

EXHIBIT 26

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

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

Docket No. DW 04-048

DIRECT TESTIMONY OF ROBERT F. REILLY

January 12, 2006

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1 Q. Have you reviewed the Riethmiller and Gannett Fleming analysis and the Thibeault real
2 property appraisal?

3 A. Yes. I met and closely coordinated my work with Mr. Riethmiller, Mr. Walker and Mr.
4 Thibeault. During the course of this assignment, I had the opportunity to review their
5 methods, procedures and findings. I have relied on and incorporated the results of the
6 Riethmiller, Gannett Fleming, and Thibeault analyses in my report and testimony.

7 **DEFINING FAIR MARKET VALUE, GENERAL APPRAISAL ASSUMPTIONS AND THE APPROACHES**

8 Q. You stated that the purpose of your testimony was to estimate the fair market value of the
9 PWW assets; what is the definition of "fair market value"?

10 A. "Fair market value" has a common definition. It is typically defined as the price at which
11 an asset would change hands between a willing buyer and a willing seller, when the
12 former is not under any compulsion to buy and the latter is not under any compulsion to
13 sell, and both parties have reasonable knowledge of the relevant facts.

14 **1. Fair Market Value is Not Equivalent to Rate Base**

15 Q. Is "fair market value" the same thing as "rate base"?

16 A. No. There are significant differences between the fair market value of a company and its
17 rate base, and these two concepts should not be confused or intermingled. Because of the
18 conceptual differences, the "rate base" of a utility does not equate to, and in fact has little
19 logical relation to, the concept of fair market value.

20 Q. What are the differences between rate base and fair market value?

21 A. Rate base is an accounting and regulatory concept that represents a statement of the
22 historical cost of some, but not all, specified utility plant in service assets less accounting
23 (or "book") depreciation. This Commission allows a utility to earn a specified allowed
24 rate of return on the original cost of its "rate base." Conversely, fair market value is an

1 appraisal concept of the current value-in-exchange between a willing buyer and a willing
2 seller. In other words, the difference is a conceptual one:

- 3 • rate base is an *income concept* that governs the relationship between the
4 regulatory Commission and the utility; and
- 5 • fair market value is an *exchange concept* that governs the relationship
6 between the utility owner and the entity purchasing the utility.

7 Q. Are contributions in aid of construction treated differently between rate base and,
8 conversely, a fair market value appraisal?

9 A. Yes, contributions in aid of construction (“CIAC”), which are familiar territory for this
10 Commission, provide one example of the conceptual differences between rate base and
11 fair market value. Typically, and I understand that this is the case in New Hampshire,
12 CIAC are excluded from the rate base on which the utility is permitted to earn a return.
13 The reason, under the income concept of rate base, is that CIAC are not capital
14 expenditures made by the public utility on which the Commission allows income to be
15 earned.

16 Conversely, in a fair market valuation, CIAC are, and must be, included in the
17 asset base being valued for exchange. In an exchange, those assets can have substantial
18 value, and that value must be accounted for in the fair market value appraisal. In this
19 case, CIAC for PWW as of December 31, 2004 accounted for a \$18,232,000 asset on
20 PWW’s balance sheet. That can be found at Attachment RFR-1, Appendix A, page 3 of
21 21 (Exhibit 3). Ownership of these assets would transfer to any purchaser of the system
22 and these assets have a value in the marketplace. As such, the assets must be included in
23 the fair market value appraisal.