 buyer and the specific seller.

15 Because the specific buyer may have the
16 sentimental attributes you mentioned a moment ago.
17 The specific buyer may have, in this case,
18 political motivations, they may -- and I'm not
19 saying this happened here -- but some political
20 leader, a mayor has gone on record as saying we
21 will buy the water company and we'll pay whatever,
22 we're going to own the water company, and then the
23 bidding becomes absurd.

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1 So we're not trying to estimate the
2 value of Pennichuck to any one buyer. What we
3 really try to do, I think as all appraisers -- I
4 think all the appraisers in this case would agree,
5 we hypothesize Pennichuck Corporation putting a
6 for sale sign on the Pennichuck Water Works
7 subsidiary, and saying anyone -- we're going to
8 sell this, we're going to sell to somebody in the
9 next six months, whoever wants to bid, whether
10 you're a privately owned IOU, a publicly traded
11 IOU, a municipality, a to be formed water district
12 entity, if you want to submit a bid, you know, by
13 the end -- by 12/31, 2007 we're going to sell our
14 assets, and they collect bids and they sell to the
15 highest bidder. That's what we're trying to
16 hypothesize.

17 COMMISSIONER BELOW: In the real world
18 where those transactions have occurred, and you've
19 looked at a good number of them, I presume --

20 MR. REILLY: Yes, sir.

21 COMMISSIONER BELOW: -- both water
22 utilities and other utilities, have you ever
23 seen -- or how many situations have you seen where

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1 an investor owned utility was putting their
2 company or assets up for sale, on the auction
3 block, if you will, how many situations have you
4 seen where there have been multiple non -- not for
5 profit or governmental bidders?

6 MR. REILLY: It has occurred. I would
7 say that's the minority of the cases. When
8 there's a municipality involved, typically there's
9 one municipality, and typically it's a friendly
10 negotiation.

11 Which I assume was the case in Tilton
12 transaction, where the municipality comes to the
13 water company, or the water company comes to the
14 municipality and says, no litigation, no taking,
15 no animosity, let's see if we can work out a deal.
16 You sit down, I sit down, let's see what's good
17 for everybody, and typically it's kind of a
18 quietly arranged situation.

19 And the only time I've seen a few
20 cases -- and I'm talking very few cases -- where
21 it may be back to back, literally next door
22 municipalities, why should we -- you know, and the
23 concern is often, I'll just be honest with you, if

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1 we're -- if I'm city A and I'm right next to city
2 B and the water company is in the middle, city A
3 and B, their concern is, well, if city A is the
4 owner, are they still going to service city B?
5 They're going to have all the wells over there, or
6 they're going to have the tanks over there, or
7 they have the lake over there, are we going to get
8 the same service. But, you know, when city A and
9 city B are both bidding, then the prices can get
10 bid up.

11 COMMISSIONER BELOW: Do you recall the
12 names of any of these situations?

13 MR. REILLY: Oh, I can look -- I can't
14 think on the top of my head, but I can research
15 that and get you that information.

16 COMMISSIONER BELOW: Can we make that a
17 record request?

18 MR. REILLY: Sure.

19 CHAIRMAN GETZ: We will reserve the
20 next company's exhibit for the answer to that
21 question from Commissioner Below, and if you have
22 the number available?

23 MS. KNOWLTON: 3268, I believe. 3258...

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1 A. (By Mr. Reilly) Yes.

2 Q. And I'm not going to ask you about
3 that, but was that transaction included within
4 Mr. Walker's list of transactions?

5 A. (By Mr. Reilly) I'd have to take just a
6 second to look.

7 Q. Okay, take a look at 1007A, page 52.
8 This is a list of 28. It's on the screen, Robert,
9 there, if you'd like.

10 A. (By Mr. Reilly) Well, if it's on here,
11 I don't see it. I just don't see it right now, so
12 you'll have to point to me.

13 Q. Represent to you that it's not.

14 A. (By Mr. Reilly) I don't see it, but I
15 guess we both agree it's not on here.

16 Q. Mr. Reilly, I'll ask you a few
17 questions concerning the Barr Devlin line of
18 questioning by Mr. Upton.

19 Mr. Reilly, you had that information.
20 Does any of that information have an impact or
21 should it have been considered in your appraisal
22 of these assets as of 12/31/05?

23 A. (By Mr. Reilly) No. I don't think the

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1 Barr Devlin confidential offering memorandum was
2 useful at all in the appraisal of the assets of
3 Pennichuck Water Works as of 12/31/04 or 12/31/05.

4 Q. Can you tell us why?

5 A. (By Mr. Reilly) Surely. There are
6 actually a number of different reasons. One is the
7 appraisal subject is different. Barr Devlin is
8 actually looking at a sale of stock of Pennichuck
9 Corporation. The appraisers in this case are
10 trying to appraise the assets of Pennichuck Water
11 Works.

12 The specific transaction that Barr
13 Devlin was focusing on, which was an offer -- an
14 unconsummated offer, but an offer by Philadelphia
15 Suburban to buy the stock of Pennichuck
16 Corporation, that was a stock for stock
17 transaction. What we're focused on is a cash for
18 assets transaction.

19 A stock for stock transaction is just a
20 fundamentally different type of transaction from a
21 tax and accounting perspective than a cash for
22 assets transaction, and there are ways to reconcile
23 them, but there are a number of very material

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1 adjustments that have to be made.

2 Q. Such as?

3 A. (By Mr. Reilly) Well, there are a
4 number. The two biggest ones is if you buy the
5 assets of a company -- if an acquirer like
6 Philadelphia Suburban buys the assets of Pennichuck
7 Water Works, they have -- they can get -- and they
8 pay any number -- you take -- I'll say \$300 million
9 because it's a number that some people in the
10 courtroom would like -- but whatever the number is,
11 the buyer gets to write up the basis in the assets
12 for federal income tax purposes to the purchase
13 price, whatever that is, 200 million, 300 million,
14 whatever it is, and gets to depreciate that
15 purchase price premium for federal income tax
16 purposes.

17 And the current tax basis of the
18 assets, at least as the end of 2004, was about
19 \$50 million, give or take. So there would be a big
20 purchase price premium paid, the buyer gets to
21 depreciate that purchase price premium if you buy
22 assets.

23 If you buy stock, you get a carryover

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1 basis. You carry over the assets at a \$50 million
2 basis, you don't get to depreciate the extra
3 \$200 million, \$250 million premium that you paid
4 for those assets.

5 So one of the things you're paying for
6 is the tax deductions on a -- let's say a
7 \$200 million purchase price premium. That's worth
8 a lot of money. That's worth tens and tens and
9 tens of millions of dollars.

10 If you buy stock, because of this fact
11 you get a carryover basis, there's no income tax
12 implications to the buyer -- rather to the seller.
13 The seller doesn't have to pay income tax on the
14 gain because they're selling the stock with a
15 carryover basis.

16 If they sell assets, there is an income
17 tax on the gain. So to make the buyer whole --
18 and, again, that income tax would be on the
19 difference between basis and sales price. In this
20 case that would be -- that could be a
21 \$50 million -- I don't know exactly, but in the
22 order of a \$50 million capital gain.

23 To make the seller of the assets whole

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1 compared to a stock deal, you'd have to put another
2 \$50 million on the table for an asset deal. So the
3 difference between an identical stock deal and
4 identical asset deal for a Pennichuck type
5 transaction could be a hundred million dollar
6 difference.

7 Exactly the same company on exactly the
8 same day, if you structure it as an asset deal, the
9 purchase price would be so much higher than if you
10 structured it as -- as a stock deal. So there are
11 big differences in buying stock versus buying
12 assets.

13 Q. The other question I asked you with
14 regard to the timing, the Barr Devlin information
15 was based on '01 financial data and projections,
16 was it not?

17 A. (By Mr. Reilly) Well, that's right.
18 But that's important for two reasons. The Barr
19 Devlin valuation was based on two analyses. One is
20 a capitalized 2001 earnings. We're now looking at
21 2004 and 2005 earnings. The company's earnings
22 increased significantly from 2001 to, say, 2005;
23 they increased very significantly.

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1 The other method that Barr Devlin used
2 is very similar to my discounted cash flow
3 analysis. They projected out five years of future
4 cash flow, they projected out 2002, 3, 4, 5 and 6;
5 that was their projection.

6 Their projection did not have in it any
7 material rate base increase. It did not have in
8 it -- and you can see this from their documents --
9 their projection did not have the new water
10 treatment plant in it, which effectively doubled
11 the rate base of Pennichuck.

12 Therefore, the cash flow projection
13 that Barr Devlin was valuing is about half of the
14 cash flow projection that I was valuing that we
15 knew about it in 2004 and 2005 that they simply
16 didn't know about in 2001. So they're valuing a
17 different company at a different point in time,
18 structured as a different type of deal.

19 Q. Mr. Reilly, did you tell Pennichuck
20 Water -- I believe Don Korell was the CEO at the
21 time -- that you would not go into the
22 proceeding -- this proceeding with a value less
23 than \$243 million?

1 MR. UPTON: I object.

2 CHAIRMAN GETZ: Let's hear the
3 objection.

4 MR. UPTON: This is rebuttal. This
5 isn't redirect. He's just trying to rebut
6 Sansoucy's testimony. I mean, that's silly.

7 CHAIRMAN GETZ: Mr. Conner?

8 MR. CONNER: Your Honor, Mr. Chairman,
9 I'm not trying to rebut Mr. Sansoucy's testimony.
10 There were questions from Mr. Upton concerning
11 Sansoucy's statements with respect to a pre --
12 going into this proceeding with a predetermined
13 number. I'm just asking him -- I'll ask the
14 question real directly.

15 CHAIRMAN GETZ: Well, it's the nature
16 of the question. It does seem to me I'm not sure
17 how this is --

18 MR. CONNER: That's fine, your Honor.

19 CHAIRMAN GETZ: -- redirect, so.

20 BY MR. CONNER:

21 Q. Last question I have, Mr. Reilly. With
22 respect to the work you've done in regard to some
23 of the cases that I have -- our firm has retained

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1 you on and with respect to condemnation and maybe
2 other valuation issues, I believe in your
3 cross-examination you stated that you have also
4 provided valuation services for municipalities and
5 non -- and public entities as well as investor
6 owned entities, is that correct?

7 A. (By Mr. Reilly) Yes, that's correct.

8 Q. With respect to our firm, have you also
9 been engaged by clients that are on the other side
10 of clients that our firm represents?

11 A. (By Mr. Reilly) Yes, I've worked for
12 two telephone utilities, I've worked for two
13 different states in property tax appraisals
14 testifying against your partner Jim McBride from
15 the DC office and Greg Fletcher from the Memphis...
16 office. And we were very successful in those
17 cases, I should add.

18 Q. That's what they tell me.

19 MR. CONNER: That's all I have,
20 Mr. Chairman.

21 CHAIRMAN GETZ: Thank you.

22 MR. UPTON: I have one or two questions
23 on recross, if I may.

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1 CHAIRMAN GETZ: Which two areas are you
2 asking for recross on?

3 MR. UPTON: It's only one. It's the
4 introduction of tax and fair market value; the
5 effect of tax on fair market value.

6 CHAIRMAN GETZ: That's one, or is that
7 it?

8 MR. UPTON: That's it.

9 CHAIRMAN GETZ: That's it?

10 MR. UPTON: Yes.

11 CHAIRMAN GETZ: I'll permit it.

12 RECROSS-EXAMINATION

13 BY MR. UPTON:

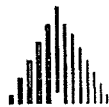
14 Q. Mr. Reilly, the tax -- the tax impact
15 on a seller doesn't affect fair market value, does
16 it?

17 A. (By Mr. Reilly) Oh, no, it doesn't
18 affect fair market value. I was just trying to
19 reconcile a stock deal to an asset deal. It
20 doesn't affect fair market value.

21 Q. So if I sell an apartment building and
22 the fair market value is the fair market value of
23 that apartment building, but the tax effect on me....

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the monetary amount that might be realized from its sale. Use value may vary depending on the management of the property and external conditions such as changes in business operations. For example, a manufacturing plant designed around a particular assembly process may have one use value before a major change in assembly technology and another use value afterward.

Real property may have a use value and a market value. An older factory that is still used by the original firm may have considerable use value to that firm but only a nominal market value for another use.

Use value appraisal assignments may be performed to value assets (including real property) for mergers, acquisitions, or security issues. This type of assignment is sometimes encountered in appraising industrial real estate when the existing business enterprises include real property.

Court decisions and specific statutes may also create the need for use value appraisals. For instance, many states require agricultural use appraisals of farmland for property tax purposes rather than opinions of value based on highest and best use. The current IRS regulation on estate taxes allows land under an interim agricultural use to be valued according to this alternative use even though the land has development potential.⁴

Limited-Market and Special-Purpose Properties

When appraising a type of property that is not commonly exchanged or rented, it may be difficult to determine whether an opinion of market value can be reasonably supported. Such limited-market properties can cause special problems for appraisers. A limited-market property is a property that has relatively few potential buyers at a particular time, sometimes because of unique design features or changing market conditions. Large manufacturing plants, railroad sidings, and research and development properties are examples of limited-market properties that typically appeal to relatively few potential purchasers.

Many limited-market properties include structures with unique designs, special construction materials, or layouts that restrict their utility to the use for which they were originally built. These properties usually have limited conversion potential and, consequently, are often called *special-purpose* or *special-design*

use value: The value of a property as it is currently used, not its value considering alternative uses; may be used where legislation has been enacted to preserve farmland, timberland, or other open space land on urban fringes; also known as *value in use*.

limited-market property: A property that has relatively few potential buyers at a particular time.

special-purpose property: A limited-market property with a unique physical design, special construction materials, or a layout that restricts its utility to the use for which it was built; also called *special-design property*.

4. The section on special use valuation in United States Estate (and Generation-Skipping Transfer) Tax Return (IRS Instructions for Form 706) states: "Under section 2032A, you may elect to value certain farm and closely held business real property at its farm or business use value rather than its fair market value. You may elect both special use valuation and alternate valuation."

properties. Examples of such properties include houses of worship, museums, schools, public buildings, and clubhouses.

Limited-market properties may be appraised based on their current use or the most likely alternative use. Due to the relatively small markets and lengthy market exposure needed to sell such properties, there may be little evidence to support an opinion of market value based on their current use. The distinction between market properties and limited-market properties is subject to the availability of relevant market data. If a market exists for a limited-market property, the appraiser must search diligently for whatever evidence of market value is available.

If a property's current use is so specialized that there is no demonstrable market for it but the use is viable and likely to continue, the appraiser may render an opinion of use value if the assignment reasonably permits a type of value other than market value. Such an estimate should not be confused with an opinion of market value. If no market can be demonstrated or if data is not available, the appraiser cannot develop an opinion of market value and should state so in the appraisal report. It is sometimes necessary to render an opinion of market value in these situations for legal purposes, however. In these cases, the appraiser must comply with the legal requirement, relying on personal judgment and whatever direct market evidence is available. Note that the type of value developed is not dictated by the property type, the size or viability of the market, or the ease with which that value can be developed; rather, the intended use of the appraisal determines the type of value to be developed. If the client needs a market value opinion, the appraiser must develop an opinion of market value, not use value.

Investment Value

While use value focuses on the specific use of a property, investment value represents the value of a specific property to a particular investor. As used in appraisal assignments, investment value is the value of a property to a particular investor based on that person's (or entity's) investment requirements. In contrast to market value, investment value is value to an individual, not necessarily value in the marketplace.

Investment value reflects the subjective relationship between a particular investor and a given investment. It differs in concept from market value,

although investment value and market value indications sometimes may be similar. If the investor's requirements are typical of the market, investment value will be the same as market value.

When measured in dollars, investment value is the price an investor would pay for an investment in light of its

investment value: The specific value of a property to a particular investor or class of investors based on individual investment requirements, distinguished from market value, which is impersonal and detached.

perceived capacity to satisfy that individual's desires, needs, or investment goals. To render an opinion of investment value, specific investment criteria must be known. Criteria to evaluate a real estate investment are not necessarily set down by the individual investor; they may be established by an expert on real estate and investment value, i.e., an appraiser.

going-concern value: The market value of all the tangible and intangible assets of an established and operating business with an indefinite life, as if sold in aggregate.

Going-Concern Value

A going concern is an established and operating business with an indefinite future life. For certain types of properties (e.g., hotels and motels, restaurants, bowling alleys, manufacturing enterprises, athletic clubs, landfills), the physical real estate assets are integral parts of an ongoing business. The market value of a such a property (including all the tangible and intangible assets of the going concern, as if sold in aggregate) is commonly called its *going-concern value*. (See Figure 2.1.) Appraisers may be called upon to develop an opinion of the investment value, use value, or some other type of value of a going concern, but most appraisals of going-concern value relate to market value.

Traditionally, going-concern value has been defined as the value of a proven property operation. The emerging definition of the term highlights the assumption that the business enterprise is expected to continue operating well into the future (usually indefinitely); in contrast, liquidation value assumes that the enterprise will cease operations. Going-concern value includes the incremental value associated with the business concern, which is distinct from the value of the real property. The value of the going concern includes an intangible enhancement of the value of the operating business enterprise, which is produced by the assemblage of the land, buildings, labor, equipment, and the marketing operation. This assemblage creates an economically viable business that is expected to continue. The value of the going concern refers to the total value of the property, including both the real property and the intangible personal property attributed to business enterprise value (see Figure 2.2).

It may be difficult to separate the market value of the land and the building from the total value of the business, but such a division of realty and non-realty components of value is often required by federal regulations. When an appraiser cannot effectively separate the market value of the real estate from its business enterprise value, it is appropriate to state that the reported opinion of value includes both market value and business enterprise value and that the appraiser has not been able to distinguish between them. Only qualified practitioners should undertake these kinds of assignments, which must be performed in compliance with appropriate USPAP standards. (Business enterprise value is discussed in Chapter 27.)

MARKET VALUE AND INVESTMENT VALUE

An important distinction is made between market value and investment value. Investment value is the value of a certain property use to a particular investor. Investment value may coincide with market value, which was defined in Chapter 2, if the client's investment criteria are typical of investors in the market. In this case, the two opinions of value may be the same number, but the two types of value and their concepts are not interchangeable.

Market value is objective, impersonal, and detached; investment value is based on subjective, personal parameters. To develop an opinion of market value with the income capitalization approach, the appraiser must be certain that all the data and forecasts used are market-oriented and reflect the motivations of a typical investor who would be willing to purchase the property at the time of the appraisal. A particular investor may be willing to pay a price different from market value, if necessary, to acquire a property that satisfies other investment objectives unique to that investor.

investment value: The specific value of an investment to a particular investor or class of investors based on individual investment requirements, distinguished from market value, which is impersonal and detached.

Leases

The income to various lease interests is generally derived through the conveyance and operation of leases. A lease is a written² document in which the rights to use and occupy land or structures are transferred by the owner to another for a specified period of time in return for a specified rent. An appraiser begins the income capitalization approach by studying all existing and proposed leases that apply to the subject property. These leases provide information on the base rent, any other income, and the division of expenses between the landlord and the tenant.

Although a lease can be drawn to fit any situation, most leases³ fall into one of several broad classifications:

lease: A written document in which the rights to use and occupy land or structures are transferred by the owner to another for a specified period of time in return for a specified rent.

base rent: The minimum rent stipulated in a lease.

- Flat rental
- Variable rental
- Step-up or step-down
- Revaluation
- Annual increase
- Percentage

Lease types include gross rental, net rental, flat rental, variable rental, step-up or step-down, revaluation, level with an annual increase, and percentage leases.

Leases may be negotiated on a gross rental basis, with the lessor paying most or all the operating expenses of the real estate, or on a net rental basis, with the tenant paying all expenses. When leases

2. Most states require a written lease only when the term is greater than one year.
3. Other lease types are defined in accounting practice, e.g., capital or financing leases and operating or service leases. These leases often involve equipment.