

STATE OF NEW HAMPSHIRE
PUBLIC UTILITIES COMMISSION

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

DAY VIII

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

1 APPEARANCES (Continued)

2 Representing Anheuser-Busch:
3 Daniel Mullen, Esq.

4 Representing the Town of Milford:
5 E. Maria Reinemann, Esq.

6 Representing the Town of Merrimack:
7 Edmund Boutin, Esq.

8 Representing PUC staff:
9 Marcia A.B. Thunberg, Esq.

10 Representing Residential Ratepayers:
11 Office of Consumer Advocate
12 Kenneth Traum
13 Stephen Eckberg

14 Claire McHugh, pro se

15 Barbara Pressley, pro se

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I N D E X

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WITNESS PANEL:

ROBERT REILLY

RICHARD RIETHMILLER

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EXAMINATION:

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Direct Examination

By Mr. Conner

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Cross-Examination

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By Mr. Boutin

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By Mr. Upton

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EXHIBITS

15

EXHIBIT NO.

DESCRIPTION

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Company 3258

(Reserved)

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Company 3259

2006 USPAP standards

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1 P R O C E E D I N G S

2 CHAIRMAN GETZ: Good morning, everyone.
3 We're resuming the hearing in docket DW 04-048,
4 and today we have scheduled the testimony and
5 cross-examination of Mr. Reilly and Riethmiller.
6 Is there anything to address before we hear from
7 the witnesses? Okay, hearing nothing, then if we
8 could proceed.

9 MR. CONNER: Do you want to do
10 appearances?

11 CHAIRMAN GETZ: Let's take appearances.
12 Thank you for the reminder.

13 MR. UPTON: Good morning. I'm Rob
14 Upton, I'm here on behalf of the city of Nashua.

15 CHAIRMAN GETZ: Good morning.

16 MS. REINEMANN: Maria Reinemann on
17 behalf of the town of Milford. Good morning.

18 MR. BOUTIN: Ed Boutin on behalf of the
19 town of Merrimack.

20 CHAIRMAN GETZ: Good morning.

21 MR. MULLEN: Good morning. Dan Mullen
22 on behalf of Anheuser-Busch.

23 CHAIRMAN GETZ: Good morning.

1 MR. TRAUM: Good morning, representing
2 the Office of Consumer Advocate, Ken Traum.

3 CHAIRMAN GETZ: Good morning.

4 MS. THUNBERG: Good morning, Marcia
5 Thunberg on behalf of staff.

6 CHAIRMAN GETZ: Good morning.

7 MR. CAMERINO: Good morning,
8 commissioners. Steve Camerino and Sarah Knowlton
9 from the McLean law firm, and Joe Conner from
10 Baker Donelson as well. And with us today in the
11 back of the room will be Mr. Ware, the president
12 of Pennichuck Water Works, and a little later
13 Mr. Patterson, the chief financial officer of
14 Pennichuck Corporation.

15 CHAIRMAN GETZ: Good morning. Can we
16 proceed with direct examination?

17 MR. CONNER: Yes, sir. Good morning,
18 Mr. Chairman, commissioners. Can we swear the
19 witnesses, please.

20 (Robert Reilly, Richard Riethmiller,
21 sworn)

22 DIRECT EXAMINATION

23 BY MR. CONNER:

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?

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

1 the cost approach under Mr. Reilly and
2 Mr. Riethmiller's supervision, and there's been
3 agreement for no cross-examination for Mr. Walker,
4 he's with Gannet Fleming, he did the reproduction
5 cost new component of the cost approach, and his
6 direct testimony is being introduced as -- by
7 agreement as Exhibit 3009 and Exhibit 3009A.

8 We also have a real estate appraisal
9 that was done on all the raw land owned by
10 Pennichuck, as well as cross-country easements,
11 and that was -- testimony is being submitted
12 through Russ Thebeault, and that is the January
13 12, 2006 testimony, trial Exhibit 3011, and then
14 there are several attachments, 3011A through H,
15 and that is also being submitted by agreement, and
16 Mr. Upton has agreed that no cross-examination is
17 necessary.

18 CHAIRMAN GETZ: So then we would be
19 taking them off the schedule for September 18th?

20 MR. CONNER: Yes, sir, we will. With
21 that, I have no further questions.

22 CHAIRMAN GETZ: Thank you. Before we
23 turn to the cross, let's make sure we have a

1 meeting of the minds on the order of
2 cross-examination.

3 MR. CONNER: I'm going to leave that to
4 Mr. Camerino.

5 CHAIRMAN GETZ: The easy part, I guess,
6 is intervenors opposing the petition and then
7 intervenors with no position on the petition.

8 MR. UPTON: I think it's just the
9 opposite. I think it's intervenors -- I'm sorry,
10 maybe you said it right and I don't -- let's do
11 it -- can you do it again for me?

12 CHAIRMAN GETZ: Okay. From both
13 schedules that I've seen, intervenors opposing
14 petition would go first.

15 MR. UPTON: Right. I'm sorry, I did
16 misunderstand you.

17 CHAIRMAN GETZ: Then with intervenors
18 with no position on the petition, which I think
19 comes down to the consumer advocate. And then do
20 we go to commission staff at that point, or -- I'm
21 assuming city of Nashua would like to go last.

22 MR. UPTON: Yes.

23 CHAIRMAN GETZ: Which seems a

1 reasonable course.

2 MR. CONNER: I think Mr. Boutin has
3 some cross. I'm not sure where that falls.

4 CHAIRMAN GETZ: Unless there's any real
5 objection, I think I would return to what had been
6 set out as an order of cross, that it would be
7 intervenors opposing petition, intervenors with no
8 position, commission staff, intervenors supporting
9 the petition, and then the city of Nashua would
10 have the last opportunity to cross.

11 MR. CONNER: That's fine.

12 CHAIRMAN GETZ: We're all agreed? So
13 let's proceed. Then we will start, Mr. Boutin, do
14 you have questions for the panel?

15 MR. BOUTIN: Yes, I do. Good morning,
16 Mr. Chairman, members of the commission.

17 CROSS-EXAMINATION

18 BY MR. BOUTIN:

19 Q. Mr. Reilly and Riethmiller, is it?

20 A. (By Mr. Riethmiller) Riethmiller.

21 Q. I haven't met either of you before
22 today, so forgive me if I ask some questions that
23 may confuse you. I'll try to be as concise as I

1 can.

2 Mr. Reilly, you recognize this volume
3 as the Uniform Standards of Professional Appraisal
4 Practice and Advisory Opinions?

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

6 Q. And would this be effective July 1,
7 2006, a current publication?

8 A. (By Mr. Reilly) Yes, that is current
9 through the end of 2007.

10 MR. CONNER: Mr. Chairman, I think his
11 microphone -- Robert, I think your microphone
12 needs to be pulled closer to you.

13 MR. UPTON: That would be very helpful,
14 if you could. He has a soft voice.

15 MR. CAMERINO: It needs to be pretty
16 close to you.

17 MR. BOUTIN: Yeah, it needs to be very
18 close. Everybody was watching the Red Sox at
19 midnight.

20 BY MR. BOUTIN:

21 Q. Now, this publication is put out by the
22 Appraisal Foundation, is it not?

23 A. (By Mr. Reilly) That's correct.

1 Q. Have you in the past been affiliated
2 with the publishers of this publication?

3 A. (By Mr. Reilly) Yes, for about a dozen
4 years, which I think is the maximum term I can
5 have, I served as a member of the issues resource
6 panel, or called IRP, of the Appraisal Foundation.

7 Q. And what did you do in that capacity?

8 A. (By Mr. Reilly) The -- each year the
9 Appraisal Standards Board updates USPAP, and they
10 usually do that in the middle to end of the year.
11 This is actually the first edition that came out
12 midyear; typically the previous editions were
13 effective on January 1st.

14 So by typically the middle to early
15 fall of each year the appraisal standards board
16 would issue a draft of next year's USPAP to the
17 members of the issues resource panel. We would
18 review the draft and then meet with the Appraisal
19 Standards Board in DC and comment on in.

20 In other words, we were asked to review
21 the annual changes to USPAP and comment as to
22 whether they were reasonable, whether they actually
23 represented the current consensus of appraisal

1 practice and appraisal procedures, whether
2 appraisers could actually live with, practically
3 implement, the next year's changes in USPAP, and we
4 effectively negotiated with the Appraisal Standards
5 Board on behalf of the appraisal community before
6 the Appraisal Standards Board finalized USPAP and
7 issued it towards the end of the year to be
8 effective for January 1st the following year.

9 Q. So the federal government is involved
10 in this process, is that right?

11 A. (By Mr. Reilly) Yes. The Appraisal
12 Foundation is authorized by Congress, funded by
13 Congress, and reports to Congress.

14 Q. Now, I understand that this process
15 emanated from the savings and loans scandals in
16 the late '80s and early '90s, am I correct?

17 A. (By Mr. Reilly) Yes, in fact was
18 initiated by the FIRREA Act in the late 1980s.

19 Q. Now, these standards form the
20 professional and ethical obligation of appraisers,
21 is that correct?

22 A. (By Mr. Reilly) Yes.

23 Q. So that a party who is called upon to

1 appraise or value an asset is subject to these
2 rules?

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

4 Q. Now, with regard to these rules --
5 strike that. I'm going to direct your attention
6 to a couple of pages here.

7 MR. BOUTIN: If we could go to the
8 Elmo. Let's see if we can blow that up a little
9 bit. Right there is fine. Let me just get my
10 cheat sheet here.

11 Q. I'm going to go to line 218. The first
12 three sections -- these are the ethical rules --
13 apply to all appraisal practice and all four
14 sections apply to appraisal practice performed
15 under standards 1 through 10.

16 This means -- this is pertinent to the
17 answer you just gave, that if you're going to
18 perform a value, then you must conform to the
19 standards, is that correct?

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

21 Q. And line 216 says to promote and
22 preserve the public trust inherent in professional
23 appraisal practice and appraisers must observe the

1 highest standards of professional ethics.

2 Now, is the reason for that tied to the
3 reliability of the information that the appraiser
4 is given?

5 A. (By Mr. Reilly) In part. There's
6 actually two components of the ethics rule. One is
7 the reliability of the information that the
8 appraiser uses, but also the ethics rule is really
9 focused on the reliability of the appraisal.

10 Why USPAP has an ethics rule is so
11 users, readers of appraisal reports, parties who
12 rely upon appraisal reports such as this commission
13 or a buyer or a seller or a financing institution,
14 knows that the appraisal report is reliable because
15 the appraiser prepared that appraisal report under
16 ethical standards; there was no bias, there was no
17 intention to deceive, there was no advocacy for a
18 certain party or position.

19 Q. Now, as part of that process, I noted
20 that one of the things that happens in an
21 appraisal report is that you must disclose
22 extraordinary assumptions?

23 A. (By Mr. Reilly) Yes.

1 Q. What are extraordinary assumptions?

2 A. (By Mr. Reilly) Well, extraordinary
3 assumptions, actually the appraisal definition is
4 pretty much like the English definition. An
5 assumption is a hypothetical situation that doesn't
6 actually exist as of right now, and extraordinary
7 just means out of the ordinary.

8 So an extraordinary assumption would be
9 an assumption about a condition or an event that is
10 out of the ordinary, and obviously if that
11 extraordinary assumption is not correct then the
12 appraisal conclusion would not be correct.

13 Q. So that if in conducting an appraisal
14 there were gaps in information or known
15 unreliability of the base information, would one
16 make an extraordinary assumption in order to
17 overcome that and arrive at a conclusion?

18 A. (By Mr. Reilly) To tell you the truth,
19 I don't think you could overcome that problem with
20 an extraordinary assumption, because in an
21 extraordinary assumption you have to -- you can
22 know that the condition -- you can make an
23 assumption about a future condition, but -- and you

1 may not know that it's right, but if you know that
2 it's wrong, you can't use an extraordinary
3 assumption.

4 In other words, I can assume that the
5 next person who walks through that door in the back
6 of the courtroom is going to be six foot tall,
7 that's my extraordinary assumption, but I can't
8 assume I'm six foot tall because, in fact, I'm only
9 about five foot tall.

10 So you can't assume away something you
11 know is wrong, and if you know that you have gaps
12 in the data that you're relying upon, I don't think
13 you can avoid that just by making an extraordinary
14 assumption.

15 Q. When you take an appraisal assignment
16 as an appraiser subject to these rules, are you
17 able ethically to enter that assignment with some
18 preconceived notion of what the appraisal will
19 show?

20 A. (By Mr. Reilly) No. If you are an
21 appraiser acting as an appraiser, performing an
22 appraisal, then you have to be unbiased, you have
23 to be -- have no advocacy, no preconceived notion,

1 you have to be objective. The actual word USPAP
2 uses is objective, objectivity. You can't go into
3 an assignment and have a subjective conclusion in
4 mind, and at the same time be objective.

5 Q. Does the -- if, in fact, there's
6 evidence of a preconceived idea of what the
7 appraisal will be, does that go to the issue of
8 reliability?

9 A. (By Mr. Reilly) Well, it does, and, in
10 fact, if you go back through the history, that
11 really is one of the very foundations why the
12 Appraisal Foundation was established by Congress
13 and why the Appraisal Foundation was required by
14 the FIRREA law to create USPAP is that the
15 government does not want appraisers to say hire me
16 and I will guarantee you a hundred dollar value, or
17 I agree I will only get paid if I can give you a
18 hundred dollar value. That's exactly what the
19 government doesn't want to have happen.

20 Q. Now, if one were to enter in a contract
21 for doing an appraisal, and that contract
22 contained terms for the delivery of other
23 services, does that raise an issue about whether

1 or not the appraiser can perform the appraisal
2 under the USPAP rules?

3 A. (By Mr. Reilly) Surely. It depends on
4 what the other services are. You can perform a
5 variety of appraisal or appraisal review or
6 appraisal consulting services. I can appraise a
7 number of properties for you, I can perform
8 different appraisal review services, different
9 appraisal consulting services, but I can't act as
10 an appraiser and as a nonappraiser under the same
11 contract for the same client.

12 Q. I'm going to ask you some more
13 questions about that later, but turning now to
14 line 245, an appraiser must not accept an
15 assignment that includes the reporting of
16 predetermined opinions and conclusions.

17 Now, if there's evidence that, in fact,
18 an appraiser has done that, would that go to the
19 reliability of the opinion?

20 A. (By Mr. Reilly) Well, it would. Again,
21 I don't know if the commission knows this, but what
22 we're looking at now is one of the very, very, very
23 first pages of the USPAP book.

1 This is really one of the foundations
2 of USPAP, and, again, this is why the government
3 required the Appraisal Foundation to write USPAP,
4 is to avoid exactly this situation, where the
5 appraiser gets hired saying, hire me and I will
6 guarantee that I will give you a hundred dollar
7 value or a thousand dollar value, or whatever the
8 number is.

9 Q. Now, I want to discuss some
10 hypothetical conduct with you. Would you turn to
11 Exhibit 3036? I'm just going to give you an
12 excerpt from a document and ask you to comment on
13 it.

14 MR. BOUTIN: Third page. Let's go back
15 one. Focus on 2.1 and eliminate the rest.

16 Q. I'd like you to read that paragraph,
17 please.

18 A. (By Mr. Reilly) Okay.

19 Q. Now, I'm going to ask you to assume
20 that a business corporation signed this agreement
21 to do this scope of work, and ask you to take note
22 of the fact that it includes valuation reports,
23 which in this case -- hypothetical case -- we're

1 going to assume are appraisals, and meant to be
2 accepted as appraisals.

3 We also know that -- or we also will
4 assume for purposes of this question that the firm
5 involved has an appraiser on staff and another
6 person who assists that appraiser and actually
7 signs the appraisal, but who performs other
8 functions such as preparing testimony for other
9 witnesses in behalf of the cause, who prepares
10 answers to data requests, which are like
11 interrogatories in a civil case, or prepares data
12 requests for the other parties who testifies on
13 issues other than appraisal.

14 Now, with that hypothetical, are the
15 USPAP rules that I've just cited to you
16 implicated?

17 A. (By Mr. Reilly) Well, I would say yes.

18 Q. Can you explain that?

19 A. (By Mr. Reilly) Well, again, I think
20 USPAP is just very clear that an appraiser -- an
21 individual can act as an appraiser and perform an
22 appraisal, where you have to be independent,
23 unbiased, objective, and so forth, or an individual

1 can act as an agent, an advocate, an investment
2 banker, a representative and be -- be an advocate,
3 but you can't do both for the same client at the
4 same time. You can be one or the other for
5 different clients at different times, but you can't
6 be both for the same client at the same time.

7 MR. BOUTIN: Going back to the Elmo,
8 please.

9 Q. I want you to take a look at 241. That
10 rule prohibits an appraiser acting as an advocate.
11 Now, I want to be clear on one thing. An
12 appraiser is always entitled to defend their
13 report, is that right?

14 A. (By Mr. Reilly) Yes, you can always be
15 an advocate for your opinion, you just can't be --
16 as it says here, you can't be an advocate for a
17 party or an issue.

18 Q. Now, going back to that scope of work
19 paragraph that I showed you, would it be your
20 opinion that the performance of the other services
21 would rise to the level of advocacy for the
22 position of the client?

23 MR. BOUTIN: You want to flip back to

1 that for a second?

2 A. (By Mr. Reilly) Please.

3 MR. BOUTIN: Daniel.

4 A. (By Mr. Reilly) Well, from what it says
5 here and what you described where the individual is
6 preparing testimony and answering questions and
7 writing cross-examination questions, it -- that
8 seems to me to be an advocacy function and not an
9 appraisal function.

10 In the USPAP world that's called
11 valuation consulting, and an individual can perform
12 valuation consulting and perform advocacy services,
13 as a real estate broker, as an investment banker,
14 as an advocate in a litigation matter, but you
15 can't do that and be an appraiser for the same
16 client. You either have to be one or the other,
17 you just can't be both.

18 Q. Now, does it matter if the corporation
19 employs multiple people, one of whom is an
20 appraiser who does an appraisal report and the
21 other of whom does all these services, is USPAP
22 implicated under those circumstances?

23 A. It's still implicated, we at

1 Willamette, we've seen other -- well, I've seen and
2 I've seen firms that put up what we call a Chinese
3 wall, where they say we have one department that
4 acts as independent appraisers and we have one
5 department, a group of individuals who act as
6 agents or advocates or representatives.

7 I don't know if I agree with that, but
8 an argument can be made that that would be
9 acceptable if we have different individuals working
10 in totally different assignments.

11 What you can't have, though -- and this
12 is the problem that USPAP really is intended to
13 address -- you can't have one individual on both
14 sides of that wall.

15 You can't have one individual who says
16 in the morning I'm going to be an advocate and try
17 to help my client get the best deal they can, and
18 in the afternoon I'm going to be objective and
19 unbiased and an independent appraiser and strive
20 for truth, justice and the American way. You just
21 can't do -- one individual can't be on both sides
22 of that wall. USPAP just doesn't -- doesn't allow
23 that.

1 Q. Let me ask you one further
2 hypothetical. Assume for the moment that the
3 nonappraiser individual -- we'll assume this is a
4 two-person corporation -- the nonappraiser
5 individual is a sole owner of the corporation,
6 supervisor of the appraiser.

7 The nonappraiser individual actually
8 participates in providing the basis for the
9 appraisal, in this case, for instance, I'd like
10 you to assume they did all or most of the work on
11 determining whether the cost approach would be
12 used and what it was. Let's also assume that that
13 individual then is a co-signor of the appraisal
14 report. Would that implicate USPAP?

15 A. (By Mr. Reilly) Well, yes. That -- in
16 my mind, that's just clear and unambiguous. Once
17 an individual participates in the appraisal, gives
18 what USPAP calls material assistance, and
19 particularly -- and this is the -- this is the
20 bright yellow line -- if that individual signs the
21 appraisal as an appraiser, then that individual
22 cannot also provide what USPAP calls valuation
23 consulting services, these advocacy services or

1 agency services or representation services. That's
2 simply not allowed under USPAP.

3 Q. Let's bring it down to what matters to
4 the commission. Does this conduct under the
5 hypothetical affect the reliability of the value
6 conclusion reached by the appraiser under USPAP?

7 A. (By Mr. Reilly) Well, I believe it
8 does, and, again, that really is one of the
9 fundamental reasons for the passage of USPAP, which
10 is the reader or party that relies on the appraisal
11 wants to know that the appraiser really is
12 objective, they don't have a hidden agenda, they're
13 not working for a party, they're not an advocate
14 for a deal, they're not getting a commission on a
15 deal, they're not getting some sort of a
16 performance bonus on a deal, they're not
17 representing a party, they're not an agent; they're
18 totally independent.

19 Once you act as a representative, as an
20 agent, as an advocate, as an attorney or -- whether
21 you're a licensed attorney or just acting as an
22 attorney -- then your whole mental mindset changes,
23 and I don't think it's possible, then, to also be

1 an independent, objective appraiser on the same
2 case.

3 Q. Let me ask you one further detail in
4 the hypothetical. Assume for the moment that
5 there was a contract with this organization that
6 I've described and that there were a range of
7 services to be performed in stages, the last stage
8 of which was contingent upon the Public Utilities
9 Commission making a certain decision. Would that
10 violate USPAP in any way?

11 A. (By Mr. Reilly) It very much would, and
12 there are a lot of examples within USPAP of that
13 sort of thing -- not necessarily where Public
14 Utility Commission is mentioned, but the same sort
15 of example where if I make a loan -- if I make an
16 appraisal on your house, you will pay me a thousand
17 dollars. But if the bank makes a loan based upon
18 my appraisal, you will then give me a \$10,000
19 bonus, that sort of contingency is just strictly
20 prohibited under USPAP.

21 Q. Now, let's go to -- I lost the question
22 in there someplace, but I want to go to a specific
23 piece of testimony.

1 I understood that the appraisal for the
2 city of Nashua made a certain assumption, and that
3 is that the Pennichuck Water Works that's going to
4 be taken if the commission approves is no longer a
5 special purpose property, and the basis for that
6 is there are transparent sales around the country
7 of privately owned water systems, and that even
8 though different, they don't have to be comparable
9 if they're transparent.

10 Can you address that and tell me what
11 that -- whether or not that is something you can
12 reliably base an opinion on?

13 A. (By Mr. Reilly) No, I don't believe so.
14 I've never seen that requirement or condition
15 before, the condition of transparency of
16 transactions. I've never seen it in any of the
17 valuation textbooks, I've never seen it in any of
18 the valuation courses, and I've taught courses for,
19 I think, virtually all the appraisal organizations.
20 I've never seen it on any of the appraisal exams
21 you have to take to become certified.

22 The first and foremost condition for a
23 special purpose property is -- again, it's really

1 not a complicated appraisal concept, it's an
2 English definition if the property is special
3 purpose -- if it can only be used for one purpose,
4 if it was intended for one purpose and it
5 physically and functionally can only be used for
6 one purpose, then it's a special purpose property.
7 That is the textbook definition of special purpose
8 property.

9 Now, there are some implications from
10 that, because the effect is there's typically a
11 limited market for special purpose properties
12 because the buyer knows I can only do one thing
13 with that property. I can't convert it from a
14 hotel to a warehouse or from a warehouse to a
15 factory or from a factory to an office building. I
16 can buy the Pennichuck Water Works and I can use it
17 as a water delivery system only; there's absolutely
18 nothing else I can do with that property.

19 So there are going to be relatively few
20 buyers -- not zero buyers, but relatively few
21 buyers -- because those buyers have to be in the
22 water delivery system, and they're going to know
23 that they're going to buy assets that can only be

1 used as a water delivery system. So there will be
2 relatively few transactions, but that's the effect.

3 The cause is we can only use that type
4 of property for one purpose and one purpose only,
5 that's the definition of special purpose, and in
6 none of the causes or effects related to special
7 purpose is there any consideration of the
8 transparency of whatever sales transactions occur.

9 Q. Now, I assume in teaching these courses
10 that one of the texts you rely on heavily is the
11 Appraisal of Real Estate, 12th edition?

12 A. (By Mr. Reilly) Yes, I think that would
13 be the most authoritative real estate appraisal
14 textbook.

15 Q. Now, going back to the special purpose
16 concept, is there in the trade a special or
17 specific way to appraise such property?

18 A. (By Mr. Reilly) Yes, and I would
19 say that -- this, again, would be true universally
20 in all of the textbooks, in all of the courses, in
21 all the certification exams -- and I would mention
22 it this way, the practice is not that there's only
23 one approach, the practice is that there's a

1 preferred approach.

2 You can certainly use an income
3 approach if the special purpose property is income
4 producing. You can use the sales comparison
5 approach if there are an adequate number of
6 comparable sales. What the procedure is or
7 practice is is you give the greatest weight, you
8 give the most emphasis, you give the priority to
9 the cost approach.

10 A lot of appraisers would say that the
11 cost approach was developed to -- originally
12 developed a hundred years ago -- to appraise
13 special purpose properties, because often -- not
14 always -- but often there is no income and often
15 there are relatively few sales and they're just not
16 comparable enough.

17 But that's not to say you can't give
18 any weight to an income approach and you can't give
19 any weight to a sales comparison approach, you can,
20 but you give the priority of weight to the cost
21 approach.

22 Q. So if there's a great disparity between
23 the former two and the latter, you would rely most

1 heavily on the latter, is that a fair statement?

2 A. (By Mr. Reilly) Well, I would say you
3 would rely most heavily on the latter, the latter
4 being the cost approach, regardless of what the
5 other values are.

6 If all three approaches are right on
7 top of each other or if there's a disparity in the
8 value indications, the appraisal practice is you
9 give the first consideration and the primary
10 consideration to the cost approach in the appraisal
11 of special purpose properties.

12 Q. Now, I assume that you have reviewed
13 the appraisal done by Mr. Walker, is that right?

14 A. (By Mr. Reilly) Yes, I have.

15 Q. Now, I want to go to the cost approach
16 for a minute that you used. I understand that you
17 did not use a trended original cost method. Would
18 you explain what that method is and then why you
19 did or didn't use it?

20 A. (By Mr. Reilly) Surely. The trended
21 original cost method, sometimes called TOC for
22 trended original cost, is a generally accepted cost
23 approach method.

1 Under the cost approach there are
2 several methods you can use; there's replacement
3 cost new less depreciation, reproduction cost new
4 less depreciation, trended original cost less
5 depreciation, and historical cost less
6 depreciation. They are the four most common, and
7 there are a few others that are rarely used.

8 But trended original cost is a
9 generally accepted method, but to use trended
10 original costs you need to know a few factors.
11 And, again, just think about basic English, those
12 factors aren't surprising; you need to know
13 original cost.

14 You need to have a listing of each of
15 the assets you're going to appraise, each of the
16 components of the property. You need to know
17 exactly what they cost when they were first put in
18 service. You need to know when they were first put
19 in service, and you need to know how much
20 depreciation was recorded on those assets from the
21 time they were put into service until today.

22 And then -- those are the three things
23 you start with, and then you apply formulas and

1 equations and tables and calculations.

2 Q. Now, if you did not perform a trended
3 original cost method, can you tell me why you
4 didn't?

5 A. (By Mr. Reilly) Well, actually, I would
6 say I didn't -- did not rely on a trended original
7 cost method. I would actually say I did perform
8 that method, or at least I attempted to.

9 That was my first inclination in this
10 assignment, and for the very first several
11 months -- not the first several weeks, but the
12 first several months after we were hired, we at
13 Willamette attempted to perform a trended original
14 cost analysis.

15 I gathered the company's historical
16 accounting records with regard to the assets in --
17 on their books and records, the assets included in
18 their rate base and attempted to perform a standard
19 trended original cost, where we start with the
20 original cost, we start with the date placed in
21 service, and we apply for the specific water
22 delivery assets, the Handy-Whitman trend factor
23 indices. For the general assets, computer assets,

1 office furniture assets, I applied the Marshall
2 Valuation Service trended indices, and then
3 attempted to apply a depreciation table to those
4 trended original costs.

5 The problems that I encountered were
6 not with the methodology. I really had no problem
7 with the actual methodology as described in
8 textbooks. The problem I encountered here were
9 totally data related. It was simply that the
10 client -- my client, Pennichuck Water Works --
11 could not give me information that I could rely
12 upon.

13 I found, as I started to go through the
14 mathematical analyses, several really important
15 gaps in the data that were overwhelming. In other
16 words, I couldn't -- I couldn't -- I couldn't fix
17 the problems.

18 The first problem -- and they were all
19 related to data. The first problem is, as we know,
20 the system started in the 1850s or thereabouts, and
21 there are no assets recorded on the books and
22 records of Pennichuck up until I believe it's 1911
23 or 1912. So there's about a 60-year gap when we

1 don't know what the historical costs were for the
2 original system in the city of Pennichuck when it
3 was built in the 1850s, 60s, 70s, 80s, and so
4 forth. We simply don't have that information. I
5 don't have it, Pennichuck doesn't have it, it was
6 simply lost to history.

7 Now, there are -- and you can see this
8 if you look at the company's accounting records,
9 and you see the first year is 1912, and you see a
10 big number for 1912. When they started the
11 current -- well, current -- then current accounting
12 records in 1912, they put on the books and records
13 what was then the depreciated original cost of all
14 the previous 60 years or so of expenditures as of
15 1912.

16 So that was then the net book value.
17 The problem is we simply don't know what the actual
18 original cost was for those assets, and we don't
19 know when those original costs were spent. Whether
20 they were spent in 1911 or 1860, we simply don't
21 have that information, and that is -- and, again,
22 you might say, well, gee, that can't be a big deal,
23 1880 numbers, how big can they be.

1 Well, 1880's numbers are not very big.
2 When you trend those up by 120 years to 2004
3 numbers, they get to be really big. So that's not
4 an insignificant problem.

5 Q. So was it your judgment that the
6 absence of that information made using or relying
7 on the trended original cost method unreliable?

8 A. (By Mr. Reilly) That was one problem.
9 I'm rambling on, I don't mean to, but there are
10 several other problems related to that.

11 The company had two sets of manual
12 accounting records, then two sets of computerized
13 records. When they went from the second or 1912
14 manual records to the first computer records, the
15 same problem happened where what was brought over
16 was not actual original costs, it was net book
17 value.

18 As of the time the accounting records
19 were computerized, the net book value was brought
20 over so the original costs, again, were lost to
21 history. And what happened in those -- at that
22 point in time was all of the net book values were
23 brought over as a specific date.

1 So, for example, any assets that were
2 purchased between 1950 and 1970 were recorded as of
3 1960, which for GAAP accounting was okay, but it
4 meant we didn't know of that amount whether the
5 assets were purchased in 1951, 1952, 1953, and so
6 forth.

7 We lost whole periods of time, and the
8 assets that came over came over at net book value,
9 so we lost both the original cost and the -- the
10 depreciation that had been taken up to the point of
11 the transition from one accounting system to
12 another. So that the data was simply unusable for
13 a trended original cost method analysis.

14 Q. Very briefly, under these
15 circumstances, is there a method of determining
16 original cost -- determining value on the cost
17 method when you encounter this type of problem?

18 A. (By Mr. Reilly) Yes. The alternative
19 is the alternative that we turned to. You can --
20 you can simply abandon original costs and perform a
21 replacement cost new less depreciation method.

22 Q. Sometimes called sticks and bricks?

23 A. (By Mr. Reilly) Well, yes. I mean,

1 that's vernacular. It's called going out and
2 appraising sticks and bricks.

3 Q. I want to turn to the income approach
4 here. Now, in determining income there's a
5 particular calculation called direct
6 capitalization calculation, are you familiar with
7 it?

8 A. (By Mr. Reilly) Yes.

9 Q. Now, in doing a direct capitalization
10 calculation, is it important to know and quantify
11 the capital expenditures from year to year?

12 A. (By Mr. Reilly) Yes, if the measure of
13 income you are capitalizing is net cash flow --
14 there are different measure of income you can
15 capitalize, but if the measure of income that
16 you're capitalizing and the capitalization rate
17 that you're using corresponds to net cash flow, net
18 cash flow is net income, plus depreciation expense,
19 minus capital expenditures. You need that last
20 part of the formula. That's just an important --
21 that's just an essential component of the formula.

22 Q. Does the failure to deduct capital
23 expense in this calculation distort the result?

1 A. (By Mr. Reilly) Well, it does, because
2 it means that your net cash flow is wrong. If the
3 formula is A plus B minus C equals D, and D is the
4 number you're capitalizing, if you leave out C,
5 then D has to be wrong.

6 Q. And would the failure to do so affect
7 the reliability of the appraisal?

8 A. (By Mr. Reilly) Well, surely.
9 Particularly in direct capitalization. Direct
10 capitalization is a very difficult procedure to
11 implement. It looks simple on paper, it's simply
12 net cash flow divided by CAP rate. It's simply two
13 numbers, net cash flow divided by CAP rate.

14 It looks very simple. But because it's
15 simple, if either one of those numbers is wrong,
16 then the whole conclusion is wrong. There is no
17 place else to correct that error. You have to have
18 both of those terms correct or the conclusion is
19 not reliable.

20 MR. BOUTIN: Thank you, Mr. Reilly.

21 CHAIRMAN GETZ: Ms. Reinemann,
22 questions for the panel?

23 MS. REINEMANN: No questions.

1 CHAIRMAN GETZ: Mr. Mullen?

2 MR. MULLEN: We have no questions.

3 CHAIRMAN GETZ: And it looks like the
4 consumer advocate is momentarily not present.
5 Ms. Thunberg?

6 MS. THUNBERG: Staff has no questions.
7 Thank you.

8 CHAIRMAN GETZ: Ms. McHugh?

9 MS. MCHUGH: No questions.

10 MR. BOUTIN: Would you like me to step
11 out and see if I can find the consumer advocate?

12 CHAIRMAN GETZ: Well, actually, we
13 have -- Mr. Eckberg?

14 MR. ECKBERG: No, the OCA has no
15 questions for these witnesses. Thank you,
16 Mr. Chairman.

17 CHAIRMAN GETZ: I believe we're up to
18 Mr. Upton.

19 MR. UPTON: I'm going to pull this
20 around here, if that's okay.

21 CROSS-EXAMINATION

22 BY MR. UPTON:

23 Q. Good morning, Mr. Reilly.

1 A. (By Mr. Reilly) Good morning.

2 Q. Welcome back from Chicago; it's nice to
3 have you back in New Hampshire. Things must be
4 good in Chicago, the Bears won last weekend?

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

6 MR. UPTON: Mr. Riethmiller, welcome
7 back -- I guess it's welcome back, from Colorado.
8 Mr. Riethmiller, I'm sorry to tell you that I
9 don't have any questions for you today. You're
10 going to be able to sit there and enjoy what
11 happens.

12 Q. Mr. Reilly, would you agree with me
13 that the determination of value in this case is
14 ultimately an issue for the commission?

15 A. (By Mr. Reilly) Oh, yes, absolutely.

16 Q. And would you also agree that it's for
17 the commission to determine ultimately the
18 reliability of the evidence before it, including
19 any of the appraisals?

20 A. (By Mr. Reilly) Yes, I agree with that.

21 Q. And what you said today about USPAP is
22 your opinion of what USPAP says?

23 A. (By Mr. Reilly) That's correct.

1 Q. Because like any set of standards,
2 they're subject to interpretation?

3 A. (By Mr. Reilly) Reasonable
4 interpretation, yes.

5 Q. And USPAP is before the commission, and
6 would you agree that it's ultimately for the
7 commission to decide what it says?

8 A. (By Mr. Reilly) Yes, I would agree with
9 that.

10 Q. When I took your deposition -- do you
11 remember your deposition?

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

13 Q. You had a chance to review it before
14 you came today?

15 A. (By Mr. Reilly) Yes, I did.

16 Q. We had a discussion about legally
17 permissible buyers, didn't we?

18 A. (By Mr. Reilly) Yes.

19 Q. And that was in the context of -- the
20 concept of highest and best use?

21 A. (By Mr. Reilly) Indirectly, yes.

22 Q. And you told me that in developing your
23 approaches to value you have to determine the

1 highest and best uses?

2 A. (By Mr. Reilly) Yes, you do.

3 Q. And you told me that for those highest
4 and best uses -- users, it had to be legally
5 permissible for them to make the acquisition, is
6 that right?

7 A. (By Mr. Reilly) Well, to determine the
8 population of hypothetical willing buyers. There's
9 really not a term highest and best users, but to
10 determine who would be in the population of willing
11 buyers, you do have to look at the buyers who --
12 who are legally able to buy the property.

13 Q. I'm showing you your deposition that I
14 took, and at the bottom of the page on line 21 I
15 asked, and for those users, it has to be legally
16 permissible for them to make the acquisition.

17 Answer. Well, yes.

18 MR. UPTON: Would you turn to the next
19 page.

20 Q. And I said, you have to make that
21 determination, and you answered, yes, because if
22 it's not legally permissible for a REIT to own
23 this office building, then they would never be

1 considered in the population of growing buyers.

2 Is that what you told me?

3 A. (By Mr. Reilly) I think that means
4 willing buyers, but, yes, I said that.

5 Q. All right, I'll accept that. And
6 that's correct; that was correct then and that's
7 correct now, isn't it?

8 A. (By Mr. Reilly) Surely.

9 Q. And the reason for that is otherwise
10 they couldn't be considered in the population of
11 likely buyers?

12 A. (By Mr. Reilly) Yes, exactly.

13 MR. UPTON: Would you turn to 3007A,
14 page 3.

15 Q. Now, in your report which is
16 Exhibit 3007A on page 3, you identify the
17 hypothetical willing buyers, correct?

18 A. (By Mr. Reilly) Yes.

19 Q. And you say that the most likely
20 population of such buyers includes public
21 entities, correct?

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

23 Q. And you also say that included are,

1 quote, any incorporated New Hampshire city or
2 town. Did I read that right?

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

4 Q. And that includes Nashua?

5 A. (By Mr. Reilly) Yes, it does.

6 Q. And it includes any existing or yet to
7 be formed water district?

8 A. (By Mr. Reilly) Yes, sir.

9 Q. And you expressed the opinion that
10 these buyers, including, quote, any incorporated
11 New Hampshire city or town and any existing or yet
12 to be formed water district have the greatest
13 expected synergies, and therefore set the range of
14 market prices, right?

15 A. (By Mr. Reilly) Yes.

16 Q. Now, when I asked about -- asked about
17 these categories of buyers in your deposition, you
18 said, starting at page 1 -- line -- on page 49,
19 all I meant to say is of these categories --

20 MR. CONNER: Can we see the prior
21 question?

22 MR. UPTON: Sure. Sure. Go back.

23 Q. Now, I said -- let's go back at start

1 at line 19. We were talking about potential
2 acquirers, does that look right?

3 A. (By Mr. Reilly) Yes.

4 Q. And I asked, now, when you say each of
5 these jurisdictions as well as other jurisdictions
6 in the surrounding area represents a potential
7 public entity buyer of Pennichuck, what did you
8 mean by that. And then you said, well, I don't
9 know if I said that as artfully as I could.

10 And then this is what I'm interested
11 in -- all I meant to say is of those categories
12 which are the incorporated New Hampshire cities or
13 towns, the city of Nashua itself, and the existing
14 or to be formed water district or regional
15 district, those are potential buyers. And I
16 understood that the potential buyers did not
17 actually have to either touch the city of Nashua
18 or touch Pennichuck Water Works. In other words,
19 the buyers could be -- and I'm not saying it
20 practically would be -- but a buyer could be a
21 municipality or a water district or a regional
22 district anyplace in New Hampshire; it doesn't
23 have to be actually physically located within the

1 Pennichuck service area.

2 Did I read that right?

3 A. (By Mr. Reilly) That's correct, yes.

4 Q. And then I asked you whether you were

5 told anything about whether or not the

6 municipality would have to be serviced by

7 Pennichuck Water Works, and you said, I don't

8 recall, it may be in my file, I just don't recall.

9 And I asked you, finally, in any event,

10 your conclusion is that any New Hampshire

11 incorporated city or town can acquire the assets

12 of Pennichuck Water Works. And your answer was?

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

14 Q. And that's still your understanding?

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

16 Q. And I think I recall that you came to

17 this understanding from a memo either prepared by

18 Mr. Conner or Mr. Donovan?

19 A. (By Mr. Reilly) Yes, that's exactly

20 correct.

21 Q. Did you ever find that memo?

22 A. (By Mr. Reilly) I don't know that I

23 looked for it. It may be in my work papers, I just

1 don't know right now.

2 Q. In any event, whether you have it with
3 you or have it anymore, it's your understanding
4 that any New Hampshire city or town or any
5 existing or yet to be formed water district could
6 legally buy Pennichuck Water Works' assets?

7 A. Yes, sir.

8 Q. And that forms the basis for your
9 conclusion that such public entities must be
10 included in the population of likely buyers,
11 right?

12 A. (By Mr. Reilly) Well, I wouldn't say
13 that's the sole reason. The reason is all the
14 reasons I mentioned on page 2 of my report that was
15 looked at a few minutes ago.

16 Q. Sure. But like we said, it's got to be
17 legally permissible for those buyers to buy those
18 assets, and that's the basis on which you form
19 that conclusion?

20 A. (By Mr. Reilly) The conclusion is that
21 any likely buyer has to be legally able to buy the
22 subject assets.

23 Q. And that means that any New Hampshire

1 city or town has to be -- not only just city or
2 town, but any formed -- existing or yet to be
3 formed water district?

4 A. (By Mr. Reilly) Well, those are -- that
5 articulates the entire population of not for profit
6 or municipal entities that could buy the system.
7 If, in fact, any of those qualify, then my opinion
8 stays the same. Not every municipality has to be
9 able to buy Pennichuck, but some municipality does.

10 Q. That's different from you --

11 A. (By Mr. Reilly) May I finish my answer,
12 please?

13 Q. You may, but that's different from
14 your --

15 A. (By Mr. Reilly) May I finish my answer,
16 please, sir? My understanding is that all
17 municipalities are legally able to buy the
18 Pennichuck assets, but as long as any of the
19 conditions on page 2 are met, then my condition --
20 then my opinion as to who is included in the
21 population of willing buyers stays the same.

22 Q. Okay. So let me just test -- test that
23 belief. Is it your opinion that the town of

1 Lancaster where Mr. Sansoucy lives, if he could
2 get the selectmen frothed up into doing an
3 acquisition of the Pennichuck Water Works, that
4 the city of -- I mean that the town of Lancaster
5 could acquire Pennichuck Water Works?

6 A. Well, I'm not familiar with Lancaster
7 specifically, but my understanding is, as indicated
8 on paragraph 3 on page 2, that the first group of
9 potential publicly owned buyers includes any
10 incorporated New Hampshire city or town.

11 Q. Okay. Do you understand that in
12 New Hampshire that a municipality, a city or a
13 town can exercise only those powers that the
14 legislature grants?

15 A. (By Mr. Reilly) That sounds like a
16 legal question, and I'd have to defer to an
17 attorney.

18 Q. Okay. Well, I want you to assume that.
19 If a municipality is going to buy a utility, if my
20 assumption is correct, it has to have been
21 authorized by the legislature to do so, wouldn't
22 that be right?

23 A. (By Mr. Reilly) I just don't know the

1 answer to that.

2 Q. Well, did you form your opinion,
3 then -- if you don't -- if you're not willing to
4 accept that, do I conclude that you formed your
5 opinion that any New Hampshire city or town could
6 buy Pennichuck's assets without knowing whether
7 there was any legal authority for them to do it?

8 A. (By Mr. Reilly) The legal authority was
9 the representation from attorneys.

10 Q. And what they told you was that any
11 New Hampshire city or town could buy the assets of
12 Pennichuck Water Works?

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

14 Q. Well, now I assume that if any
15 New Hampshire city or town could buy the assets of
16 Pennichuck Water Works, that would be equally true
17 for the assets of Pennichuck East or Pittsfield
18 Aqueduct Company?

19 A. (By Mr. Reilly) I would assume that to
20 be correct, yes.

21 Q. So any New Hampshire city or town could
22 acquire those assets?

23 A. (By Mr. Reilly) That would be my

1 understanding.

2 Q. And according to your hypothesis, that
3 could include Nashua or an existing or yet to be
4 formed regional water district?

5 A. (By Mr. Reilly) That's correct.

6 Q. And I just want to make sure that we're
7 clear on -- strike that. Were you ever advised by
8 Mr. Donovan or Mr. Conner that in this proceeding
9 Nashua originally sought to acquire the assets of
10 Pennichuck East and Pittsfield Aqueduct Company?

11 A. (By Mr. Reilly) I don't recall if I
12 knew that or not.

13 Q. Were you ever told that Pennichuck
14 objected to the acquisition and moved to dismiss
15 Nashua's petition?

16 A. (By Mr. Reilly) I don't recall if I
17 knew that or not.

18 Q. Let me show you a copy of the
19 memorandum Pennichuck Water Works submitted to the
20 commission in support of its motion to dismiss.

21 MR. BOUTIN: Excuse me, has that been
22 marked in the case?

23 MR. UPTON: This is just for purpose of

1 cross-examination. I assume if the commission
2 wants, it can take administrative notice of it.

3 MR. BOUTIN: All I wanted to know is if
4 it's been marked.

5 BY MR. UPTON:

6 Q. Would you read the sentence that I
7 highlighted?

8 A. (By Mr. Reilly) Sure. Nowhere do the
9 words of RSA chapter 38 give a municipality the
10 authority to seize the assets of a utility that
11 does not provide service within the municipality
12 attempting to take it.

13 Q. Were you told by Mr. Conner or
14 Mr. Donovan that the PUC agreed with Pennichuck
15 and held that Nashua did not have the authority as
16 a matter of law to acquire the assets of
17 Pennichuck East and Pittsfield Aqueduct Company?

18 MR. CONNER: Objection, your Honor.
19 That's not what that statement says. There's a
20 difference between authority to acquire
21 consensually and authority to condemn.

22 CHAIRMAN GETZ: Well, I think we do
23 need to be clear on our use of the terms here

1 between buy, acquire, take.

2 MR. UPTON: It's the position of the
3 city -- I'll be very clear with the commission.
4 It's the position of the city that a municipality
5 only has the authority to acquire or take the
6 assets under RSA 38, that there is no alternative
7 statute under which it can acquire.

8 MR. CONNER: Well, if we're stating
9 positions, your Honor, there's a difference
10 between a city's legal authority to have -- enter
11 a consensual willing buyer/willing seller
12 transaction, and in that situation the city could
13 take, if it's a consensual deal. This is directed
14 to their power to condemn and seize, two different
15 things.

16 MR. UPTON: I'll leave for the
17 commission to determine what -- what authority
18 there is under RSA 38. RSA 38, we believe, is not
19 limited to just condemnation.

20 CHAIRMAN GETZ: Well, for purposes of
21 the questions to the witness, let's try to make
22 sure we have some precision between the different
23 modes of acquisition.

1 BY MR. UPTON:

2 Q. Well, let me show you a copy of order
3 24425.

4 MR. CONNER: Could you show him that?
5 You asked him if he's seen it at all. I think
6 it's fair for him to see what the order is in
7 total.

8 MR. UPTON: I'd be glad to.

9 Q. Have you ever seen order 24425 by this
10 commission?

11 A. (By Mr. Reilly) No, I haven't.

12 Q. Well, I'm going to show it to you
13 anyway. I want you to look at -- this is page 15
14 of the decision. I want you to look at the
15 sentence that I've underlined. Nashua's
16 interpretation, I'll represent to you, was that it
17 could acquire the assets of PEU and PAC, and the
18 commission ruled that Nashua's interpretation
19 would lead to the incongruous result that a single
20 municipality could effectively municipalize
21 property in the 21 towns and cities that
22 Pennichuck Utilities served.

23 And isn't that exactly what your

1 hypothesis includes?

2 A. (By Mr. Reilly) Absolutely not. In
3 fact, it's just 180 degrees off the mark. My
4 premise is not that a municipality will condemn the
5 assets of Pennichuck and therefore should be
6 included in the population of willing buyers. A
7 condemnation, per se, is not a fair market value
8 transaction and should be excluded from
9 consideration.

10 My hypothesis, my premise, my
11 appraisal, is that any municipality could enter
12 into a willing buyer/willing seller negotiated
13 transaction just like Tilton-Northfield Aqueduct
14 transaction that was approved by this commission
15 here in New Hampshire and is one of the comparable
16 transactions -- well, noncomparable transactions I
17 considered in my appraisal, guideline company
18 transactions.

19 So that's an example of the type of
20 transaction I contemplated where a municipality and
21 IOU, investor owned utility, come together as
22 equals and negotiate a price and -- and enter into
23 a transaction, just like any other willing buyer

1 and willing seller.

2 My understanding from legal counsel and
3 the premise of my appraisal is that a current or to
4 be formed governmental agency in New Hampshire has
5 the ability, like any other party, to negotiate a
6 friendly acquisition of an investor owned utility.

7 My premise is not at all -- in fact,
8 it's antithetical to my premise -- that a
9 municipality would, in fact, condemn the assets of
10 Pennichuck Water Works.

11 Q. Can you tell me the authority for what
12 you've just said, the legal authority for what
13 you've just said?

14 A. (By Mr. Reilly) You're going to have
15 ask either Mr. Conner or Mr. Donovan.

16 Q. Now, they produced a memo for you,
17 didn't they?

18 A. (By Mr. Reilly) That's my recollection.

19 MR. UPTON: And I would ask the
20 commission for an order that he produce that
21 memorandum so that we can explore what that
22 authority is. I made a request following his
23 deposition for that memo from Mr. Conner; I've

1 never received it.

2 CHAIRMAN GETZ: Any objection to
3 producing that memorandum?

4 MR. CONNER: Your Honor, I'm not
5 sure -- we're not trying to hide anything. If
6 there's a memorandum there, we'll be glad to
7 provide it, but there are several documents that
8 were asked for back and forth with each other in
9 that deposition that were not produced by either
10 side.

11 And I think those issues should have
12 been resolved before we finished -- before we
13 started this trial. So I'm hesitant to do that
14 because it opens up a whole can of worms. I had a
15 whole list of things that I had asked for that I
16 didn't get from Mr. Upton either from those
17 depositions.

18 CHAIRMAN GETZ: Well, it looks like
19 that memo provides the foundation for the witness'
20 opinion here, so I'd like to see it produced.

21 MR. CONNER: Sure.

22 CHAIRMAN GETZ: If there's issues of
23 privilege or confidentiality, we can deal with

1 that, but I'd like to see it made available to
2 the -- to the parties and to the bench.

3 MR. CONNER: I have no problem.

4 MR. CAMERINO: Mr. Chairman, if I could
5 just add, I was not a participant in these
6 discussions that Attorney Upton and Attorney
7 Conner and Mr. Reilly are referring to, but to be
8 frank, I would be surprised that an internal
9 memorandum by my office was provided to a witness,
10 and I suspect -- and this is what I would like to
11 check on with Mr. Donovan before we start
12 producing internal memoranda -- that there may
13 have been just discussion about the substance of
14 it, which would be very different from having
15 provided the actual document. So I'd like to
16 reserve my right to just find out what actually
17 occurred.

18 MR. CONNER: I would agree with that,
19 Mr. Chairman.

20 CHAIRMAN GETZ: Then I would suggest
21 follow up and discuss it with Mr. Upton, and if we
22 need to address it on the record, then we'll do
23 that.

1 MR. CONNER: That would be fine.

2 MR. UPTON: Is there any chance I can
3 get it today so I can complete my
4 cross-examination of Mr. Reilly.

5 MR. CAMERINO: What I can do is as soon
6 as we break I can make a phone call, but as the
7 chair may know, Attorney Donovan is trying to
8 become Mayor Donovan, so I don't know how quickly
9 I can get a hold of him. I will make every
10 effort, sincerely.

11 CHAIRMAN GETZ: Make the effort, and
12 we'll hear back on the issues.

13 The question occurs to me, Mr. Upton,
14 why it would be necessary for cross-examination.
15 I can understand why it would be helpful for your
16 briefing of the issues.

17 MR. UPTON: It may not be, but I would
18 like to see it and see if it raises issues that I
19 need to cross-examine the witness on.

20 MR. CONNER: That's the other point. I
21 think the chair is correct that this isn't a legal
22 issue, and clearly there will be briefing on that
23 at the conclusion of the case.

1 MR. UPTON: But if that memo says
2 something different from what he said today --

3 MR. CONNER: I understand.

4 MR. UPTON: -- I want to be able to
5 cross-examine him about it.

6 MR. CONNER: I understand.

7 CHAIRMAN GETZ: Let's continue with
8 this, and we'll pick that up after either the
9 morning recess or the lunch recess.

10 BY MR. UPTON:

11 Q. All right. Now, one of the things that
12 you've relied on in your testimony that any
13 New Hampshire city or town could buy or acquire
14 the assets of Pennichuck Water Works is the
15 decision Southern New Hampshire Water V Hudson, do
16 you remember that?

17 A. (By Mr. Reilly) I don't recall that
18 specifically.

19 Q. Well, you cite it in your report.

20 MR. UPTON: Would you go to 3017A, page
21 100.

22 A. (By Mr. Reilly) I'm sorry, page --

23 Q. Page 100. But it may not -- it may be

1 a different page for you.

2 MR. UPTON: Can you switch that back
3 over?

4 MR. CONNER: Me?

5 MR. UPTON: No fair; Daniel left.

6 BY MR. UPTON:

7 Q. Do you recall this?

8 A. (By Mr. Reilly) Not really. Do you
9 know which report this comes out of?

10 MR. CONNER: This is the --

11 MR. UPTON: 3017A.

12 MR. CONNER: 3017A is the reply report,
13 May 22, 2006.

14 Q. And that's actually page 7, if I look
15 at the top of it, Mr. Reilly, of your --

16 A. (By Mr. Reilly) I don't think I have
17 that with me, so I'll just have to read along.

18 MR. CONNER: I've got a copy.

19 MR. UPTON: Sure, go ahead. That's
20 fine.

21 A. (By Mr. Reilly) Yes, I have it.

22 Q. And you say we understand that in
23 Southern New Hampshire Water, a case in which

1 Sansoucy testified, the Supreme Court confirmed
2 that the pool of hypothetical buyers for the water
3 companies in the state consist of both
4 municipalities and private companies regulated by
5 the PUC, correct?

6 A. (By Mr. Reilly) Yes.

7 Q. And you then cite from the opinion;
8 there's a quote from the opinion.

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

10 Q. Now, do you read that quote to say any
11 New Hampshire city or town could have acquired the
12 Southern New Hampshire water utility property?

13 A. (By Mr. Reilly) Well, no, I don't think
14 it says any town, what it says is the town. The
15 town could acquire the utility's property.

16 Q. The town is Hudson, isn't it?

17 A. (By Mr. Reilly) That's correct. Well,
18 the case has to do with Hudson, the case was not
19 Southern New Hampshire Water Company versus every
20 town --

21 Q. Right.

22 A. (By Mr. Reilly) -- in New Hampshire, it
23 was Southern New Hampshire Water Company versus the

1 town of Hudson.

2 Q. And it doesn't say broadly that any
3 New Hampshire city or town could acquire utility
4 property, does it?

5 A. (By Mr. Reilly) No. What it says is
6 what I said in the previous sentence, that the
7 hypothetical buyers for water companies in the
8 state consist of both municipalities and private
9 companies regulated by the PUC.

10 Q. You think that's what it says? You
11 think that's what that quote says?

12 A. (By Mr. Reilly) Yes, exactly.

13 MR. UPTON: 3007A, page 5.

14 MR. CONNER: This is not matching up
15 with the numbers on our exhibit.

16 MR. UPTON: It's not matching up with
17 mine either. I probably don't need it.

18 BY MR. UPTON:

19 Q. There's no doubt that you believe this
20 is a special purpose property, you said that
21 earlier?

22 A. (By Mr. Reilly) That's correct. That's
23 right.

1 Q. And according to the Appraisal of Real
2 Estate, special purpose property is property that
3 has a limited market?

4 A. (By Mr. Reilly) That is one of the
5 results of being special purpose property, that's
6 not the definition of special purpose property.

7 Q. Well, let's get out the real estate
8 appraisal.

9 Special purpose property in the box is
10 a limited market property with unique physical
11 designs, special construction materials, or a
12 layout that restricts its utility for the use of
13 which it was built, also called special design
14 property. Is that the proper definition?

15 A. (By Mr. Reilly) I would agree with
16 that, yes.

17 Q. Included in that is limited market?

18 A. (By Mr. Reilly) Yes, but that's not the
19 cause, that's the effect. The cause is the rest of
20 that paragraph, which is the special design,
21 special construction, and special use.

22 Q. Well, the question I have is in your
23 analysis of hypothetical willing buyers, you

1 assert that there are numerous public entities
2 that could acquire Pennichuck. Doesn't that mean
3 that these public entities form a market for
4 Pennichuck's assets?

5 A. (By Mr. Reilly) Yes, they form a
6 limited market.

7 MR. UPTON: I'm about to go on to
8 another area.

9 CHAIRMAN GETZ: Just in general terms,
10 how much cross do you predict?

11 MR. UPTON: Oh, I'm going to go
12 probably another hour, I would guess, minimum.

13 CHAIRMAN GETZ: Okay, let's take the --
14 I assume the next subject matter you're addressing
15 is going to be a lengthy inquiry?

16 MR. UPTON: Well, I have actually some
17 more on this, but it's going to be -- I have three
18 or four pages of notes on it, so I don't --

19 CHAIRMAN GETZ: Okay, well, let's take
20 the morning recess then, and we will come back in
21 at eleven o'clock.

22 MR. UPTON: Thank you.

23 (Recess taken.)

1 CHAIRMAN GETZ: Okay, we're back on the
2 record and resuming with the cross-examination by
3 Mr. Upton.

4 MR. UPTON: Thank you very much.

5 BY MR. UPTON:

6 Q. Mr. Reilly, I want to go back to the
7 quote from Southern New Hampshire Water, Southern
8 New Hampshire Water case that you had in either --
9 I can't remember if it is your testimony or your
10 report, I think it's your rebuttal testimony in
11 May of 2006.

12 A. (By Mr. Reilly) Yes.

13 Q. The sentence that I want you to focus
14 on is the one starting with the town. Now, that
15 says that the town could acquire the utility's
16 property, and then it says see RSA 38-3, correct?

17 A. (By Mr. Reilly) That's correct.

18 Q. So would you interpret that as the
19 court saying that's the authority under which the
20 town can buy the facility, acquire the property?

21 A. (By Mr. Reilly) I would assume so, yes.

22 Q. Mr. Reilly, who is SG Barr Devlin?

23 A. (By Mr. Reilly) They are a regional

1 investment banking firm.

2 Q. And did it play some role for
3 Pennichuck Corporation?

4 A. (By Mr. Reilly) Yes. There was -- as I
5 understand it, they performed a -- or prepared an
6 offering memorandum with regard to an aborted sale
7 of Pennichuck Corporation stock in early 2002, I
8 believe.

9 Q. And did you review the SG Barr Devlin
10 material?

11 A. (By Mr. Reilly) Yes, I did.

12 MR. UPTON: If it please the
13 commission, I'm going to show him a page from
14 Exhibit 1094 which is confidential. I have copies
15 of the page. I'm not going to refer to the
16 specific information on the page, so that I'm not
17 going to make the actual information a part of the
18 record.

19 I'm going to provide a copy to each of
20 the commissioners and to the parties who have
21 signed the appropriate confidentiality agreement.
22 Is that acceptable with you?

23 CHAIRMAN GETZ: Any objection?

1 MR. CAMERINO: No objection, and I
2 would just note that what we tried to work out
3 with Mr. Upton is a way for him to utilize
4 information that needs to be kept confidential but
5 that we don't need to clear the room and divide
6 ourselves between those who have signed the
7 agreement and those who have not.

8 CHAIRMAN GETZ: And I assume,
9 Mr. Upton, this will be a foundation for a
10 question that you're going to try to elicit some
11 kind of qualitative response, this won't include
12 any numerical representations --

13 MR. UPTON: It's not going to be any
14 numerical or names or any of that kind of thing.

15 MR. CAMERINO: Maybe if we -- the
16 witness was not actually part of those
17 conversations, just caution him not to refer to
18 information that's confidential. If that becomes
19 necessary, then we'll have to take the next steps.

20 MR. UPTON: Is there anybody who has
21 signed the confidentiality agreement?

22 MS. MCHUGH: I believed I signed it,
23 yes.

1 CHAIRMAN GETZ: Let's go off the record
2 for this.

3 (Discussion off the record.)

4 CHAIRMAN GETZ: Back on the record,
5 then, please.

6 BY MR. UPTON:

7 Q. Now, in the course of performing the
8 work that you described that SG Barr Devlin did
9 for Pennichuck, did it identify potential
10 strategic partners?

11 A. (By Mr. Reilly) Yes, it did.

12 Q. And is that the document that I've
13 provided you?

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

15 Q. Are there any cities or towns on this
16 list of potential strategic partners?

17 A. (By Mr. Reilly) No, of course not.

18 Q. In fact, the only mention of
19 municipalities on this exhibit is that the company
20 could acquire small, private municipal water
21 operations, is that correct, at the bottom?

22 A. (By Mr. Reilly) That's correct, because
23 municipalities cannot acquire the stock of

1 Pennichuck Corporation.

2 Q. Now, Tilton-Northfield -- or the sale
3 of Tilton-Northfield Aqueduct Company,
4 Tilton-Northfield, that's one of your guideline
5 transactions?

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

7 CHAIRMAN GETZ: Excuse me, Mr. Upton,
8 we've moved on from --

9 MR. UPTON: No -- yes, yes. We're done
10 with the exhibit. I'm sorry.

11 MR. CONNER: You want to take it back
12 up?

13 MR. UPTON: You can keep it. Does the
14 company want me to take it back up?

15 MR. CAMERINO: It might be simply just
16 to minimize the copies that are floating around.
17 As I understand it, this is part of a premarked
18 exhibit anyways.

19 MR. UPTON: Can I leave the copies with
20 the commission?

21 MR. CAMERINO: Sure.

22 MR. CONNER: Do you have an exhibit
23 number?

1 MR. UPTON: 1094.

2 MR. BOUTIN: What page, for the record?

3 MR. CONNER: Thirty-three.

4 MR. UPTON: Yes, I believe it is, but
5 I -- it's page 33, even in the exhibit.

6 BY MR. UPTON:

7 Q. Tilton-Northfield Aqueduct sale to
8 Tilton-Northfield is one of your guideline
9 transactions?

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

11 Q. And do you know whether that was an
12 asset or a stock transaction?

13 A. (By Mr. Reilly) That was a stock
14 transaction.

15 Q. So if the Tilton-Northfield Water
16 District could buy the stock of Tilton-Northfield
17 Aqueduct Company, don't you think it's likely that
18 a municipality could buy the stock of Pennichuck
19 Corporation, if only to acquire the assets?

20 A. (By Mr. Reilly) No. My understanding
21 is that a municipality cannot own the stock of a
22 publicly traded company.

23 Q. But a municipality could acquire the

1 stock and liquidate the stock, couldn't it, for
2 the purpose of acquiring the assets?

3 A. (By Mr. Reilly) My understanding is
4 that's not correct.

5 Q. Okay. Well, how do you explain the
6 order under which this commission allowed
7 Tilton-Northfield to acquire the stock of
8 Tilton-Northfield Aqueduct Company?

9 A. (By Mr. Reilly) I don't believe
10 Tilton-Northfield was a publicly traded
11 corporation.

12 Q. I understand. Is there a difference
13 between publicly traded stock and stock?

14 A. (By Mr. Reilly) Yes, one is publicly
15 traded and one isn't.

16 Q. And that's a distinction that would
17 preclude a municipality from acquiring -- you're
18 making a distinction. You're saying, am I
19 correct, that a municipality could acquire stock,
20 privately held stock, but it can't acquire
21 publicly traded stock?

22 A. (By Mr. Reilly) That's my
23 understanding.

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

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

1 trying to get at -- are well known in the
2 appraisal and the investment banking business?

3 A. (By Mr. Reilly) Yes.

4 Q. And, as an example, if I can borrow at
5 5 percent, I've got a leg up over somebody who has
6 to borrow at 7 or 8 percent, don't I?

7 A. (By Mr. Reilly) Absolutely.

8 Q. And that's one of the synergies that
9 we're talking about?

10 A. (By Mr. Reilly) That's one of them,
11 yes.

12 Q. And you would expect, I assume, that
13 these synergies were known to SG Barr Devlin?

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

15 Q. Do you know how many public entities SG
16 Barr Devlin sent the confidential offering to in
17 January 2002?

18 A. (By Mr. Reilly) Well, I would assume
19 zero, again, based upon my understanding that a
20 public entity cannot purchase the stock of a
21 publicly traded corporation.

22 Q. Do you know if SG Barr Devlin provided
23 Pennichuck Corporation with any indications of

1 value when it did its work?

2 A. (By Mr. Reilly) I don't know if you
3 would call them indications of value, that they
4 were four expressions of interest from four
5 potential buyers that each of which had a range of
6 values that Devlin reported back to the company.

7 Q. Prior to the receipt of bids, did SG
8 Barr Devlin provide the company any indications of
9 what they thought the company was worth?

10 A. (By Mr. Reilly) They may have, I just
11 don't recall offhand.

12 MR. UPTON: I have the same kind of
13 confidential exhibit that I'm going to -- this is
14 Exhibit -- for the commission -- 1094, page 41.

15 Q. Mr. Reilly, in order to protect the
16 confidentiality of the actual figures, I want to
17 make sure that I don't -- you and I both don't say
18 what they are, but there's a line that's entitled
19 total SGBD estimated value ranges. Do you see
20 that?

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

22 Q. And there are implied aggregate values
23 and implied equity value on those two lines, is

1 that correct?

2 A. (By Mr. Reilly) Yes, there are.

3 MR. UPTON: Does the commission see
4 what those lines are? Okay.

5 Q. And that's for the whole company?

6 A. (By Mr. Reilly) Yes, that's for
7 Pennichuck Corporation.

8 Q. Mr. Reilly, one of the intangible
9 assets you valued was a Synergen work order
10 database, do you recall that?

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

12 MR. UPTON: Would you pull up 3007A,
13 page 30.

14 MR. CONNER: Rob, that's not the page
15 of the exhibit, though.

16 MR. UPTON: I thought this was 30 of
17 the exhibit.

18 MR. CONNER: It may be. I'm sorry.

19 MR. UPTON: Whatever page. What page
20 is that? That's page 29. I apologize, I said 30.
21 Would you highlight the first three paragraphs?

22 BY MR. UPTON:

23 Q. Now, you described the Synergen work

1 order database as a compendium of historical work
2 orders which are continuously used to assist in
3 the operation and maintenance of the Pennichuck
4 Water Works operating assets, is that correct?

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

6 Q. And you say it tracks costs associated
7 with maintenance of the production, transmission
8 and distribution system, correct?

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

10 Q. Office and equipment maintenance?

11 A. (By Mr. Reilly) Yes.

12 Q. And customer accounting?

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

14 Q. And it also tracks special project

15 work --

16 A. (By Mr. Reilly) Yes.

17 Q. -- that would continue for an

18 unspecified period of time?

19 A. (By Mr. Reilly) Yes, all open projects.

20 Q. And the work orders entered into the
21 system provide information about such things as
22 vehicle usage, inventory, and subcontractor costs?

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

1 Q. And it allows customer and contractor
2 invoices to be generated each week?

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

4 Q. And completed work orders are closed at
5 the end of the month?

6 A. (By Mr. Reilly) Yes.

7 Q. Now, did I describe accurately the
8 information you have in your report on Synergen?

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

10 Q. Do you know, by the way, how much the
11 software costs?

12 A. (By Mr. Reilly) No, I don't.

13 Q. If I told you 600,000, would that
14 surprise you?

15 A. (By Mr. Reilly) No, it wouldn't.

16 Q. It's a pretty significant amount,
17 though, for software, isn't it?

18 A. (By Mr. Reilly) Well, I guess it
19 depends on how you define a pretty significant
20 amount.

21 Q. All right, I'll leave it like that.
22 Now, I assume somebody at the company helped you
23 with the description of how it uses Synergen?

1 A. (By Mr. Reilly) Yes.

2 Q. You did this through interviews with
3 company personnel?

4 A. (By Mr. Reilly) Yes, I did.

5 Q. And did you discuss this with Mr. Ware?

6 A. (By Mr. Reilly) I am not sure if I
7 discussed the Synergen work order database with
8 Mr. Ware or not. I may have, I just don't recall.

9 Q. Okay. In any event, based on this
10 description you got from company personnel and the
11 information the company gave you about the hourly
12 cost of employees who would have to reproduce
13 their work orders in the system, you calculated
14 the reproduction costs new less depreciation of
15 the Synergen database at 8.1 million?

16 A. (By Mr. Reilly) That's correct.

17 Q. And if I told you that with the
18 exception of the water pumping rights that your
19 valuation of the Synergen system was considerably
20 higher than any of the other intangible property
21 that you valued, would you agree?

22 A. (By Mr. Reilly) Oh, I agree with that,
23 yes.

1 Q. So in your opinion, this is a very
2 valuable asset?

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

4 Q. And in order to put a value of
5 8.1 million on it, you must have assumed, I
6 gather, that it was fully functional, and that it
7 was doing the job it was designed to perform?

8 A. (By Mr. Reilly) That's correct, yes.

9 Q. Nobody at the company said anything
10 differently to you?

11 A. (By Mr. Reilly) That is correct.

12 Q. I want to show you an audit by the
13 staff of the PUC dated October 28th, 2004.

14 I'm going to show you a copy of the
15 audit performed on Pennichuck Water Works by the
16 Public Utilities Commission staff on October 28 --
17 or dated October 28, 2004 in connection with the
18 rate filing in docket DW 04-056.

19 MR. CONNER: Mr. Chairman, we'd like to
20 object to this document, use of the document. It
21 has been marked as Exhibit 1136, but this document
22 was not provided to us prior to the proceeding,
23 was not on the original list, and I would submit

1 based on prior objections and rulings by the
2 commission that it's inappropriate to be utilized
3 as an exhibit in this proceeding.

4 CHAIRMAN GETZ: Tell me where the
5 source of this is again, this is staff audit --

6 MR. UPTON: Staff audit from DW 04-056.
7 You will recall that Mr. Richardson yesterday in
8 cross-examining Mr. Ware attempted to make it an
9 exhibit. That's why it's marked.

10 We didn't -- we didn't have any idea
11 that it would be -- we didn't know whether it
12 would be permitted as an exhibit by the commission
13 or not. I think the commission can certainly take
14 administrative notice of the audit by the staff,
15 but I don't intend to make it an exhibit, I just
16 intend to cross-examine him on it.

17 CHAIRMAN GETZ: And does this follow up
18 on the value of the Synergen --

19 MR. UPTON: Yes. It is all related to
20 Synergen and its functionality and everything
21 else.

22 CHAIRMAN GETZ: Okay. Well, I'm going
23 to allow the use of this staff audit for

1 cross-examination of the witness.

2 MR. CONNER: Okay. Mr. Chairman, if
3 Mr. Reilly has not reviewed this in the past and
4 cannot identify the document, can it still be
5 utilized?

6 CHAIRMAN GETZ: Well, let's see what
7 his response is.

8 MR. CAMERINO: Mr. Chairman, I
9 understand you've ruled on this item, but I want
10 to raise a very serious concern here as to this
11 happening again.

12 Mr. Upton has actually premarked --
13 he's actually got this labeled as an exhibit with
14 a number, and he could have provided this to us
15 two weeks ago. Again, I understand you've ruled
16 on this item, but I'm concerned that there's the
17 other five or six numbers that we haven't seen yet
18 that they've reserved.

19 We had an exchange of correspondence.
20 The parties specifically addressed the issue of
21 whether additional exhibits could be added. The
22 city sought to add two, we objected to any, and
23 now at the hearing they are providing us with

1 documents that they knew they wanted to add.

2 They should have raised this issue
3 before, and I really think it's inappropriate. I
4 think if this happens again, you need to deal with
5 it differently.

6 CHAIRMAN GETZ: Well, we're going to
7 deal with these exhibits one at a time whether
8 it's -- it seems to be the argument where it's
9 impermissible supplemental exhibits by the company
10 or a permissible use of an exhibit to
11 cross-examine or impeach a witness. So we're just
12 going to have to take them one at a time. I've
13 heard your argument a couple of times,
14 Mr. Camerino.

15 MR. CAMERINO: It's that he knew in
16 advance, and yet still didn't disclose that
17 intentionally.

18 MR. UPTON: The fact that it's marked
19 as an exhibit is a red herring. We discovered
20 this exhibit, we had no idea that Mr. Ware was
21 going to testify as he did about it --

22 CHAIRMAN GETZ: I've heard both sides
23 of this. Let's proceed with the questioning, and

1 we'll deal with them one at a time.

2 BY MR. UPTON:

3 Q. This indicates that it is a final
4 report dated October 28, 2004, would you agree
5 with that?

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

7 Q. And that was prior to the time you did
8 your work, wasn't it?

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

10 Q. Were you ever provided a copy of this
11 by the company?

12 A. (By Mr. Reilly) No, I was not.

13 Q. I refer you to page 6 which discusses
14 the -- discusses the findings of the staff
15 concerning the use of the Synergen system, doesn't
16 it?

17 A. (By Mr. Reilly) It -- it appears to be.

18 Q. And among other things, the staff says
19 it was noted that when PWW pays a contractor for
20 work, the work order description column does not
21 state the contractor's name, but instead just
22 states contractor, correct?

23 A. (By Mr. Reilly) That's what it says,

1 yes.

2 Q. And it says the unit cost is reported
3 at 1 cent, and the quantity column reads .01
4 divided by total contract dollars, right?

5 A. (By Mr. Reilly) That's what it says,
6 yes.

7 Q. And then it says on some work orders
8 the PWW accountants manually wrote the contractor
9 name which is cross-referenced to a part number.
10 PWW accountants also manually calculated overhead.
11 And then it concludes, due to the above lack of
12 detailed information contained on the work orders,
13 it appears that the automated system is not being
14 efficiently or effectively used for the purpose
15 intended. Correct?

16 A. (By Mr. Reilly) That's correct.

17 Q. And it refers to audit find 4, is that
18 right?

19 A. (By Mr. Reilly) That's what it says,
20 yes.

21 Q. Let's look at audit find 4.

22 MR. BOUTIN: Mr. Chairman, because
23 we're going to go on and look at these pages, the

1 witness has testified he's never seen them. I
2 don't know whether this is going to end up being
3 important at all, but to the extent it's more or
4 less important, I think the witness ought to have
5 time to actually review the page before he
6 testifies so we can get whatever quality we can
7 get out of this.

8 MR. UPTON: I'm happy to do that. I'm
9 happy to do that.

10 A. (By Mr. Reilly) Okay, I've read page 45
11 and 46.

12 Q. Okay, good. Thank you. One of the
13 things in the finding that was interesting to me
14 was that the Synergen work order does not show the
15 plant account that was charged or credited. Do
16 you think that's significant also?

17 A. (By Mr. Reilly) From an accounting
18 perspective, yes, I do.

19 Q. And do you think it's -- do you think
20 it's -- it's difficult to track plant if you don't
21 have it properly entered -- if the work order
22 doesn't show the plant account number?

23 A. (By Mr. Reilly) Well, it's difficult to

1 get the charges into the right fixed asset account.

2 Q. Exactly. And, again, staff points out
3 that in-house data processing and engineering
4 labor costs and benefit overhead --

5 MR. CONNER: Where are you reading
6 from?

7 MR. UPTON: I'm sorry, that's not a
8 full sentence.

9 Q. The work order does not provide the
10 month of capital, data processing and engineering
11 labor, nor does it specify what the contractor's
12 name is or month paid. In many cases the PWW
13 accountants handwrote this information on the work
14 order.

15 Would you look at the conclusion. The
16 Synergen work order system needs improvement. The
17 unit cost and quantity are in most cases
18 meaningless. Did I read that right?

19 A. (By Mr. Reilly) That's what it says,
20 yes.

21 Q. Would you look at the last page of
22 audit find 4. The company's response was the
23 Synergen work order system is capable of

1 addressing all of the concerns mentioned above.
2 There are a few, quote, bugs, closed quote, in the
3 system that have been addressed with an upgrade
4 completed in October 2004. Did I read that right?

5 A. (By Mr. Reilly) Yes.

6 Q. And the company's -- I mean the audit
7 staff's exit audit comment indicates that it had
8 provided a copy of the Uniform System of Accounts
9 For Water Utilities, and specifically the work
10 order system required to the company, and that the
11 company was well aware of its commitments and
12 responsibilities. Did I read that correct?

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

14 Q. Does that staff comment indicate to you
15 that the company was not meeting its
16 responsibilities under the portion of the Uniform
17 System of Accounts cited?

18 A. (By Mr. Reilly) That -- I think that's
19 a reasonable interpretation, yes.

20 Q. Okay. I now want to show you the
21 February 2, 2007 audit of the commission staff of
22 Pennichuck Water Works in connection with its rate
23 filing DW 06-073. And let me get you a full copy

1 of that, sir.

2 MR. CONNER: Is this the one that
3 begins on page 44?

4 MR. UPTON: Yes.

5 Q. And specifically I want to refer you,
6 sir, to audit issue 3. It's on page 85.

7 MR. CONNER: Can he get the first page
8 of that, Rob, or did you already give it to him?

9 MR. UPTON: I gave him a full copy of
10 it.

11 Q. Were you ever shown this document,
12 Mr. Reilly?

13 A. (By Mr. Reilly) No, I was not.

14 Q. And this was after you had performed
15 your work?

16 A. (By Mr. Reilly) That's correct.

17 Q. And after you'd placed a value of
18 8.1 million on the Synergen work order database?

19 A. (By Mr. Reilly) Yes, I placed a value
20 on the Synergen database.

21 Q. I understand.

22 A. (By Mr. Reilly) Not on the Synergen
23 software.

1 Q. I understand.

2 A. (By Mr. Reilly) I assigned zero value
3 on the software.

4 Q. That's fine. It's the information that
5 you're valuing?

6 A. (By Mr. Reilly) That's correct.

7 Q. Now, I want you to look at audit find
8 3, the paragraph entitled issue.

9 A. (By Mr. Reilly) Yes.

10 Q. And the second paragraph specifically.
11 The work order summaries are part of the Synergen
12 system, but as in the prior audit do not reflect
13 the information in a manner that is useful.
14 Correct?

15 A. (By Mr. Reilly) That's what it says,
16 yes.

17 Q. And then it goes on and talks about an
18 example. It says that the work order's quantity
19 column is not used for the actual quantity except
20 labor hours, and the column unit costs reflects a
21 dollar for all items except labor hours which is
22 reflected as zero dollars, and the transaction
23 date does not appear to be used. Is that right?

1 A. (By Mr. Reilly) That's what it says
2 here.

3 Q. That's the criticism of the staff?
4 That's the audit of the staff?

5 A. (By Mr. Reilly) That's what it appears,
6 yes.

7 Q. And I want you to look at the
8 recommendation, and specifically the second
9 paragraph. The staff recommends that the company
10 should review its costs to date for the Synergen
11 system, which it notes are in excess of 600,000,
12 as that system does not appear to be used and
13 useful to the extent reported or anticipated.

14 You weren't -- you weren't told
15 anything about any of this when you did your
16 valuation, were you?

17 A. (By Mr. Reilly) No, I was not.

18 Q. And almost two and a half years after
19 the first audit it doesn't appear that the company
20 has made very much progress with Synergen, does
21 it?

22 A. (By Mr. Reilly) Not with the software,
23 no.

1 Q. Used and useful, as it's in the
2 recommendation, is a -- are words of art in
3 regulated utilities, aren't they?

4 A. (By Mr. Reilly) That's my
5 understanding.

6 Q. You can't earn on an asset which is not
7 used and useful?

8 A. (By Mr. Reilly) That's correct.

9 Q. And this is an asset, the information
10 in this -- the information in this database is an
11 asset that you valued at 8.1 million?

12 A. (By Mr. Reilly) Yes. But, again, I
13 valued the database. The information. This
14 comment is talking about the Synergen system, the
15 software itself, the actual code that cost 600,000.

16 I assigned zero value to the code that
17 apparently has a lot of problems associated with
18 it. But I didn't value the code. I valued the
19 actual manual information at the company that's
20 processed through the system.

21 Q. Well, how good is the information if
22 the system that you use to get it isn't used or
23 useful?

1 A. (By Mr. Reilly) Well, actually, sir, it
2 could be quite valuable if the company decides to
3 replace the Synergen system with another database
4 management system, of which there are many. They
5 could use the same database that they have now.

6 From what I'm -- this is the first time
7 I'm reading these documents, but I don't see these
8 documents complaining about the database, they seem
9 to be complaining about the software that processes
10 the data.

11 And it looks like the company -- the
12 company being Pennichuck -- may have to spend many
13 hundreds of thousands of dollars to buy new
14 software, but if they bought new software, and
15 let's say that cost \$500,000 or a million dollars
16 or whatever it costs, that particular transaction
17 would illustrate the value of the data.

18 The fact is they would not have to
19 spend another \$8 million to collect and categorize
20 the data. They've already spent \$8 million to
21 collect and categorize the data. All they need to
22 do now is to buy -- apparently -- it is to buy some
23 software that lets them use the database

1 effectively.

2 Q. Isn't the database only as good as the
3 system that accesses that database, and isn't
4 the -- isn't the corollary true, that a system
5 that -- a system that retrieves a database is only
6 as good as the information inputted?

7 A. (By Mr. Reilly) Well, you're talking
8 about -- there are two issues here. One is
9 functionality and one is value. When we value
10 software --

11 Q. I do agree that. I do agree with that.

12 A. (By Mr. Reilly) Okay.

13 Q. I'm not arguing with you about your
14 8.1 million.

15 A. (By Mr. Reilly) Okay. But the issue is
16 if the company did not have an \$8.1 million
17 database. If they spent \$600,000 to replace the
18 software, they would then have to pay \$600,000 for
19 software and \$8.1 million for the man-hours --

20 Q. I think I understood that you said
21 that?

22 A. For the 305,000 man-hours to recreate
23 the information in the 67,800 work orders that are

1 on file now. Because they have already incurred
2 that cost, they have 67,800 work orders in the
3 database, they spent 305,1000 man-hours doing that
4 at a cost of \$8 million --

5 Q. I understand that --

6 A. -- all they need to do is spend
7 \$600,000 for software and not \$8 million for the
8 database.

9 Q. This is cumulative. Are you done?

10 A. (By Mr. Reilly) I could go on, if you'd
11 like.

12 Q. I bet you could. You didn't value any
13 other work order database, did you?

14 A. (By Mr. Reilly) No, this is the only
15 one they had.

16 Q. And you would have wanted to know if
17 there was another work order database because it
18 would have been another intangible asset you would
19 have wanted to value, isn't that true?

20 A. (By Mr. Reilly) Yes, likely that's
21 true.

22 Q. Let's move on. You projected in this
23 case for purposes of your income analysis a long

1 term growth rate of 2 percent, right?

2 A. (By Mr. Reilly) That's correct, yes.

3 Q. And from your deposition I know that
4 the 2 percent represents, quote, inflation only,
5 and no real growth, correct?

6 A. (By Mr. Reilly) That's right. The
7 2 percent does represent inflation only, even
8 though I know that there would be real growth. I
9 selected a downward biased growth rate to reflect
10 inflation only.

11 Q. Didn't you say that in your analysis
12 that capital improvements would be netted out by
13 depreciation?

14 A. (By Mr. Reilly) I don't understand
15 that. You'd have to show that to me.

16 Q. Well, what is the real growth?

17 A. (By Mr. Reilly) Oh, what is the real
18 growth? Oh, surely. There's real growth from
19 several areas. One is an increase in population.

20 We know from the state of New Hampshire
21 that conducts studies that there's expected to be a
22 real growth in the number of people in the
23 Pennichuck service area of something between one

1 half of a percent and 1 percent.

2 So we know that in terms of -- ignoring
3 any rate increases that would come from capital
4 expenditures, we know that the state believes there
5 will be 1 percent more people each year in the
6 Pennichuck service area, so, in other words, there
7 will be more people, perhaps.

8 We know from history that the actual
9 water consumption per person in Pennichuck has been
10 increasing at a rate of more than 2 percent a year.
11 So we know that the number of people per house in
12 the Pennichuck area is increasing, and we know that
13 the water consumption per person in the Pennichuck
14 area is increasing.

15 We know that there's also a limited
16 amount of build out yet available in Nashua,
17 New Hampshire, but a substantial amount --
18 according to the state of New Hampshire -- a
19 substantial amount of buildup available in the
20 other service areas serviced by Pennichuck.

21 All that being said, I didn't include
22 any real growth in my growth rate. My growth rate
23 only includes inflationary growth.

1 Q. Okay. So when you say it's an
2 inflation only growth rate in your deposition,
3 that's what you mean?

4 A. (By Mr. Reilly) That's what I mean, and
5 that's what I used. You asked me a moment ago what
6 is the real growth.

7 Q. I understand.

8 A. (By Mr. Reilly) So I answered your
9 question.

10 Q. And your deposition testimony, at
11 least, was that there was inflation -- the
12 2 percent growth rate represented inflation only
13 and no real growth. Do you want me to bring that
14 up for you?

15 A. (By Mr. Reilly) Well, no. That's
16 exactly what it does. That's why I said my long
17 term projection rate was downward biased, it's
18 conservative. There is real growth that I did not
19 include in the 2 percent. If I included real
20 growth in the 2 percent, it would be a higher
21 number.

22 Q. Okay. Now, your testimony is a little
23 bit different. I refer you to page 3007, page 29,

1 when you were asked how did you conclude an
2 expected long term growth rate of 2 percent, and
3 what was your answer?

4 A. (By Mr. Reilly) This is a conclusion
5 based on several factors, including the company's
6 current projected long term growth rate, historical
7 increases in consumption and population served by
8 the PWW system, and interviews with PWW management.

9 Q. Let's go through those factors. Did
10 the company have a long term projected growth
11 rate?

12 A. (By Mr. Reilly) Yes, it did.

13 Q. Well, when I asked you about that in
14 your deposition -- I asked you starting at page 16
15 on this page, did you have discussions with
16 company personnel about what they anticipated the
17 long term growth rate would be. Do you remember
18 that?

19 A. (By Mr. Reilly) Yes.

20 Q. And your answer was, yes, I did, I
21 asked almost everyone. I asked a lot of people in
22 Pennichuck Corporation, as well as Pennichuck
23 Water Works, including people in the operations

1 area, people in the finance area, up through
2 Mr. Korell, then CEO of the company, and no -- no
3 one could give me an estimate.

4 A. (By Mr. Reilly) Well, I have a
5 different interpretation of long term growth rate.
6 Long term growth rate is the growth rate included
7 in my appraisal that goes through 2009 that comes
8 from company documents. So the company does have a
9 projection of 2004 through 2009.

10 As I'm sitting here right now, that's
11 how I interpreted your question of long term growth
12 rate. Are you asking me about a longer than long
13 term growth rate?

14 Q. I'm asking you what I asked you in the
15 deposition. And you went on to say, I don't
16 recall any one individual at all giving me an
17 estimate of either a long term growth rate, an
18 actual number 1, 2, 3 percent, whatever, or
19 someone being able to project for me key financial
20 statement accounts like revenues, capital
21 expenditures, net income, net cash flow, beyond
22 2009.

23 In other words, I couldn't get either a

1 percentage or a number for 2010, 2012, 2015, so
2 ultimately I had to come up with my own estimate.
3 So that the expected long term growth rate that I
4 used is entirely my estimate based on considering
5 all the factors we talked a few minutes ago about.
6 Is that right?

7 A. (By Mr. Reilly) And that's entirely
8 consistent with what I said a moment ago, which is
9 the company provided me with a long term growth
10 rate up through 2009, as it says in the next
11 sentence. Was the company able to provide you with
12 the projections up through 2009; yes. So when I
13 answered you a few moments ago, it was up through
14 2009.

15 Q. Okay. Okay. Okay. And we've
16 marked -- let me just show you.

17 MR. UPTON: And I'm not going to ask
18 any questions about this, Steve, I'm just going to
19 show him.

20 I'm not quite sure how to do this with
21 the commission. All I'm going to ask is that
22 these are projections from which he took his --
23 took his long-term growth rate with the company.

1 CHAIRMAN GETZ: Is this a confidential
2 document?

3 MR. UPTON: It's a confidential
4 document, yes.

5 CHAIRMAN GETZ: Do you just have one?

6 MR. UPTON: I have three, but I need
7 one.

8 CHAIRMAN GETZ: We'll take two.

9 MR. CAMERINO: Could I just note as the
10 commission is dealing with those documents,
11 apparently Mr. Upton is telling me they're dealing
12 with a confidential document, but those pages or
13 the front page is not marked confidential, so if
14 we could either get those back and stamp them.

15 MR. UPTON: It's clearly confidential.
16 It's confidential in his deposition and provided
17 confidential.

18 MR. CAMERINO: That's fine. If it were
19 to remain with the commission if there is an
20 indication later when they put it in their files
21 that it's confidential.

22 CHAIRMAN GETZ: We're doing some
23 self-help in marking these as confidential.

1 BY MR. UPTON:

2 Q. Mr. Reilly, I handed you Exhibit 1075
3 which is a confidential -- I didn't hand it to
4 you?

5 A. (By Mr. Reilly) I have it.

6 MR. UPTON: Good job, Rob.

7 Q. Are those the projections that you were
8 referring to?

9 A. (By Mr. Reilly) Yes, they are.

10 MR. UPTON: I don't need to ask
11 anything more about it. It's marked a
12 confidential exhibit, the commission can review
13 it.

14 MR. CONNER: Do you have a exhibit
15 number for it?

16 MR. UPTON: It's 1075, Joe.

17 BY MR. UPTON:

18 Q. The 2 percent inflation only growth
19 rate I gather is your opinion of how inflation is
20 going to impact PWW?

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

22 Q. Am I correct that expenses and costs of
23 operation will also experience the same

1 inflationary pressure?

2 A. (By Mr. Reilly) They may, yes.

3 Q. And for a utility, in fact, isn't it
4 the inflationary effect on expenses and costs of
5 operation that generates increases in revenue?

6 A. (By Mr. Reilly) Well, actually, in a
7 rate based regulated utility like Pennichuck there
8 are a lot of factors. The primary driver is the
9 rate base and the allowed rate of return, so those
10 two factors are the primary drivers. The operating
11 expenses are a third, but somewhat less important
12 factor.

13 Q. Well, if there's no real growth, a
14 utility can't increase its revenues and
15 consequently cash flows unless it's cost and
16 expenses increase, can it?

17 A. (By Mr. Reilly) Well, no, that's not
18 correct. The revenues would increase with the rate
19 base.

20 Q. Oh, sure. But if there's no real
21 growth, is rate base going to increase?

22 A. (By Mr. Reilly) Yes, it would increase
23 due to replacement capital expenditures being a

1 greater amount than historical capital
2 expenditures.

3 Q. Wait a minute. I understand you to be
4 saying that net cash flows -- and that means
5 revenues greater than costs and expenses will
6 increase 2 percent more than whatever inflation
7 increases there are to costs and expenses, is that
8 correct?

9 A. (By Mr. Reilly) Could you ask me that
10 again? I'm afraid I'm confused.

11 Q. Isn't what you're saying is that net
12 cash flows, which to me means revenues that are
13 greater than the costs and expenses, will increase
14 2 percent more than whatever inflation increases
15 there are to costs and expenses?

16 A. (By Mr. Reilly) No, that's actually not
17 what it means at all.

18 Q. Okay. Well, let's -- shall we try to
19 make an equation? You've got revenues and you've
20 got costs and expenses. And if you subtract costs
21 and expenses from revenue and it's less than
22 revenues, that's net cash flow, isn't it?

23 A. (By Mr. Reilly) Only by Mr. Sansoucy's

1 definition. The rest of the world would add
2 depreciation expense and subtract capital
3 expenditures --

4 Q. I'm trying to simplify this.

5 A. (By Mr. Reilly) Well, do you want an
6 incorrect answer or do you want a correct answer?

7 Q. No, I want an answer to my question.

8 CHAIRMAN GETZ: Gentlemen, for the
9 record, the court reporter is, I think, being
10 pushed to the limit sometimes in trying to get
11 both conversations down, so let's have one person
12 speak at a time, please.

13 Q. I'm really not trying to quibble with
14 you, I'm trying to make it -- I'm trying to do the
15 easy version. If you subtract costs and expenses
16 from revenues and there's a balance, that's net
17 cash flow, isn't it?

18 A. (By Mr. Reilly) Well, no, that's simply
19 wrong.

20 Q. Okay, what is it?

21 A. (By Mr. Reilly) It's wrong.

22 Q. But what is -- what's left over? What
23 do you call what's left over?

1 A. (By Mr. Reilly) Well, I don't know, but
2 it's not net cash flow. If you want to finish to
3 get to net cash flow, you add depreciation expense
4 and subtract capital expenditures.

5 Q. Okay. All right, and in your model --
6 in your model in this case, capital appreciation
7 and -- I'm sorry, capital improvements and
8 depreciation net each other out, isn't that
9 correct?

10 A. (By Mr. Reilly) Can you be more
11 specific? Because the correct answer to your
12 question is no.

13 Q. Let me ask you, in your deposition.

14 MR. UPTON: I haven't anticipated this,
15 and I've got to find it in his deposition, if I
16 could have a moment.

17 Why don't I come back to that because
18 I'm not finding it immediately in his deposition.

19 CHAIRMAN GETZ: That's fine.

20 MR. UPTON: I do want to come back to
21 it, though.

22 CHAIRMAN GETZ: Let me ask this,
23 Mr. Upton. It's noon now, normally we would take

1 our lunch recess at 12:30. How much more
2 cross-examination?

3 MR. UPTON: I've actually got quite a
4 bit. It's not going nearly as fast as I thought
5 it was going to.

6 CHAIRMAN GETZ: So we'll go to 12:30,
7 and then you can get back to this after lunch?

8 MR. UPTON: Yes.

9 BY MR. UPTON:

10 Q. I'll come back after lunch to the whole
11 long term growth rate issue, if that's all right
12 with you?

13 A. (By Mr. Reilly) Sure.

14 Q. One of the things that you've testified
15 about and you did some more this morning was
16 relative to Mr. Sansoucy and his independence and
17 what you call apparent bias, is that correct?

18 A. (By Mr. Reilly) Yes. I don't think I
19 testified to that this morning, but I have
20 testified to that.

21 Q. And one of the reasons that you believe
22 that is because he had a stated goal to conclude a
23 value for the PWW assets that would allow Nashua

1 to purchase those assets without raising rates?

2 A. (By Mr. Reilly) That's correct.

3 Q. And some of the things that you point
4 to when you do that are the statements he makes to
5 the board of aldermen about what he thinks the
6 value is going to be?

7 A. (By Mr. Reilly) Yes, sir.

8 Q. Now, he had done appraisals of the PWW
9 assets prior to 2004, is that correct?

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

11 Q. In 1995 and in 2002?

12 A. (By Mr. Reilly) That's correct.

13 Q. So he had a pretty good working
14 knowledge of the PWW assets?

15 A. (By Mr. Reilly) I would assume so.

16 Q. And those prior appraisals were
17 obviously available to him when he commenced his
18 work for Nashua on this project?

19 A. (By Mr. Reilly) Sure.

20 Q. And like Mr. Sansoucy, you had your
21 appraisal available from Peoria available to you
22 when you started your assignment?

23 A. (By Mr. Reilly) I assume I did, sure.

1 Q. I'm sorry?

2 A. (By Mr. Reilly) I assume I did. I'll
3 say yes, I did.

4 MR. UPTON: That is Exhibit 1084. Put
5 that on the screen.

6 MR. CONNER: Rob, do you have a copy of
7 his Peoria appraisal to show him?

8 MR. UPTON: It's going to be on the
9 screen. I assume he has his own. Why don't you
10 give him yours; I need mine.

11 Q. Does that look to be your 2003
12 valuation analysis of Peoria?

13 A. (By Mr. Reilly) Well, it looks like the
14 cover. I obviously can't see what's underneath it.

15 Q. All right, let me share with you my
16 copy. I'm going to ask you some comparisons to
17 your analysis in this case?

18 A. (By Mr. Reilly) Surely.

19 Q. And that your report here is 3007A, is
20 that correct? Would you agree with me, sir,
21 that -- would you agree with me that your Peoria
22 appraisal, except for the numbers, is almost
23 identical to the appraisal you performed here?

1 A. (By Mr. Reilly) Well, I don't know what
2 you mean by almost identical, they're two different
3 systems. I mean, obviously they're both water
4 systems, I'd expect a lot of similarity; the
5 systems are significantly different, so I'd expect
6 the descriptions to be significantly different.

7 Q. You reached the same -- you have the
8 same discussion in both Peoria and Nashua about
9 hypothetical willing buyers, is that correct?

10 MR. CONNER: Mr. Chairman, I'm not
11 exactly sure where we're going with this. If he's
12 asking for a line-by-line comparison, or is there
13 a section on hypothetical willing buyers in both
14 reports; that is there. But these are two
15 different systems in two different states in two
16 different time periods. I don't really understand
17 where it's going.

18 MR. UPTON: Well, it's my
19 cross-examination.

20 CHAIRMAN GETZ: I think it's a fair
21 line of inquiry.

22 MR. CONNER: Sure.

23 BY MR. UPTON:

1 Q. If I read those two, those are
2 virtually identical, aren't they; it's almost word
3 for word the same?

4 A. (By Mr. Reilly) Well, I guess I
5 wouldn't say they're almost virtually identical,
6 they look pretty different to me, but the
7 conclusion is the same.

8 Q. Yeah, the most likely hypothetical
9 buyers in New Hampshire is any New Hampshire city
10 or town -- any incorporated city or town, and in
11 Peoria it's any city or town -- Illinois city or
12 town with a population less than 500,000?

13 A. (By Mr. Reilly) Well, actually, you've
14 just fundamentally mischaracterized my position.
15 My position is not that these buyers represent the
16 most likely buyer. My position is that the
17 population of willing buyers includes municipal
18 entities.

19 Q. Okay, I didn't mean to --

20 A. (By Mr. Reilly) But that is a
21 fundamental mischaracterization of the entire
22 premise of my appraisal.

23 Q. I didn't think I made any --

1 A. (By Mr. Reilly) Well, sir, you did.

2 Q. All I'm saying is are these the same?

3 A. (By Mr. Reilly) Do you want to go line
4 by line?

5 Q. No, I just want you to say are they --
6 is it essentially the same conclusion, same
7 language, except for the difference in the
8 municipalities?

9 A. (By Mr. Reilly) Well, as I mentioned
10 before, the conclusion is the same, that the
11 population of hypothetical willing buyers includes
12 public entities.

13 Q. Okay.

14 A. (By Mr. Reilly) That conclusion in
15 these two specific appraisals of two waterworks
16 companies is the same, and I think they're both
17 correct assumptions.

18 Q. I can keep going with this and show the
19 similarities, Mr. Reilly, but I'm going to let the
20 commission do that.

21 Let me ask you if you agree that you
22 used the same present value factor for your DCF at
23 5 percent for both systems?

1 A. (By Mr. Reilly) The weighted average
2 cost of capital rounded to 5 percent in both cases,
3 the unrounded weighted average cost of capital, of
4 course, is different.

5 Q. Of course. And you used the same
6 direct capitalization rate of 3 percent for the
7 DCF in both systems, didn't you?

8 A. (By Mr. Reilly) I know I did in
9 Pennichuck, and it looks like I did in Peoria as
10 well.

11 Q. And you even used the exact same growth
12 rate of 2 percent, didn't you?

13 A. (By Mr. Reilly) Yes, I did.

14 Q. Is that all just coincidence?

15 A. (By Mr. Reilly) Yes, actually, I
16 believe it is.

17 Q. Now, one real difference between your
18 report in Peoria and the one you performed for
19 Pennichuck is that in Peoria you actually
20 performed a sales analysis, isn't that correct?

21 A. (By Mr. Reilly) Well, no, I guess I
22 wouldn't agree with that.

23 Q. All right, let me ask you this. Did

1 you rely on a sales analysis in Pennichuck?

2 A. (By Mr. Reilly) Yes, I did.

3 Q. Okay. Did you give it any weight?

4 A. (By Mr. Reilly) No, I assigned zero
5 weight.

6 Q. In Peoria how much weight did you give
7 to the sales analysis?

8 A. (By Mr. Reilly) 10 percent weight.

9 Q. And in Peoria your sales analysis was
10 more than a hundred million dollars less than your
11 cost analysis, wasn't it?

12 A. (By Mr. Reilly) That's not what it
13 looks like to me.

14 Q. All right, what do you think it is?

15 A. (By Mr. Reilly) Well, the cost approach
16 was 298,100.

17 Q. What page are you reading from?

18 A. (By Mr. Reilly) It's Exhibit 1. I
19 don't think it has a page number. And the sales
20 comparison approach value is 211,730, so the zero
21 is \$86,370,000.

22 Q. I stand corrected, 86 million.
23 Mr. Reilly, based on what you had done in

1 Peoria -- well, let me ask you about Peoria again.
2 In Peoria Mr. Conner was involved, is that
3 correct?

4 A. (By Mr. Reilly) Yes, he was.

5 Q. And you testified on behalf of -- was
6 it American Water Illinois?

7 A. (By Mr. Reilly) That's correct.

8 Q. And Mr. Riethmiller was involved?

9 A. (By Mr. Reilly) Yes, he was.

10 Q. And based upon what you did in Peoria
11 and the other assignments you had from
12 Mr. Conner -- have you done any other -- I'm
13 sorry, I'm getting scatterbrained -- have you done
14 any other water company valuations for Mr. Conner?

15 A. (By Mr. Reilly) Yes. In addition to
16 this case and Peoria, I believe there have been two
17 or three others. One of which is going on now,
18 it's a current case.

19 Q. The others were prior to Pennichuck?

20 A. (By Mr. Reilly) There were one or two
21 prior to Pennichuck.

22 Q. Well, based upon what you had done in
23 Peoria in 2003 and the other assignments you had

1 done for Mr. Conner in that time, you had a pretty
2 good idea of what you were going to do on this
3 case, too, didn't you?

4 A. (By Mr. Reilly) Well, I had a good idea
5 of what approaches, methods and procedures I would
6 use, they're pretty standard with regard to the
7 appraisal of water companies. What I didn't do is
8 simply promise my client a number before I put
9 pencil to paper.

10 Q. And that's not appropriate to do, to
11 promise a number, is it?

12 A. (By Mr. Reilly) I don't believe so.

13 Q. But if you had previously valued the
14 Pennichuck Water Company and you had some idea of
15 what that value was, it wouldn't be improper for
16 you to tell your client, this is the area where
17 it's going to come in, I think?

18 A. (By Mr. Reilly) Well, actually, under
19 USPAP, it is. Once you put a number on the table
20 under USPAP, you've performed an appraisal -- I
21 should say you've given an appraisal conclusion,
22 and you can't give an appraisal conclusion without
23 performing an appraisal.

1 And certainly under USPAP one of the
2 things you can't do is promise that I will give you
3 a value that will make sure your rates don't
4 increase or that will do you no harm, because that
5 is a -- certainly a contingency that as an
6 appraiser you cannot represent before you've
7 performed an appraisal.

8 Q. I understand. But if you were an
9 appraiser and you had performed prior appraisals
10 for a client and you were meeting with a client
11 and you continued to follow the industry, as I
12 know you do, you would be able, wouldn't you, to
13 say to the client, look, this is where I think
14 it's going to come in?

15 A. (By Mr. Reilly) No. Actually, USPAP is
16 very specific about prohibiting that. Appraisers
17 did that for years and resulted in a -- a virtual
18 destruction of the real estate industry in the late
19 1980s. USPAP strictly prohibits that.

20 Now, what you could say is I have
21 performed previous appraisals on previous dates and
22 these were my previous conclusions, but once you
23 say I believe the value will be X, then you have

1 given a value opinion, and USPAP prohibits an
2 appraiser from giving a value of opinion unless the
3 appraiser has performed an appraisal.

4 Q. Well, if you're talking with the person
5 to whom or for whom you have provided those prior
6 appraisals, they presumably know what's in those
7 prior appraisals, and you say to them, look, I
8 think this is the area where I'm going to come in,
9 what's the problem if you finally produce a -- an
10 appraisal so that it can be tested?

11 A. (By Mr. Reilly) Well, the only problem
12 is it's strictly prohibited under USPAP. If you
13 don't mind violating USPAP, flagrantly and grossly
14 violating USPAP, if that's not a problem to your
15 personal ethical standards, then I guess it's not a
16 problem. If you do have any personal ethical
17 standards, then it is a problem.

18 Q. And you clearly have personal ethical
19 standards, don't you?

20 A. (By Mr. Reilly) I like to think so.

21 Q. And you think that Mr. Sansoucy doesn't
22 think that he has personal ethical -- personal and
23 ethical standards?

1 A. (By Mr. Reilly) You'd have to ask him
2 that.

3 Q. I want to talk about the assumptions
4 for comparability that you used in your sales
5 analysis.

6 MR. CONNER: Are you still on Peoria?

7 MR. UPTON: No, I'm sorry. Take Peoria
8 down.

9 (Discussion off the record.)

10 MR. UPTON: 3007A, I'm sorry.

11 MR. CONNER: What page?

12 MR. UPTON: I'm sorry, 40. Pull up the
13 first paragraph.

14 (Discussion off the record.)

15 MR. UPTON: The problem I'm having is
16 that the electronic version of the exhibit, this
17 is page 40. On the actual exhibit, the hard copy,
18 it's page 39. So I don't know how to describe it
19 for the commission.

20 If you're going to look at it as an
21 electronic exhibit, I'm going to describe it as
22 page 40. If it's the hard copy, it's page 39. I
23 don't know; I'm stymied.

1 CHAIRMAN GETZ: We'll just have to do
2 both.

3 COMMISSIONER BELOW: I would note we
4 don't access it with the version of electronic
5 page numbers, so that's not particularly relevant
6 to us, that's only for this particular system, so
7 I would think the page 39 is most useful.

8 MR. UPTON: Okay, page 39 of your
9 actual thing.

10 BY MR. UPTON:

11 Q. It talks about the willing buyer and
12 willing seller concept underlying the fair market
13 value standard of values based upon several
14 assumptions, correct?

15 A. (By Mr. Reilly) Yes, sir.

16 Q. And the first of those assumptions is
17 that the buyer's seeking investment in a
18 particular industry?

19 A. (By Mr. Reilly) Yes.

20 Q. And the second is that value is a
21 function of the strength in quality of earnings,
22 assets, dividend yield, or some other relevant
23 bearing?

1 A. (By Mr. Reilly) Yes.

2 Q. And then in the next paragraph I think
3 what you're saying is you seek guidance from
4 prices investors are willing to pay for companies
5 in the same or similar lines of business. This --
6 you're not requiring it be identical?

7 A. (By Mr. Reilly) Well, you would for
8 comparable -- if you're going to select comparable
9 companies, but I didn't select comparable
10 companies. So for guideline companies they do not
11 have to be identical.

12 Q. Well, there is no identical copy of
13 Pennichuck Water Works, is there?

14 A. (By Mr. Reilly) Well, I don't know. I
15 just haven't researched that.

16 Q. Sure. And you identified 12
17 transactions that you located?

18 A. (By Mr. Reilly) Yes.

19 Q. And in your opinion these are not
20 comparable to Pennichuck?

21 A. (By Mr. Reilly) That's right.

22 Q. And on page --

23 (Discussion off the record.)

1 Q. It's page 40 of your report; you list
2 some of the differences between Pennichuck and the
3 guideline company transactions, is that correct?

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

5 Q. And those include that they operate in
6 different geographic areas, correct?

7 A. (By Mr. Reilly) That's correct.

8 Q. And they operate in different
9 regulatory environments?

10 A. (By Mr. Reilly) Yes.

11 Q. And many of them are either
12 significantly larger or smaller than Pennichuck?

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

14 Q. So can I conclude that in your list of
15 12, some of the sales are superior to Pennichuck
16 and some are inferior?

17 A. (By Mr. Reilly) That may be the case.
18 I never analyzed that, but that may be the case.

19 Q. And in looking at comparability, if I
20 have -- if I've done what I think I've done
21 right -- if you will look at page 40 through 45 of
22 the -- of the report, would you agree with me that
23 the primary differences that you've noted relate

1 to revenues and customers?

2 A. (By Mr. Reilly) No. Actually, I -- if
3 that was the impression I gave you, that was not
4 the impression I meant the reader to have. There
5 are a number of differences mentioned here. Size
6 is one, but size isn't the only difference. Size
7 can sometimes be adjusted for.

8 The other differences that I wanted to
9 emphasize are that some of these transactions are
10 step transactions or multiple state transactions.
11 Another difference I wanted to emphasize was
12 geography.

13 A number of these transactions occur in
14 the southern portion of the United States or in the
15 western portion of the United States, particularly
16 in desert or high plain areas, and a number of
17 these transactions occur in areas where populations
18 are growing at either a faster rate or slower rate
19 than the Nashua, New Hampshire, area.

20 So I wanted to emphasize a number of
21 different factors, not just revenue and customers.

22 Q. Can you point out in your report where
23 you say that the area is growing faster than in

1 Nashua?

2 A. (By Mr. Reilly) I don't think I
3 concluded that in the narrative. I did say, for
4 example, under the Citizens communications
5 transaction that the transaction brought
6 approximately 284,000 new water customers to AWW in
7 Arizona, California, Illinois, Indiana, Ohio and
8 Pennsylvania. The population growth rates in each
9 of those states is greater than the expected growth
10 rate in the Nashua area.

11 Q. But you don't in any of those analyses
12 say and by comparison the population growth
13 experienced in this area is much greater than --
14 or much less than in New Hampshire, do you?

15 A. (By Mr. Reilly) I think you have to
16 look at the underlying data to reach that
17 conclusion.

18 Q. Okay, but you don't say it in the
19 report, do you?

20 A. (By Mr. Reilly) That's correct. I do
21 talk about the desert area, the states, the source
22 of supply, the number of states involved --

23 MR. UPTON: If I can, this is not

1 responsive to my question, and it's going to take
2 a lot longer if he doesn't just deal with my
3 questions.

4 CHAIRMAN GETZ: Well, this is -- the
5 question has been answered, the question has been
6 explained, it's additional explanation. If you
7 really think that additional explanation is
8 necessary, then I'm sure you'll have the
9 opportunity on redirect to --

10 MR. REILLY: I'm sorry.

11 Q. And there's no doubt, is there,
12 Mr. Reilly, that you do compare the revenues of
13 the company being acquired and the revenues of
14 Pennichuck?

15 A. (By Mr. Reilly) Among many other
16 factors, yes.

17 Q. And, for example, if you look at page
18 43, the Sierra Pacific transaction -- maybe that
19 starts back on 42 -- but in the second paragraph
20 on page 43 you say, in comparison -- you point out
21 that Sierra served 68,000 some-odd customers and
22 recorded approximately 54.3 million in revenue,
23 and in comparison, Pennichuck serves approximately

1 25,000 customers and recorded approximately
2 15.7 million in revenue, correct?

3 A. (By Mr. Reilly) That's correct. But I
4 really think it's worth mentioning, that's after I
5 say Sierra Pacific supplied water to the Reno
6 Sparks region of Nevada which is located in a
7 desert. The desert climate poses unique operating
8 and regulatory constraints on a water company.

9 Q. I agree. I'm just saying you used as a
10 comparison revenues and customers?

11 A. (By Mr. Reilly) Among other factors,
12 yes.

13 Q. And in Indianapolis, in the fifth
14 paragraph -- under Indianapolis on page 43 you
15 point out that IWC employed approximately 800
16 people and serviced 273 customers -- 273,000
17 customers, by comparison Pennichuck employed 285
18 people and services 25,000 customers.

19 Furthermore, IWC operating revenues for
20 2001 was 95.5 million before it was acquired, in
21 contrast, the Pennichuck operating revenues was
22 approximately 15.7 million.

23 A. (By Mr. Reilly) Yes.

1 Q. Again, you compare revenues and
2 customers?

3 A. (By Mr. Reilly) Yes. But, again, I
4 think this is important, it's after I mentioned
5 that this transaction was a forced sale ordered by
6 the U.S. Securities and Exchange Commission.

7 Q. These are -- the two that I referenced,
8 Indianapolis and -- Indianapolis and Sierra, those
9 were both instances of a public entity acquiring a
10 water company?

11 A. (By Mr. Reilly) That's correct.

12 Q. Do you think that those are superior to
13 the Pennichuck sale?

14 A. (By Mr. Reilly) Do I think the sales
15 are superior?

16 Q. Yes.

17 A. (By Mr. Reilly) I don't know how -- in
18 what way? I don't know what you mean.

19 Q. Well, when you do a -- I thought that
20 what you said was that some of the sales were
21 better than -- than the PWW transaction and some
22 of them were not. I'm asking you is this better?
23 Are these better?

1 A. (By Mr. Reilly) Well, I don't recall
2 that characteristic. I think you mentioned you
3 thought some were better and some were worse. I
4 would say I don't know how to compare the actual
5 sales. We can compare the underlying companies.

6 Q. Sure. Let me ask it this way. Are the
7 assets better?

8 A. (By Mr. Reilly) Sitting here, I don't
9 recall enough about the assets. I'd have to look
10 at each of the transactions, but I think with
11 regard particularly to these two transactions, they
12 may be the least reliable transactions.

13 The Indianapolis transaction that you
14 mentioned is effectively a liquidation, it is a
15 forced sale. NiSource, the seller, was compelled
16 to sell by the SEC.

17 The same thing was true with regard to
18 the Sierra Pacific Resources transaction. The
19 seller was getting out of entirely the water
20 business because the overwhelming majority of the
21 rest of their business is electric power, natural
22 gas, and they'd already announced they were going
23 to divest themselves of all water operations.

1 So I think neither sale would be a
2 reliable indicator of value because they are both
3 essentially forced sales.

4 Q. But you think that of all 12 of your
5 guideline sales, don't you?

6 A. (By Mr. Reilly) That they're forced
7 sales? No, I don't.

8 Q. That they are not reliable?

9 A. (By Mr. Reilly) That they are not
10 sufficiently reliable indicators of value for an
11 appraisal of Pennichuck.

12 Q. What I want to do is I'm going to take
13 those two sales, even though I hear you say that
14 you don't think that they are reliable, and I want
15 to develop a sales price to revenue multiple for
16 them.

17 A. (By Mr. Reilly) Okay.

18 Q. Now, the Sierra sales price was
19 350 million, correct?

20 A. (By Mr. Reilly) I don't know. What am
21 I looking at?

22 Q. I think you're -- I hope you're looking
23 at the information that you have.

1 A. (By Mr. Reilly) Well, I don't see that
2 on this page.

3 Q. Well, look on page 42.

4 A. (By Mr. Reilly) Oh, yes. The aggregate
5 purchase price was \$350 million.

6 Q. And what were the revenues?

7 A. (By Mr. Reilly) The water division
8 revenues were \$54.3 million.

9 Q. So if my math is right, that's a -- a
10 sales price to revenue multiple of 6.45, does that
11 sound right?

12 A. (By Mr. Reilly) That sounds --

13 Q. Subject to check?

14 A. (By Mr. Reilly) Yes.

15 Q. Thanks. And your book, which I had
16 great pleasure reading -- I'm being sarcastic.
17 I'm a lawyer, so I didn't have great pleasure
18 reading it -- but your book recognizes that the
19 sales price to revenue multiples is an appropriate
20 multiple, doesn't it?

21 MR. CONNER: He has several books that
22 he's authored. Which book are you referring to?

23 MR. UPTON: Yeah, I will. I will. If

1 I could have that.

2 MR. BOUTIN: Is it the one on the table
3 here?

4 MR. UPTON: If I could have that --

5 MR. CONNER: Elmo?

6 MR. UPTON: Elmo back on.

7 BY MR. UPTON:

8 Q. I thought I got the face sheet.

9 Mr. Reilly, is that a book that you are an author
10 of?

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

12 Q. And that book recognizes that a
13 multiple of sale price to revenue is an
14 appropriate multiple, doesn't?

15 A. (By Mr. Reilly) Well, I have to look at
16 the page, but --

17 Q. I'm going to show you the page.

18 A. (By Mr. Reilly) I would say it's
19 probably the least reliable multiple. Typically we
20 focus on price to earnings multiples --

21 Q. All right, let me show you page 263.
22 Controlled transactions -- I'm reading in the
23 second paragraph. Controlled transaction value

1 measures, also called deal multiples or
2 acquisition multiples often use the following
3 measures of return in the denominator. And the
4 very first one is revenues, correct?

5 A. (By Mr. Reilly) Well, you read that
6 correctly, but this section has nothing to do with
7 estimating fair market value, this section has to
8 do with estimating control premiums, something that
9 has absolutely nothing to do with the appraisal of
10 any party in this case.

11 Q. So, anyway, you agreed with me that the
12 Sierra multiple was 6.45. If I apply that
13 multiple to the Pennichuck Water Works revenues
14 which are now 17.8 million -- isn't that what you
15 used in your last analysis? I want to make sure I
16 use the right one.

17 MR. CONNER: Are you talking about his
18 update?

19 MR. UPTON: Yes.

20 Q. Your updated testimony?

21 A. (By Mr. Reilly) Well, the revenue
22 through 2005 was 16.952. Is that what you're
23 looking for?

1 Q. I thought you used 17.8, but we can use
2 16.9, if you'd rather. That gives an indicated
3 value of 109 million, would you agree that would
4 be in the ball park?

5 A. (By Mr. Reilly) That sounds about the
6 right math.

7 Q. Okay. And if I do the same thing for
8 the Indianapolis sale, that had a sale price of
9 540 million?

10 A. (By Mr. Reilly) Yes.

11 Q. And revenues of 95.5 million?

12 A. (By Mr. Reilly) That's correct.

13 Q. And that's a multiple of 5.65 million,
14 isn't it?

15 A. (By Mr. Reilly) That's correct.

16 Q. I'm sorry, multiple of 5.65,
17 not million, excuse me. And if you apply that to
18 the 16.9, that yields an indicated value of
19 95 million?

20 A. (By Mr. Reilly) That's correct.

21 Q. Now, what I -- the other thing I want
22 to do is I want to look at what the multiple would
23 be using your value estimates starting with your

1 original report and then your updated report.

2 Your original report concluded a value
3 of 248.4 million?

4 A. (By Mr. Reilly) That's correct.

5 Q. And if you divide that by 15.7, which
6 is the time -- the revenues at the time, that
7 would yield a multiple of 15.8, isn't that
8 correct?

9 A. (By Mr. Reilly) That sounds correct,
10 yes.

11 Q. And using your new value and the
12 updated revenues, it's 273 million --
13 273.4 million --

14 A. (By Mr. Reilly) Yes.

15 Q. -- and that's divided by 16.9, and that
16 yields a value of 161 million?

17 A. (By Mr. Reilly) I don't think that's
18 right.

19 Q. Well, wait a minute. Maybe I've done
20 this wrong. Why don't you do it for me, if you
21 could.

22 A. (By Mr. Reilly) Sure.

23 CHAIRMAN GETZ: You're trying to

1 determine the multiple given the updated revenues?

2 MR. UPTON: I keep slipping from
3 multiple to value. I'm sorry.

4 Q. What is the multiple that that
5 indicates?

6 A. (By Mr. Reilly) Sure, just a second.
7 That's about 16.1 times.

8 Q. Okay, and that compares with the 6 and
9 5 something of Sierra and Indy?

10 A. (By Mr. Reilly) For the desert sale and
11 the distressed sale, yes.

12 Q. Yes. Now, I've calculated the sale
13 price to revenue multiple for the other sales, and
14 I've also calculated the median, and I assume you
15 agree that the median is a better measure of
16 central tendency for ratios than the median, don't
17 you?

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

19 Q. And if I told you that the median was
20 6.89, subject to check, would you accept that?

21 A. (By Mr. Reilly) For the 12 guideline
22 sales that I used, yes.

23 Q. And if I applied that to Pennichuck's

1 2005 earnings, which was 16.9.

2 A. (By Mr. Reilly) Actually, it's almost
3 17. It might be easier just to round it to 17.

4 Q. I've been using 16.79, so I'm going to
5 continue to use it. That implies a value of
6 116 million 441, does that sound right?

7 A. (By Mr. Reilly) The math sounds
8 correct, yes.

9 Q. Now, do you agree that even when
10 valuing special purpose properties, that sales of
11 properties in the same general category help
12 establish broad limits for the value which help
13 support the findings of the other value approaches
14 used?

15 A. (By Mr. Reilly) They can if the sales
16 are sufficiently comparable.

17 Q. What I questioned you about,
18 Mr. Reilly, was from the appraisal of real estate
19 which we talked about earlier, and I'm reading in
20 the paragraph that begins, when the market is
21 weak, and it's down three or four pages. It says
22 to value special purpose properties a cost
23 approach may be more appropriate and reliable.

1 Nevertheless, sales and offers for
2 properties in the same general category may be
3 analyzed to establish broad limits for the value
4 of the property being appraised which may help
5 support the findings of the other value approaches
6 applied. Do you agree with that statement?

7 A. (By Mr. Reilly) Well, it's the
8 statement you just asked me on, I have the same
9 answer.

10 Q. Okay, so the answer is yes?

11 A. (By Mr. Reilly) Yes, assuming the sales
12 are sufficiently comparable.

13 MR. UPTON: This is a good time for me
14 to break, and I'm hopeful I'll get the information
15 about the memo, and I'll come to that issue, and
16 then I'll be done.

17 CHAIRMAN GETZ: So let me make sure I
18 understand. The last remaining line of inquiry is
19 finishing off the questions about the long term
20 growth rate?

21 MR. UPTON: Yes.

22 CHAIRMAN GETZ: Mr. Conner?

23 MR. CONNER: I'll have redirect.

1 MR. UPTON: That's subject to getting
2 the memo. I may go back to that information.

3 CHAIRMAN GETZ: Do you have any idea
4 about the lengths of your redirect, Mr. Conner?

5 MR. CONNER: We'll finish today, I'll
6 guarantee you that. I don't think it will be more
7 than an hour.

8 CHAIRMAN GETZ: Okay. Mr. Camerino,
9 you have something about this memorandum?

10 MR. CAMERINO: We're still looking for
11 it. I just want to be clear, we're talking about
12 producing a document if it was provided to the
13 witness, not just if there happens to be an
14 internal memo on the subject, if I'm correct.

15 CHAIRMAN GETZ: That's my
16 understanding. It goes to the issue of how it
17 formed the witness' opinion.

18 MR. CAMERINO: That's what I'm trying
19 to find out from Mr. Donovan.

20 MR. UPTON: What the witness says was
21 that he received a memo, and he's either right or
22 he's wrong. He can't have -- you know, he can't
23 have it both ways. He either received it or he

1 didn't.

2 MR. CONNER: We understand.

3 MR. UPTON: And if he didn't, I want to
4 know that, and I want to know how he formed his
5 judgment.

6 MR. CONNER: We'll provide that
7 information.

8 CHAIRMAN GETZ: Let's take the lunch
9 recess, and we'll return at 1:45.

10 (Recess taken.)

11 CHAIRMAN GETZ: Okay, we're back on the
12 record, and, Mr. Upton, you have a couple of items
13 you wanted to address, but I see Mr. Conner --

14 MR. CONNER: Mr. Chairman, your Honor,
15 just if I could ask your indulgence, could I
16 question the rest of the afternoon without my
17 jacket on? I had a bee sting and had a reaction
18 and I'm on some medication, and it's a little
19 warm.

20 CHAIRMAN GETZ: Well, in light of the
21 bee sting.

22 MR. CONNER: I appreciate it. I look
23 like I've been in a fight, too, but it's not the

1 case.

2 MR. CAMERINO: Do you want to cover the
3 issue of that memo we were discussing this morning
4 now or later?

5 CHAIRMAN GETZ: Well, Mr. Upton, you
6 had two areas, one you wanted to follow up your
7 own on the long term growth rate, and the other
8 was the issue of the memo.

9 MR. UPTON: I'd like to have him put
10 whatever the status of the memo is on the record.

11 CHAIRMAN GETZ: Mr. Camerino?

12 MR. CAMERINO: We were able to locate
13 Mr. Donovan, or he located us, not directly, left
14 a message. First of all, he indicated that he had
15 not provided any documents to Mr. Reilly, and my
16 understanding is, in fact, that Mr. Reilly's
17 entire file has been produced to Nashua in this
18 case, and that would explain why that isn't in
19 there.

20 He did indicate that he had a
21 conversation with him --

22 CHAIRMAN GETZ: He being Mr. Donovan?

23 MR. CAMERINO: Mr. Donovan had a

1 conversation with Mr. Reilly, and we were able to
2 locate some internal e-mails that reflected the
3 substance of the information that was conveyed,
4 that's what I can indicate for the commission and
5 I've provided this for Mr. Upton.

6 What they discussed was that the
7 potential governmental buyers would be, obviously,
8 Nashua. Any other town where Pennichuck Water
9 Works provides service, any village district,
10 similarly where Pennichuck Water Works provides
11 service, all of those could, by consensually or
12 exercise eminent domain under RSA 38.

13 In addition, the current regional water
14 district, any new water district that was formed
15 or any other intermunicipal special district
16 formed pursuant to RSA 52A all can buy on a
17 consensual basis.

18 The state of New Hampshire could
19 acquire the utility, the United States Government
20 could acquire the utility, or any out of state or
21 bi-state governmental body.

22 CHAIRMAN GETZ: Thank you. Is there
23 anything further on that issue?

1 MR. UPTON: No. I appreciate
2 Mr. Camerino tracking that down for me. So, is it
3 okay for me to start my cross again?

4 CHAIRMAN GETZ: Please.

5 BY MR. UPTON:

6 Q. So, Mr. Reilly, you stand corrected
7 that there was not a memo?

8 A. (By Mr. Reilly) That's correct. I
9 think I said in my deposition, although I could be
10 wrong, I thought there was a memo, and there may
11 have been a memo -- what I understood is there may
12 have been from Mr. Donovan a memo to the file which
13 apparently he never sent it to me, which is why
14 it's not in my work papers that I provided to you.

15 Q. And is your understanding similar to
16 what Mr. Camerino just said to the commission?

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

18 Q. Okay, I want to go back to the concept
19 of long-term growth. And what we were talking
20 about when I couldn't find what I needed to find
21 in your deposition was this notion of revenues,
22 costs and expenses and cash flow.

23 Now, I want to make sure that I don't

1 either misrepresent what you said or that I don't
2 state it improperly myself. I thought what you
3 were saying when we ended was that to get to cash
4 flow, start with revenues, deduct costs and
5 expenses, add back in depreciation, and deduct
6 capital expenditures?

7 A. (By Mr. Reilly) That's exactly correct.

8 Q. And that will get you your net cash
9 flow, is that right?

10 A. (By Mr. Reilly) Yes, that's exactly
11 right.

12 Q. I'm not an economist, and I got my
13 first Dartmouth letter at Dartmouth in economics.

14 Now, in this case as I understand it,
15 what you've said, and what you told me in your
16 deposition was when I was asking about this, you
17 indicated that because you don't know exactly how
18 much is going to be in either depreciation or
19 capital expenditures, you assumed, going forward,
20 that capital expenditures would equal the
21 depreciation?

22 A. (By Mr. Reilly) Well, not exactly. I
23 think I can clarify that. That's kind of what you

1 asked me before. That is not true for the discrete
2 projection period. For the years 2005, 6, 7, 8 and
3 9 we have the company's projections, so we know
4 exactly what depreciation will be and what capital
5 expenditures will be, and they will be unequal.
6 But there is no projection for the year 2010 and
7 going forward.

8 So in the terminal value and only in
9 the terminal value, which is the year 2010 going
10 forward, we make -- I make a simplifying assumption
11 that depreciation expense equals capital
12 expenditures.

13 Q. I think we've been talking over each
14 other, because that's just what I was going to
15 show you in your deposition.

16 On page 26 you said, we don't know
17 exactly how much it's going to be because we don't
18 know exactly what the capital expenditures will be
19 in 2010. My assumption going forward, though, is
20 that capital expenditures will equal depreciation.

21 A. (By Mr. Reilly) That's right. But
22 that's not true for the entire model.

23 Q. It's the going forward, it's the

1 projected period?

2 A. (By Mr. Reilly) It's the 2010 and going
3 forward.

4 Q. Yes. And it's that that you use to
5 calculate the value, isn't it? That's what you're
6 performing your discounted cash flow analysis on,
7 that period?

8 A. (By Mr. Reilly) Well, no, that's not
9 correct. The discounted cash flow analysis is the
10 present value of six columns. The six columns or
11 the 2005, 6, 7, 8, 9, 10, so you're looking at one
12 of six columns. Five of six columns have a
13 discrete depreciation expense number and a discrete
14 capital expenditure number.

15 Q. Right. And what you did is you
16 normalized the first non -- 2010 in order to
17 create that period going forward?

18 A. (By Mr. Reilly) In order to create the
19 period of 2010 and going forward, yes.

20 Q. All right. And just to show what we
21 did with the -- to show how you showed for me the
22 netting out of capital and depreciation, you
23 actually wrote on your Exhibit 21, didn't you --

1 and that's a confidential document, so don't say
2 what the figures are -- but you netted it out,
3 right?

4 A. (By Mr. Reilly) Yes, in the year 2010.

5 Q. And that's Exhibit 21 --

6 A. (By Mr. Reilly) To my appraisal report
7 as of December 31, 2004.

8 Q. Now, do you agree that changes in the
9 projected growth rate when you do a valuation like
10 this, even though seemingly small, can have a big
11 impact?

12 A. (By Mr. Reilly) Yes, I agree with that.

13 Q. And in this case your 2 percent growth
14 rate actually represents 40 percent of your
15 discount rate of 5 percent, right?

16 A. (By Mr. Reilly) That's correct, yes.

17 Q. And as a result, that means 40 percent
18 of your value conclusion is being generated by the
19 use of this growth rate?

20 A. (By Mr. Reilly) Well, not really. It's
21 40 percent of the terminal value conclusion, not
22 40 percent of the overall value conclusion.

23 Q. What is the terminal value?

1 A. (By Mr. Reilly) The terminal value is
2 year 2010 and going forward.

3 Q. And what did you determine the terminal
4 value was?

5 A. (By Mr. Reilly) The future value of the
6 terminal value was 302 million and the present
7 value of the terminal value is 242 million.

8 Q. So doesn't the 2 percent growth rate
9 equal 40 percent of each of those?

10 A. (By Mr. Reilly) Yes, but it doesn't
11 affect -- my point is it doesn't affect years 2005,
12 6, 7, 8 and 9.

13 Q. Well, would you agree that of your
14 value of 273.4 million, 40 percent of that is
15 represented by the 2 percent growth rate?

16 A. (By Mr. Reilly) I see the point you're
17 trying to make. I wouldn't say it that way, but it
18 is true the first five years of the projection are
19 essentially a wash. They don't add value and they
20 don't detract value.

21 So since the terminal value is so
22 important to the overall conclusion, it is true
23 that the terminal value growth rate has a

1 disproportionate effect on the overall value.

2 Q. And if it's 40 percent of that
3 273 million, would you agree that that's
4 approximately 109 million, is represented by the
5 growth rate?

6 A. (By Mr. Reilly) It's 40 percent of the
7 242 million. I can calculate that out.

8 Q. Okay.

9 A. (By Mr. Reilly) It's about 97 million.

10 Q. So if there was not growth rate or not
11 growth and you didn't use a growth rate, you would
12 subtract that from your 273 million?

13 A. (By Mr. Reilly) Not really. It's not
14 that simple of a cal -- it would have a significant
15 effect. It's not that simple of a calculation
16 because the present value is a compounding effect,
17 it's not a linear effect. So I'd need to compute
18 it to make that calculation, but it would have a
19 big impact.

20 Q. Do you agree that a key driver of
21 growth is -- a growth in long term earnings is
22 plant additions?

23 A. (By Mr. Reilly) Well, as I mentioned

1 before, there are really three factors, one is rate
2 base, one is rate of return, and the other is
3 revenues and expenses. So plant additions affect
4 the first factor, rate base.

5 Q. So the answer is yes, but with that
6 explanation?

7 A. (By Mr. Reilly) Yes, but it's only --
8 it only affects one of three factors, it's not --
9 it's not the big factor.

10 Q. Well, plant additions increase rate
11 base, don't they?

12 A. (By Mr. Reilly) Yes, but they don't
13 affect rate of return, and they don't directly
14 affect revenues or expenses.

15 Q. But without plant additions there can't
16 be a growth in earnings, can there?

17 A. (By Mr. Reilly) Sure there can.

18 Q. If, as you say, there's inflation that
19 exceeds expenses -- or revenues, I'm sorry.

20 A. (By Mr. Reilly) Revenues exceed
21 expenses.

22 Q. All right. But what you've done here,
23 if I'm correct, is you've assumed that plant

1 additions net out depreciation?

2 A. (By Mr. Reilly) That's correct.

3 Q. Netted out by depreciation. So in your
4 analysis you have -- you have to, I think, have a
5 constant rate base, don't you?

6 A. (By Mr. Reilly) After the year 2010
7 there will be a constant rate base, but --

8 Q. But -- I'm sorry?

9 A. (By Mr. Reilly) But there still will be
10 revenues exceeding expenses, and as revenues
11 increase -- I don't mean to answer a question that
12 you haven't asked, so if I have, cut me off, feel
13 free to do that.

14 But in the formula you have up on the
15 board, if revenues increase at 2 percent and
16 expenses increase at 2 percent, then cash flow will
17 increase at 2 percent. Cash flow doesn't stay
18 constant.

19 If revenues increase at 2 percent and
20 expenses increase at 2 percent, cash flow increases
21 at 2 percent, that's the assumption of my model.

22 Q. Is the fact that rate base is staying
23 constant what you mean by no real growth?

1 A. (By Mr. Reilly) That's correct, yes.

2 Q. Now, I need to show you schedule B from
3 Mr. Guastella's testimony which is marked
4 confidential. It's 3010X, and it's schedule B to
5 that exhibit.

6 MR. UPTON: And, again, since it's
7 confidential, I'm going to provide copies to the
8 commission.

9 Q. Mr. Reilly, we have the same thing
10 again where you can't blurt out figures, and I
11 can't either.

12 For the period 2010 to 2015, would you
13 agree with me that Mr. Guastella shows actually a
14 decline in rate base?

15 A. (By Mr. Reilly) That's what this
16 appears, yes.

17 Q. And what happens to his net operating
18 income over the same period?

19 A. (By Mr. Reilly) He has a decline in net
20 operating income.

21 Q. Now, I asked Mr. Guastella about this
22 in his deposition, and I want to show you that
23 right at the top, Mr. Reilly, at line 2.

1 I asked Mr. Guastella if rate base
2 doesn't grow, doesn't it also follow that net
3 earnings are not going to grow.

4 And his response was, well, net
5 earnings are going to be a combination of rate
6 base as well as rate filings and rates of return
7 and future costs of capital -- some of the things
8 that you referred to -- but steadily -- I mean,
9 typically, all other things being equal, a
10 declining rate base would result in a declining
11 earnings, all other things being equal.

12 Do you agree with that statement?

13 A. (By Mr. Reilly) Well, yes, I do. If
14 that's your assumption that there's a declining
15 rate base, and that's what the assumption is in
16 schedule B. Again, without mentioning numbers, you
17 can see that Mr. Guastella -- assuming that's who
18 prepared this, I haven't seen this before -- but he
19 has depreciation expense increasing every year and
20 he has the rate -- the capital expenditures
21 increasing at an increasing rate.

22 My assumption is the capital
23 expenditures equal depreciation each year; his

1 assumption is that capital expenditures exceed
2 depreciation each year -- I'm sorry, his assumption
3 is that depreciation expense exceeds capital
4 expenditures each year, and therefore he has an
5 ever decreasing rate base, so he has created the
6 incredible shrinking company.

7 Q. So you and Mr. Guastella, both
8 representing Pennichuck Water Works, both doing
9 this financial work for them, don't agree on what
10 the future looks like?

11 MR. CONNER: Objection. Mr. Chairman,
12 they have not been hired to do the same thing in
13 this proceeding. Mr. Guastella was not hired to
14 do a fair market value appraisal.

15 CHAIRMAN GETZ: Well, I'm not sure that
16 that's something objectionable in itself.

17 MR. UPTON: It's another talking
18 objection, too, your Honor.

19 CHAIRMAN GETZ: I think if the witness
20 can make a distinction, he can make a distinction.

21 A. (By Mr. Reilly) Sure. All I can say --

22 MR. UPTON: I want to get an answer to
23 the question first.

1 CHAIRMAN GETZ: Well, okay.

2 BY MR. UPTON:

3 Q. Is that yes or no?

4 A. (By Mr. Reilly) I may not remember the
5 question now.

6 Q. Let me try it again.

7 A. (By Mr. Reilly) Okay.

8 Q. And let me try to state it differently
9 so that we get the right question because it's
10 only fair that you have the right question.

11 You projected -- you projected PWW
12 ownership after 2010, and if I'm reading schedule
13 B correct, this is projected operations under PWW
14 ownership, and he goes through -- and you both go
15 through 2015, correct?

16 A. (By Mr. Reilly) Well, I go beyond that.

17 Q. That's right, you go indefinitely,
18 don't you?

19 A. (By Mr. Reilly) That's correct.

20 Q. And he goes through 2015?

21 A. (By Mr. Reilly) That's correct.

22 Q. And your analysis, I gather, is
23 different from his, both doing the same thing?

1 A. (By Mr. Reilly) Well, we're not doing
2 the same thing at all. We're doing two
3 fundamentally different things.

4 Frankly, I don't know what Guastella is
5 doing. I've never seen this schedule before, I've
6 never seen Guastella's work; I don't know what his
7 objective is. But I can tell you this, my
8 projection is for a static rate base, rate base
9 being constant, which is depreciation expense
10 equalling capital expenditures.

11 Guastella's projection is for
12 depreciation expense to exceed capital
13 expenditures, so he's projecting an ever decreasing
14 rate base. But why he made that projection and
15 what his assignment is, I have no idea at all.

16 Q. Okay. Thank you.

17 CHAIRMAN GETZ: Mr. Upton, the exhibit
18 number, I didn't catch that for this.

19 MR. UPTON: It is -- I have it here, if
20 I can find the list. It's 3010 X. It's a
21 confidential document. It's the confidential
22 pages to Mr. Guastella's testimony.

23 CHAIRMAN GETZ: Yes. Thank you.

1 Q. Mr. Reilly, when I asked you about the
2 use of sales to revenue analysis and showed you --
3 showed you your book, you took issue with me
4 because a section that I pointed you to was for
5 something other than for fair market value?

6 A. (By Mr. Reilly) Yes, sir.

7 Q. Would you explain that to me?

8 A. (By Mr. Reilly) Sure. I don't have
9 that book again, but the page that you presented
10 looked like it was a section relating to
11 calculating control premiums, how much of a control
12 premium would be paid in the acquisition of a
13 publicly traded company.

14 Q. And I -- I'm sorry, go on.

15 A. (By Mr. Reilly) And in this case
16 neither party -- neither we, at Willamette, nor the
17 appraisal firm that worked for the city had
18 appraised Pennichuck with respect to publicly
19 traded companies and adding a controlled premium.
20 So neither party has calculated a controlled
21 premium in this case.

22 Q. All right. Now, but you do agree that
23 using a sale price to revenue multiple is an

1 appropriate multiple?

2 A. (By Mr. Reilly) It is one of many
3 appropriate multiples. My point was I think the
4 book says, my recollection is, that it is
5 typically -- a multiple gets a lower weighting than
6 income multiples. Income multiples typically get
7 the highest rate, asset related multiples get the
8 second highest weighting, and revenue related
9 multiples get the third highest weighting.

10 Q. So if Mr. Walker did an analysis that
11 used sales price to EBITDA, sales price to EBIT,
12 those would be more appropriate multiples to use?

13 A. (By Mr. Reilly) Yes, sir.

14 Q. You did, however, in Peoria, use a
15 sales price to revenue multiple, didn't you?

16 A. (By Mr. Reilly) Yes, but looking at the
17 report that you gave me a few moments ago, I only
18 gave that a 20 percent weighting out of a hundred
19 percent weighting.

20 MR. UPTON: Mr. Reilly, thank you for
21 your patience. I appreciate it.

22 MR. REILLY: Thank you.

23 COMMISSIONER BELOW: Yes. Thank you,

1 Mr. Chairman.

2 Mr. Reilly, on the -- in your
3 discussion of work orders in the value you placed
4 on the intangible work order database, I think at
5 one point you referred to the value being
6 estimated based on the cost to create the
7 database?

8 MR. REILLY: Yes, sir.

9 COMMISSIONER BELOW: Was the value you
10 placed on it based on an estimate of the cost to
11 actually create it or the cost to recreate it if
12 didn't exist?

13 MR. REILLY: You're actually correct,
14 it's the cost to recreate it. What I did was sit
15 down with management and the actual people who
16 fill out the work order -- the work orders
17 themselves are manual pieces of paper that are
18 filled out manually, and we counted the number of
19 work orders that are in existence.

20 And I'll find it in here, I think it
21 was 34,000 that were in place on the valuation
22 date. And we actually timed -- and there were
23 several people who were involved in filling out

1 these work orders, some operations people, some
2 engineering people, some accounting people.

3 We actually timed how long does it take
4 for you to fill out these work orders for a
5 completed project, and we came up with -- I forget
6 the number, but it's in my report -- an hour and a
7 half, something like that. And then we estimated
8 the average time of -- of all those people what's
9 the average salaries we pay those people, the
10 average benefits we pay those people.

11 So it really would be the cost as of
12 the end of 2004 if all of that database -- which
13 includes the information in the computer and the
14 information on the manual work orders, but not the
15 software itself -- if the information disappeared
16 on December 31, 2004 and starting on January 1st,
17 2005 the company started scrambling to refill out
18 those work orders so everyone knew what they had
19 to do on January 1st, 2005, it's how much -- how
20 much would it cost the company in 2005 dollars to
21 recreate that database.

22 COMMISSIONER BELOW: And did the value
23 include both the value in electronic form or paper

1 form or just one or the other?

2 MR. REILLY: It included the value both
3 in the paper form -- again, I think there's an
4 exhibit in my report -- the actual pieces of paper
5 that got filled out, and it includes the cost --
6 which is a relatively small component -- but
7 there's a cost of -- I think they're actually all
8 ladies, I don't mean to be sexist about it -- who
9 then take the manual work orders and keypunch them
10 into the computer.

11 But all I'm looking for in that cost is
12 the cost to get it into the computer. It's not
13 the cost of the software that then generates
14 reports based on that, it's just the cost to get
15 the information into the computer for whatever
16 software program is used.

17 COMMISSIONER BELOW: How many work
18 orders did you examine?

19 MR. REILLY: We looked at -- I'd have
20 to say it wasn't thousands, but it was hundreds.
21 I mean, all told, there was something like
22 43,000 -- I'll give you an exact number as soon as
23 I find it. There's several tens of thousands of

1 work orders outstanding. Here it is, 67,800.

2 In terms of sampling the work orders,
3 my colleagues and I at Willamette may have looked
4 at a few hundred; we didn't look at thousands.
5 But we spent -- not weeks, but the better part of
6 a week, two or three of us just looking at work
7 orders.

8 COMMISSIONER BELOW: And were those
9 complete? Did they have all the fields filled in,
10 in contrast to the audit findings you found fields
11 that had inaccurate or incomplete numbers?

12 MR. REILLY: I believe, if I -- my
13 reconciliation of the work orders that I saw and
14 the database I saw to the audit findings I've seen
15 for the first time today is I believe the
16 information on the work order forms is complete --
17 I'm sure of that, looking at the form. The
18 information that gets key punched into the
19 computer is complete.

20 What happens is then that database goes
21 through the Synergen software, which you might
22 think of like Word or Excel or any other
23 commercial software package. The reports that

1 come out don't seem to have the right data in the
2 right fields on the reports that come out. But I
3 believe the data is in the computer someplace.

4 It's not a data problem, it's a
5 creation of reports from the Synergen software
6 that's the problem.

7 COMMISSIONER BELOW: You're
8 hypothesizing this; you don't know that to be the
9 case?

10 MR. REILLY: That's exactly right,
11 because we never looked -- once we got the data
12 into the computer, we never valued the software or
13 looked at the reports that come out of the
14 computer.

15 COMMISSIONER BELOW: Okay. On page 40
16 of your appraisal, Exhibit 3007A, you list
17 differences that -- among others, that would be
18 factors which you say would render the
19 transactions -- the guideline transactions a
20 little useless indicators of fair market value.

21 The second one of those says that the
22 acquired companies operate in different regulatory
23 environments than Pennichuck. Could you elaborate

1 on what you mean by that statement?

2 MR. REILLY: Surely. In some of the
3 states -- and just because we've appraised a lot
4 of water companies in a lot of different states --
5 and you all, in your jobs may be more familiar
6 with this than I am -- in some states the water
7 utility companies can go -- and do, they schedule
8 these years in advance.

9 They come in for a rate case every
10 year. They'll schedule, I'll say, every November
11 or every July, they'll come in for a rate case.
12 In some states it may be two or three or four
13 years before the water companies come in for a
14 rate case.

15 In some cases you can only come in for
16 a rate case if there's, you know, a material
17 increase in the rate base, or a material increase
18 in your operating expenses, it can't be a
19 minimum -- you know, de minimis increase in rate
20 base or a de minimis increase in operating
21 expenses.

22 So the point I was trying to make is
23 simply in some states the rate increase -- the

1 regulatory process is -- I don't mean to offend
2 you by this -- but may be more water company
3 friendly, and in some states it's a little bit
4 more rigorous where you have to wait until certain
5 events occur before you can come in for a rate
6 case.

7 And that's going to make a big
8 difference in the profitability of a company
9 whether they can come in every year, even if they
10 only have \$50,000 of rate base increase, or
11 whether they have to come in every four or five
12 years when they have \$5 million of rate base
13 increase.

14 COMMISSIONER BELOW: So you're saying
15 the regulatory environment could affect the
16 profitability of the utility, and that would in
17 turn affect the fair market value?

18 MR. REILLY: Yes, exactly. And you can
19 see that, for example, not only in our discounted
20 cash flow analysis, but in any acquisition
21 discounted cash flow analysis where the buyer has
22 to project, you know, first what capital
23 expenditures am I going to make and when am I

1 going to make them, when do they get into rate
2 base, and what's going to be my increase in
3 revenue associated with that.

4 Do I think I can get those capital
5 expenditures into rate base and into rates the
6 same year, or is there going to be a two or three
7 year lag. And if you're doing a five or ten year
8 projection, you know, that -- having increases in
9 rates every year versus a step increase in rates
10 every three years can make a big impact on a
11 discounted cash flow analysis.

12 COMMISSIONER BELOW: Did you use any
13 kind of analysis of different regulatory
14 environments of different states in your
15 evaluation of the guideline transactions?

16 MR. REILLY: No, I tried to do that. I
17 really tried to make these 12 fit. I mean, I
18 didn't include all the schedules and exhibits that
19 I ran because I couldn't rely on them, but I tried
20 to make adjustments for size. I tried to make
21 adjustments for different -- you know, how quickly
22 we can get regulatory rates through. I tried to
23 make adjustments for geography. I tried to make a

1 lot of adjustments.

2 The problem with my conclusion was --
3 you know, which is almost like an appraisal of
4 real estate. When you have so many adjustments
5 that are hard to quantify, it just becomes
6 unreliable.

7 If I'm going to compare an 80-year-old
8 six bedroom house to a six-year-old three bedroom
9 house and I have to start making all those
10 adjustments, you know, at that point it's just not
11 a good comparable.

12 COMMISSIONER BELOW: On page 41 of your
13 appraisal -- maybe somebody could put this up on
14 the screen -- in the middle of the page, one of
15 the transactions you looked at was one called
16 Heater Utilities.

17 MR. REILLY: Yes, sir.

18 COMMISSIONER BELOW: And perhaps you
19 could just look over those three paragraphs and
20 characterize why you considered that not to be a
21 comparable.

22 MR. REILLY: Well, the biggest problem
23 here -- I mean, the smaller problem is simply the

1 location, it's in the south -- you know, southeast
2 versus the northeast, North Carolina versus, you
3 know, the northeast where we're located here.

4 The biggest problem, which is really a
5 difficult problem to adjust for, and I think there
6 was some testimony about this last week, is that
7 Heater includes both water and wastewater
8 operations.

9 Now, even though the wastewater is only
10 three and a half million dollars out of
11 \$17 million of revenues -- I'm sure you all know
12 this -- once you have a wastewater system as part
13 of the water system, the whole type of assets
14 change. You have a whole wastewater treatment
15 plant that you don't have in a water delivery
16 system.

17 There are all types of permitting
18 issues, there are all types of environmental
19 concern issues, you need a whole additional set of
20 engineers that you didn't have before, and you
21 have to -- you have the whole rate base issue of
22 having not just a water treatment plant but of a
23 wastewater treatment plant.

1 It just makes the multiples -- you
2 know, whenever I have tried to use water and
3 wastewater together, the multiples are just
4 different from water/wastewater companies as
5 opposed to water companies.

6 COMMISSIONER BELOW: What portion of
7 the revenue in this transaction comes from
8 wastewater versus water?

9 MR. REILLY: Sure. You can see that in
10 the second paragraph in this section that
11 Heater -- that their total revenue is 17 million,
12 the wastewater part is three and a half million
13 dollars. So that's only -- what is that,
14 20 percent or so, but it's not -- it is part of
15 the impact on revenue; the biggest part is the
16 impact on the assets.

17 You just have a whole additional set of
18 fixed assets in a wastewater treatment plant that
19 you don't have in a water treatment plant.

20 COMMISSIONER BELOW: Is wastewater
21 regulated substantially different from water in
22 terms of rate base and rate setting, things like
23 that?

1 MR. REILLY: No, the rate making
2 process is almost identical, in my experience.
3 The problem because, typically -- and this is
4 almost a classic situation -- if you have an
5 acquisition target that's about 50 percent -- the
6 revenue is about 50 percent water and 50 percent
7 wastewater, then -- then that's -- sometimes you
8 use that transaction and bring it across and apply
9 it to a water company.

10 When you have a case where water is 75,
11 80 percent of the revenues, and wastewater is 20,
12 25 percent of the revenues, that company is -- I
13 can promise you this, is going to show really low
14 profitability, because a relatively small
15 percentage of their revenue has to absorb this big
16 rate base which is this big wastewater treatment
17 plant they have got someplace, which has not only
18 this big fixed asset, it has all the distribution
19 going to the wastewater plant, it has the
20 wastewater plant, it has the licensed engineers,
21 it has all the permitting requirements, and that's
22 going to have to be absorbed by \$3.4 million of
23 revenue, so it usually bring the profitability of

1 the combined system way down.

2 COMMISSIONER BELOW: You've testified
3 that rate base of utility has little logical
4 relation to its fair market value, is that
5 correct?

6 MR. REILLY: Yes, sir.

7 COMMISSIONER BELOW: And you further
8 stated in your appraisal that rate base, to
9 paraphrase, is completely unrelated to the current
10 fair market value.

11 MR. REILLY: Yes, sir.

12 COMMISSIONER BELOW: And yet you also
13 state in your appraisal in looking at the income
14 approach to value indicated, that it's a factor in
15 enabling an acquirer to evaluate whether or not
16 the acquirer can earn a fair rate of return on the
17 acquisition price, is that correct?

18 MR. REILLY: Yes.

19 COMMISSIONER BELOW: Is the fair rate
20 of return on the acquisition price related to what
21 would be allowed as a fair rate of return on the
22 rate base?

23 MR. REILLY: Indirectly. And by

1 indirectly I just mean in order to project out
2 income, in an income approach analysis for a water
3 utility, or any regulated utility, we -- basically
4 we start with the rate base.

5 We project out what will be the rate
6 base each year over the next five or ten years,
7 however many years we're projecting out. You
8 project what's going to be the allowed rate of
9 return each year, what's going to be the operating
10 expenses, what's going to be the revenue.

11 Then we go back and subtract the
12 operating expenses and get the income, make
13 adjustments for depreciation and capital
14 expenditures.

15 So we do need a projection of the rate
16 base in order to get the income we need to project
17 out at the present value back, so it's a component
18 of the income approach.

19 My point is, though, that the
20 conclusion you get from either an income approach
21 or a cost approach or a sales comparison approach,
22 for every water and wastewater -- but we can
23 ignore wastewater -- for every waste -- water

1 company I've seen for the last 30 years, they
2 always traded multiples of rate base.

3 Now, depending on the transactions we
4 can disagree whether that's three times rate base,
5 or four times rate base, or two and a half rate
6 base, but the transactions are always at -- not at
7 rate base or even close to rate base, they're
8 multiples of rate base, because rate base is based
9 on historical cost less depreciation.

10 And what buyers would look at is
11 replacement cost less depreciation. And
12 particularly for an old system like Pennichuck,
13 replacement cost is just many, many times
14 historical cost, and that's why the rate base just
15 doesn't give you any good indication of values
16 standing on its own.

17 COMMISSIONER BELOW: Can a regulated
18 utility earn in regulated revenues earnings on
19 assets that aren't used or useful?

20 MR. REILLY: No. My understanding is
21 no. I've never seen a utility client be allowed
22 to earn a return on assets that are not used or
23 useful.

1 COMMISSIONER BELOW: Isn't the rate
2 base the universe of what's valued as used and
3 useful?

4 MR. REILLY: Not necessarily.
5 Honestly, you all may do things differently in
6 New Hampshire, and you do what's the right thing
7 to do, I'm sure, here.

8 And in many states, I will say this --
9 it wouldn't be unique -- many states require that
10 companies bring over the carryover rate base.
11 Even if they pay three or four times rate base as
12 the purchase price, they only get to earn on the
13 carryover rate base.

14 Many states, however, allow an
15 acquisition adjustment in a rate base. It's not
16 guaranteed, and it's not always a hundred percent
17 of a premium.

18 So if a company pays three and a half
19 times rate base, they don't always get the
20 adjustment of three and a half times rate base,
21 but they often, depending on the state, get an
22 adjustment to rate based for a purchase price
23 premium so the rate base increases the year after

1 the acquisition based on a rate case, and then
2 that becomes the new rate base that goes forward
3 after that.

4 COMMISSIONER BELOW: So for purposes of
5 this valuation, did you assume whether there could
6 be earnings on the acquisition premium or not?

7 MR. REILLY: No, I assumed no earnings
8 on the acquisition premium. For my revenue
9 projection I assumed the carryover rate base.

10 COMMISSIONER BELOW: So if there's no
11 earnings on acquisition premium, the earnings can
12 only be on rate base, isn't there a relationship,
13 a connection between the rate base and the fair
14 market value?

15 MR. REILLY: There would be if -- if
16 the buyer only wants to earn an allowed rate of
17 return. In other words, this is a -- a formula
18 that is just a tautology.

19 If you start with a rate base and
20 multiply that by the allowed rate of return and
21 get to the amount of income you're going to earn
22 in that rate base and then capitalize that, the
23 allowed rate of return, you'll get back to the

1 rate base; mathematically that's a certainty.

2 If you do, what I've done in this
3 case -- and which I believe acquirers, not just
4 municipal acquirers but IOU acquirers that we've
5 worked for do -- which is to say here's the rate
6 base I'm starting with, here's the rate base I'll
7 carry over.

8 I'm going to assume two things. I'm
9 going to assume that I'm going to have some
10 operating expense decreases in the future, either
11 because I'm a municipal buyer and I don't have to
12 pay income taxes or I can have lower interest
13 expense or whatever, or I'm an IOU buyer and I can
14 share corporate overhead among many systems that I
15 own; I have one superintendent who can supervise
16 six systems instead of one system, and the
17 regulators -- you all, Public Utility
18 Commission -- will allow me to keep some of that
19 increased profitability, that's a reason to pay
20 more than rate base.

21 The other reason to pay more than rate
22 base is if you believe, as I do, in this
23 appraisal, that you may allow currently Pennichuck

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

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

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,

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

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

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

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?

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

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

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

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,

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.

1 And we're trying to appraise a big
2 house and we're trying to appraise a house that
3 has six bedrooms, six bathrooms, it's a 10,000
4 square foot house, just a big house, and you think
5 a real big family is going to buy that house.

6 And if there are ten buyers come
7 through the house on the Sunday and, you know,
8 eight or ten buyers are either young couples with
9 no children, or retired couples with no children,
10 but one or two of the buyers are couples that have
11 six children, they're going to set the market
12 price.

13 Because they are going to look at the
14 house and say that's just what we need, we need a
15 house with six bedrooms and six bathrooms, they're
16 going to set the market price. And if the couples
17 with no children want to buy the house, they're
18 going to have to outbid the family with the big
19 family.

20 CHAIRMAN GETZ: A couple of other
21 areas. I want to turn to some issues that
22 Mr. Boutin started with early this morning about
23 standards that are set out in the USPAP. And I

1 guess what I'm looking at is generally what I'm
2 thinking of is independence, and I think some of
3 the language from the USPAP is about preconceived
4 notions and predetermined results. And then you
5 followed up, there was discussion between you and
6 Mr. Upton, and I want to make sure I have this
7 understanding clear.

8 Basically it seemed to me you had said
9 in the later conversation with Mr. Upton you
10 don't -- you as an appraiser don't need to come to
11 the -- to the job as a complete blank slate. You
12 could have some general knowledge or even some
13 specific knowledge about the specific property or
14 assets you're going to appraise.

15 MR. REILLY: Well, I would agree with
16 that. In fact, I would hope so. I would hope if
17 an astute client hired an astute appraiser, that
18 appraiser would say I've done ten jobs just like
19 this in the last three years. I've got a work
20 program, I know exactly what I'm going to do, I
21 know what multiples are in this industry, I know
22 what discount rates are, I know what CAP rates
23 are, and there's absolutely nothing wrong with

1 that.

2 The USPAP problem is before you get
3 hired you can't say to -- the couple who's buying
4 this house, you can't say, oh, I've appraised a
5 lot of houses in this neighborhood, I'm going to
6 appraise your house \$300,000, and then have the
7 couple say, great, that's what I need, I need a
8 \$300,000 appraisal to qualify for a mortgage, I'm
9 going to hire you to do my appraisal. You can't
10 give the client --

11 CHAIRMAN GETZ: That's what I'm trying
12 to get to, is what in your mind the range of
13 acceptable types of statements.

14 I mean, I think you -- in response to
15 Mr. Upton earlier you had said, you know, if the
16 appraiser had said, yes, I appraised this property
17 in the past in '95 and '98 and these were the
18 results.

19 But in the instance of your
20 hypothetical here about homes, would it be
21 acceptable for the appraiser to say, every other
22 house on the block that looks just like this has
23 been appraised at \$300,000. I'm not seeing

1 anything at the moment why yours wouldn't be in
2 the same neighborhood?

3 MR. REILLY: Well, I think I'd agree
4 with sentence one, I don't know -- I think I may
5 have a problem with sentence two. USPAP -- this
6 is one area where USPAP I think is pretty clear,
7 it's not a judgment, where the appraiser can state
8 the facts.

9 The appraiser can say, I've appraised
10 your house for the last three families who lived
11 here, and I've appraised it at this date, this
12 date, and this date for these numbers. I've
13 appraised every other house in this neighborhood.
14 Every other house in this neighborhood has sold in
15 the last two years and here are the selling
16 prices.

17 You can state the facts, but once you
18 give an opinion, and I think your house could sell
19 in the midpoint or in the upper quartile or would
20 be at the top of the range or would be whatever,
21 once you give an opinion, USPAP says you can't do
22 that.

23 You can't give an opinion. You can

1 give the facts -- kind of like in the old Jack
2 Webb Dragnet series -- you can give the facts, but
3 once you give an opinion and I think your house
4 could sell for \$300,000, then you've issued an
5 appraisal, and you can't do that before you
6 perform the appraisal.

7 CHAIRMAN GETZ: Now, I think there were
8 some related issues that Mr. Boutin raised
9 about -- related to this issue of advocacy I'm
10 trying to understand. He -- Mr. Boutin -- used --
11 I think at one point referred you to what I call
12 the contract between Mr. Sansoucy and his company
13 and the -- and the city and then asked you
14 questions using the device of a hypothetical that
15 had some strikingly similar facts to this case.
16 Now -- and you answered those questions based on
17 the hypothetical.

18 If rather than using a hypothetical he
19 had come -- he had asked you about the --
20 specifically about the ethical question of
21 advocacy and independence with respect to the
22 Sansoucy firm, would that be a problem for you
23 because of the advocacy issue?

1 MR. REILLY: Well, the concern -- and I
2 don't know everything that the Sansoucy firm has
3 done for the city in the last several years. I
4 was here in the courtroom last Tuesday when
5 Mr. Sansoucy testified, and I've seen his reports
6 and some other interrogatory answers, if that's
7 what they're called.

8 My concern is not that the Sansoucy
9 firm has performed certain litigation support type
10 services and representation and agency type
11 services, and it's not that they performed an
12 appraisal. Under USPAP, I think it's absolutely,
13 positively appropriate to do either one, and USPAP
14 clearly covers appraisals and clearly doesn't
15 cover advocacy work.

16 The problem that I have, because I
17 think it's the problem -- and it's much as my
18 opinion. In my opinion, the problem that USPAP
19 has, is when an individual such as Mr. Sansoucy
20 for the same client is performing advocacy
21 services on Monday, and then on Tuesday signs a
22 report as an independent appraisal, my opinion,
23 USPAP just doesn't allow that.

1 Because then you're -- you're wearing
2 both hats for the same clients as opposed to
3 wearing two different hats for two different
4 clients.

5 CHAIRMAN GETZ: Well, I guess this is a
6 recurring theme in this case, is the definition of
7 terms and varying relative uses of -- or precision
8 of language used by -- by the parties, but I'm
9 still a little stuck on advocacy.

10 And I took it -- I think there was a
11 distinction earlier made by Mr. Walker that I
12 believe is set forth in USPAP and which you have
13 used that it's permissible to advocate for the
14 result.

15 MR. REILLY: Absolutely.

16 CHAIRMAN GETZ: That you can defend
17 your appraisal as you're doing here, as Mr. Walker
18 earlier did. So that's -- that's not considered
19 advocacy when you're defending your appraisal.

20 MR. REILLY: Absolutely. And I think
21 USPAP would say that's expected, that you're going
22 to defend your appraisal as rigorously as you
23 possibly can.

1 CHAIRMAN GETZ: If I look at -- I'm
2 trying to understand where your statements in
3 Exhibit 3017 kind of fall in this spectrum. And
4 it's your testimony of May 22nd, page 3, and I'm
5 looking at the -- for the most part that answer on
6 lines 13 to 18. Have you had a chance to --

7 MR. REILLY: Sure.

8 CHAIRMAN GETZ: Just take a chance to
9 read that, and I want to ask you a question.

10 MR. REILLY: I've looked at it.

11 CHAIRMAN GETZ: It seems to be a pretty
12 definitive statement about the appraisal conducted
13 by Mr. Sansoucy. So in your mind this isn't
14 something that falls under the -- or in your mind
15 or your interpretation of USPAP, this doesn't fall
16 under the category of advocacy?

17 MR. REILLY: I don't -- I think this
18 falls under the unpermitted advocacy and not the
19 permitted advocacy. And, again, it's nothing more
20 than my interpretation or opinion, so I'm not --

21 CHAIRMAN GETZ: Wait. What I'm asking
22 for, is this permitted or unpermitted advocacy by
23 you to be making these definitive statements about

1 Mr. Sansoucy?

2 MR. REILLY: Oh, I don't think I'm
3 being an advocate here, I think I'm just giving my
4 opinion. My opinion is that based on the
5 statement that Mr. Sansoucy gave, that he
6 shouldn't have made that statement.

7 And, again, I have no problem with
8 Mr. Sansoucy performing an appraisal. I have no
9 problem if he had said to his client, I will give
10 you fair market value with perfect precision and
11 perfect accuracy, it will just be absolutely,
12 positively fair market value. The problem that I
13 have is the implication here that he's saying, I
14 will give you --

15 CHAIRMAN GETZ: Well, that's getting
16 back to the substance of it, I want to follow up a
17 little on that. I'm just trying to get a feel for
18 what is advocacy --

19 MR. REILLY: Sure.

20 CHAIRMAN GETZ: -- with respect to
21 USPAP. Okay, then, let's turn to now the
22 substance of the statements.

23 You've drawn this conclusion,

1 especially in lines 16 through 18, that
2 Mr. Sansoucy's goal was to conclude a value for
3 the PWW assets that would allow the city of Nashua
4 to purchase the system without raising rates. And
5 you base this on materials that you mention in
6 line 13 which include the transcripts of the
7 statements that were made at the board of
8 aldermen.

9 Is it your opinion that those
10 statements are susceptible only to one
11 interpretation, or as we've seen -- you haven't
12 been here through all of this -- but seen the
13 characterization of them as -- as meaning
14 something else.

15 One example would be rather than saying
16 that this -- there's going to be a value that will
17 be provided to you that will result in no increase
18 in rates or that -- or at least one alternative
19 characterization that would have been if you get a
20 value of this amount that would result in rates,
21 then you shouldn't do the deal. Now, that's a
22 long, complex question.

23 MR. REILLY: No, I understand.

1 CHAIRMAN GETZ: I usually get away with
2 it because I'm the chair.

3 MR. CONNER: No objection, your Honor.

4 CHAIRMAN GETZ: But you understand --

5 MR. REILLY: Oh, I understand.

6 CHAIRMAN GETZ: I would like to know if
7 you believe his statements are susceptible to more
8 than one interpretation, or you think they're so
9 clear that your conclusion here is the only
10 defensible one.

11 MR. REILLY: Well, I feel comfortable
12 in my conclusion, but I would recommend this --
13 and I wasn't here for the entire proceeding last
14 week. If you believe -- meaning the commission
15 believes -- what Mr. Sansoucy meant to say or was
16 really saying is if you have to pay more than X
17 million dollars then rates will go up and then you
18 shouldn't do the deal, I don't have a problem with
19 that. I don't think that's USPAP violation at
20 all, that's just good business advice.

21 If you go to buy the house and the
22 seller won't sell for more than -- for under a
23 million dollars, don't buy the house, you can't

1 afford the mortgage.

2 That's not what I interpret him -- my
3 interpretation was that he was saying I will give
4 you an appraisal that will be low enough to insure
5 that your rates will not increase, and I think
6 that's just a clear USPAP violation.

7 So I think you all have to decide what
8 did he mean when he said that, and did he mean --
9 you know, that's the interpretation part. I'm
10 just reading the words in a statement. I could
11 not get into his head because I wasn't there when
12 he -- when he made the statement.

13 COMMISSIONER BELOW: The chair sort of
14 caused me to wonder about something else. Sort of
15 jumping back to sort of the nonprofit or municipal
16 bidder.

17 On page 17 of your testimony,
18 Exhibit 3007, you made a conclusion about the
19 advantages or synergies that a nonprofit might
20 have relative to for profit and how that might
21 impact fair market value, and you kind of
22 concluded on line 13 and 14 as a result the
23 municipal buyer generally can pay more for the

1 system than the private entity purchaser.

2 MR. REILLY: Yes, sir.

3 COMMISSIONER BELOW: And then you
4 observe that that presence of nonprofit purchasers
5 and the attendant synergies would tend to drive up
6 the price when they enter bidding. And then you
7 observe that other -- other buyers in the
8 population would have to outbid those nonprofits
9 to win.

10 If all the other bidders were ones sort
11 of driven by economic investment determinations;
12 i.e., they had no sort of other special value to
13 them other than its value as an investment, and
14 none of them had any particular synergies that
15 were stronger than the nonprofit, they would tend
16 to fall out of the bidding, is that correct?

17 MR. REILLY: Absolutely.

18 COMMISSIONER BELOW: If the universe of
19 potential willing buyers only included one
20 possible nonprofit entity for a number of for
21 profit entities, would that have a slightly
22 different effect than if there were multiple
23 nonprofit bidders?

1 MR. REILLY: It may. That hypothetical
2 is the hardest question to answer. I think it's
3 easy to ask the question assume no not for profits
4 in this area, or assume a number -- a couple, and
5 we just need a couple.

6 If you assume one, there's uncertainty,
7 and it really becomes a bidding contest -- it
8 becomes more of an issue of psychology than
9 economics, will the for profits assume the not for
10 profits are going to put all the chips on the
11 table at one time and they'll have to bid up
12 against the not for profit.

13 We've seen cases where that happens,
14 where just having one not for profit can increase
15 the bidding, but we've also seen cases where that
16 didn't happen, where the not for profit was
17 perhaps astute enough or well advised enough to
18 say everyone around here other than me is a for
19 profit corporation, they will have a higher cost
20 financing, they will pay income taxes, they're
21 going to bid down here, I just need to be one
22 dollar above them.

23 In the case of one municipal buyer, it

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

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

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.

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

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

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.

1 CHAIRMAN GETZ: The next step,
2 Mr. Conner, is redirect. Do you have any idea of
3 how much redirect you have?

4 MR. CONNER: Yes, sir. You all have
5 covered some of my questions, honestly. So I
6 think 35, 40 minutes. If you'd like to take a
7 short break.

8 CHAIRMAN GETZ: Yeah, let's take 15
9 minutes now, recess, because we actually have
10 other things that we need to do, too, so.

11 MR. CONNER: I understand.

12 CHAIRMAN GETZ: Thank you.

13 (Recess taken.)

14 CHAIRMAN GETZ: Okay, we're back on the
15 record with redirect from Mr. Conner.

16 MR. CONNER: Thank you, Mr. Chairman.

17 REDIRECT EXAMINATION

18 BY MR. CONNER:

19 Q. Mr. Reilly, Chairman Getz asked you a
20 few questions following up on Mr. Boutin's
21 cross-examination of you this morning, and I think
22 I want to follow up a little bit further along
23 those lines, if possible.

1 He asked you several hypotheticals
2 which are strikingly similar to the facts in this
3 case.

4 CHAIRMAN GETZ: He being Mr. Boutin?

5 MR. CONNER: Yes.

6 Q. Would you turn to Exhibit 3036, please?
7 Exhibit 3036 is the contract signed by
8 Mr. Sansoucy with the city of Nashua dated March
9 19, 2004. You've reviewed this document, I
10 believe?

11 A. (By Mr. Reilly) Yes, I have.

12 Q. And what I want to direct you to is the
13 portion of your testimony that you gave in
14 response to Mr. Boutin's questions concerning
15 valuation services as opposed to appraisal
16 practice.

17 And I believe from your testimony an
18 appraisal firm or valuation firm can readily
19 perform valuation services which may include a
20 number of things including litigation support,
21 things of that nature, investment banking
22 services, broker services, things of that nature,
23 and that same can also have a division that does

1 appraisal work, correct?

2 A. (By Mr. Reilly) Yes, sure.

3 Q. But you see a problem -- particularly a
4 problem where a person that's, let's say, on the
5 litigation support side of the business is also
6 signing the appraisal?

7 A. (By Mr. Reilly) Well, that's right.
8 That's the problem, is when the same person
9 operates on both sides of that wall for the same
10 client at the same time.

11 Q. What I'd like to do is just let's go
12 through just briefly the -- if you would turn to
13 page -- there's four phases of this agreement.
14 Phase A includes initial appraisal work.

15 MR. CONNER: Go to page 3, Daniel.
16 Then go to the next page.

17 Q. I'm sorry, page 4. If you'll direct
18 your attention, there's several items here. Eight
19 is to propose an RFP and a draft contract for
20 subcontract operations and maintenance. Eleven is
21 to draft a set of ordinance for rates, rules and
22 regulations under regional ownership. Twelve is
23 prepare final summary public interest findings.

1 Fifteen is prepare summary to show public benefit
2 of total taking.

3 In your opinion, Mr. Reilly, are those
4 litigation support services and advocacy services?

5 A. (By Mr. Reilly) Yes, in my opinion,
6 they are.

7 Q. If you'll go to the next page, page 5,
8 I direct your attention to No. 10, is assist in
9 preparation of a trial plan for the main
10 proceedings before the PUC.

11 Phase C deals with general consulting
12 during all phases supporting attorneys, legal
13 staff. And it itemizes a number of topics under
14 there in items, including preparing and responding
15 to data requests, correct?

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

17 Q. Would those also, in your opinion, be
18 viewed as litigation support and advocacy
19 services?

20 A. (By Mr. Reilly) Yes, I believe they
21 are.

22 Q. Now, that being the case, that -- what
23 is your opinion with respect to compliance with

1 USPAP in performing the appraisal and those
2 services?

3 A. (By Mr. Reilly) Well, I believe USPAP
4 says that you can't perform these types of
5 advocacy, slash, litigation support services and at
6 the same time act as an independent appraiser
7 signing an appraisal report as a -- as an
8 independent appraiser.

9 Q. Mr. Reilly, I want to direct your
10 attention to advisory opinion 21. And what is an
11 advisory opinion under USPAP?

12 A. (By Mr. Reilly) Sure. It's an
13 implementation guide. The standard rules are the
14 actual USPAP, the uniform standards, but the
15 advisory opinion is issued by the Appraisal
16 Standards Board to appraisers to help appraisers
17 implement or live on a day-to-day basis under the
18 standards rules.

19 Q. And I want to direct your attention to
20 illustration No. 5 under advisory opinion 21, and
21 it deals specifically with litigation services.
22 Could you kind of --

23 MR CONNER: Bill, could you put your

1 head down just a second?

2 MR. UPTON: You know, this is way
3 beyond the direct -- I mean the cross-examination.
4 I didn't go into any of this, and neither did
5 Mr. Boutin -- even if he could redirect on what
6 Mr. Boutin crossed him on. I mean, that's in
7 essence like another direct examination. This is
8 way beyond the scope of my cross.

9 MR. CONNER: Mr. Chairman, it's not
10 beyond the scope. He went back to the USPAP and
11 asked Mr. Reilly concerning Mr. Sansoucy's
12 services. That was part of his direct
13 examination. I'm just referring to this
14 illustration for the panel, for the commission.

15 CHAIRMAN GETZ: To Marie Vaughn again?
16 That's where we are? Didn't we deal with Marie
17 the other day?

18 MR. CONNER: If we did, I'll stop. I
19 was not under the impression that we had. But
20 this is the Marie Vaughn demonstration, so, we'll
21 proceed.

22 CHAIRMAN GETZ: We've been there once
23 before. Let me bring up one issue with respect to

1 this -- it's the USPAP treatise, document, I don't
2 know what we're calling this -- some pieces of it
3 are in the record?

4 MR. CONNER: What I would like to
5 suggest, and I'll be glad to provide a copy for
6 the commission -- I could get you three, if you'd
7 like -- make it an exhibit, the entire --

8 CHAIRMAN GETZ: What we would like to
9 do at least make it an exhibit or take
10 administrative notes; whatever it takes for us to
11 get full copies.

12 MR. UPTON: We agree entirely. And we
13 think -- Mr. Walker thinks he has it in electronic
14 form, so that we can make an electronic exhibit.

15 CHAIRMAN GETZ: That would be great,
16 but I'm kind of a troglodyte.

17 MR. CONNER: Why don't we go ahead and
18 mark -- mine is marked up, so we'll get you a
19 clean copy. Can we reserve the next exhibit?

20 COMMISSIONER BELOW: Just to be clear,
21 is this going to be the 2006 edition? Because
22 some earlier editions were referenced or used in
23 earlier testimony, but I think the current edition

1 would be the most useful to us.

2 MR. CONNER: Yes, Commissioner Below.
3 I believe that Mr. Walker and Mr. Reilly have both
4 used in their updates the 2006 adoption, and that
5 is the latest adoption. We'll make sure that's
6 the exhibit.

7 CHAIRMAN GETZ: Great.

8 MR. CONNER: That will be 3259, the
9 2006 edition of the USPAP standards.

10 MS. THUNBERG: Joe, if I can offer,
11 this is a clean copy for the clerk right now.

12 MR. CONNER: All right, put a stamp on
13 that.

14 MS. THUNBERG: Then your other copies
15 we'll supplement for the commission, but at least
16 we'll have one for the record.

17 (Exhibit No. 3259 was marked.)

18 Q. Mr. Reilly, Commissioner Below covered
19 the issue of the work orders, but I do want to
20 make a point, if I could.

21 MR. CONNER: Daniel, if you would pull
22 up Nashua Exhibit 1007B-1. And go -- this is the
23 listing of the documents depicting the property to

1 be taken by city of Nashua. This is in Mr. Walker
2 and Mr. Sansoucy's report. And go to page 22.
3 And highlight the records section at the bottom.

4 Q. Mr. Reilly, did you take a look at
5 the -- and consider all the records that were
6 going to be acquired by -- or sought to be
7 acquired by Nashua in this proceeding?

8 A. (By Mr. Reilly) Yes, I did.

9 Q. And did you specifically value those
10 records?

11 A. (By Mr. Reilly) Yes. I think I valued
12 every item on this list, including specifically the
13 last sentence which are all work orders completed
14 and opened. That's the category of work orders
15 that I valued in my appraisal.

16 Q. And those were the -- I mean, how many
17 thousand?

18 A. (By Mr. Reilly) Oh, it's about 84 or
19 87,000 I believe.

20 Q. Now, you have valued intangible assets
21 before?

22 A. (By Mr. Reilly) Yes, I have.

23 Q. And you've written widely on the issue,

1 have you not?

2 A. (By Mr. Reilly) Yes.

3 Q. Is the way, the methodology you used to
4 value these assets an accepted methodology in
5 the appraisal industry?

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

7 Q. One that you've employed on numerous
8 occasions?

9 A. (By Mr. Reilly) For this type of asset,
10 for this type of work order type assets, using a
11 reproduction cost new less depreciation method is
12 very commonplace.

13 Q. Thank you. With respect, there was a
14 lot of questioning today from Mr. Upton concerning
15 your long term growth rate. And it's my
16 understanding, I believe you've explained that
17 adequately.

18 You were here when -- with respect to
19 the income approach, and I believe Mr. Upton was
20 asking you about the calculation of gross revenue
21 minus cost and expenses?

22 A. (By Mr. Reilly) Yes.

23 Q. Trying to get to net income?

1 A. (By Mr. Reilly) Yes.

2 Q. Now, you indicated that he needed to
3 make sure in the cost and expense deductions that
4 you included capital expenditures, correct?

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

6 Q. And why is that important?

7 A. (By Mr. Reilly) Well, that is an item
8 of cash flow. Capital expenditures, while not an
9 operating expense that shows up on the company's
10 income statement, is a use of funds that shows up
11 as a deduction on the company's sources and uses of
12 funds statement.

13 In fact, when a company buys a capital
14 expenditure, the easiest way, again, I always find
15 to think of this is go back to accounting 101, you
16 debit figured assets for X dollars and you credit
17 cash for X dollars, and a credit to cash is a
18 reduction to cash, so cash is going out the door
19 every time a company buys a fixed asset.

20 Q. Mr. Reilly, you were here when I asked
21 Mr. Walker to include as an expense approximately
22 \$3 million as a capital expenditure in his direct
23 capitalization calculation, weren't you?

1 A. (By Mr. Reilly) Yes.

2 MR. CONNER: And I'd like to, Daniel,
3 pull up the transcript from the redirect of
4 Mr. Walker on page 82.

5 Q. The question asked Mr. Walker on his
6 redirect is on line 14, Mr. Reilly. During his
7 cross-examination Mr. Conners -- Conner did a
8 number of mathematical adjustments that were
9 designed to suggest that your income approach was
10 the same as rate based, do you recall that?
11 Answer by Mr. Walker, I do recall those
12 calculations.

13 Question. Were those adjustments that
14 you made proper, in your opinion? Answer,
15 Mr. Walker. No. Question. Why not. By
16 Mr. Walker. Well, for one thing, the result you
17 value is that -- that is inconsistent in the
18 marketplace. Again, without harping on, you know,
19 the sales comparison approach, people are paying
20 far more than rate based for these facilities, and
21 to use an example, the offer of Philadelphia
22 Suburban and Pennichuck Water Works, they weren't
23 buying the system for rate based, they were buying

1 it for something in excess of rate based.

2 Mr. Reilly -- and you can read the rest
3 of that, I don't want to cut you off -- is that an
4 appropriate explanation on why you should not use
5 or deduct for capital -- normalized capital
6 expenditures in Mr. Walker's capitalization
7 approach?

8 A. (By Mr. Reilly) No. As I read this
9 answer, basically he's saying if I subtract,
10 depreciate -- or subtract capital expenditures and
11 capitalize net cash flow, I'll get to rate base.
12 And we know that buyers pay multiples of rate base,
13 not rate base, so I know that answer is wrong.

14 So -- but that doesn't explain -- you
15 know, I agree with Mr. Walker's conclusion, the
16 answer is wrong if it's inconsistent with
17 transactional market data, but it doesn't explain
18 why you should not subtract capital expenditures
19 from cash flow.

20 Q. In his model?

21 A. (By Mr. Reilly) In his model. But I
22 don't know if he has an answer to that, because the
23 fact is in any model if you're going to include

1 cash flow whether it's a direct capitalization or a
2 yield capitalization model, the definition of cash
3 flow is what we talked about before, it's revenues
4 minus expenses plus depreciation minus capital
5 expenditures, that's the -- the textbook
6 definition.

7 CHAIRMAN GETZ: Mr. Conner, I hope this
8 is the end of this topic.

9 MR. CONNER: Yes, it is.

10 CHAIRMAN GETZ: Because it seems to me
11 we are getting beyond redirect. It's rebuttal of
12 previous redirect or something.

13 MR. CONNER: I was just trying to cover
14 that issue and bring it to a closure. That's it
15 on that, Mr. Chairman.

16 BY MR. CONNER:

17 Q. Mr. Reilly, I believe
18 Commissioner Below asked you about the Heater
19 transaction?

20 A. (By Mr. Reilly) Yes.

21 Q. And I believe you explained your
22 opinion why that was not viewed as a comparable
23 transaction of the company.

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

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

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

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

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.

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

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.

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 REXCROSS-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

1 doesn't affect that?

2 A. (By Mr. Reilly) Well, yes and no. It
3 doesn't affect the fair market value, but it
4 depends on what the fair market value is.

5 If the fair market value of the
6 stock -- if you form a corporation as we have in
7 this case, and you put the apartment building in
8 it, and you sell the stock of the corporation for a
9 hundred, the stock of the corporation would be a
10 hundred.

11 The equivalent, the corresponding fair
12 market value of the assets would probably be
13 something like 140.

14 Q. Isn't what you're talking about net
15 proceeds as opposed to fair market value?

16 A. (By Mr. Reilly) No, no, no, it's fair
17 market value. You can take exactly the same
18 company and sell the stock for X, but you'd have to
19 sell the assets at a premium over X to make the two
20 deals equivalent.

21 MR. UPTON: I don't think that was my
22 question, but I'll sit down.

23 CHAIRMAN GETZ: Last opportunity on

1 this one issue.

2 Okay, then I think that concludes
3 cross-examination and redirect of the witnesses,
4 so the panel is excused. Thank you very much,
5 gentlemen, and Riethmiller, for standing by all
6 day.

7 Tomorrow morning we're beginning at
8 9 a.m., and is it the idea to start with
9 Mr. Korell tomorrow?

10 MS. KNOWLTON: Right. Our proposed
11 order of witnesses is Mr. Korell, Mr. Joyner and
12 then Ms. Hartley.

13 CHAIRMAN GETZ: And what is the
14 expectation, that we'll get through all three
15 witnesses tomorrow? Has there been some
16 discussion about the possible length of cross,
17 et cetera?

18 MR. UPTON: I don't think we've had any
19 discussion, but I think we expect that we will get
20 through tomorrow.

21 CHAIRMAN GETZ: Then we'll close the
22 hearing for today, take a recess, and we'll be
23 optimistic we'll get through our witnesses

1 tomorrow. Thank you.

2 (The hearing was adjourned at 4:06 p.m.)

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CERTIFICATE

I, Pamela J. Carle, Certified Court Reporter and Notary Public of the State of New Hampshire, do hereby certify that the foregoing is a true and accurate transcript of my stenographic notes of the hearing Re: DW 04-048, taken at the place and on the date hereinbefore set forth.

I further certify that I am neither attorney nor counsel for, nor related to or employed by any of the parties to the action in which this proceeding was taken, and further that I am not a relative or employee of any attorney or counsel employed in this case nor am I financially interested in this action.

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