

# **EXHIBIT 8**



## Willamette Management Associates

November 14, 2006

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Dear Messrs. Conner and Donovan:

We understand that you represent Pennichuck Water Works, Inc. ("PWW") and its parent Pennichuck Corporation in a condemnation proceeding ("the dispute") with the City of Nashua, New Hampshire ("Nashua" or "the City"). We understand that the City has filed a petition to condemn the PWW subsidiary of Pennichuck Corporation.

We understand that the dispute is pending before the New Hampshire Public Utilities Commission ("the PUC").

We understand that the dispute involves the valuation of all of the PWW business operations, including all of the tangible property and all of the intangible property of the PWW operating business, as of December 31, 2004.

### INTRODUCTION

In our rebuttal report dated May 22, 2006 ("the Willamette Rebuttal Report"), we formed an opinion as to:

1. the appropriateness of the valuation approaches, methods, and procedures presented in a report dated January 12, 2006 ("the 2004 Sansoucy Report") prepared by George E. Sansoucy, P.E., LLC; and

2. the reliability of the fair market value conclusion presented in the 2004 Sansoucy Report.<sup>1</sup>

At your request, we analyzed the deposition of George E. Sansoucy (“Sansoucy”) dated July 11, 2006 and July 12, 2006 (“the Sansoucy Deposition”) and the deposition of Glenn C. Walker (“Walker”) dated July 13, 2006 (“the Walker Deposition”), (collectively, “the Depositions”).

This analysis of the Depositions supplements the Willamette Rebuttal Report.

## **PURPOSE AND OBJECTIVE OF THE ANALYSIS**

The objective of this analysis of the Depositions is to supplement the opinions, comments, and conclusions presented in the Willamette Rebuttal Report.

The purpose of this analysis is to assist you in your representation of PWW in the dispute.

This analysis is not to be considered an appraisal or a review appraisal, as those terms are described by Uniform Standards of Professional Appraisal Practice (“USPAP”).

## **ANALYSIS PROCEDURES**

As part of our analysis, we relied on a collection of documents, including, but not limited to, the following:

1. the documents listed in the Willamette Rebuttal Report;
2. the 2004 Sansoucy Report; and
3. the Sansoucy Deposition and the Walker Deposition.

## **ANALYSIS SUMMARY**

### *1. Special Purpose Property*

The 2004 Sansoucy Report does not address whether the PWW system constitutes special purpose property. Sansoucy testified, however, that “From a valuation perspective, [the operating assets of PWW] are drifting away from special purpose property.”<sup>2</sup> This is a fundamental error.

Special purpose property is property (1) with a unique physical design, special construction materials, or a layout that restricts its utility to the use for which it was built and (2) that has relatively limited market at any particular time.<sup>3</sup>

First, PWW was built for the unique purpose of supplying potable water and fire protection to the residents of Nashua and ten surrounding New Hampshire municipalities. Second, the PWW system

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<sup>1</sup> “In this appraisal, the term market value is considered to be synonymous with fair market value.” The 2004 Sansoucy Report. 2.

<sup>2</sup> The Sansoucy Deposition. 294.

<sup>3</sup> Appraisal Institute. *The Appraisal of Real Estate*. 25.

represents property that is not frequently exchanged in the market. Since both requirements of special purpose property are met, the operating assets of PWW represent special purpose property.

The 1995 Sansoucy Report concluded that the PWW system qualified as special purpose property. That report stated that the two requirements to qualify as special purpose property were met: “[1] These types of properties [special purpose properties], such as a water utility, are designed, constructed, franchised, and utilized for a specific, monopolistic purpose and regulated by state government, federal government or both. [2] Public utility property is not routinely bought and sold between willing buyers and sellers, and therefore does not lend itself to a recurring and commonly known market system.”<sup>4</sup>

In the Sansoucy Deposition, and in regard to the operating assets of PWW, Sansoucy is asked, “Is it special purpose property in your opinion or not?” He responds, “Yes and no.” He continues, “Yes, it’s special purpose property within its immediate area, No, it is no longer special purpose property in the marketplace by definition of special purpose property in the marketplace.”<sup>5</sup>

Sansoucy contends that the only factor relevant to his determination that the PWW operating assets no longer constitute special purpose property in the marketplace is the fact that some water utility sale transactions have occurred nationally over a period of time.<sup>6</sup>

Furthermore, Sansoucy asserts that it is not necessary for such sale transactions to be comparable to the PWW system, just that such water utility sales be “transparent and identifiable.”<sup>7</sup>

Based on Sansoucy’s flawed analysis, it would be logical to conclude that every water utility system in the nation is “drifting away from special purpose property.” However, the mere fact that some water utility sale transactions have occurred nationally over the last eleven years does not automatically remove the PWW system (or any other water utility system in the nation) from the special purpose property classification.

Sansoucy considers all water utility system sales collectively as evidence of the exchange of water utilities in the marketplace. By doing so, Sansoucy fails to consider each water utility system sale individually. He has no opinion as to whether any (or all) of the water utility system sales are comparable to the PWW system. More importantly, Sansoucy did not consider contemporaneous market characteristics of each water utility system sold.

The detailed market analysis in our appraisal report and the Willamette Rebuttal Report demonstrates that there are no sufficiently comparable sales of water utility systems to support Sansoucy’s contention that the PWW operating assets are “drifting away from special purpose property.”

Therefore, the 2004 Sansoucy Report claim that the PWW system is not special purpose property is fundamentally erroneous. This error affects the proper weighting in the reconciliation of value between the various approaches because the cost approach is typically accorded more weight in valuing special purpose property. In fact, Sansoucy acknowledges that if the property qualifies as special purpose property, the cost approach to valuation is “an appropriate approach to consider and rely upon.”<sup>8</sup>

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<sup>4</sup> The 1995 Sansoucy Report. 8.

<sup>5</sup> The Sansoucy Deposition. 294.

<sup>6</sup> The Sansoucy Deposition. 300.

<sup>7</sup> The Sansoucy Deposition. 295.

<sup>8</sup> The Sansoucy Deposition. 315.

## 2. Intangible Personal Property

As noted in the Willamette Rebuttal Report, the 2004 Sansoucy Report fails to value the PWW intangible personal property. This is a fundamental error because the City is attempting to acquire all of the tangible property and all of the intangible property of the PWW operating business.

The 2004 Sansoucy Report does not discretely identify and individually value the PWW intangible property. Sansoucy stated, in regard to the categories of intangible property, “You need to take them one at a time, because they’re in different places in the company records.”<sup>9</sup>

Sansoucy indicated that some intangible property is valued through his cost approach. As to whether specific categories of intangible personal property (specifically, logs, data sheets, recordings and other records of every test performed on every component of the water treatment, transmission, and distribution facilities) are included in his cost approach value indication, Sansoucy says, “Half and half”<sup>10</sup> As to whether engineering and design studies, either preliminary or final, complete or incomplete, together with all supporting data, work papers, and analyses related to every component of the water treatment, transmission, and distribution facilities are included in his cost approach value indication, Sansoucy says, “Those are generally in.”<sup>11</sup>

Sansoucy testified that other intangible property is not valued through the cost approach. In regard to these categories of intangible personal property (namely, the repair and maintenance records), Sansoucy states, “[Your income and market value indications] are used to make [your economic obsolescence calculation], but you don’t pick up the value in that. You pick them up in those valuation methods.”<sup>12</sup> In other words, Sansoucy concedes that the value of these particular categories of intangible personal property is excluded in his cost approach value indication. He argues that the value of these particular intangible personal property categories is included only in the income and market approach value indications.

In the Sansoucy Deposition, Sansoucy contends that the value of intangible personal property is included in his cost approach value indication. He states, “So, they’re [the intangible personal property] either in the market and income portion of the cost approach or they are found in the original costs and are swept down through the original cost analysis. It’s all part of the same approach, which is the cost approach.”<sup>13</sup> This is an error because the asset-based approach directly values all of the tangible and intangible personal property. In contrast, the income and market approaches indirectly estimate the value of the subject personal property.

Most fundamental, however, is the fact that the asset-based approach (1) discretely identifies and (2) individually values the subject personal property. As evidenced in the 2004 Sansoucy Report, and as confirmed in the Sansoucy Deposition, none of the PWW intangible personal property is (1) discretely identified or (2) individually valued.

Therefore, the 2004 Sansoucy Report’s failure to properly value the PWW intangible personal property is fundamentally incorrect.

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<sup>9</sup> The Sansoucy Deposition. 350.

<sup>10</sup> The Sansoucy Deposition. 361.

<sup>11</sup> The Sansoucy Deposition. 362.

<sup>12</sup> The Sansoucy Deposition. 360.

<sup>13</sup> The Sansoucy Deposition. 353-354.

### 3. Continuing Property Records

As noted in the Willamette Rebuttal Report, the 2004 Sansoucy Report relies on inaccurate and incomplete original cost data in the tangible personal property trended original cost analysis.

The 2004 Sansoucy Report uses the *Pennichuck Water Works, Inc. – GAAP Taxable Assets Reports*, also referred to as the Continuing Property Records (“CPR”), as the data source for the original costs used in the tangible personal property trended original cost analysis.<sup>14</sup>

As discussed in the Willamette Rebuttal Report, PWW notified Sansoucy in a letter dated November 15, 2005 that (1) the original cost and (2) the acquisition date data within the CPR are not correct.

In the Sansoucy Deposition, Sansoucy is asked, “The trended original cost is problematic, isn’t it?” He responds, “It could be slightly off, sure.”<sup>15</sup> Sansoucy later confirms that he “choose to go with the [CPR] as they were regardless of their accuracy.”<sup>16</sup>

Sansoucy (1) understands that the CPR are inaccurate and incomplete yet (2) relies on this inaccurate and incomplete data as the basis of his trended original cost analysis. Moreover, he admits that his tangible personal property trended original cost analysis “could be”<sup>17</sup> incorrect due to his reliance on the CPR.

Therefore, the 2004 Sansoucy Report reliance on inaccurate and incomplete original cost data in the tangible personal property trended original cost analysis is fundamentally flawed.

### 4. Capital Expenditures and Functional Obsolescence Considered in Cost Approach Valuation Analysis

In the 2004 Sansoucy Report, Sansoucy applies functional obsolescence to items that are not, in fact, subject to functional obsolescence.

Functional obsolescence is the decrease in the value of an asset due to its inability to perform the function (or yield the periodic utility) for which it was originally designed. An asset’s deficiencies are considered curable when the prospective economic benefit of enhancing or modifying the asset exceeds the current cost (in terms of material, labor, and time) to change it. An asset’s deficiencies are considered incurable when the current cost of enhancing or modifying the asset (in terms of material, labor, and time) exceeds the expected future economic benefits of improving it.

According to the 2004 Sansoucy Report, “There is curable functional obsolescence due to deficiencies in the system caused by assets not complying with the required water quality regulations.”<sup>18</sup> In the Sansoucy Deposition, Sansoucy acknowledged that there should not be functional obsolescence deductions for planned capital investments that are not required by water quality regulations.

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<sup>14</sup> Although the 2004 Sansoucy Report also refers to the Main Pipe Inventory as a data source, the Report does not indicate what information, if any, was extracted from the Main Pipe Inventory. The Main Pipe Inventory, also referred to as the engineering records, is simply a list of the PWW pipes. No cost information is included in the Main Pipe Inventory. Therefore, it appears that Sansoucy relied exclusively on the CPR as the data source for his original cost information.

<sup>15</sup> The Sansoucy Deposition. 409.

<sup>16</sup> The Sansoucy Deposition. 432.

<sup>17</sup> The Sansoucy Deposition. 409.

<sup>18</sup> The 2004 Sansoucy Report. 41.

Sansoucy included a significant deduction for functional obsolescence based on “the cost to cure.” This “cost to cure” was based on certain planned capital investments for the years 2004 through 2007 “related to the water treatment plant upgrade, meters radio reader program, the Armory pump house, the Shakespeare high pressure project, the [Fifield] tank, the community water systems and the EPA vulnerability upgrades.”<sup>19</sup>

In the Sansoucy Deposition, Sansoucy repeatedly contends that the water treatment plant upgrade, meters radio reader program, the Armory pump house, the Shakespeare high pressure project, the Fifield tank, the community water systems, and the EPA vulnerability upgrades are all required due to new water quality regulations.<sup>20</sup> Sansoucy is simply incorrect, according to PWW management, because only the water treatment plant upgrade is required due to new water quality regulations.

Sansoucy agrees that capital expenditures not mandated by new water quality regulations would not be subject to functional obsolescence.<sup>21</sup> Nevertheless, Sansoucy erroneously applies functional obsolescence to the meters radio reader program, the Armory pump house, the Shakespeare high pressure project, the Fifield tank, the community water systems, and the EPA vulnerability upgrades, which are items that are not, in fact, subject to functional obsolescence.

Therefore, the 2004 Sansoucy Report application of functional obsolescence to items that are not, in fact, subject to functional obsolescence is fundamentally wrong.

#### 5. Capital Expenditures Disregarded in Income Approach Valuation Analysis

Capital expenditures are erroneously excluded in the 2004 Sansoucy Report income approach valuation analysis. The measure of cash flow that is capitalized in the 2004 Sansoucy Report yield capitalization method fails to consider either (1) capital expenditures or (2) changes in working capital. Failure to include these capital expenditures has resulted in an inflated value under the 2004 Sansoucy Report income approach valuation analysis. This inflated value conceals the fact that the methodology employed in the 2004 Sansoucy Report income approach valuation analysis will, if applied to the actual cash flow stream, simply approximate rate base.

Fundamentally, the income approach is based on the economic principle that the value of the operating business assets is equal to the present value of the expected economic income to be derived by the owners of the subject assets. As stated in the 2004 Sansoucy Report, “The elements of the income capitalization approach that impact value are the reliability of the anticipated future cash flows and the cost of capital associated with the particular investment.”<sup>22</sup>

In preparing the income approach, Walker did not include the effect of the capital expenditures in normalizing the cash flow of PWW for the income approach. Walker testified that he “looked at that as being something that would be [a] function of – future rate cases.”<sup>23</sup> In the Walker Deposition, Walker performed a rudimentary calculation of a corrected measure of cash flow, which adjusted for the capital expenditures that would be made.

Using the original assumptions of the 2004 Sansoucy Report capitalization method, including the PWW tax-affected rate of return as the cost of capital, the capitalization of this corrected measure of cash flow

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<sup>19</sup> The 2004 Sansoucy Report. 41.

<sup>20</sup> The Sansoucy Deposition. 441. 443.

<sup>21</sup> The Sansoucy Deposition. 463.

<sup>22</sup> The 2004 Sansoucy Report. 53.

<sup>23</sup> The Walker Deposition. 131-133.

results in a number that approximates the PWW rate base as of December 31, 2004.<sup>24</sup> This corrected measure of cash flow resulted in a value indication of approximately \$40,000,000. Rate base at that time was \$44,000,000.

The resultant approximation of the PWW rate base upon the capitalization of this corrected measure of cash flow indicates the serious error in disregarding capital expenditures in the 2004 Sansoucy Report income approach valuation analysis. Walker agrees that "Rate base is not fair market value."<sup>25</sup>

Furthermore, as discussed in the Willamette Rebuttal Report, and as cited in the 1995 Sansoucy Report, "The choice of capitalization rates is dictated by the nature of the income stream to be capitalized. If the appraiser uses the rate of return allowed by the regulatory agency and capitalizes the regulatory agency's forecasted income at that rate, the resulting value estimate will be exactly equal to the utility's rate base. This result is a mathematical certainty and contributes nothing to the valuation process."<sup>26</sup>

Therefore, the 2004 Sansoucy Report's exclusion of capital expenditures in the income approach valuation analysis is fundamentally invalid.

## **SUMMARY AND CONCLUSION**

For the reasons explained in the Willamette Rebuttal Report, the 2004 Sansoucy Report is fundamentally flawed. Therefore, the 2004 Sansoucy Report is unreliable and fails to provide a reliable conclusion of the fair market value of the PWW operating assets as of December 31, 2004.

For the following reasons, our analysis of the Depositions further supports our conclusion:

1. The 2004 Sansoucy Report claim that the PWW system is not special purpose property is fundamentally erroneous;
2. The 2004 Sansoucy Report failed to properly value the PWW intangible personal property;
3. The 2004 Sansoucy Report reliance on inaccurate and incomplete original cost data in the tangible personal property trended original cost analysis is fundamentally flawed;
4. The 2004 Sansoucy Report application of functional obsolescence to items that are not, in fact, subject to functional obsolescence is fundamentally wrong; and
5. The 2004 Sansoucy Report exclusion of capital expenditures in the income approach valuation analysis is fundamentally invalid.

We are independent of PWW and all other parties associated with the dispute. We have no current or prospective financial interest in the subject assets. Our fee was in no way influenced by the results of this analysis.

This analysis is not to be considered an appraisal or a review appraisal, as those terms are described by USPAP.

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<sup>24</sup> The Walker Deposition. 137.

<sup>25</sup> The Walker Deposition. 138.

<sup>26</sup> Woolery, Arlo. *Valuation of Railroad and Utility Property*. Lincoln Institute of Land Policy and Wichita Public Utility & Railroad Workshop. 35.

Very truly yours,

**WILLAMETTE MANAGEMENT ASSOCIATES**

*Robert Reilly*

Robert F. Reilly