

STATE OF NEW HAMPSHIRE
PUBLIC UTILITIES COMMISSION

DW 04-048

In the Matter of:
City of Nashua
Petition for Valuation
Pursuant to RSA 38:9

**CITY OF NASHUA'S MEMORANDUM
IN SUPPORT OF PETITION FOR
VALUATION PURSUANT TO RSA 38:9**

November 16, 2007

STATE OF NEW HAMPSHIRE
BEFORE THE
PUBLIC UTILITIES COMMISSION

City of Nashua: Petition for Valuation Pursuant to RSA 38:9

DW 04-048

**MEMORANDUM IN SUPPORT OF PETITION
FOR VALUATION PURSUANT TO RSA 38:9**

NOW COMES the City of Nashua (“Nashua”) and respectfully submits the following *Memorandum in Support of Petition for Valuation pursuant to RSA 38:9*:

I. INTRODUCTION: NASHUA WILL PROMOTE THE PUBLIC INTEREST

On December 15, 2006, Nashua submitted its pre-trial Memorandum in these proceedings. Nashua’s pre-trial Memorandum described the public interest standard applicable under RSA 38 and articulated its position that its acquisition of the Pennichuck Water Works, (“Pennichuck” or “PWW”) would be entirely consistent with the public interest. Rather than simply reiterate Nashua’s pre-trial Memorandum, this Memorandum documents how the evidence presented at the Commission’s hearings demonstrates that: (a) approval of Nashua’s Petition for Valuation will promote the public interest; and (b) any alleged harms to the public interest have been adequately addressed, or, are entirely speculative and unsupported by the evidence.

Nashua therefore incorporates by reference its pre-trial Memorandum, and, by way of summary, notes that: (a) while RSA 38:2 expressly authorizes Nashua to *establish* a water system by filing a petition for valuation before this Commission, Nashua has gone to extraordinary lengths to demonstrate that it will operate and manage its water system consistent with the public interest; and (b) while RSA 38 entitles Nashua to a rebuttable presumption that its petition is in the public interest, Nashua has provided evidence demonstrating that it will not

only provide service that is “reasonably safe and adequate and in all other respects just and reasonable”¹ but that it will do so at reduced rates while significantly improving its operations and the quality of service customers currently receive.

The examples of improvements in the quality of service that will result from Nashua’s acquisition are too numerous to list comprehensively. However, several merit mention in this introduction. For example, the Commission received evidence that Pennichuck provided service in violation of primary drinking water standards for radionuclides, arsenic, lead and other contaminants in order to make sure capital improvements are recovered in rates.² Under Nashua’s OM&M Agreement, Veolia Water is required to “identify capital improvement projects necessary [...] in order to meet prospective operating parameters, such as changes in regulatory standards” and implement those projects before they occur.³ Nashua also provided testimony that, rather than deliver capital projects and services to customers over budget estimates, with no fixed prices, and no contractual recourse when projects are over-budget or do not perform, Nashua, Veolia Water and R.W. Beck will ensure that projects are delivered on-time, on-budget and that customers receive value for the dollar.⁴ In addition, Nashua’s acquisition of the Pennichuck Water Works will provide customers legal and political accountability for the management of the water system to ensure that profits cloaked behind fraudulent financial transactions⁵ and revision to technical reports⁶ do not supplant protection of the state’s limited water resources, or result in a “feeding frenzy at the public trough.”⁷

While Pennichuck and Staff have speculated that political or other motivations will harm

¹ RSA 374:1.

² Transcript, September 11, 2007, Page 78.

³ Exhibit 1005B, Appendix G, Section 2 (C), Page 78.

⁴ See Section II(c), *infra*.

⁵ Exhibit 1121.

⁶ See Section VI, *infra*.

⁷ Exhibit 1011A, Pages 87-88.

the public interest, these speculations stand in stark contrast to the evidence, to the commitments Nashua has made in this proceeding to protect the public interest, and to the State policy as embodied by RSA 38. In Nashua's May 22, 2007 and July 20, 2007 Testimony,⁸ Nashua officials articulated their commitment to provide service to all satellite customers at core rates, on a non-discriminatory basis; to make the terms and conditions of its wholesale service, and outside its borders, its retail service including its Main Extension Policy, its customer service, its compliance with Dig Safe and other Commission's regulations, all subject to the Commission's jurisdiction.⁹ In Appendix A to this Memorandum, Nashua has incorporated these and other commitments into proposed conditions for the Commission's consideration. *Nashua invites the Commission to impose these or any other conditions it deems necessary to satisfy the public interest, as conditions on the Commission's approval that pursuant to RSA 38:11 will legally bind the City as a matter of law.*

Nashua believes that the evidence it has presented in this proceeding and the commitments it has made as part of this proceeding are indicative of Nashua's greater commitment to acquire PWW's assets in order to promote the public interest. Unlike PWW, which must gear its operations to satisfy the needs of shareholders, Nashua's Petition is rooted in the motivation to serve the public which is the driving force behind all municipal operations. It explains why municipalities provide fire and police protection, education, street lighting and public works and why 80% of all water systems in the country are owned and operated by municipalities.¹⁰ It further explains why cities such as Nashua provide services outside their political borders¹¹ contrary to the cynical assertions of PWW and Staff that they act only in their

⁸ Exhibits 1014 & 1016.

⁹ See Exhibit 1014, Pages 4-5, 16-17, 21-23 & 70-88; Exhibit 1016, Pages 19-20.

¹⁰ Exhibit 3007A, Page 17

¹¹ See generally, Exhibit 1014.

own self-interest. As an example of such criticism and the false foundation on which it is built, the Commission should consider the assertion that if PWW is acquired by Nashua, a resource for the acquisition of “troubled systems” will be lost. In the first place, the Pennichuck companies are not the only purchasers of troubled systems.⁷ The Pennichuck companies consider such purchases on a case-by-case basis and they must fit a financial model.⁸ In fact, other companies during the last five years have purchased more so called “troubled systems.”⁹ What makes this assertion so cynical is that Nashua has committed to consider purchasing “troubled systems” on a case by case basis in the same manner as Pennichuck; and that contrary to the impression both PWW and Staff would leave with the Commission the universe of “troubled systems” is small¹⁰ and will become smaller over time.¹¹

The suggestion that the commitments made by Nashua and the conditions it has proposed are not enforceable by the Commission is not supported by law. The authority of the Commission to enforce conditions to satisfy the public interest is clear from RSA 38:6 and RSA 38:11. Furthermore, the Commission’s decisions affirm that it retains jurisdiction over the service provided by a municipal utility decades, or even a century, after it is established under RSA 362 and RSA 374.¹² The argument that customers would lose the regulatory oversight if Nashua’s petition were granted is founded on myth and speculation; is inconsistent with the law, and the Commission’s own decisions; and is not supported by any facts.

Nashua is confident that the Commission will not read RSA 38:2 to require that in order to establish a water utility Nashua must have described its proposal with absolute certainty. Such

⁷ Exhibit 1132, Data Request 6-45, 6-46; Transcript, September 26, 2007, Page 117.

⁸ Transcript, Sept. 13, 2007, Page 138, 139.

⁹ Exhibit 1132, Data Request 6-45, 6-46.

¹⁰ Exhibit 1132, Regulated Water Systems, Transcript, September 26, 2007, Page 121-124.

¹¹ Env-Ws 360-363; Transcript, September 26, 2007, Page 113-115.

¹² See e.g., Exhibit 1074, Order No. 24,649, *Petition of Peter St. James* (Warner Village District).

a requirement would impose a standard no municipality could meet without creating and operating a water department before filing its RSA 38 Petition and conflicts with the plain language of RSA 38:2. It would further ignore the reality that Nashua from the outset has sought to take whatever steps are necessary to protect the interests of customers consistent with the public interest.

There was no roadmap for Nashua when it commenced this proceeding. Nashua has pursued its Petition with diligence and has presented a compelling case that its acquisition of the PWW assets is in the public interest pursuant to a statute which recognizes that public ownership, in and of itself, is consistent with the public good. The fact that Nashua has made commitments and proposed conditions should not be seen as detracting from its case. Rather, they should be viewed by the Commission as evidence of Nashua's assurance that it is prepared to do whatever is reasonably necessary to satisfy the public interest and serve the public good.

II. OPERATIONS: NASHUA'S PUBLIC-PRIVATE PARTNERSHIP WITH VEOLIA WATER WILL PROMOTE THE PUBLIC INTEREST

A. OVERVIEW

This section illustrates how Nashua's operations, through its partnership with Veolia Water, will improve operations and will promote the public interest. A complete list of all the benefits, direct and indirect, is beyond the scope of this memorandum. However, the direct, tangible benefits that customers will realize as a result of Nashua's establishment of its water system include the following:

- Nashua will provide customers with greater technical and managerial expertise and improved performance of operations, maintenance, capital projects than currently exists under Pennichuck ownership.
- Nashua's OM&M Agreement will ensure that Veolia Water provides service to

customers in compliance with all contractual and regulatory requirements, and delivers performance at its contract price, whereas Pennichuck passes all of its costs to customers without any contract or direct contractual oversight.

- Nashua’s OM&M Agreement with Veolia Water will ensure that drinking water violations are identified and prevented before they occur, in contrast to Pennichuck’s testimony that it waits for drinking water violations to occur in order to reduce its risk and guarantee its costs in rates.

The Commission is undoubtedly aware that Pennichuck leveled a number of criticisms specifically at Veolia Water. For example, in pleadings, motions and objections, Pennichuck argued that Veolia Water, a company that depends on the success of its performance to promote its business, engaged in “disturbing themes”¹² and was therefore not worthy of the public’s trust. However, when given the opportunity to raise its alleged “disturbing themes” before the Commission, Pennichuck carefully avoided asking even a single substantive question related to the alleged disturbing themes it had discovered, and even offered to “stipulate for the record that I understand that Veolia feels that the claims relating to them are ill founded” and that so that it was unnecessary “to put on the record what the other side of the story might be”.¹³

Veolia Water received only limited opportunity to respond to these allegations, noting, for example, that in the case of Bridgeport, Connecticut, Veolia Water received a letter from law enforcement “thanking us ... for our complete and open cooperation with law enforcement” and that “[n]o one from Veolia was ever accused of anything and there was no litigation.”¹⁴ These opportunities were limited because Pennichuck’s counsel repeatedly emphasized that “all I want

¹² See Exhibit 3014, as revised, Pages 14-17.

¹³ Transcript, September 5, 2007, Page 280.

¹⁴ Transcript, September 5, 2007, Pages 278-279.

to do is identify these items” in order to ask “a more generalized question.”¹⁵

Nashua has little doubt that Pennichuck’s passing reference to its criticisms and allegations sought to go only as far as necessary to include them in its brief. However, Nashua does not believe that the Commission will or should decide a case of this magnitude on the basis of newspaper articles downloaded from internet, and then never raised at trial. Pennichuck’s failure to raise its allegations of “disturbing themes” is evidence that those allegations have little or no merit and were never intended to withstand the light of day.

In fact, Pennichuck’s President, Donald Ware, when faced with numerous letters of deficiency showing violation of drinking water and environmental standards acknowledged, that “sometimes good companies can have Letters of Deficiency written to them, where they can violate drinking water standards, and that doesn't mean they're a bad company.”¹⁶ Donald Correll, Pennichuck’s former CEO, further acknowledged that it was possible to find negative articles concerning any large water services provider because companies such as Veolia Water “are large companies, operating all over the country, and are big targets” and “because the authors of many of these [types of articles] are anti-privatization/anti-business”¹⁷ and that “if you looked for them, you'd likely find, for all three companies, articles and information that are favorable to them”.¹⁸ It is telling that, despite these acknowledgments, the Pennichuck witnesses made no effort to weigh both the positives and (alleged) negatives in their analysis.

That two Pennichuck witnesses both provided testimony to the Commission, without attempting to consider opposing views or evidence, strongly suggests that in order to arrive at the truth in this proceeding, when evaluating Pennichuck’s testimony concerning complicated or

¹⁵ Transcript, September 5, 2007, Pages 279-280.

¹⁶ Transcript, September 11, 2007, Page 83, Lines 11-16.

¹⁷ Transcript, September 13, 2007, Page 17, Lines 15-22.

¹⁸ Transcript, September 13, 2007, Pages 17-18.

technical matters such as rates, the Commission should carefully consider whether these or other witnesses failed to take in to consideration opposing views or evidence contrary to the position they advocate.

Nashua therefore describes herein the evidence presented to the Commission that responds to those concerns related to rates and quality of service that it expects the Commission will want to address directly. In particular, Nashua asserts :

- Pennichuck’s criticism of Veolia Water’s staffing levels contained in its proposal is misplaced because it does not include the additional staff that Veolia Water will add to perform capital projects and is not relevant to the OM&M Agreement which requires Veolia Water to perform operations and maintenance in compliance with the Agreement, regardless of the number of employees required.
- Pennichuck’s criticism of variable costs for RRRM and capital projects under Nashua’s OM&M Agreement is baseless because these same variable costs under Pennichuck ownership are passed directly to customers, without any contractual oversight or accountability.
- Pennichuck’s argument that Nashua’s OM&M Agreement should specify fixed costs for fuel, electricity, and maintenance is misplaced because Pennichuck has never reported those costs accurately, and its own experts acknowledge that the OM&M Agreement effectively mitigates the kinds of financial risks that resulted in the failures and “mass exodus” that had occurred under the agreement he negotiated in Atlanta.

B. NASHUA WILL PROVIDE CUSTOMERS WITH GREATER TECHNICAL AND MANAGERIAL EXPERTISE AND IMPROVE OPERATIONS, MAINTENANCE, AND EXECUTION OF CAPITAL PROJECTS RELATIVE TO PENNICHUCK.

Nashua’s selection of Veolia Water as its operator brings the knowledge, expertise and

qualifications of an industry-leader and the largest water service provider in the world.¹⁹ Veolia Water's parent company, Veolia Water North America, provides water and waste water services in over 600 communities in the United States, annual revenues of \$530,000,000 serving approximately 1.4 million customers.²⁰

The Northeast LLC alone ("Veolia Water" as referenced herein), operates in all 6 New England states and New York and has approximately 560 operations and maintenance and support employees, provides service to 36 municipal/government clients and 5 industrial-private clients. It operates 11 municipal water plants, 30 municipal waste water plants, 2 industrial waste water plants and 1 industrial water plant.

Veolia Water's president, Mr. Philip Ashcroft, testified that its expertise and resources from its North American operations would "absolutely" be available to benefit not only the Nashua "core" system, but also its satellites.²¹ As a result, "staff involved in the operation, maintenance and management of Nashua's water system will have the ability to draw upon professional experience and resources gained from other water systems in the United States and around the globe."²²

C. BY COMPARISON, PENNICHUCK'S TECHNICAL AND MANAGERIAL EXPERTISE IS LIMITED AND ADVERSELY IMPACTS CUSTOMERS.

By comparison, Pennichuck, as a stand-alone utility serving only 30,000 customers "can not reasonably afford the Northeast LLC's tools and level of sophistication."²³ Its President and former Chief Engineer admitted that construction of its water treatment plant was a "major challenge" and that Pennichuck "did not have the internal expertise to carry out an in-depth,

¹⁹ Exhibit 1005, Page 2.

²⁰ Exhibit 1005, Page 2.

²¹ Transcript, September 7, 2007, Page 141.

²² Exhibit 1013, Page 14, Lines 13-16, Transcript September 7, 2007, Page 142.

²³ Exhibit 1013, Pages 13-14.

detailed study of an appropriate approach for the Company to follow.”²⁴ In fact, Pennichuck’s President testified that its current water treatment plant upgrade is the “first major water treatment plant construction project [he has] been involved in,”²⁵ with the exception of a “relatively small”²⁶ treatment plant he constructed for Augusta Water, that was decommissioned eleven years after it was constructed, leaving some \$14 million in treatment plant costs on the books for a treatment plant it no longer uses.²⁷ Indeed, Pennichuck’s limited “in house technical expertise” relative to Philadelphia Suburban was cited by Pennichuck’s former CEO, Mo Arel, in support of the proposed sale of Pennichuck Corporation in 2002.²⁸

This lack of experience has a profound impact on the service provided to customers and rates. In the case of Pennichuck’s own water treatment plant, what was once described to this Commission as a “6 million to 14 million”²⁹ dollar filter upgrade in 2002 increased to a \$25.5 million engineer’s estimate in May of 2004,³⁰ and subsequently to a “final projected cost for the water treatment plant upgrades [of] about \$40,425,000, *not including AFUDC*” according to testimony filed with the Commission on June 16, 2006.³¹ Pennichuck accrues AFUDC,³² at a rate of 8% meaning that cost of the upgrade will continue to increase by a rate of 8% per year until the plant is placed into service.³³ Thus, assuming that assets costing \$20 million have not yet been placed in service, the costs to customers for the treatment plant would increase by 8% per year, or approximately \$1.6 million in the first year.

²⁴ Transcript, September 11, 2007, Pages 15-16.

²⁵ Transcript, September 11, 2007, Pages 15-16.

²⁶ Transcript, September 11, 2007, Page 12, Lines 16-17.

²⁷ Transcript, September 11, 2007, Pages 12-13.

²⁸ Transcript, September 11, 2007, Page 18, Lines 9-23.

²⁹ Transcript, September 11, 2007, Page 19, Lines 23-24.

³⁰ Transcript, September 11, 2007, Page 21, Lines 6-7 & Page 20, Lines 20-24.

³¹ Transcript, September 11, 2007, Page 20, Lines 11-18.

³² AFUDC or “Allowance for Funds Used During Construction” is

³³ *Re Pennichuck Water Works*, 90 NH PUC 371, 374-375 (Order No. 24,510) (noting that “Utilities recognize the revenue from AFUDC in their earnings, even though the associated cash is not collected from ratepayers until the project is completed and in service, and rates are increased to reflect recovery of the new asset”).

Under Pennichuck's ownership as an investor-owned regulated monopoly utility, customers are liable for not only the original estimated cost of \$25.5 million, but also the \$14 million (or 53%) in costs over the original estimate, plus AFUDC and return on Pennichuck's investment.³⁴ As a result, Pennichuck is actually rewarded for its failure to control costs, in theory, as long as it is able to convince the Commission that its costs are reasonable. In practice, however, if Pennichuck itself lacks the technical resources to manage the technical challenges of upgrading its own water treatment plant, it is nearly impossible to imagine how the Commission or its staff could second guess whether in fact those costs were reasonable.

There is, however, another way. Despite Pennichuck's President opining gratuitously that "[i]n this case, Veolia would have never taken a preliminary estimate on a five year project going into a design/build" the City of Nashua using R.W. Beck as its oversight contractor and Veolia Water as its operator, intend to accomplish precisely that.

As a provider of water services under contracts to municipalities, Veolia Water operates in what it described under cross examination as a "very competitive industry".³⁵ In this competitive environment, Veolia Water's business strategy is not to "make a quick buck" by exploiting opportunities for price increases, but rather "to develop a long-term relationship, [...] supplying the citizens of Nashua with water for many years to come."³⁶ This was stated precisely in Veolia Water's pre-filed testimony that:

Veolia Water's "business model relies on its ability to provide results to its customers. The Northeast LLC's ability to provide savings to the City of Nashua and customers of the water system will only increase the likelihood that Nashua will extend and continue to renew its contract with the City of Nashua. In addition, because the success of the Northeast LLC's business is based on its performance in a competitive environment, the Northeast LLC's ability to produce these savings will further its competitive business opportunities in other

³⁴ Transcript, September 11, 2007, Pages 23-24.

³⁵ Transcript, September 11, 2007, Page 155, Lines 15-16.

³⁶ Transcript, September 5, 2007, Page 271, Lines 6-16.

markets.”³⁷

Veolia Water’s approach to the performance of RRRM and capital projects is to “develop a detailed RRRM plan and a capital plan by projects and scope [and] if those projects are approved, for a certain estimated cost, our intent is to deliver those projects within that budget.”³⁸ Furthermore, its approach to capital projects is not to use “open-ended” contracts but rather, “[we] quote a price and we deliver on that price.”³⁹ Indeed, when asked if one of Veolia Water’s capital project costs were “53 percent higher than [when] it had been proposed to the client before construction started, would you consider that a successful project and would you pass that cost onto the customer?” Mr. Philip Aschcroft responded:

Certainly, it's not acceptable. When we bid for some design/build/operate contracts, which is our general modus operandi, we bid a price and we deliver on that price. If the costs go up, we have to absorb it. And, as for coming in at 53 percent over budget, we just wouldn't accept that. And, clearly, there would be some redirection of someone's career.⁴⁰

Indeed Veolia Water must do precisely that because Nashua’s water system will be overseen by R.W. Beck and its “considerable expertise in alternative project delivery methods including design-build contracting and program management.”⁴¹ R.W. Beck’s Project Manager for the Nashua, Mr. Paul Doran, P.E., lists as his first item of experience “utilize[ing] a blend of technical, business and project implementation skills to manage all facets of nationwide Design/Build (D/B), Design/Build/Operate (D/B/O) and Contract Operations (CO) alternate project delivery/contracting approaches for municipal and industrial water and wastewater collection, distribution and treatment projects”.⁴² Stated more plainly, as project manager for

³⁷ Exhibit 1013, Page 18, Lines 3-10.

³⁸ Transcript, September 7, 2007, Page 161, Lines 11-15.

³⁹ Transcript, September 7, 2007, Page 161, Lines 19-20.

⁴⁰ Transcript, September 7, 2007, Page 166, Lines 3-14

⁴¹ Exhibit 1006, Page 2.

⁴² Exhibit 1006, Page 10.

Nashua, Mr. Doran's expertise is ensuring that projects are delivered on time, on budget, and as promised.

Another example of the adverse impact of Pennichuck's limited technical and managerial expertise was revealed in its use of computerized maintenance management software ("CMMS"), and specifically, Synergen. CMMS is a system that Veolia Water uses as a tool to "to optimize asset performance and reliability"⁴³ and an entire section of Nashua's OM&M Agreement with Veolia Water focuses on its use of CMMS-Synergen to develop a comprehensive asset registry and optimize asset performance, maintenance, inventory and other functions,⁴⁴ with a goal of reducing expensive unplanned maintenance.⁴⁵

In his pre-filed testimony to the Commission, Pennichuck's President, Donald Ware, tried to claim that Pennichuck "has used a CMMS package for over five years so Veolia will gain no 'operating efficiencies' over Pennichuck's current operations by using a CMMS."⁴⁶ The CMMS program used by Pennichuck was known to be Synergen.⁴⁷ In fact, prior to the commencement of the Commission's hearings in January 2007, Mr. Ware had responded in data requests that Synergen, Inc., was its "Vendor of CMMS software package"⁴⁸ and in Pennichuck's valuation effort Robert Reilly had identified Synergen as the Company's fully functional work order database and valued it at \$8.1 million."⁴⁹

However, in February of 2007, the Commission staff released an audit report highly critical of Pennichuck's use of Synergen, stating that, despite its spending over \$600,000 to

⁴³ See generally, Exhibit 1013, Page 33 9 (discussing Synergen-CMMS).

⁴⁴ See generally, Exhibit 1005B, Appendix D, Section 9.0, Pages 51-53.

⁴⁵ Exhibit 1013, Page 13 (12).

⁴⁶ Exhibit 3014, Page 9, Lines 10-14.

⁴⁷ See Exhibit 1005C, Page 21 ("PWW is currently using the Synergen maintenance management software (now SPL Enterprise Asset and Work Management System) to track their maintenance tasks and procedures."); and generally, Nashua's Motion to Strike Testimony of Donald Ware.

⁴⁸ Exhibit 1055, Page 3.

⁴⁹ Exhibit 3007A, Pages 30, 31(29, 30); Transcript September 12, 2007 Pages 79-83

acquire and implement the system, its use of the system “as in the prior audit, do not reflect the information in a manner that is useful” due to its failure to record even the performance of maintenance information and that “the system does not appear to be used and useful to the extent reported or anticipated”.⁵⁰ When asked “if this were a Veolia operation, and the system was, after spending \$600,000, the system wasn't used and useful, what would happen within the Company?” Mr. Philip Ashcroft testified that there “would be a major inquiry into why the money had been spent and not utilized”⁵¹ and that he would not consider Veolia Water to be in compliance with its contract, and expects that Nashua’s oversight contractor, R.W. Beck “would be all over that.”⁵²

Armed with the knowledge that Nashua knew that Pennichuck had spent over \$600,000 on a system that Staff had described as “meaningless”, “not used and useful to the extent reported or anticipated”, Donald Ware having previously testified that Synergen was its “Vendor of CMMS software package”⁵³ and that its CMMS package was just as good as Veolia’s, chose to provide false testimony that the CMMS package Pennichuck uses was “OPS 32”, a water treatment plant program that has no CMMS capabilities, which he would later confide to Veolia Water’s project manager was a mistake.⁵⁴

There was indeed a series of mistakes: first when Pennichuck charged its customers over \$600,000, not including its return on investment, for a system that Staff described as not useful; second, when Donald Ware provided written testimony, either with actual knowledge or reckless disregard of its failures, that Pennichuck’s own CMMS package would provide the same “operating efficiencies” that Veolia Water had described in its proposal and in the OM&M

⁵⁰ Transcript, September 7, 2007, Pages 152-153 ; Transcript, September 12, 2007, p. 87-95 (includes 2004 Audit).

⁵¹ Transcript, September 7, 2007, Page 153.

⁵² Transcript, September 7, 2007, Page 153.

⁵³ Exhibit 1055, Page 3.

⁵⁴ See generally, Nashua’s *Motion to Strike Testimony of Donald Ware*.

Agreement; and third, when Donald Ware testified under oath before this Commission that he had no knowledge of what Synergen is used for, and, despite several opportunities to correct his testimony concerning OPS 32, he declined to do so. These mistakes, however, have consequences. For the customers of Pennichuck Water Works, it means that they have spent over \$600,000 to acquire, and allegedly \$8.1 million to maintain, a system that is “useless”. For the Commission, it means that Donald Ware’s testimony, not only that related to Synergen, but also his allegations concerning “disturbing themes” and Pennichuck’s costs of operations and maintenance, should be given no weight in this proceeding.

D. NASHUA’S WILL PROVIDE SERVICE TO CUSTOMERS IN COMPLIANCE WITH ALL CONTRACTUAL AND REGULATORY REQUIREMENTS AND DELIVER PERFORMANCE AT ITS CONTRACT PRICE WHEREAS PENNICHUCK PASSES ALL OF ITS COSTS TO CUSTOMERS WITHOUT ANY CONTRACTUAL OVERSIGHT.

Nashua’s proposed OM&M Agreement with Veolia Water⁵⁵ describes in detail how Nashua will provide service that exceeds that currently provided to customers of Pennichuck. The OM&M Agreement is described as a “proposed” agreement because Nashua intends to modify incorporate any terms and conditions imposed by the Commission as a result of this proceeding. Pennichuck delights in referring to the OM&M Agreement as a “draft” contract, because it hopes to convince the Commission that neither Nashua nor Veolia Water are bound by its terms. However, both Nashua and Veolia Water have entered into a *Memorandum of Understanding* that requires that, they enter into a final “definitive agreement” based on the terms as the OM&M Agreement, and any conditions imposed by the Commission.⁵⁶

The OM&M Agreement, by its very existence, provides customers a level of oversight and accountability that currently does not exist. As a direct contract between the City of Nashua,

⁵⁵ Exhibit 1005B.

⁵⁶ Exhibit 3054.

representing customers of the water system, and Veolia Water, the service provider, it is a document that requires Veolia Water to provide service to customers in compliance not only with its provisions and regulatory requirements such as drinking water standards. Veolia Water must also live up to customers' expectations as to the level of service they receive. If Veolia Water fails to live up to either the terms and conditions of the OM&M Agreement, or customers' expectations, it faces the same risks faced by any supplier of services in a "very competitive industry":⁵⁷ that its Agreement will not be renewed; that it will not receive a more valuable long-term contract; or that its contract could even be terminated for convenience or for cause.⁵⁸

This level of performance and value driven accountability does not currently exist under Pennichuck ownership. Should Pennichuck fail to deliver value for the dollar, fail to live up to its commitments, or fail to provide service in compliance with regulatory requirements, as was demonstrated in evidence before the Commission, the only recourse available to customers is to complain to the company that failed to provide the service in the first instance, or to the Commission staff in order to invoke regulatory process that is likely to be untimely and uncertain in the eyes of the customer. Pennichuck is a regulated monopoly in both the legal and practical sense.

Under Nashua's ownership, however, in addition to continued oversight by the Commission as provided by RSA 362:4, RSA 374, and the conditions imposed by the Commission pursuant to RSA 38:11, customers will have recourse to both their ability to require service in compliance with the terms and condition of Nashua's OM&M Agreement, but also recourse to the very competitive markets for water services to select another service provider.

It is for these reasons that Mr. Philip Ashcroft testified that: with respect to fire insurance

⁵⁷ Transcript, September 5, 2007, Page 155, Lines 15-17.

⁵⁸ See e.g., Exhibit 1005B, Article XIII, Section 13.2.

ratings Veolia Water “will not in any way put the citizens of Nashua at any disadvantage”;⁵⁹ with respect to hydrant flushing that “the bottom line driver for hydrant flushing is, as you stated articulately, is the impact on the customers, and not only residential, but industrial and commercial customers [and] we’ll schedule the hydrant -- the flushing as necessary to be sure we don’t adversely impact the -- the -- the customers”;⁶⁰ and with respect to capital and RRRM projects that Veolia Water will “quote a price and we deliver on that price.”⁶¹ There are numerous other examples.

Nashua does not, however, simply ask the Commission to expose the operation of its water system to competitive forces without clearly defining the requirements for service. Nashua’s oversight contractor, R.W. Beck, described in detail its approach to the oversight of the system and ensuring that Veolia Water meets not only regulatory and contractual requirements, but that it provides value for the services provided. Both the structure and the terms of the OM&M Agreement provide the means to achieve this.

The Agreement provides specific performance standards, such as requiring that Veolia Water operate the system in compliance with the provisions of the OM&M Agreement,⁶² the various operating and maintenance “plans generated in conformity with [the OM&M] Agreement,⁶³ all Applicable State, Federal or local laws and regulations, including all applicable permits, authorizations, licenses or other requirements, including conditions imposed by this Commission,⁶⁴ all applicable State and Federal water quality standards,⁶⁵ Prudent Industry

⁵⁹ Transcript, September 5, 2007, Page 195, Lines 3-8.

⁶⁰ Transcript, September 5, 2007, Page 197-198.

⁶¹ Transcript, September 7, 2007, Page 161, Lines 19-20.

⁶² Exhibit 1005B, Article V, Section 5.1.1.

⁶³ Exhibit 1005B, Article V, Section 5.1.1.

⁶⁴ Exhibit 1005B, Article V, Section 5.1.2.

⁶⁵ Exhibit 1005B, Article V, Section 5.1.3.

Practice,⁶⁶ and where appropriate and consistent with the above, manufacturer's instructions and warranty requirements related to the water system.⁶⁷

E. NASHUA'S OM&M AGREEMENT WITH VEOLIA WATER WILL ENSURE THAT DRINKING WATER VIOLATIONS ARE IDENTIFIED AND PREVENTED BEFORE THEY OCCUR WHEREAS PENNICHUCK WAITS FOR DRINKING WATER VIOLATIONS TO OCCUR IN ORDER TO REDUCE ITS RISK AND GUARANTEE RECOVERY IN RATES.

Pennichuck has received a number of letters of deficiency for violations drinking water standards by the New Hampshire Department of Environmental Services related to its water system operations. These include violations for contaminants such as arsenic,⁶⁸ total coliform bacteria,⁶⁹ radon, uranium and other radiological contaminants,⁷⁰ including violations at the Glen Ridge system viewed by the Commission on December 6, 2006, organics and other violations of drinking water and environmental or safety standards.⁷¹ Additional violations for contaminants such as arsenic, lead, total coliform bacteria, trihalomethanes, and uranium were reported in the company's consumer confidence reports.

It could be argued that violations of drinking water standards is the result of increasingly stringent water quality standards established by Federal or state regulatory agencies. Indeed, Donald Ware argued just that, stating that a May 23, 2005 Letter of Deficiency issued by the NHDES for drinking water violations for uranium at Glen Ridge,⁷² was not due Pennichuck's non-compliance but due to "[t]he way the regulations were written, when the regulation passed, you were immediately in noncompliance for this particular item" and that "Pennichuck had no choice but to wait for this system to find out what the new rules were going to be and then be out

⁶⁶ Exhibit 1005B, Article V, Section 5.1.4.

⁶⁷ Exhibit 1005B, Article V, Section 5.1.5.

⁶⁸ Exhibit 1119, Pages 21-27.

⁶⁹ Exhibit 1119, Pages 9-10.

⁷⁰ Exhibit 1119, Pages 1-3 & 17-20.

⁷¹ Exhibit 1119, Pages 4-8, 11-13 & 25-26.

⁷² Exhibit 1119, Page 1.

of compliance”.⁷³

However, Donald Ware’s testimony misleads the Commission: the maximum contaminant level of 30 [mu]g/L for Uranium, the very standard violated by Pennichuck , was established by the EPA on December 7, 2000.⁷⁴ According to the EPA, “[u]nder the Safe Drinking Water Act, the final rule [for Uranium] becomes effective three years after promulgation[:] December 8, 2003.”⁷⁵ Thus, contrary to Mr. Ware’s testimony to the Commission, that Pennichuck reads all the “notices issued by the EPA”, his testimony that this standard became effective immediately is false. The standard was established and known for nearly five years prior to the NHDES’s issuance of Letter of Deficiency.⁷⁶

Similarly, Mr. Ware’s testimony that Pennichuck did not treat for total coliform violations, an indicator that more harmful bacteria may be present, because “customers don't like chlorine in the water”,⁷⁷ is not credible and demonstrates a level of disregard for the health and safety of the public. In fact, on or about September 10, 2007, the day before Donald Ware’s testimony, it was reported “nine people became ill as a result of drinking the water, that some were hospitalized” due to harmful bacteria, e-coli,⁷⁸ or giardia being present in the water.⁷⁹ It is simply inconceivable that nine customers that fell ill or were hospitalized would prefer to risk their health and safety because they “don’t like chlorine in the water.” Even worse, while the bacteria violations were first reported in July 2007,⁸⁰ Pennichuck did not install treatment until

⁷³ Transcript, September 11, 2007, Page 77-78.

⁷⁴ See Environmental Protection Agency, *National Primary Drinking Water Regulations; Radionuclides, Final Rule*, 65 FR 76708, 76712 (December 7, 2000) *codified as* 40 CFR Pts 9, 141 & 142.

⁷⁵ 65 FR 76708 at 76731.

⁷⁶ Exhibit 1119, Page 1.

⁷⁷ Transcript, September 11, 2007, Page 80, Lines 9-12.

⁷⁸ Transcript, September 11, 2007, Page 83, Lines 21-23.

⁷⁹ Transcript, September 26, 2007, Pages 161-162.

⁸⁰ Transcript, September 26, 2007, Pages 161, Lines 8-11.

September 10, 2007, after a boil water order had been issued.⁸¹

Pennichuck's strategy of not acting to protect the public health and waiting "to find out what the new rules were going to be and then be out of compliance" because "if we spend money on proposed regulations that aren't finalized, and they aren't finalized, such as the radon standard, *we would not be able to earn on that investment*"⁸² is inconsistent with the public interest, as embodied by the State and Federal Drinking Water Acts, and the NHDES findings of violations.

It is also, fundamentally at odds with the approach to be taken by Nashua and Veolia Water. Under the OM&M Agreement, Veolia Water is required to operate the system in compliance with all "State, Federal or local laws and regulations, including all applicable permits, authorizations, licenses or other requirements"⁸³ and all applicable State and Federal water quality standards.⁸⁴ As part of its initial 5-year capital improvements plan, updated annually, Veolia Water is also required to "identify capital improvement projects necessary for the OM&M of the Managed Assets in accordance with this Agreement, *or in order to meet prospective operating parameters, such as changes in regulatory standards*".⁸⁵ In the event that Veolia Water fails to identify the necessary improvements, it is liable for any resulting fines or penalties and must indemnify Nashua for the same.⁸⁶

III. NASHUA WILL IMPROVE CUSTOMER SERVICE.

The City of Nashua, in partnership with Veolia Water, will provide customer service that meets or exceeds that currently provided by the Pennichuck Water Works. Testimony provided to the Commission, both in writing and at the Commission's hearings, demonstrated that

⁸¹ Transcript, September 26, 2007, Pages 161-162 & September 11, 2007, Page 83, Lines 21-23.

⁸² Transcript, September 11, 2007, Page 78, Lines 6-13.

⁸³ Exhibit 1005B, Article V, Section 5.1.2., Page 9.

⁸⁴ Exhibit 1005B, Article V, Section 5.1.3., Page 9.

⁸⁵ Exhibit 1005B, Appendix G, Section 2 (C), Page 78 (emphasis added).

⁸⁶ Exhibit 1005B, Section 12.4, Page 21.

Nashua's customer service department is highly efficient and capable of doing whatever is necessary in order to provide high quality customer service related to customer billings and collections. The evidence showed Nashua, in partnership with Veolia Water, will use sophisticated management tools, call logs and work orders to track customer and respond to customer service questions related to operational issues. Finally, Nashua demonstrated that criticisms and concerns expressed by Pennichuck and Staff witnesses that Nashua's customer service proposal is inadequate are based on fundamental errors and misunderstandings.

A. NASHUA'S CUSTOMER SERVICE DEPARTMENT IS HIGHLY EFFICIENT AND CAPABLE OF DOING WHATEVER IS NECESSARY IN ORDER TO PROVIDE HIGH QUALITY CUSTOMER SERVICE

Nashua presented evidence that its current customer billings and collections department is highly efficient and capable of doing whatever is necessary in order to provide high quality customer service for all of its enterprises, including its property tax, waste water, vehicle registrations, and all of its other enterprises. Nashua's Chief Financial Officer, Carol Anderson, and Deputy Treasurer-Tax Collector, Ruth Raswyck, testified that the City of Nashua's billings and collections department currently manages 141,000 customer bills per year related to its wastewater treatment facilities, property taxation and other services provided by the City.⁸⁷ These 141,000 bills per year include 27,000 property tax customers, over 18,000 residential sewer system customers, and 1,000 commercial and industrial sewer system customers.⁸⁸

Ms. Anderson and Ms. Raswyck testified that Nashua currently employs six full time customer service employees and one part-time data entry person within the billings and collections department.⁸⁹ They indicated that "[a]ll six [customer service representatives] are

⁸⁷ Exhibit 1008, Page 6; Transcript, January 11, 2007, Page 158.

⁸⁸ Transcript, January 11, 2007, Pages 163-164 (commercial and industrial customers are billed monthly)

⁸⁹ Transcript, January 11, 2007, Page 165, Lines 14-19.

highly and fully-cross trained to handle waste water, property tax, and all the other billings”⁹⁰ questions, and, when they are not performing customer service functions, they are “looking at other ways to streamline functions, whether its in [the customer service department] or in other departments[.]”⁹¹ Ms. Anderson and Raswyck also explained to the Commission that the six existing cross-trained employees have time and resources to assist in providing customer service to customers of the water system.⁹²

Ms. Anderson and Raswyck explained that the City has experience using Pennichuck’s water consumption data to generate customer bills for its waste water system and has “a ten year history” of information “at our fingertips”⁹³ including pipe sizes, group numbers, consumption history, periods of billing. Because of the City’s experience using the existing Pennichuck data, Ms. Anderson and Raswyck indicated that assumption of the Pennichuck water billings and collections function “is not going to be a major change” for its billings and collections department.⁹⁴ Nashua’s already puts Pennichuck “meter readings through extensive testing to pick up”⁹⁵ errors it receives from the company including “poor readings, decimal points missing, meter removed information that we have not always gotten, negative bills, negative consumption, [and] zero consumption.”⁹⁶ Indeed, during the normal course of operations, Nashua’s customer service staff regularly performs “a series of exception reports”⁹⁷ that discovered in 2002, that approximately 2,500 customers⁹⁸ had received bills containing “zero

⁹⁰ Transcript, January 11, 2007, Page 166, Lines 7-9.

⁹¹ Transcript, January 11, 2007, Page 167 Lines 9-18.

⁹² Transcript, January 11, 2007, Pages 166-167, Beginning at Line 12.

⁹³ Transcript, January 11, 2007, Page 191, Lines 1-3.

⁹⁴ Transcript, January 11, 2007, Page 191, Lines 3-81.

⁹⁵ Transcript, January 11, 2007, Page 193, Lines 193.

⁹⁶ Transcript, January 11, 2007, Page 193, Lines 5-8; see also Exhibit 1008, Page 5, Lines 68-75 & Page 10.

⁹⁷ Transcript, January 11, 2007, Page 194, Lines 2-5.

⁹⁸ Exhibit 1008, Page 10.

consumption, high/low readings, readings that are not complete in a 90 day period”.⁹⁹ In fact, it was Nashua’s customer service representatives that discovered “major discrepancies” and “unusually high or low readings” in Pennichuck’s billing data, and brought it to Pennichuck’s attention.¹⁰⁰ Despite Pennichuck’s commitment that “it has taken steps to correct the situation so that it will not happen again[,]”¹⁰¹ Ms. Anderson and Ms. Raswyck testified that these problems continue to this day.¹⁰² Nashua corrected these errors through the diligence and professionalism of its own staff. Neither Pennichuck nor Staff provided any explanation as to why Pennichuck’s own staff failed to identify and correct these errors.

B. NASHUA’S CUSTOMER SERVICE PROPOSAL

The City of Nashua proposes to use: (a) two additional customer service representatives within the City of Nashua to handle billing and collection functions; (b) all six existing customer service representatives, plus other staff,¹⁰³ who will be cross-trained to respond to customer inquiries related to the water system to be acquired by this proceeding; and (c) additional customer service representatives to be employed by Veolia Water to perform customer service functions related to operations.

During the Commission’s hearings and in their testimony, both Pennichuck and Staff focused on Veolia’s staffing proposal for two customer service employees related to operations. These two employees proposed by Veolia Water reflect its estimate of the incremental number of employees necessary to meet its customer service obligations under its OM&M Agreement with the City of Nashua. The OM&M Agreement, however, requires that Veolia Water provide customer service related to operations in full compliance with the Agreement, applicable law,

⁹⁹ Transcript, January 11, 2007, Page 194, Lines 2-5.

¹⁰⁰ Exhibit 1008, Page 5 & Page 10 (2,500 customer accounts incorrectly billed).

¹⁰¹ Exhibit 1008, Page 10.

¹⁰² Transcript, January 11, 2007, Pages 251-252

¹⁰³ This would include data entry staff and interns used from time-to-time.

and prudent industry practice, *regardless of the number of employees required to get the job done.*

In fact, the OM&M Agreement requires that Veolia Water “maintain the number of qualified, certified and experienced employees, staff and third-party contractors to operate, maintain and manage the Managed Assets in accordance with this Agreement”¹⁰⁴ and sets specific enforceable standards for customer service. For example, Veolia Water is required to: (a) perform all meter reading as required by the OM&M Agreement;¹⁰⁵ (b) “[p]erform service disconnects (shutoffs) and reconnects (turn ons) for enforcement of payment and for other utility requirements [as required by Nashua’s] rules pertaining to water service”;¹⁰⁶ (c) test meters in accordance with PUC regulations;¹⁰⁷ (d) “[i]nform and update customers during service outages”;¹⁰⁸ and (e) “provide a customer contact *to answer all water quality-related customer inquiries*”.¹⁰⁹ In addition, Veolia Water must operate and manage the water system in compliance with all applicable laws and regulations, including those related to customer service such as the Commission’s Puc 1200 rules.¹¹⁰ Thus, the OM&M Agreement requires Veolia Water meet all customer service and operational requirements regardless of the number of employees required.

Nashua and Veolia Water are confident that evidence demonstrates that Nashua and Veolia Water will provide customer service that meets or exceeds that currently provided by Pennichuck. Moreover, both Nashua and Veolia Water have a strong incentive to provide the best possible customer service because failure to provide quality customer service would result

¹⁰⁴ Exhibit 1005B, Appendix D, Section 15.0 (emphasis added).

¹⁰⁵ Exhibit 1005B, Section 7.2, Page 12.

¹⁰⁶ Exhibit 1005B, Appendix D, Section 7.0 (b), Page 50.

¹⁰⁷ Exhibit 1005B, Appendix D, Section 7.0 (c), Page 50.

¹⁰⁸ Exhibit 1005B, Appendix D, Section 7.0 (h), Page 51.

¹⁰⁹ Exhibit 1005B, Appendix D, Section 7.0 (i), Page 51 (emphasis added).

¹¹⁰ Exhibit 1005B, Article 5.1, Page 9; Appendix D, Section 7.0 (d), Page 51.

in complaints to the City of Nashua's Mayor and Board of Aldermen, both of which are accountable to the public they serve. Furthermore, because the OM&M Agreement is limited to an initial term of six years, Veolia Water has an exceptionally strong incentive to provide superior customer service in order to obtain renewals of the Agreement, and potentially to negotiate a long-term contract thereafter. As a regulated monopoly, Pennichuck Water Works has no such incentive.

C. NASHUA'S PARTNERSHIP WITH VEOLIA WATER WILL ENHANCE CUSTOMER SERVICE.

Nashua's customer service representatives will provide the first point of contact for customers. However, behind the scenes, Nashua and Veolia Water will work in partnership to greatly enhance the customer service.

Veolia Water brings to Nashua its experience operating water systems throughout the Northeast, North America and world-wide to the benefit of Nashua customers.¹¹¹ Veolia Water provided testimony that "staff involved in the operation, maintenance and management of Nashua's water system will have the ability to draw upon professional experience and resources gained from other water systems in the United States and around the globe."¹¹² In the case of the Indianapolis Water System, for example, Veolia Water implemented automation of customer bill payment "which resulted in streamlining this task from hours to minutes, resulting in faster response time to customer inquiries" and numerous other improvements.¹¹³

Veolia Water will maintain a call log of all customer inquiries related to water service, water quality or operational issues and "[w]hen necessary, specific work orders will be issued to

¹¹¹ See e.g., Exhibit 1051, Pages 3-15 (List of North American Water Systems); Exhibit 1005, Page 2 (Scope of Water and Wastewater operations in North America).

¹¹² Exhibit 1013, Page 13, Line 17 to Page 14, Line 19.

¹¹³ Exhibit 1013, Page 29.

investigate and resolve the issue related to the call.”¹¹⁴ Veolia Water provided examples of detailed customer service process charts it uses to ensure that all customer inquiries and related field work is completed in a timely and efficient matter.¹¹⁵ These and other measures will ensure that all customer service responsibilities will be clearly delineated and tracked in order to ensure that customers receive timely and efficient responses to all billings or operational inquiries.

For example, whenever Nashua receives a request for customer service such as a new account or new service connection, Veolia Water is required to generate a work order which Nashua customer service will have the ability to track by accessing Veolia Water’s work order system.¹¹⁶ This system will “(a) track work that has been transitioned to other divisions or entities, (b) ensure completion of any necessary follow up tasks, and (c) update the database of completed work. This system will ensure that all divisions will have access to the most recent status of the work which, in turn, will allow the agents to provide quality customer service to the Nashua community.”¹¹⁷

Nashua’s OM&M Agreement requires that Veolia Water implement a CMMS system, called Synergen, capable of “issuing equipment status and repair reports”¹¹⁸ that can be accessed by customer service representatives that would inform them not only of the status of work on their service connection, but also the cost, time and materials spent performing work to address their service requests.¹¹⁹ Pennichuck also uses Synergen. However, despite its spending over

¹¹⁴ Exhibit 1008, Page 7, Response to Staff Data Request 4-22.

¹¹⁵ The customer service process charts were provided in response to data requests included in Exhibit 1053 and used extensively by Staff during cross examination of Ms. Anderson and Raswyck (see e.g. Transcript, January 11, 2007, Page 181, Lines 7-16); and Veolia Water (see Transcript, September 5, 2007, Pages 305 Line 16 to Page 309 Line 7; Pages 317 Line 15 to Page 322, Line 11). However, following the hearings on October 17, 2007, the Commission ruled that this exhibit was inadmissible as supplemental testimony.

¹¹⁶ Exhibit 1005B, Page 12, Para. 7.3.

¹¹⁷ Exhibit 1013, Pages 9-10.

¹¹⁸ Exhibit 1005B,

¹¹⁹ See generally, Exhibit 1005B, Section 9.0, beginning at Page 51.

\$600,000 to purchase this system,¹²⁰ and over \$8 million in expenses to maintain its work order database,¹²¹ Pennichuck's President and Chief Engineer testified that he could not recall what the system was used for and,¹²² due to numerous errors in database, the Commission staff has described the information contained therein "not useful" and "meaningless" because of the lack of quality information concerning labor, inventory and other costs incurred related to work performed in the field.¹²³

D. VEOLIA WATER'S CUSTOMER SERVICE EXPERIENCE IN INDIANAPOLIS

Veolia Water's experience transitioning investor-owned utilities to public ownership while maintaining, and actually improving customer service will benefit customers. As noted in the testimony of Philip Ashcroft et al.:¹²⁴

Many of the team members, including key technical and management staff, were involved in Indianapolis in 2002 when the City acquired the water assets from an investor owned utility and then transitioned the operations and management responsibility for the system to a public-private partnership with a Veolia Water North America subsidiary providing them with unique experience to carry out this transition.

Veolia Water's experience transitioning the Indianapolis Water system from private to public operations will ensure that customers continue to receive the same or better customer service during the transition and in the future. Veolia Water's testimony includes a customer satisfaction survey documenting the improvements made to customer service relative to the prior investor-owned utility.¹²⁵

Veolia Water's experience in Indianapolis is also helpful to understanding the degree to which an efficiently operated customer service department can produce savings for customers.

¹²⁰ Transcript, September 11, 2007, Page 56.

¹²¹ Exhibit 30071, Pages 30-31.

¹²² Transcript, September 11, 2007, Page 56.

¹²³ See, Transcript, September 7, 2007, Pages 152-153; Transcript, September 12, 2007, Pages 85-95.

¹²⁴ Exhibit 1005, Page 4.

¹²⁵ Exhibit 1013, Pages 38-46.

For example, Veolia Water further testified that:

*In 2005, Veolia Water Indianapolis's twenty-seven, full-time, customer service representatives handled 614,027 calls (or 51,169 calls per month on average with a peak month of 58,849 calls). In other words, each customer service representative in Indianapolis handled 1,859 calls per month, roughly the same volume as the entire PWW customer service staff.*¹²⁶

Veolia Water's testimony provides a significant measure of the savings that can result from efficient, performance-based operations relative to a regulated monopoly like Pennichuck that, despite its failures to successfully implement technology, is able to recover its cash from its customers.

E. PENNICHUCK AND STAFF CRITICISMS OF NASHUA'S CUSTOMER SERVICE PROPOSAL ARE BASED ON FUNDAMENTAL ERRORS AND MISUNDERSTANDINGS

Pennichuck and Staff provided testimony criticizing Nashua's customer service proposal. However, the evidence presented to the Commission demonstrated that Pennichuck and Staff witnesses made fundamental errors in their assumptions that allowed them to reach that they desired or expected. These errors include the following:

- Pennichuck and Staff criticisms were based on Pennichuck's current staffing levels and failed to take in to account that 22,419 customers, nearly one-half of the total customers served by Pennichuck, are not customers of the system to be acquired by this proceeding
- Pennichuck and Staff failed to consider or conduct any real analysis of Veolia Water's experience providing customer service as a regulated utility in the City of Indianapolis.
- Pennichuck and Staff witnesses failed to consider that, within franchises located outside of the City, Nashua's customer service will be subject to Commission jurisdiction.
- Pennichuck and Staff witnesses conclusion that a lack of coordination or delineation of

¹²⁶ Exhibit 1013, Page 11, Lines 13-19 (emphasis added).

responsibilities will occur is pure speculation or opinion, unsupported by any real evidence.

These errors are addressed below.

1. Pennichuck and Staff failed to take into account that half of the customers served by PWW customer service department are not customers of PWW.

Mr. Donald Ware provided written testimony stating that:

Customer service - The Veolia staffing model (DLW-5C) shows only two customer service employees to handle customer complaints and requests for service. **PWW has at least a half dozen employees who field well over 10,000 calls a year from customers on a wide range of inquiries.** This reduction in staffing can be expected to have a direct impact on responsiveness to customer concerns.¹²⁷

Mr. Ware failed to inform the Commission of a key point: Pennichuck Water Works customer service employees provide customer service not only for the 24,500 customers of Pennichuck Water Works, Inc., but they also serve “approximately 4,900 customers” of PEU,¹²⁸ a total of 1,685 customers of PAC,¹²⁹ and, as part of its unregulated service company, 5,300 customers in Hudson,¹³⁰ 7,300 customers in Barnstable and 3,234 customers in Salisbury, Massachusetts.¹³¹ Pennichuck’s customer service representatives also perform customer service functions for “developer and other privately owned water systems in New Hampshire and Massachusetts under contracts with over 80 owners of those systems.”¹³² Thus, Pennichuck customer service representatives serve over 22,419 non-PWW customers, in addition to the 24,500 customers of the system to be acquired by Nashua.

Ms. Hartley also confirmed in her testimony that Pennichuck’s customer service

¹²⁷ Exhibit 3014, Page 7, Lines 1-6 (emphasis added).

¹²⁸ Exhibit 3001, Page 7, Lines 20-21.

¹²⁹ Exhibit 3001, Page 9, Lines 1-6.

¹³⁰ Although not reflected in the testimony, Nashua understands that, similar to Nashua proposal, the Town of Hudson performs its own billings and collections while Pennichuck provides customer service related to operations.

¹³¹ Exhibit 3001, Page 9, Lines 16-20.

¹³² Exhibit 3001, Page 9, Lines 16-20.

department serves some 21,400 non-PWW customers, in addition to those that Nashua will acquire as a result of this proceeding.¹³³ However, like Mr. Ware, in her data responses and testimony before the Commission, she attempted to use the entire Pennichuck customer service staff to demonstrate that Nashua's customer service levels are "woefully inadequate *to meet the needs of the Company's 24,000 customers.*"¹³⁴ Thus, while both Mr. Ware and Ms. Hartley were fully aware that Pennichuck Water Works represents only half of Pennichuck's total customers, their testimony attempts to mislead the Commission into reaching the conclusion that the entire customer service staff is necessary to serve only "the Company's 24,000 customers."¹³⁵

In fact, in her testimony to the Commission, Ms. Hartley attempted to add additional employees from other Departments to beef up the numbers:

There's currently six full-time equivalents at Pennichuck and two part-time employees at Pennichuck, and two supervisors. One is a billing supervisor and the other is the manager of the department. That's at Pennichuck. And, then, we have two administrative assistants located at our Will Street facility, and one administrative assistant located at the Water Street -- at the water treatment plant, and then administrative assistant for engineering. And, in some fashion, those folks and those administrative assistants in the outlying, outside the department, still service customers in one fashion or another. So, even though there are six customer service reps, and a receptionist, I neglected to mention that, at the front desk to take payments, we have a complement of people with different expertises and even cross-trained in the Customer Service Department to answer any question a customer has regarding their service, their water quality, or pressure, or any of the various items that may come forward.¹³⁶

It should be apparent that Ms. Hartley is simply an attempt to multiply the number of customer service employees Pennichuck has in order to make as fantastic a comparison as possible, while ignoring the fact that at least half of customer service is being provided non-PWW customers.

She adds a supervisor and manager overseeing the customer service, four administrative

¹³³ Exhibit 3003, Page

¹³⁴ Exhibit 1068, Page 1, Para (a) (emphasis added).

¹³⁵ Exhibit 1068, Page 1, Para (a).

¹³⁶ Transcript, January 13, 2007, Pages 105-106.

assistants, additional administrative assistants in outlying areas, plus a receptionist, all of whom she claims are necessary to perform customer service. Ms. Hartley testified that she was unable to state how many calls or employees were necessary in order to provide customer service to non-PWW customers, or its unregulated insurance program sales.¹³⁷

Her testimony does reveal one important point. Nearly all staff, whether a field services employee, receptionist, treatment plant specialist, engineer, or any other employee performs a function related to customer service. The fact that Veolia Water's proposal identified two employees to provide as customer service some operations function simply recognizes that it expects two employees will focus exclusively on customer service questions related to operation of the water system. However, simply doing the arithmetic shows that Nashua has selected an appropriate number of customer service representatives. Pennichuck employs six full time, plus two part-time, customer service representatives to handle calls, plus one utility disconnect employee, as well as a supervisor and a manager.¹³⁸ Dividing these nine¹³⁹ or ten full time equivalent employees in half to reflect that approximately half of the customer service is being provided to non-PWW customers results in a total of only four and one half to five employees.

2. Pennichuck and Staff failed to consider Veolia Water's experience providing customer service as a regulated utility in the City of Indianapolis.

Pennichuck and Staff witnesses failed to take into account Veolia Water's experience providing customer service to the City of Indianapolis, a regulated water utility.¹⁴⁰ Both with respect to the improvements made to customer service, and the fact that Veolia Water Indianapolis is a water utility regulated by the Indiana Utility Regulatory Commission.

¹³⁷ Transcript, January 13, 2007, Page 147, Lines 1-19.

¹³⁸ Exhibit 1068.

¹³⁹ Transcript, September 13, 2007, Page 145, Lines 18-19.

¹⁴⁰ Transcript, September 26, 2007, Pages 42-50.

3. Pennichuck and Staff failed to consider that Nashua’s customer service outside the City will be subject to Commission jurisdiction.

Both Pennichuck and Staff witnesses based much of their criticism on the loss of Commission oversight. Donald Ware’s testimony represents the extreme end of such testimony, when he states that:

If Nashua were to take over PWW’s assets, it would not be governed by the NHPUC from a ratemaking or customer service perspective, it would not be subject to the statewide DIG SAFE program, it would be exempt from mandatory zoning and planning ordinances, and its own employees would not have to comply with federal worker safety regulations promulgated by OSHA. The loss of these protections for PWW’s customers, the public and utility employees is quite significant, and could well lead over time to a degradation of service quality, land use protection, and public and worker safety.¹⁴¹

As a matter of law, Nashua’s franchises outside the City of Nashua remain subject to the Commission’s jurisdiction under RSA 362:4, III-a and RSA 374. Nashua will continue to be subject to the Commission’s jurisdiction except as set forth in the limited areas articulated by statute., i.e. auditing, reporting, and to the extent that it provides the same service to all customers outside its borders, rates. However, nothing in N.H. law suggests that Nashua will be wholly exempt from regulations by the Commission, particularly to service outside its borders.

IV. VALUATION & RATES

In *Appeal of Seacoast Anti-Pollution League*, 125 NH 708 (1984), the Court reminded the Commission that “the primary public interest may be found to be affected injuriously” “if it appears, upon all the evidence, that the capitalization sought is so high that the utility, because of [its] inability to earn operating costs, depreciation and other charges, will not be able to give its consumers at reasonable rates the service to which they are entitled” 125 NH at 718. Consequently, one of the most important, if not the “primary” issues in the public interest

¹⁴¹ Exhibit 3004, Pages 13-14.

determination is whether, under Nashua ownership, customers will be afforded the service to which they are entitled at reasonable rates. Nashua asserts that the evidence before the Commission demonstrates that customers, under its ownership, will receive service that will equal or exceed that provided under continued PWW ownership at rates below those that will be charged under continued PWW ownership.

In order for the Commission to make the kind of rate analysis necessary for its public interest determination, it must establish the price or “fair value” under RSA 38:9 Nashua must pay for the PWW assets. The value concluded by the Commission is largely determinative of the rates Nashua will charge and therefore is the first inquiry of this Brief.¹⁴²

A. THE FAIR MARKET VALUE OF THE PWW ASSETS WILL BE \$139,000,000 AS OF DECEMBER 31, 2007.

Nashua employed George E. Sansoucy, P.E., LLC to appraise the value of the PWW assets. The firm’s certified appraiser, Glen C. Walker with assistance from George E. Sansoucy, P.E., employing all three generally accepted appraisal methods¹⁴³ concluded that the value of PWW’s assets as of December 31, 2004 was \$85,000,000.¹⁴⁴ Because of the addition of new plant, property and equipment by PWW after December 23, 2004, much of it related to capital improvements to its water treatment plant, Walker increased the fair market value by the cost of such plant, property and equipment by \$54,000,000 to a total of \$139,000,000.¹⁴⁵ A true up to the date of closing will also be necessary.

In his appraisal of the PWW assets as of December 31, 2004, Walker reconciled the three appraised methods used to his final determination of value by relying on the sales comparison and income capitalization methods, which he asserted, were the most reliable. The trended cost

¹⁴² See Nashua’s March 8, 2005 Memorandum Regarding Bifurcation Page 3.

¹⁴³ Cost, sales comparison and income capitalization. The Appraisal of Real Estate, 12th Ed. Page 62.

¹⁴⁴ Exhibit 1007, Page 3; Exhibit 1007A, Page 2, 65.

¹⁴⁵ Exhibit 1017, Page 5.

approach performed by Sansoucy was given no weight because the value derived (cost new less physical deterioration and functional obsolescence), \$104,000,000 was greater than what the revenue from the PWW system could support. As a result a deduction for economic obsolescence would have been necessary that would have reduced the cost approach value to an amount equal to those derived by the sales and income methods.¹⁴⁶

Because Walker ultimately gave no weight to it, PWW's attack on the cost approach performed by Sansoucy was largely irrelevant. Moreover, it was ironic for the Company to urge that the use of a trended cost analysis was inappropriate because it failed to keep accurate continuing property records (CPRs) as required by the Uniform System of Accounts for Water Utilities, Rule Puc 610. As Sansoucy noted, in any event, even though, use of trended cost results in inaccuracies when the CPR's are not properly kept, "[I]t's an efficient method of arriving at a good band of reproduction cost and some of the [in]accuracies that are bound to occur in regulatory bookkeeping become de minimus."¹⁴⁷

The attack on cost and Walker's determination to give no weight to it, because of the extent of economic depreciation evidenced by the sales and income approach, was necessitated as a result of PWW's valuation witness, Robert Reilly's reliance on it; and especially because of his insistence that since the water system was special purpose property, the cost method was most reliable. As with several other important valuation issues, Mr. Reilly was wrong.

There is no doubt that the water system is special purpose property.¹⁴⁸ Likewise there is no doubt that the cost method is not the exclusive method for valuing special purpose property. The key, as noted by Sansoucy and Walker, and confirmed by *The Appraisal of Real Estate*, is

¹⁴⁶ *The Appraisal of Real Estate, 12th Ed.*, Pages 412-414.

¹⁴⁷ Transcript, September 4, 2007, Pages 206, 207.

¹⁴⁸ Transcript September 4, 2007, Pages 241-243; Transcript September 10, 2007 (Afternoon) Pages 72-72.

the existence of a market for the special purpose property.¹⁴⁹ What was once special purpose property with no market can become special purpose property with a limited market that provides evidence of value that must be considered. For example, when Sansoucy and Walker appraised the PWW property in 1995 there was an insufficient market on which they could rely. By 2004, however, an “active and transparent market” of sales of water systems had developed such that the cost method was no longer the most reliable.¹⁵⁰ Once a market develops, even if it is limited, an appraiser is obligated to consider the sales and if they provide evidence of value to utilize the findings.¹⁵¹ Because the cost method sets the upper limit of value,¹⁵² it was critical for Mr. Reilly to justify its use at all cost and to ignore the market evidence.

The sales method used by Walker identified 28 sales of water systems that he analyzed for comparability to PWW. The characteristics he considered in selecting comparable sales to PWW were: size (customers, assets, revenue); location; motivation of buyer and seller; expectations of future cash flows; whether other businesses were involved; age of the assts; and physical condition and economic characteristics.¹⁵³ Ultimately Walker concluded that the characterization that had the greatest impact was size and the sales were grouped according to the National Association of Water Companies classification for revenue.¹⁵⁴ From these 28 sales Walker developed market-based ratios he believed were the best indicators of the value of PWW and ultimately selected sale price to net plant less CIAC and sale price to EBITDA. Applying these ratios he concluded that the larger system typically commanded a premium over the smaller systems¹⁵⁵ and as a result he selected those sales of systems with gross annual revenues

¹⁴⁹ Transcript September 4, 2007, Pages 250, 251; *The Appraisal of Real Estate, 12th Ed.*, Pages 354, 419.

¹⁵⁰ Transcript September 4, 2007, Pages 243, 244.

¹⁵¹ *The Appraisal of Real Estate, 12th Ed.*, Page 419.

¹⁵² *Ibid* Page 355.

¹⁵³ Exhibit 1007A Pages 49, 50.

¹⁵⁴ *Ibid*.

¹⁵⁵ *Ibid* Pages 53, 54.

of \$10 million or more as the most comparable to PWW.¹⁵⁶ The ratios established for the 9 most comparable sales were then applied to PWW, which resulted in range of values under the sales comparison approach of between \$81.6 million and \$96 million, which Walker reconciled to \$89 million.¹⁵⁷

In order to determine the reliability of his sales approach value, Mr. Walker examined the auction of Pennichuck Corp. in 2002 which resulted in four confidential competing bids for the entire company including PWW.¹⁵⁸ The bid made by Philadelphia Suburban for \$106 million was accepted by Pennichuck Corp. following the auction process. Mr. Walker deemed the 2002 offer of Philadelphia Suburban, which was withdrawn only after Nashua took its RSA 38:3 vote, to be an important indicator and evidence of value as December 31, 2004 and a confirmation of his sales comparison value.¹⁵⁹

PWW's cross-examination of Walker concerning his sales method utilized a ploy often used by lawyers to attack an appraisal witness who has hurt them – identify an error contained in the mountain of data relied upon by the witness to imply that his work was not reliable but never provide the trier of fact with the impact of the error. So Mr. Conner pointed out that one of the sales relied upon by Walker contained erroneous information transferred from his work papers¹⁶⁰ to his report¹⁶¹ but never asked what impact dominating that sale would have on his sales analysis. In fact, as Mr. Walker testified to on redirect, over Mr. Conner's objection, there was **no** impact whatsoever and equally important his income method supported his sales method even

¹⁵⁶ Ibid.

¹⁵⁷ Ibid Pages 55, 56.

¹⁵⁸ Transcript, September 10, 2007, Pages 78, 79; Exhibit 1015 (confidential version) Pages 7-8, 48, GES Exhibit, 11.

¹⁵⁹ Ibid.

¹⁶⁰ Exhibit 3252. Walker agreed that the document contained in his work papers marked by PWW was erroneous. He was not permitted to introduce the correct document, which was contained in his copy of his work papers.

¹⁶¹ Exhibit 1007A.

with the sale in question eliminated.¹⁶² The PWW cross-examination of Walker concerning sales accomplished nothing. The ratios he developed, his reliance on the Philadelphia Suburban transaction and his conclusions were untouched and stand in stark contrast with Mr. Reilly's failure to complete or weight the sales method.¹⁶³

The income capitalization method used by Mr. Walker recognizes that buyers of income producing property such as a water system are making an investment and view cash flow as the critical element affecting value.¹⁶⁴ Under the income capitalization method a value is estimated by capitalizing the cash flows available to satisfy debt and equity with a market based rate of return.¹⁶⁵ Because Walker's capitalization rate assumed no further earning growth, it is considered a yield capitalization method.¹⁶⁶ The value estimated by Mr. Walker applying this method was \$80,000,00.¹⁶⁷ When developing the income capitalization approach Walker correctly employed a "typical buyer"¹⁶⁸ as opposed to the not-for-profit or special buyer used by PWW's expert Robert Reilly which has certain benefits or synergies available to it that a "typical buyer" would not. These benefits or synergies would include, inter alia, the ability to utilize tax-exempt debt and to avoid certain types of taxes and other expenses. The availability of these benefits to a not-for-profit buyer are not attributes of the property being acquired nor are they subsequently transferable by the not-for-profit buyer unless it also sells to another not-for-profit buyer. Rather, they are attributes that are unique to the buyer and impact the buyer's investment decision.

Mr. Walker then reconciled the cost, sales comparison and income capitalization

¹⁶² Transcript September 10, 2007 (Afternoon), Pages 111-113.

¹⁶³ Exhibit 3007A, Pages 46.

¹⁶⁴ Transcript, September 10, 2007 (Afternoon) Page 33; *The Appraisal of Real Estate, 12th Ed.*, Page 471.

¹⁶⁵ Exhibit 1007A, Pages 59, 63(54), 63(58).

¹⁶⁶ Transcript, September 4, 2007, Pages 252, 263, 264; Exhibit 1007A, Pages 63(58).

¹⁶⁷ Exhibit 1007A, Pages 63(58), 64(59).

¹⁶⁸ Exhibit 1007B, Pages 114-120 (Appendix K).

approaches to arrive at a final value estimate of \$85 million as December 31, 2004 which was the valuation date established by the Commission. As noted above, Walker then trued up this value to account for the additions to rate base made by PWW subsequent to December 31, 2004 and concluded that the value of PWW's assets as of December 31, 2007 would be \$139,000,000.

The Walker valuation as of December 21, 2004 was confirmed by an unlikely source. John Joyner, President of IMG, a consulting firm with significant experience in the utility industry and investment banking,¹⁶⁹ was produced by PWW to criticize Nashua's contract with Veolia. Mr. Joyner and two of his colleagues at IMG, including an SEC registered broker-dealer who provided financial advisory services for IMG Capital, authored a report entitled "Tapping Public Assets"¹⁷⁰ which suggested that municipalities should consider selling their infrastructure assets including water systems to private companies to ease financial crunches.¹⁷¹ In the section of the report providing advice about the value of infrastructure assets, Mr. Joyner and his colleagues stated certain "rules of thumb" based on "experience and case studies of comparable sales" were applicable.¹⁷² For municipal water utilities Mr. Joyner and his IMG colleagues opined that regulated utilities "usually sell for at or close to their 'rate base'" which they defined as original cost less depreciation.¹⁷³ Sales prices for water utilities they stated "usually range from \$1,500 to \$3,500 per customer connection..."¹⁷⁴ When Mr. Joyner applied the highest price in the range to PWW (25,000 customers), it yielded a value of \$87.5 million,¹⁷⁵ virtually identical to the value concluded by Mr. Walker on December 31, 2004.

Much time during the cross examination of Sansoucy and Walker was devoted to the

¹⁶⁹ Transcript, September 2007, Pages 47, 48.

¹⁷⁰ Ibid at Pages 48, 49; Exhibit 1099.

¹⁷¹ Exhibit 1099 Pages 4(1).

¹⁷² Ibid., Page 6(3).

¹⁷³ Ibid.

¹⁷⁴ Ibid.

¹⁷⁵ Transcript Sept 2007, Page 51.

allegations of PWW that, in particular, Sansoucy was biased and partial; that their engagement violated USPAP; and that they were not credible witnesses.¹⁷⁶ This “shoot the messenger” approach by PWW is an indication of the harm it believed Nashua’s valuation had inflicted. Rather than challenge the conclusion of value, PWW and its ally, Merrimack, attacked the witnesses. The effort flopped.

Sansoucy and Walker have been providing utility valuations in New Hampshire and elsewhere since at least the early 1990’s and in the case of Mr. Sansoucy prior to that time. As their resumes¹⁷⁷ reflect they have hands-on experience in the construction, pricing and appraisal of underground utilities and have been found by numerous judges and other fact finders to be credible and competent witnesses.¹⁷⁸ As early as 1994 utilities began attacking Sansoucy’s credibility by pointing to his suspension from practice before FERC for misrepresentation, just as occurred here.¹⁷⁹ No court or regulatory body in which this attack was made has found that the events made him or his testimony less credible and the New Hampshire Supreme Court has upheld a lower court determination to that effect.¹⁸⁰ The 1984 FERC 3 month suspension is yesterday’s stale news. It has no place in this proceeding.

PWW and its ally Merrimack attempted through the use of the minutes of several Aldermanic meetings in Nashua and in particular the minutes of March 16, 2004,¹⁸¹ to show that Mr. Sansoucy had predetermined the value of PWW’s assets and promised Nashua a particular value; predetermined the valuation methods to be used and the weighting of those methods; and used an improper valuation method. Focusing on the minutes in a vacuum and ignoring

¹⁷⁶ See also discussion concerning the testimony of Robert Reilly, *infra*.

¹⁷⁷ Exhibit 1007 B, Pages 122-135 (Appendix L).

¹⁷⁸ See e.g., Public Service Co., of New Hampshire v. Town of Bow, 139 NH 105, 108, 109 (1994); Crown Paper Co., v. City of Berlin, 142 NH 563, 570 (1997).

¹⁷⁹ Transcript, September 4, 2007 Pages 271-280.

¹⁸⁰ Southern NH Water Co., v. Town of Hudson, 39 NH 139, 144 (1994).

¹⁸¹ Exhibit 3197A.

Sansoucy's prior history in valuing the assets of the Pennichuck companies, they ignored the plain meaning of Sansoucy's remarks. Mr. Sansoucy never predetermined or promised the Aldermen a value. He had previously valued the Company for tax purposes and had considerable knowledge about it and the water utility industry when he made his remarks. Lost in PWW and Merrimack's rant is the fact that his discussion of value related to **all three regulated companies** and was less than Mr. Walker's final value for **PWW alone**. Moreover, the language of his remarks shows the length of the stretch they were taking. Sansoucy didn't say he was presenting a value. Instead, he discussed the three valuation methods and the ratios that could be used based on other sales. He then told the Aldermen, "Let's look at what the indicators **might** mean." (emphasis supplied).¹⁸² This is not the language of a promise or the statement of a predetermined value. Even his final statement of value, "We feel the PUC will likely be finding a value in the range of \$82-100 million" is not a promise or predetermination of value.¹⁸³ Mr. Sansoucy is merely giving the Aldermen, based on his knowledge of the value of the Company from his prior valuations and his knowledge of the water utility industry, his thoughts about what might ultimately happen. They already had been told about all of the valuation methods and the work that was required for each. Mr. Sansoucy was not shy in announcing there was "a lot more work digging out data".¹⁸⁴ Nobody in the room understood, nor would anyone fairly reading the minutes, that Sansoucy had prejudged what the value of PWW's assets were and promised the value he would deliver. Moreover, the proof is in the pudding because Mr. Walker's value was not the same.

PWW would also have the Commission believe that Sansoucy, as of March 16, 2004, had already decided that he would not give any weight to the cost method. Again his remarks do not

¹⁸² Ibid at Page 16.

¹⁸³ Ibid at Page 17.

¹⁸⁴ Ibid at Page 15.

support the argument. What he told the Aldermen is the same thing he and Walker told the Commission: from their experience in the industry they knew in 2004 and when they testified that a value based on replacement cost new, less physical and functional depreciation could not be supported by the revenues that could be generated from the system and as a result the application of economic obsolescence would be necessary and would result in the cost approach value approximating the values derived from the sales and income approaches.¹⁸⁵ He specifically told the Aldermen that in the valuation he did in 1996 for tax purposes that the cost approach exceeded income and sales by 30-40%.¹⁸⁶ Moreover, it is important to note that even if one could conclude that Sansoucy had prejudged the weighting of cost, it was Walker who performed the reconciliation where the weighting occurred and there is no suggestion or evidence that he had prejudged the matter.

Finally the minutes were used by PWW and Merrimack to suggest that Sansoucy, through his discussions of the concept of no net harm, had decided prior to performing an appraisal that a value would be concluded that would not raise rates. What he told the Aldermen¹⁸⁷ is consistent with his testimony. If he and Mr. Walker had estimated a value that would have caused rates to exceed those that would otherwise have been charged by PWW, he would not recommend that Nashua commence this case.¹⁸⁸ PWW, as it has throughout the proceedings in this Docket has attempted to manipulate the facts in its favor. Its use of the minutes of March 16, 2004 is an example of its overreaching.

In the same vein was the cross-examination of Sansoucy and Walker regarding their

¹⁸⁵ Transcript September 4, 2007, Pages 99-101; Transcript, September 10, 2007 (Afternoon) Pages 31-32, 43-44.

¹⁸⁶ Exhibit 3197A, Page 15.

¹⁸⁷ Exhibit 3197A, Page 14, 21.

¹⁸⁸ Transcript September 10, 2007 (Afternoon) Page 93.

“loyalty” to Nashua.¹⁸⁹ Although explained benignly as not doing work adverse to a client as opposed to the suggested notion of doing whatever a client wants,¹⁹⁰ PWW and Merrimack sought to convert their loyalty, along with the assertion that Sansoucy had predetermined value and the methods of valuation he would and would not use, into advocacy under USPAP in an effort to discredit the reliability of their Appraisal Report (Exhibit 1007A).

Although Sansoucy, neither a certified or licensed appraiser in New Hampshire, is not technically subject to USPAP,¹⁹¹ both Sansoucy and Walker, whose compliance with USPAP was raised only because of his association with Sansoucy, fully complied with its requirements. Their work on behalf of Nashua was no different and no greater advocacy than the work performed by Reilly on behalf of PWW. In his May 22, 2006 testimony (Exhibit 3017), for example, Mr. Reilly concluded that the Sansoucy/Walker Report contained “14 fundamental errors”, which made it one of the most flawed appraisals he had reviewed and rendered its conclusion an unreliable indicator of value.¹⁹² Discrediting the Sansoucy/Walker Report certainly advances the interest of PWW and when Reilly went beyond defending his own appraisal he was engaged in advocacy.¹⁹³ If the Sansoucy/Walker appraisal is not reliable under USPAP, the same is true of the Reilly appraisal.

What PWW ignores in this argument, however, is that appraisers are often engaged to do more than render a value and that there different roles are permitted under USPAP. USPAP distinguishes between “valuation services” defined as services pertaining to aspects of property value and “appraisal practice” defined as valuation services performed by an individual acting as

¹⁸⁹ Transcript September 4, 2007, Page 45.

¹⁹⁰ Transcript September 10, 2007 (Afternoon) Pages 90-94.

¹⁹¹ New Hampshire Real Estate Appraiser Board, Rule Rab. 301,01(F).

¹⁹² Exhibit 3017, Pages 2(1), 3(2).

¹⁹³ Exhibit 3259, Page 1 (advocacy defined as “representing the cause or interest of another...”).

an appraiser.¹⁹⁴ USPAP applies to appraisal practice,¹⁹⁵ but when a person who acts as an appraiser performs valuation or other services, the only USPAP requirement is not to mislead the users of the service about the capacity in which he is acting.¹⁹⁶ Services, which are neither appraisal practice or valuation services are obviously not governed by USPAP.

The relationship between appraisal practices and valuation services is well illustrated by the figure in Advisory Opinion 21 to USPAP.¹⁹⁷ As explained by Mr. Walker the inner circle representing active appraisal work required full compliance with USPAP and as you move away from the center what is required to make sure the user is not misled about the services being performed.¹⁹⁸ Walker and Sansoucy, when the services they provided to Nashua were within the circle met the requirements of USPAP. The fact that they had previously valued the PWW assets in 1995 and 2002 provided a level of knowledge about the value of the assets in 2004, which Sansoucy shared with the Aldermen. That knowledge, however, was neither a prejudgment of the 2004 value nor a promise of what the value the appraisal would produce. Nor did that knowledge create a bias under USPAP any more than Reilly's work in Peoria¹⁹⁹ created a bias in his appraisal.

The services provided by Sansoucy in addition to the appraisal performed by Walker were outlined in the contract with Nashua.²⁰⁰ Those services, which go beyond appraisal practice and constitute valuation services are clearly identified and explained. The USPAP required that an appraiser not misrepresent his role was satisfied by the contract. It is important to note that many of the services to be performed are neither appraisal practice or valuation

¹⁹⁴ Exhibit 3259, Page. 183.

¹⁹⁵ Ibid.

¹⁹⁶ Exhibit 3259, Page 185.

¹⁹⁷ Exhibit 3259, Page. 186.

¹⁹⁸ Transcript, September 10, 2007 (Afternoon), Page 71-72. See also explanation of figure at Exhibit. 3259, Page. 186.

¹⁹⁹ Exhibit 1084.

²⁰⁰ Exhibit 3036.

services and are not, therefore, covered by USPAP.

B. THE VALUATION TESTIMONY AND OPINION OF VALUE PRESENTED BY ROBERT REILLY IS UNRELIABLE.

PWW's expert valuation witness, Robert Reilly, has testified that the value of PWW's assets as of December 31, 2004 was \$248,400,000,²⁰¹ which he updated to \$273,400,000 as of December 31, 2005.²⁰² Both estimates of value are based upon a hypothesis, which is not supported by appraisal theory, the facts of this case or the law of New Hampshire. The hypothesis in Reilly's own words is that the likely population of hypothetical willing buyers includes "any incorporated New Hampshire city or town" including Nashua and "any existing or yet to be formed district".²⁰³ Because this hypothesis, which is the foundation of his inflated opinion of value fails, his testimony and conclusions of value are unreliable and not entitled to any weight.

1. The Reilly hypothesis results in an estimate of investment value rather than fair market value.

Because of his hypothesis, Reilly endows his hypothetical not-for-profit public entity buyer with certain benefits or synergies that are not available to other potential buyers (IOUs), including the avoidance of income and other taxes, access to low-cost municipal financing and less regulation.²⁰⁴ As previously noted, these benefits are not inherent in the PWW assets but rather are available only to the particular class of hypothetical buyers. By using his hypothesis Reilly has focused not on a "typical buyer" but rather a "particular buyer" which establishes not fair market value but rather investment value.

The Appraisal of Real Estate, 12th Ed. defines investment value as "the specific value of a

²⁰¹ Exhibit 3007, Page 3(1).

²⁰² Exhibit 3021, Page 3.

²⁰³ Exhibit 3007A, Page 3(2).

²⁰⁴ Exhibit 3007A, Page 4(3).

property to a particular investor or class of investors based on individual investment requirements; distinguished from market value, which is impersonal and detached”²⁰⁵ (emphasis supplied). It further notes that in contrast to fair market value, “investment value is value to an individual, not necessarily value in the marketplace.”²⁰⁶ By relying on his hypothesis, Reilly has created a buyer, who because of the benefits and synergies available to it, has the ability if it becomes necessary as a part of its investment decision to pay more for the property. The ability to pay more, which is what Reilly is really measuring, however, is not the same as fair market value.²⁰⁷ As a result, the Reilly hypothesis does not measure what RSA 38:9 demands – fair or fair market value – and is contrary to sound appraisal theory.

2. The Reilly hypothesis is not supported by the market.

If the Reilly hypothesis was true, the sales from IOUs to municipalities should reflect the higher prices they can pay. The ratios established from such sales should be greater than the ratios from sales to IOUs. Mr. Reilly, conveniently, however, performed no sales or market analysis other than to conclude from the sales he looked at that there were no comparables. He asks the Commission to accept his hypothesis not because the evidence supports it but because he says it is true. After all, he “literally” wrote the book on business valuation.²⁰⁸

In fact the only empirical evidence in the case about whether municipalities pay more than IOU’s came from Nashua’s witness, Glenn Walker. In his sales or market approach Mr. Walker prepared a scatter graph for the sale price to EBITDA ratio, on which he relied, for all twenty-eight sales he identified.²⁰⁹ He subsequently, for the benefit of the Commission,

²⁰⁵ *The Appraisal of Real Estate, 12th Ed.*, Page 26.

²⁰⁶ *Ibid.*

²⁰⁷ Transcript September 12, 2007, Page 76.

²⁰⁸ Exhibit 3007, Page 5(3).

²⁰⁹ Exhibit 1007A, Page 54(49).

identified the municipal sales on the scatter graph.²¹⁰ These sales clearly cluster in a pattern in the middle of the chart, similar to investor owned sales, demonstrating with market based evidence that the Reilly hypothesis is incorrect. If the Reilly hypothesis was correct and not-for-profit public entities were expected to pay a premium of almost twice what a typical buyer would pay, it is probable that Pennichuck Corporation's financial advisor, in the 2002 auction of the Company, S.G. Barr Devlin ("SGBD") would have relied on it. Certainly SGBD was aware of the benefits that such entities possess²¹¹ but when it identified strategic partners for the Company there were no cities or towns or districts on its list.²¹² They were not included because SGBD recognized that cities, towns and districts do not pay more than other purchasers, unless they are driven by investment decisions which are peculiar to their needs. In other words, it was apparent that SGBD, which had access to much of the same sales information as Walker and Reilly, did not view not-for-profit public entities any different than any other purchasers.

PWW will attempt to distinguish the 2002 auction and what SGBD did by arguing that the auction was for Pennichuck Corporation's stock and a municipality could not buy stock. Such an argument ignores the Tilton Northfield Aqueduct Company sale of stock to the Tilton and Northfield Water District²¹³ and the fact that there is no prohibition against a municipality using a stock purchase as a vehicle to acquire assets.²¹⁴ Mr. Reilly tried to distinguish the Tilton Northfield stock sale by suggesting that a municipality can acquire the stock of a private corporation but not a publicly traded corporation.²¹⁵ He testified that he gained this understanding from PWW's attorneys but couldn't remember the method of communication.²¹⁶

²¹⁰ Exhibit 1007E, See also Transcript, September 10, 2007 (Afternoon) Pages 85, 89.

²¹¹ Transcript September 12, 2007, Page 77.

²¹² Transcript September 12, 2007, Page 71; Exhibit 1094 Page 33.

²¹³ Order No. 24562, December 9, 2005.

²¹⁴ Transcript September 12, 2007, Pages 73, 74.

²¹⁵ Transcript September 12, 2007, Pages 74, 75.

²¹⁶ Ibid.

One can only imagine what the attorneys might recall about this communication and the validity of Reilly's understanding. There is no such distinction in the NH Business Corporation Act, RSA 293-A, or elsewhere.

3. The Reilly hypothesis is not legally permissible.

Mr. Reilly's hypothesis is founded on the conclusion "that any likely buyer has to be legally able to buy the subject assets".²¹⁷ Consequently, under his hypothesis, any New Hampshire city or town or any existing or yet to be formed district must be legally able to buy the PWW assets.²¹⁸ In fact he agreed that the Town of Lancaster, as an incorporated New Hampshire town, was legally able to buy the PWW assets²¹⁹ and that Nashua was legally able to acquire the assets of PEU and PAC.²²⁰

Under New Hampshire law, cities, towns, regional water districts and other municipal corporations are subdivisions of the State and have only the powers the legislature grants them.²²¹ In order for a city, town or district to acquire the assets of a utility, therefore, there must be a specific grant of authority from the legislature. That grant of authority is contained solely in RSA 38, which applies not only to the taking of utility assets but also to their consensual sale.²²²

Although Mr. Reilly believed he had received a memorandum from PWW's attorneys, which confirmed his understanding that any New Hampshire city, town or district could acquire the assets of PWW,²²³ it turned out there was no such memorandum. One of the PWW attorneys recalled a conversation with Mr. Reilly about the subject but it was different from his ultimate

²¹⁷ Transcript, September 12, 2007, Page 49.

²¹⁸ Ibid at Pages 50, 51.

²¹⁹ Ibid at Page 51.

²²⁰ Ibid at Pages 52, 53.

²²¹ Piper v. Meredith, 100, NH 291, 296 (1970); Dugas v. Conway, 125 NH 175, 181 (1984); City of Manchester School District v. City of Manchester, 150 NH 664, 666 (2004).

²²² RSA 38:2, 7, 8, 9, 10.

²²³ Ibid at Pages 48, 49.

hypothesis.²²⁴ Assuming the same information was actually conveyed to Mr. Reilly, his hypothesis is a considerable leap. Moreover, with the exception of the discussion about RSA 38 and the ability of the State or United States government to acquire the assets, the information given to Mr. Reilly was wrong. There is no authority in RSA 52 for a village or other district to acquire or take the assets of a utility. The grant of that authority is contained solely in RSA 38:4.

In order to assess whether the Reilly hypothesis is legally permissible, the question then becomes whether any New Hampshire city, town or district can acquire the assets of PWW under RSA 38. The answer to that question is contained in RSA 38:6. After a municipality takes the required votes to establish a utility, RSA 38:6 requires notice to the “utility engaged...in... distributing...water for sale in the municipality”. The notice provisions of RSA 38:6 apply whether the acquisition is consensual or pursuant to a taking. Consequently, notwithstanding the Reilly hypothesis and notwithstanding his understanding that a municipal buyer did not “have to be actually physically located within the Pennichuck service area”,²²⁵ the only New Hampshire city, town or district that could acquire PWW’s assets is one in which PWW is engaged in distributing water for sale. Although PWW serves a number of satellite systems in other communities, as a practical matter the only likely and legally permissible municipal buyer is Nashua. This Commission has already ruled in this case, that the provisions of RSA 38:6 precluded Nashua from taking the assets of PEU and PAC.²²⁶ As noted above, there is nothing in RSA 38:6 which limits its applications to takings. Even if the acquisition is consensual, the notice must be given and is limited to the utility engaged in distributing water for sale in the municipality. Moreover, making a distinction between a taking and consensual sale makes no sense give the language of RSA 38:6. Even the language that a municipality shall acquire plant

²²⁴ Ibid at Pages 144, 145.

²²⁵ Transcript, September 12, 2007, Pages 48, 49.

²²⁶ Order No. 24, 425, January 21, 2005.

or property outside the municipality which “the public interest may require”, as the Commission noted, is limited by the notice requirement.²²⁷

Reilly sought to bolster his hypothesis by relying on *Southern NH Water v. Hudson*, 139 NH, 139 (1994) which he argued held that hypothetical buyers for water companies in New Hampshire consist of both municipalities and private regulated companies.²²⁸ Any fair reading of the case without a bias toward achieving the highest possible estimate of value, would conclude that the Court recognized for purposes of calculating economic depreciation that the utility’s argument that a buyer would have to be regulated ignored RSA 38:3 (now RSA 38:3,4 and 5), which permitted the Town of Hudson, not any New Hampshire city, town or district to acquire the utility’s property. This actual holding is a far cry from what Mr. Reilly has represented to the Commission.

4. Reilly’s use of a long-term growth rate of 2% is not supported by the evidence and is contrary to the rate analysis performed by PWW’s witness, John Guastella.

For purposes of calculating economic obsolescence in his cost method and value in his income approach, Reilly utilized a 2% long-term growth rate which he characterized as “inflation only, and no real growth”.²²⁹ He further assumed, for purposes of his discounted cash flow analysis,²³⁰ which he used to establish value in his income method, that capital expenditures would equal depreciation²³¹ and rate base would remain constant.²³² The fact that the rate base remained constant was what he meant by “no real growth”.²³³

Notwithstanding his assumption that there would be no growth in rate base and that expenses would increase at the same level as revenues Reilly continued to insist there would be a

²²⁷ Ibid at Pages 12, 13.

²²⁸ Transcript September 12, 2007 Page 65.

²²⁹ Transcript September 12, 2007, Pages 99, 100.

²³⁰ Exhibit 3007X, RFR-1 (Exhibit 21).

²³¹ Transcript, September 12, 2007, Page 148.

²³² Ibid at Pages 154, 155.

²³³ Ibid.

2% growth in earnings.²³⁴ His analysis, however, is completely contrary to that of John Guastella and defies sound economics. Mr. Guastella, for purposes of his rate analysis, projected PWW operations including revenues, expenses and rate base²³⁵ over a similar period as Reilly and likewise concluded that rate base would either remain constant or decline slightly after 2009.²³⁶ Unlike Reilly, however, during the period of flat or declining rate base, Guastella projected a decline in earnings or net operating income.²³⁷ When asked about this in his deposition, Guastella admitted that a declining rate base would result in declining earnings.²³⁸ And he is right! A regulated utility such as PWW experiences growth in earnings through capital expenditures and rate increases allowed by the Commission to pay for the capital additions. If the earnings of PWW increased at Reilly's long term growth rate of 2% without capital expenditures as he projects, and as he must to achieve the level of value he has, the company would soon be over-earning on its allowed rate of return and an adjustment to rates would be necessary.²³⁹

Reilly's a long term growth rate of 2%, even though seemingly small, had a huge impact on his valuation under the income method. Because of his hypothesis he used a municipal discount rate of 5%. The long-term growth rate of 2% represented 40% of his terminal value conclusion.²⁴⁰ In the case of his updated valuation, the terminal value conclusion was \$284,667,000²⁴¹ of which \$113,866,800 was attributable solely to the 2% long-term growth rate. Without a growth rate, as projected by Guastella, the Reilly income valuation would have been

²³⁴ Ibid at Page 154.

²³⁵ Exhibit 3010, Page 7.

²³⁶ Exhibit 3010X, Schedule B; Transcript, September 12, 2007, Page 155; Transcript, September 18, 2007, Page 132.

²³⁷ Ibid.

²³⁸ Transcript, September 12, 2007, Page 155.

²³⁹ Exhibit 1015X, Page 12(11).

²⁴⁰ Transcript, September 12, 2007, Page 150.

²⁴¹ Exhibit 3021X (Exhibit 21).

approximately \$170,800,000 and caused a considerable decline in his overall valuation estimate.

What Reilly did with his use of the 2% long-term growth rate is consistent with his entire approach to his appraisal. Whenever he could make a choice, he always chose whatever would increase the value of the PWW assets. He chose the hypothetical buyer that would result in the greatest value; he chose a long term growth rate when there was no projected growth to rate base; and as will become apparent, he chose a municipal capitalization rate and chose not to do a sales or market approach. He knew from his Peoria appraisal that these were choices that would result in the highest possible valuation which was clearly his goal.

5. The use by Reilly of a municipal capitalization rate in the calculation of economic depreciation in the cost approach and in the development of value in the income approach was not warranted.

Because of the benefits or synergies available to his hypothetical not-for-profit public entities, Mr. Reilly has assumed a 5% rate of return, which he used to establish the capitalized income shortfall from which he calculated economic obsolescence attributable to his cost method.²⁴² Because his hypothesis concerning the likely buyers of the system is flawed and fails, his use of a municipal cost of capital and the resulting rate of return is likewise flawed and must fail. Instead, the cost of capital and rate of return of a typical buyer or investor should have been used.²⁴³ A good proxy for a typical buyer is the rate of return of PWW itself, or 8.68%, according to Walker.²⁴⁴ If a rate of return of 8.68% had been used by Reilly, the economic obsolescence applied to his cost method, instead of 47% would have increased to 68% and resulted in a cost method value of \$160,000,00.²⁴⁵ Because Reilly weighted his cost approach at 60% the overall impact on value would be significant.

²⁴² Exhibit 3007A, Exhibit 14, 15.

²⁴³ *The Appraisal of Real Estate, 12th Ed.*, Pages 487-493.

²⁴⁴ Exhibit 1015, Page 13(12).

²⁴⁵ *Ibid*; GES Exhibits 16, 17.

If, in addition to using the rate of return of a typical as opposed to a municipal buyer, Reilly's unsupported 2% growth rate was eliminated, the economic obsolescence would have increased to 83% and resulted in a cost approach value of \$89,000,000.²⁴⁶ The cost approach value concluded by Walker was \$104,000,000.²⁴⁷ Correcting the erroneous and unsupported rate of return and long-term growth rate in Reilly's income approach had a similar impact. Changing the rate of return from 5% to PWW's 8.68% alone, would reduce his income method value to \$90,000,000.²⁴⁸ If the 2% long-term growth rate was also corrected, Reilly's income approach value would have been \$68,000,000.²⁴⁹ The Walker income approach value was \$80,000,000.²⁵⁰

In his correlation of value, Reilly weighted his cost approach 60% and his income approach 40%. If the same weighting was applied to the values estimated after correcting for the erroneous and unsupported rate of return and growth rate, his fair market value would have been \$81,000,000²⁵¹ which is remarkably similar to Walker's estimate of \$85,000,000.

6. Reilly failed to perform a sales or market method valuation because the result would have required him to reduce his estimate of fair market value.

The Appraisal of Real Estate states that:

The sales comparison approach is a significant and essential part of the valuation process, even when its reliability is limited. Although appraisers cannot always property identify and quantify how the factors affecting property value are different, they can still use the sales comparison approach to determine a probable range of value in support of a value indication derived using one of the other approaches. Furthermore, the comparison process often provides data needed to apply the other approaches –e.g., overall capitalization rates for the income capitalization approach or depreciation estimates for the cost .²⁵²

Given the important role in developing value the sales or market approach plays, the reasons for

²⁴⁶ Ibid.

²⁴⁷ Exhibit 1007A, Page 48(43).

²⁴⁸ Exhibit 1015, Page 14(13); GES Exhibit 18.

²⁴⁹ Exhibit 1015, Page 14(13); GES Exhibit 19.

²⁵⁰ Exhibit 1007A, Page (64)59.

²⁵¹ Exhibit 1015, Page 14(13); GES Exhibit 20.

²⁵² *The Appraisal of Real Estate, 12th Ed.* Page 421.

Reilly's failure to use it become suspect. It is not enough, as he says, that the sales were not comparable. Even when the market is limited, the appraiser "must search diligently for whatever evidence of market value is available",²⁵³ if only to find evidence to support the other approaches.

In this case, it was not that Reilly was unable to find any sales – he identified 12. And it was not that his research yielded insufficient information to develop ratios that could be applied to PWW. In his Report alone, without reference to his work papers, he provided evidence of its customers and revenues of the acquired water companies both of which can be used to create ratios.²⁵⁴ Rather it was that Reilly had recently performed a sales comparison approach in Peoria, Illinois, in which he applied these ratios and he knew that it concluded a value almost \$100,000,000 less than his income and cost method values,²⁵⁵ which were based on the same hypothesis concerning hypothetical likely buyers that he has used here. He knew, in other words that the market approach provided no support for his hypothesis or the values he concluded relying on his hypothesis. It is small wonder, therefore, that Reilly did not use the sales or market approach for the PWW assets. He knew it would lower his overall value and he probably knew he wasn't going to use it as soon as he looked at the sales he identified. Using the revenues from these sales and creating the same sales price to revenues ratio used by Reilly in Peoria²⁵⁶ and recognized as an appropriate ratio or deal multiple in his book,²⁵⁷ it was immediately apparent that not only didn't they support his overall value but more importantly, how much they supported Walker's value. Taken as a group, the median ratio was 6.89.²⁵⁸

²⁵³ Ibid at Page 26.

²⁵⁴ Exhibit 1007A Pages 41-46(40-45).

²⁵⁵ Exhibit 1084, Pages 33, 36.

²⁵⁶ Exhibit 1084 (Ex. 28, 29, 33).

²⁵⁷ Exhibit 1081, Page 263.

²⁵⁸ Transcript, September 12, 2007, Page 139; Exhibit 1096.

Applied to PWW's 2005 earnings of \$16.9 million it implied a value of \$116,400,000.²⁵⁹

Applied to PWW's 2004 earnings of \$15.9 million²⁶⁰ the implied value is \$109,500,000.

When the same analysis is performed for the sales price per customer ratio, also used by Reilly in Peoria,²⁶¹ the results are no different. The median price per customer developed from Reilly's 12 sales is \$3,243.00. Applied to PWW's 25,000 customers, it yields an indicated value of \$81,000,000.

The sales approach was not used by Mr. Reilly because it did not support the values derived from his flawed hypothesis. Notwithstanding that it was the only empirical data about what buyers were doing in the market place, he ignored it because it did not fit his model. The irony of Mr. Reilly's criticism of Sansoucy and assertions of USPAP violations is not lost on Nashua.

7. Reilly's value of PWW alone exceeds the value of Pennichuck Corporation including PWW.

On December 31, 2005, the day for which Reilly concluded a value of \$273,400,000 for PWW alone, the stock of its parent, Pennichuck Corporation, closed at \$20.45.²⁶² The outstanding number of shares was 4,200,000 (rounded) and its outstanding debt was \$41,456,000.²⁶³ Applying the stock and debt method which is premised on the assumption that the market value of the equities and liabilities that comprise an enterprise equal its market value²⁶⁴, indicates a value for Pennichuck Corp., including PWW, of \$127,346,000. This enterprise value of Pennichuck Corporation is consistent with the opinion of value expressed by

²⁵⁹ Transcript, September 12, 2007, Pages 136, 137.

²⁶⁰ Exhibit 1075, Page 2.

²⁶¹ Exhibit 1084 (Exhibit 28, 29).

²⁶² YahooFinance <http://finance.yahoo.com/g/hp?s=PNNW&a=ll&b=31&c=2005&d=118&d=11&e=2005&g-d>

²⁶³ Pennichuck Corp., Form 10-K, December 31, 2005

<http://www.sec.gov/Archives/edgar/data/788885/00009106470680005/penn-10K.htm>

²⁶⁴ Exhibit 1007A, Page 57(52).

the Company's former chief executive officer, Maurice Arel,²⁶⁵ the opinions of value expressed by S.G. Barr Devlin prior to the 2002 auction,²⁶⁶ the bids received in the auction²⁶⁷ and the offer of Philadelphia Suburban, which was accepted.²⁶⁸

If the value of PWW alone is \$273,400,000, no buyer, including a municipal buyer, would pay that price when it could pay approximately one-half, buy the whole company and sell off the assets it did not want. Mr. Reilly's value defies not only accepted appraisal theory, it defies common sense. Nashua urges the Commission to give the incredible Reilly estimate of fair market value the weight it deserves – none.

C. UNDER NASHUA OWNERSHIP RATES WILL BE LESS THAN RATES LIKELY TO BE CHARGED BY PWW OVER THE SAME TIME PERIOD.

In GES Exhibit 2-7-Revised 11/14/2006²⁶⁹ Nashua has presented a comparison of the revenue requirements for PWW and Nashua using the same methodology required by the Commission for rate cases. Excluding year 2007, the savings that accrue to ratepayers under City ownership are approximately \$360,000,000²⁷⁰. The Nashua revenue requirements are largely driven by the cost of its acquisition bonding and the cost of operation of the system. For purposes of the analysis Nashua has assumed the Walker value as well as the cost of completing the water treatment plant and additional reconstruction of the system.²⁷¹ It further has assumed capital spending of \$6 million per year, which is reflected by a system repair and replacement bond of \$18 million every 3 years.²⁷²

The starting point for the revenue requirements for PWW is the 2004 Annual Report

²⁶⁵ Exhibit 1059 (\$119,200,000).

²⁶⁶ Exhibit 1094, Page 41 (\$85,000,000 to \$96,000,000).

²⁶⁷ Exhibit 1093, Page 40-51.

²⁶⁸ Exhibit 1059 (\$106,000,000)

²⁶⁹ Exhibit 1017

²⁷⁰ Exhibit 1017, GES Exhibit 7.

²⁷¹ Exhibit 1017, GES Exhibit 5.

²⁷² Ibid.

escalated annually.²⁷³ What Nashua's analysis shows clearly is that the City's operation and maintenance expense is \$1.7 million less than PWW's in the first year alone and that the difference increases each year.²⁷⁴ Nashua is able to achieve lower cost of operation as a result of its contract with Veolia, the elimination of PWW's bloated administrative and overhead expense and the unique benefits and synergies available to municipalities.

The Veolia contract presented a unique model in Hew Hampshire. Unlike the traditional regulated model used by PWW in which there is no incentive to control cost, the Veolia contract introduced the public-private partnership which brings significant advantages to customers because it exposes both the cost and quality of service to competitive market forces²⁷⁵. These advantages were recognized by PWW's former CEO, Donald Correll who testified to a Congressional subcommittee, while still employed by PWW, inter alia, that the public-private partnership frees up capital for infrastructure without burdening the customer or the taxpayer and that communities relying on the partnership realize cost savings of up to 40%.²⁷⁶

PWW made great moment of what it claimed were areas not covered by the Veolia contract for which it argued there would be additional expense. What this argument overlooked or ignored was the fact that the Veolia contract was designed to mirror PWW's operation, maintenance and capital cost.²⁷⁷ As a result, if Nashua overlooked any expenses in the Veolia contract, (and it submits that the evidence was clear that it did not) both Nashua **and** PWW would have that additional cost and there would be no change in the analysis. For example, PWW, cross-examined the Veolia panel at length about the fact that unplanned maintenance was a supplemental service under the contract for which Nashua would have to pay above the annual

²⁷³ Exhibit 1007, Page 7.

²⁷⁴ Exhibit 1017, (GES2, line 10); (GES 4, lines 2-11).

²⁷⁵ Exhibit 1016, (SMS Exhibit., Pages 5, 7, 9).

²⁷⁶ Transcript, September 13, 2007, Page 20; Exhibit 1016 (SMS, Exhibit 2).

²⁷⁷ Exhibit 1007, Page 5.

fee. Lost in this discussion was the fact that under PWW ownership ratepayers paid for unplanned maintenance whenever it occurred in the same manner. The fact that Nashua has to pay Veolia for unplanned maintenance creates no benefit to the ratepayer under PWW ownership. In either case, the cost will be incurred and paid for. What is different, however, is the ability of Veolia to perform preventive and predictive maintenance to reduce the cost of more expensive unplanned maintenance, something PWW's inability to use Synergen effectively, precludes.

Another reason for Nashua's lower cost of operations is that in its model it will be able to eliminate virtually all of the administrative and general expense carried by PWW, especially the portion attributable to salaries. In 2004, administrative and general salaries were approximately 58% of the companies' total salary cost.²⁷⁸ By 2005 administrative and general salaries had increased to 76 percent.²⁷⁹ Officers' salaries alone grew from \$913,307 in 2004 to \$1,129,114 in 2005.²⁸⁰ According to the 2005 Annual Report²⁸¹ the five officers of the Company made almost as much as the 45 operations and maintenance employees. The elimination of PWW's administrative expense, alone, accounts for much of the difference in operation and maintenance expense.

The balance of the difference between Nashua and PWW's cost of operations were attributable to the synergies of a municipality as recognized by Messrs. Reilly and Guastella in addition to Sansoucy. A relatively comprehensive list of such benefits is contained in Sansoucy's Reply Testimony of May 22, 2006²⁸² and does not need to be repeated here.

Nashua's lower cost of operation was also reflected in the rate analysis performed by Mr.

²⁷⁸ Transcript, September 13, 2007, Page 126; Exhibit 1069B (F-58).

²⁷⁹ Transcript, September 13, 2007, Page 127; Exhibit 1070 (F-58).

²⁸⁰ Exhibit 1069-B (F-58); Exhibit 1070 (F-58).

²⁸¹ Exhibit 1070 (F-58).

²⁸² Exhibit 1015, Pages 41-44 (44-43).

Guastella. Under PWW ownership, operating expenses were projected at \$17.7 million in 2008 and escalated to \$25.3 million in 2015.²⁸³ Under City ownership, Guastella projected operating expense at \$9.3 million in 2008, which escalated to \$14.3 million in 2015 – a considerable savings over PWW’s projected operating expense.

Moreover, the difference between the Nashua and PWW operating cost in the Guastella analysis did not even consider the savings that accrue from the Veolia contract. In fact, he never even looked at the Veolia contract²⁸⁴ or tried to determine if Veolia would have the same employee cost as PWW.²⁸⁵ He just assumed that the City could not, through the Veolia contract be more efficient than PWW and consequently adjusted PWW’s operating cost only to eliminate the municipal synergies.²⁸⁶ The revenue requirements analysis performed by Guastella was nothing more than an attempt to demonstrate that Nashua could pay Mr. Reilly’s original value of \$248,000,000 and not raise rates.²⁸⁷ He readily admitted that using the Walker value of \$85,000,000 would result in the City needing significantly less revenue²⁸⁸ and that if the City’s operating expenses were less than he projected the rate differential between PWW and the City would increase.²⁸⁹ It is no wonder that PWW did not request that he do a similar analysis with Reilly’s updated value of \$273,400,000.²⁹⁰ Clearly with an increased revenue requirement of \$25,000,000 Nashua would have to raise rates.

Although Mr. Guastella says he excluded from his City operating costs those costs a municipality would not incur, there were some that be overlooked. For example, notwithstanding that under Nashua’s proposal it will have no employees, Mr. Guastella requires

²⁸³ Exhibit 3016X, (JFG-1 Revised, Schedule B).

²⁸⁴ Transcript, September 18, 2007, Pages. 105, 110, 111.

²⁸⁵ Ibid at Pages 105, 106.

²⁸⁶ Ibid at Pages 103-107.

²⁸⁷ Transcript, September 18, 2007, Page 101.

²⁸⁸ Ibid at Page 102.

²⁸⁹ Ibid at Page 103.

²⁹⁰ Ibid at Pages 129, 130.

the City to pay a payroll tax of \$427,272, escalating to \$585,574.²⁹¹ In addition, he was unaware of the Sarbanes-Oxley law and did not exclude that cost from City operations²⁹² although it is significant. Those 2 items alone would have reduced Nashua's overall revenue requirements by well in excess of \$4 million.²⁹³

In order to conclude Nashua could pay \$248,400,000 and not raise rates, Mr. Guastella had to use what he called revenue anticipation notes or RANs. These notes required payment of interest only for the first three years. No principal was paid until the permanent financing occurred. Although Mr. Guastella argued it could be beneficial, the use of RANs created and deferred interest rate risk. If during the 3-year period they are used, interest rates rise, when the permanent financing is placed, it will be subject to the higher rates. In the same vein, the municipality, if RANs are used, will incur issuance costs for each year of the temporary financing as well as the issuance costs for the permanent financing. Under traditional revenue bond financing, the issuance fees would be paid only once. It is important for the Commission to recognize that under the Guastella financing plan what is really happening in the first 3 years, is that current ratepayers will not pay the actual cost of service which will be borne by future ratepayers.

Another problem with Mr. Guastella's financing plan is that he does not assume the use of revenue bonds²⁹⁴ or assume an interest rate attributable to revenue bonds.²⁹⁵ RSA 38:13 requires a municipality to issue bonds and notes "pursuant to RSA 33-B" to purchase utility assets. RSA 33-B, entitled "Municipal Revenue Bonds", applies to the financing of "revenue

²⁹¹ Ibid at Pages 112, 113; Exhibit. 3016X, (JFG-1 Revised, Sch. C).

²⁹² Transcript, September 18, 2007, Page 113.

²⁹³ Exhibit 3016X, (JFG-1 Revised, Sch. C).

²⁹⁴ Transcript, September 18, 2007, Pages 126, 127.

²⁹⁵ Ibid at Pages 128, 129.

producing facilities”, the definition of which includes “waterworks”.²⁹⁶ It further distinguishes such bonds from general obligation bonds by stating the bonds issued under RSA 33-B “shall not be deemed to be a pledge of the faith and credit of...the municipality”.²⁹⁷ By not assuming the use of revenue bonds the Guastella financing plan does not meet the requirements of RSA 38 and as a result is unreliable.

In addition, the interest rate used by Mr. Guastella is not reliable. Not only is it not an interest rate associated with a revenue bond,²⁹⁸ it was a figure he simply accepted from Mr. Reilly²⁹⁹ instead of making his own analysis.³⁰⁰ And once again, true to form, Mr. Reilly made a choice which best suited PWW. When PWW needed the value to be high, Reilly used a cost of capital of 5%.³⁰¹ When PWW needed Nashua’s need for revenue to be low, Reilly provided Guastella a cost of capital of 4.6%.

Most importantly, what the Guastella revenue requirement analysis demonstrates is that any value determined by the Commission that is less than that derived by Reilly, there will be immediate and growing savings to ratepayers under Nashua’s ownership. The fact that his analysis of Nashua’s costs ignores the savings from the Veolia contract and fails to give effect to certain synergies available to the City only increases those savings. Contrary to what he intended, Mr. Guastella’s analysis demonstrates that at any value less than what Mr. Reilly has opined, the acquisition is in the public interest.

In his zeal to support PWW, Mr. Guastella has also reworked the Sansoucy revenue requirements analysis in an effort to demonstrate that Sansoucy had understated Nashua’s

²⁹⁶ RSA 38-B:1 (VI).

²⁹⁷ RSA 33-B:2.

²⁹⁸ Transcript, September 18, 2007, Pages 128, 129.

²⁹⁹ Ibid at Page 115.

³⁰⁰ Ibid at Page 129.

³⁰¹ Exhibit 3007, Page 39 (38).

operating costs.³⁰² In doing so, Guastella relied solely on PWW's President, Donald Ware, as the source of his figures³⁰³ and admitted that his analysis was only as good as the information provided to him by Mr. Ware.³⁰⁴ In fact, many of the adjustments or figures provided by Mr. Ware were wrong, or overstated, including taxes,³⁰⁵ insurance,³⁰⁶ mailing cost for bills,³⁰⁷ utilities (electric and heat),³⁰⁸ maintenance of vehicles,³⁰⁹ providing computers,³¹⁰ equipment maintenance³¹¹ and PWW labor rates.³¹² In addition, he was also wrong when he stated that Veolia would gain no operating efficiencies from the use of computerized maintenance management systems (CMMS) also referred to as Synergen, because PWW has used CMMS for over 5 years.³¹³ By relying on Mr. Ware's erroneous and overstated adjustments and changes to the operating costs used by Sansoucy, Mr. Guastella's attempt to discredit the Sansoucy analysis fails.

V. PENNICHUCK FAILED TO DEMONSTRATE ANY ALLEGED HARM TO PENNICHUCK EAST UTILITY, PITTSFIELD AQUEDUCT COMPANY AND PENNICHUCK WATER SERVICE CORPORATION THAT CANNOT BE MITIGATED OR ADDRESSED THROUGH CONDITIONS

Pennichuck has argued that if Nashua is permitted to acquire the assets of PWW, its two regulated affiliates, PEU and PAC will require rate increases in excess of 64% to continue to provide service to its regulated customers, and its unregulated contracts with PWSC.

Pennichuck has in turn argued that because of the alleged harm to its sister companies, the

³⁰² Exhibit 3020, Page 2(1).

³⁰³ Transcript, September 18, 2007, Pages 135, 135, Exhibit. 3020, Page (2)1.

³⁰⁴ Transcript, September 18, 2007, Pages 135, 135, 138.

³⁰⁵ Transcript, September 11, 2007, Pages 24-29.

³⁰⁶ Ibid at Pages 30-33.

³⁰⁷ Ibid at Pages 33-34.

³⁰⁸ Ibid at Pages 35-37.

³⁰⁹ Ibid at Pages 37-39.

³¹⁰ Ibid at Pages 39-41.

³¹¹ Ibid at Page 42.

³¹² Ibid at Pages 47-54.

³¹³ See generally Motion to Strike Testimony of Donald Ware, dated September 25, 2007.

acquisition of PWW's assets is not in the public interest.

As set forth herein: a) the alleged harm is vastly overstated and self-inflicted; b) the Guastella analysis of the alleged harm is deficient; c) any harm at the level alleged goes beyond economy of scale that benefits all customers of the system and constitutes an unreasonable subsidy; d) any alleged harm to PWSC, an unregulated company, should not be considered by the Commission; and e) it is beyond the scope of this Docket to determine the extent of the alleged harm, if any, to PEU and PAC.

A. ANY ALLEGED HARM TO PEU AND PAC IS SELF-INFLICTED.

Nashua commenced this proceeding on March 25, 2004 by filing its *Petition for Valuation Pursuant to RSA 38:9* that sought to acquire all of the assets of PWW, PEU and PAC. As explained in the November 19, 2004 testimony of Brian McCarthy, Nashua sought to acquire the assets of PEU and PAC to eliminate any potential harm to their customers in the form of rate increases and diminished service and to mitigate harm to Pennichuck Corp., and its shareholders by eliminating the need to operate smaller and less profitable portions of the system.³¹⁴ Nashua stands by its commitment to acquire the assets of PEU and PAC at their fair market value as determined by the Commission, and has proposed for that purpose.³¹⁵

As part of a legal strategy, to create harm to its own customers in order to argue that Nashua's Petition should not be approved, PWW moved to dismiss PEU and PAC from the case. It then, instead of making the harm part of its public interest case in January 2006 when it would have been subject to significant discovery and scrutiny, waited to file it with its rebuttal testimony on May 22, 2006 when the remaining discovery and opportunity for rebuttal testimony had passed. Even the Commission Staff Director, Mark Naylor, commented that there was no

³¹⁴ Exhibit 1001, Testimony of Brian McCarthy, November 22, 2004, Pages 8, 9.

³¹⁵ See Appendix A, proposed Condition 11.

opportunity for discovery on the alleged harm.³¹⁶ If PWW had been truly concerned about the impact on the ratepayers of PEU and PAC it would not have moved to dismiss them from Nashua's petition. By doing so it has created the very harm that forms the basis of its legal strategy that the acquisition is not in the public interest. It further demonstrates that PWW's real concern is the shareholders of Pennichuck Corp., as opposed to its ratepayers and the ratepayers of PEU and PAC.

Over time PWW has created a corporate structure that was largely driven by its acquisition of other systems and creation of other companies. Rather than provide PEU, PAC and PWSC with their own employees and assets, PWW retained them and performed all service on their behalf. Rather than require each company to pay its actual cost of service, Pennichuck has devised a Cost Allocation and Services Agreement,³¹⁷ under which costs incurred by Pennichuck Water Works and its parent, the Pennichuck Corporation, are allocated to its regulated utilities regardless of the actual cost to each. In theory, its unregulated companies also pay a share of the cost allocation. In practice, however, their costs, calculated under the Agreement, are non-existent.³¹⁸

Pennichuck uses this corporate structure to argue that any event which affects PWW will have a ripple effect on PEU and PAC and will permit PEU and PAC to cry that they have been harmed. If PWW's argument is accepted, it means that, contrary to the policies established by RSA 38, PWW could never be acquired because of the harm it alleges to the others precludes a finding that the acquisition is in the public interest.³¹⁹ And this will be so in spite of the fact that, as in this case, the number of customers in the company to be acquired (25,000) dwarfs the

³¹⁶ Exhibit 5001, Page 46.

³¹⁷ Exhibit 3001A, p.1

³¹⁸ See eq. Exhibit 1132, Page 4 (Southwood paying \$2,000 in corporate costs relative to \$957,000 by PWW).

³¹⁹ Transcript, September 26, 2007, Page 132

number of customers in the remaining companies (6,300). Nashua urges the Commission not to subvert the legislative policy contained in RSA 38 to this argument.

B. THE GUASTELLA ANALYSIS OF ALLEGED HARM IS DEFICIENT.

Pennichuck alleged, through the testimony of John Guastella, that if Nashua acquired PWW, PEU would need a rate increase of 64% and PAC a rate increase of 66%.³²⁰ Their combined additional revenue requirement under his analysis was \$3.4 million.³²¹

In order to obtain these results Guastella determined the employee needs of the companies, including PWSC, the assets necessary for their operations and the cost of operation.³²² Although he objected to the term, he then allocated cost to the employees, assets and operations based on the PWW model without any consideration of whether the model was justified or whether a less costly model could be used. For example, he did not test his analysis by looking at the operations of similarly sized water companies, chanting the Reilly mantra that there are no similarly sized or comparable water systems.³²³ Despite Nashua's Petition to acquire both PEU and PAC in this proceeding, he did not consider a sale of the two companies to Nashua or a third party.³²⁴ He did not look at how PAC operated before its purchase by Pennichuck.³²⁵ Nor did he consider the market or actual contracts to operate water systems by contract operators like Veolia Water to see if his conclusions about the cost of operations made sense.³²⁶ Given his regulatory background,³²⁷ it is apparent he was stuck in the regulated model and unwilling to consider anything different. Or perhaps he just didn't want to know what such comparisons would show.

³²⁰ Exhibit 3016, Page 1.

³²¹ Exhibit 3016, Page 2.

³²² Exhibit 3016, Page 2.

³²³ Ibid at Pages 141, 142.

³²⁴ Ibid at Page 155.

³²⁵ Ibid at Pages 142,143.

³²⁶ Ibid at Page. 143.

³²⁷ Exhibit 3010, Page 2-4.

There is evidence that these alternatives could have reduced PAC and PEU's costs. Even Mr. Correll recognized that a big company that either purchased or operated PEU and PAC would have economies of scale that could replace those existing under PWW.³²⁸ More importantly Mr. Correll testified that the purchase of PEU and PAC was something his company, American Water, would take a look at.³²⁹ Donald Ware also testified the sale of PAC and PEU to Nashua should be considered.³³⁰ Guastella's failure to even consider such possibilities, along with everything else he refused to look at, makes his analysis suspect.

A simple way to test Guastella's conclusion that PEU and PAC could not be operated at a lower cost is to compare the rates of the new PEU and PAC with the Guastella rate increases in place to the rates of other New Hampshire water utilities. Application of a 64% increase to the listed rate of PEU would raise its GMS-A rate from \$604.96 to \$992.13.³³¹ Likewise, increasing PAC's rates by 66% would raise them from \$413.64 to \$686.64.³³² With the exception of two companies, PEU and PAC would have the highest rates in New Hampshire.³³³ PEU is comparable in size with Aquarion Water Company³³⁴ but its new rates would be more than double Aquarion's rates. PAC is comparable in size to Hanover Water Works³³⁵ but its new rates would be one-third greater. If these similarly sized water companies **in New Hampshire** can operate at rates so much lower than Guastella's analysis requires, there is something wrong with what he has done.

Another measure of the Guastella analysis is his calculation of a proposed mitigation

³²⁸ Transcript, September 13, 2007, Pages 10-13.

³²⁹ Ibid.

³³⁰ Transcript, September 11, 2007, Page 61.

³³¹ New Hampshire Hampshire PUC Water Company Annual Rates (July 2007); <http://www.puc.state.nh.us/Water-Sewer/Water%20Company%20Annual%20Rates.pdf>.

³³² Ibid.

³³³ Ibid.

³³⁴ Exhibit 1132, Regulated Water Systems.

³³⁵ Ibid.

fund. Using the total revenue shortfall of \$3.4 million and a capitalization rate of 6.5% to 8.5%,³³⁶ Guastella suggested a mitigation fund of \$40 to \$50 million to protect PEU and PAC.³³⁷ The only problem with his suggestion is that his mitigation fund exceeds the regulatory value of the two companies. What Mr. Guastella has proved by suggesting a mitigation fund that exceeds the value of the two companies is what Nashua has urged from the beginning. Under RSA 38:6 and RSA 38:11, the PUC should determine that the public interest requires that Nashua purchase the property of PEU and PAC. The mitigation fund discussion further demonstrates, that if the Commission does not require the purchase, that a prudent owner of PEU and PAC, concerned with the impact on their ratepayers would consider a sale to Nashua or a third party.

C. HARM AT THE LEVEL PROJECTED BY GUASTELLA DEMONSTRATES THAT PWV PROVIDES AN UNREASONABLE SUBSIDY TO PEU AND PAC.

What is apparent from the Guastella analysis, that if Nashua acquired the assets of PWV, PEU and PAC it would require rate increases of 64% and 66% respectively, is that, under the Cost Allocation and Services Agreement, PEU and PAC, as well as PWSC and Southwood, do not pay anything resembling the actual cost of the service provided by PWV.

If PEU, PAC, and PWSC need additional combined revenue of \$3.4 million without PWV that means PWV is providing services to PEU, PAC, and PWSC which have an actual cost of \$3.4 million more than what PEU and PAC pay under the Cost Allocation and Services Agreement. The \$3.4 million represents \$136 for each of 25000 PWV ratepayers that is not being paid by PEU, PAC, and PWSC and would, if paid, offset their rates. Without some demonstrated benefit in return, by any definition, this arrangement results in a subsidy. In fact, there is no hard evidence to demonstrate that the harm to PEU and PAC is not the result of PWSC pricing its contract below market by avoiding their true costs under the Cost Allocation

³³⁶ Why he did not use Reilly's capitalization rate of 5% was never explained.

³³⁷ Exhibit. 3016, p. 3.

Agreement.³³⁸

Both Staff and PWW point to the Commissions' 1998 Order No. 22,883 in which it permitted an \$8.00 per year subsidy by the PWW core ratepayers of the satellite rate payers as justification for the level of support PWW provides PEU and PAC. Their reliance on order No. 22,883, however, is not justified. The subsidy that was allowed in 1998 was **intra** as opposed to **inter** company. Some ratepayers of PWW were subsidizing other PWW ratepayers. In that context rate averaging can make sense. For example, Nashua has recognized the potential for harm by agreeing to continue to charge the satellites the same core rates. The same is not true when the ratepayers of PWW are subsidizing the ratepayers of two separate and distinct companies and the customers of the unregulated PWSC. In addition, the level of subsidy in 1998 was only \$8.00 per year. A subsidy of \$136.00 per year is 17 times greater and includes unregulated real estate and contract operations simply cannot be justified. It represents approximately one-third of the current rate of \$395.52.³³⁹

D. IT IS BEYOND THE SCOPE OF THIS DOCKET TO DETERMINE THE EXTENT OF HARM, IF ANY, TO PEU AND PAC.

As has been noted, the Guastella analysis was not filed until May 2006 and, thereafter, there was "a pretty limited window of time" to conduct discovery and perform any independent analysis.³⁴⁰ As a result neither Nashua nor Staff have been able to properly test the Guastella analysis, which is the only attempt to quantify the harm in the case. Nashua has presented a number of deficiencies in the Guastella work which make it unreliable and even Director Naylor admitted that if PEU and PAC came in seeking 60+% interest rate increases, Staff would want to

³³⁸ See generally Exhibit 1132.

³³⁹ NHPUC, Water Company Annual Rates, July 2007.

³⁴⁰ Transcript, September 26, 2007, Page 129.

see whether there were more economical ways for them to operate,³⁴¹ including treating them as “troubled systems” and looking for a buyer.³⁴²

The public interest standard under RSA 38 does not and should not allow a self-inflicted harm to trump the legislative policy of RSA 38. Moreover, the record concerning the alleged harms is flavored, speculative and untested. Nashua urges the Commission, in light of the way this issue was raised and the lack of discovery and independent analysis, to hold further hearings after appropriate time for discovery and developing the record on what the harm is or to establish a related docket for that purpose. Consistent with Nashua’s Petition, Nashua proposes in Appendix A, a condition that would require Nashua to either purchase the assets of PEU and PAC at their fair market value, or, mitigate that harm up to their fair market value.

VI. NASHUA WILL PROMOTE THE PUBLIC INTEREST BY PROTECTING NEW HAMPSHIRE’S LIMITED WATER RESOURCES FOR FUTURE GENERATIONS

The testimony concerning watershed protection highlights some of the differences between a municipally owned water utility and one owned by shareholders. To some extent, it could be argued that publicly owned systems focus more heavily on conservation whereas an investor-owned regulated utility might focus more heavily on installation of best management practices funded using public grants. The general question as to whether one approach or the other is better could be debated. The specific question presented in this case, however, is not open for debate. The following evidence is not meaningfully contested:

- Nashua has taken significant steps to protect the watershed, both by adopting regulations that the NHDES cites as an example for other communities to follow, and by acquiring 483 acres of land within the watershed.

³⁴¹ Ibid at Page 132.

³⁴² Ibid at Page 133.

- Kathy Hersh, Nashua’s Director of Community Development, provided testimony that she spoke with Ms. Eileen Pannetier during her preparation of Pennichuck’s August 1998 Watershed Management Plan³⁴³ and she told Ms. Hersh that “she was very upset *because Pennichuck management was pressuring her to make changes in her recommendations.*”³⁴⁴
- In fact, a July 1997 draft of the Watershed Management Plan, one year prior to the final version, analyzed the potential development of lands owned by Pennichuck’s real estate development affiliate, the Southwood Corporation,³⁴⁵ and stated that: “[t]here is a *significant difference in the pollutant load* from those with conservation and those without”; that development would cause phosphorous levels to “jump to 0.06 mg/l, *nearly twice as high as the current level* and almost three times as high as naturally occurring” and that “*to keep the pollutant load low, Pennichuck and the towns must conserve the existing lands.*”³⁴⁶
- However, under the pressure described by Ms. Hersh, the same section of the final Watershed Management Plan was watered down to state that “[t]here is not a significant difference in the pollutant load from those with conservation and those without.”³⁴⁷ Ms. Pannetier was able to reverse her earlier conclusion because, shockingly, all of the undeveloped Southwood Corporation lands, formerly owned for water supply protection, was removed from the analysis of conservation lands.³⁴⁸ By taking these 1000 (+/-) acres of land out of the build out analysis, Ms. Pannetier was able to conclude that there was

³⁴³ Exhibits 3005a (starting at Page 4), 3005b, 3005c, 3005d & 3005e (up to page 30).

³⁴⁴ Exhibit 1012, Page 7, Lines 10-15 (emphasis in the original).

³⁴⁵ Exhibit 1109, Page 101, Figure 6-2 (CEI Map showing lands subject to potential development); *see also* Exhibit 1016A

³⁴⁶ Exhibit 1109, Section 6.4, Page 100 (6-16) (emphasis added).

³⁴⁷ Exhibit 3005B, Section 6.4, Page 21 (221)(6-15). w

³⁴⁸ Exhibit 3005B, Figure 6.2, Page 23 (223); *compare to* Exhibit 1109, Figure 6-2, Page 101 and Exhibit 1016A.

not a significant benefit to conservation. However, the original conclusion remains valid, but is simply disguised by the statement that “[a] more significant difference would be noted if the amount of the conservation land owned by Pennichuck Water Works or others were larger.”³⁴⁹

- This change from the draft to the final report corroborates a key point made in the testimony of Allan Fuller: that “while the CEI reports look real good and it shows that Pennichuck is thinking about watershed management, it doesn't really bring into play the fact that Pennichuck, ... at the other side of the coin they're actually developing the land and destroying the watershed, and they know -- because the reports are there, they know what the right thing to do is, and what they're doing is not the right thing.”³⁵⁰
- During the period that Ms. Pannetier was developing Pennichuck’s Watershed Management Plan, including the July 1997 draft recommending that “Pennichuck and Towns must preserve existing lands[,]”³⁵¹ Pennichuck continued to transfer its real estate assets to develop commercial and residential projects, including Westwood Park, LLC on December 4, 1997³⁵² (overlying the Parcel M, high-yield aquifer described in the Testimony of Kathy Hersh et al.),³⁵³ Heron Cove at Bowers Pond, LLC in August 1998,³⁵⁴ Bowers Pond LLC developments in October 1997,³⁵⁵ June 1997,³⁵⁶ December

³⁴⁹ Exhibit 3005B, Section 6.4, Page 21 (221)(6-15). w

³⁵⁰ Transcript, September 10, 2007, Page 59, Lines 11-19.

³⁵¹ Exhibit 1109, Section 6.4, Page 100 (6-16).

³⁵² See Exhibit 1127; Transcript, September 18, 2007, Page 55.

³⁵³ See Exhibit 1012, Pages 4-5, Page 31 (“Despite the fact that “a good part of that site overlies a very high yield ground water aquifer ... City had to step forward and purchase the developable parcels of Parcel M to prevent it from being developed by the water company.”). See also Exhibit 1123 (showing the location of the aquifer relative to the land Pennichuck proposed to develop in Exhibit 1127 and that acquired by the City in Exhibit 1016B).

³⁵⁴ Transcript, September 18, 2007, Page 58.

³⁵⁵ Transcript, September 18, 2007, Pages 59-60.

³⁵⁶ Transcript, September 18, 2007, Page 60.

1996,³⁵⁷ and many others.³⁵⁸

- Pennichuck’s real estate operations were not disinterested third-party transactions.

During the same period that Pennichuck officials were reviewing drafts of its Watershed Management Plan, at least one Pennichuck official, its CEO Maurice Arel, was actively engaged in the negotiation of the purchase of his own residence on the very lands that Ms. Pannetier had recommended be conserved in her July 1997 draft report.³⁵⁹ Mr. Arel’s son, Timothy Arel³⁶⁰ and Bernie Rousseau, a Pennichuck employee that Ms. Pannetier identified as one of her contacts at Pennichuck,³⁶¹ also received lands formerly held for water supply protection.

- These and other transactions involved fraudulent misrepresentations to investors and to the public. On December 16, 2004, Pennichuck and its CEO, Maurice Arel, agreed to pay significant fines and penalties related to “material, false, and misleading” statements made to Pennichuck’s investors related to its real estate development operations,³⁶² in which Pennichuck “failed to oversee the negotiations [and] [t]he Developer received over two million dollars in profit personally through his profit-sharing arrangement with the joint venture, in addition to the profits made by the Stabile Companies on the site work, construction, management fees, and home sale commissions.”³⁶³

Pennichuck’s real estate operations have harmed the public interest. According to its own experts, in a March 2003 report funded by the NHDES, Ms. Pannetier reported that “the estimated yield of Pennichuck Brook has declined by over 75% in the last 100-years” and “these

³⁵⁷ Transcript, September 18, 2007, Page 60.

³⁵⁸ See e.g. Exhibits 1127 & 1128 generally.

³⁵⁹ See Exhibits 1128, Pages 24-25 (deed from Bowers Pond, LLC dated December 1998), Page 26 (property shown on Nashua tax maps)

³⁶⁰ Exhibit 1128, Pages 1-2.

³⁶¹ Exhibit 1128, Pages 1-3; Transcript, September 18, 2007, Page 67, Lines 7-19.

³⁶² Exhibit 1121, Page 6 and generally, Pages 6-9.

³⁶³ Exhibit 1121, Page 9.

water supplies are being affected because natural hydrologic cycles have been interrupted.”³⁶⁴ In an November 2002 application to the EPA, Ms. Pannetier reported: that “the watershed has become more “flashy” and much of the water runs off impervious surfaces and out to the ocean without being captured for water supply or ground water recharge”; that “[y]ields of the surface water supply in the Pennichuck Brook pond system have declined by about 75% over the last 100 years, largely due to imperviousness, which reaches 35+% in some of the more urban subwatersheds and an overall 15% in the watershed”; and that “[m]any of the ponds experience algae blooms and are in various stages of eutrophication.”³⁶⁵

These reports, offered freely and voluntarily outside the context of this proceeding, confirm the testimony of Nashua’s witnesses, that Pennichuck’s role as a real estate developer and its failure to act as a proper steward of the water supply “has led to significant deterioration within the supply ponds”³⁶⁶ and “undesirable impacts in both the quantity and quality of water within the chain pond system.”³⁶⁷

They also serve to illustrate a key difference between a publicly-owned and an investor-owned water utility. Regardless of whether Pennichuck’s decision to pursue thousands of acres of real estate development in the early 1980s was consistent with the public interest, it became clear by the time Pennichuck began preparing its Watershed Management Plan in 1997 that this was no longer the case.³⁶⁸ But rather than discontinue, or reverse or even scale back its real estate development operations, Pennichuck continued or even accelerated those operations and its consultants modified their reports to allow these operations to continue. It even opposed

³⁶⁴ Exhibit 1105, Page 12 (2-2).

³⁶⁵ Exhibit 1108, Pages 3-4.

³⁶⁶ Exhibit 1012, Page 22.

³⁶⁷ Exhibit 1012, Pages 22-23.

³⁶⁸ See, e.g. Transcript, September 10, 2007, Page 18, Lines 21-23 (“as time has gone on, scientific information has said no, that's not good to do.”).

legislation intended to protect its own water supply,³⁶⁹ arguing it would make numerous parcels in the watershed “undevelopable”.³⁷⁰

Nashua did not follow this approach. Rather it adopted regulations to protect the water supply over Pennichuck’s objection,³⁷¹ and acquired 483 acres in the watershed, including the significant portions of the Parcel M high yield aquifer property formerly owned by Pennichuck.³⁷² Nashua’s protections are not perfect: It has denied permits for projects in the watershed and had those decisions reversed by the Courts, and it has issued permits for others. However, in response to a question from Commissioner Morrison, Alan Fuller noted that the “reason why I think the city would be better is Pennichuck is kind of not controllable, but the city can be controlled by the people with elections, and so ultimately you have some control what's going on, some control [over] what's going on.”³⁷³ At the end of the day, it is not Nashua’s history of acquiring key parcels to protect Pennichuck’s water supply, or its record approving or denying particular developments, or the success of its own Water Supply Protection Overlay District that matters. It is the fact that it will be a water supply owned, controlled and accountable to the public it serves and not the needs of the investment community. It is for this fundamental reason that approval of Nashua’s petition will help protect many of the most important water supplies in Southern New Hampshire, in a manner that will promote the public interest.

VII. CONCLUSION

RSA 38 is a unique eminent domain statute limited to the acquisition of utilities. Its provisions call upon the Commission not only to be the arbiter of fair value but also to make

³⁶⁹ See, e.g. Exhibit 1011, Pages 25-27 (Fuller); Exhibit 1012, Pages 5-6 (Hersh).

³⁷⁰ Exhibit 1012, Page 46 (Exhibit 4)

³⁷¹ See e.g., Exhibit 1012, Page 14.

³⁷² Exhibit 1012, Pages 11-13; Exhibit 1016B.

³⁷³ Transcript, September 18, 2007, Pages 37-38.

determinations regarding the public interest, a more traditional regulatory concept. Because, however, of the impact of value on rates and the impact of rates on public interest, the two functions are intimately intertwined.

Not only has Nashua met all the requirements of RSA 38, entitling it to a presumption that its acquisition is in the public interest, but also the evidence demonstrated that Nashua has gone to great lengths to promote the public interest. Approval of Nashua's petition, upon such conditions as the Commission determines to be reasonable and appropriate, will result in significant rate savings to customers and in all likelihood improve the quality of service provided to customers as well as advance other important public benefits such as land and water conservation.

WHEREFORE, Nashua respectfully requests that the Commission:

- a. Find that Nashua's Petition is in the public interest and impose in its discretion, pursuant to RSA 38:6, 11, 14, RSA 362, RSA 374 and as otherwise provided by law, any or all of the conditions proposed by Nashua in Appendix A or such other conditions the Commission shall deem necessary and appropriate to satisfy the public interest;
- b. Determine the price to be paid by Nashua for the assets of PWW under RSA 38:9 and, in connection therewith, establish a procedure to determine the value of any additions to and deletions from the assets of PWW after December 31, 2004.
- c. Equitably allocate the expense of the Commission in its investigation of the matter covered by Nashua's Petition under RSA 38:9; and

d. Grant such other and further relief as justice may require.

Respectfully submitted,

CITY OF NASHUA

By Its Attorneys,

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Date: November 16, 2007

By:



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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing has been sent this day by e-mail and first class mail to all persons on the Commission's official service list in this proceeding.

Date: November 16, 2007



Justin C. Richardson, Esq.

APPENDIX A - CITY OF NASHUA'S PROPOSED CONDITIONS

Pursuant to RSA 38:11 & 14, RSA 362, RSA 374, Nashua proposes the following conditions to the Commission:

I. PROPOSED CONDITIONS RELATIVE TO CUSTOMERS IN FRANCHISES LOCATED OUTSIDE THE CITY OF NASHUA

1. *Service to All Customers at Core Rates.*

Nashua shall provide service to all customers located outside the City, including customers of satellite systems, at core rates.

2. *Quality of Service is Subject to Commission Jurisdiction.*

Nashua shall provide service to customers outside the City that shall be reasonably safe and adequate and in all other respects just and reasonable. Service within franchises outside of Nashua's borders shall be subject to the Commission's jurisdiction under RSA 374, and, the Commission shall have jurisdiction relative to any complaint alleging that service is not reasonably safe and adequate and in all other respects just and reasonable.

3. *Non-discriminatory Service Pursuant to Nashua's Water Ordinance.*

- a. Nashua shall provide service to all customers pursuant to its Water Ordinance, including a Main Extension Policy, as may be amended. Nashua's service to customers and the terms and conditions of its Water Ordinance shall not discriminate against customers located outside of the City.
- b. The terms and conditions of the Water Ordinance, including its Main Extension Policy, shall be subject to the jurisdiction of the Commission, except as provided by RSA 362:4, III-a and RSA 362:4, II. The Commission shall have jurisdiction relative to any complaint alleging that the terms and conditions of Nashua's water ordinance are unjust or unreasonable.

4. *No transfer of franchises without prior Commission Approval.*

As a condition of approval pursuant to RSA 38:11, Nashua shall not sell, lease or otherwise transfer its franchises without prior approval from the Commission.

II. PROPOSED CONDITIONS RELATIVE TO WHOLESALE CUSTOMERS

5. *Wholesale Contracts.*

- a. Nashua shall provide service in accordance with the rates, terms and conditions of all existing wholesale contracts (i.e., Anheuser Busch, Town of Milford) and the renewal

thereof, or, if required for bonding purposes, Nashua shall create a wholesale tariff that incorporates the rates and provisions of the existing wholesale contracts.

- b. Nashua shall be subject to the Commission's jurisdiction relative to any complaint alleging that the rates, terms and conditions for wholesale service provided by Nashua are unjust or unreasonable. Any complaint relative to wholesale service may be brought before the Commission as provided by RSA 365 and applicable laws, rules and regulations of the Commission with respect to such wholesale service.

III. PROPOSED CONDITIONS RELATIVE TO CUSTOMER SERVICE

6. *Compliance with Laws and Regulations Concerning Customer Service.*

Nashua shall provide customer service in compliance with applicable laws, rules and regulations governing customer service, including the Commission's Puc 1200 governing customer service.

7. *Technical Advisory Help Line and Process Information.*

- a. Nashua shall have technical advisors on call 24-hour per day available to industrial and wholesale customers of the system.
- b. Nashua shall make technical water treatment process information available electronically on a daily or more frequent basis, upon request from any industrial or wholesale customer.

8. *Technical Advisory Board.*

- a. Nashua shall establish a technical advisory board to provide recommendations concerning technical operations and policies related to the water system, including but not limited to: customer service, technical operations, watershed, water quality, and source water protection.
- b. Membership in the technical advisory board shall include representatives of retail and wholesale customers, regulatory agencies, municipalities served by the system, developers, and public interest organizations. Nashua shall provide updates to the technical advisory board concerning its operations, maintenance and management of the system. The technical advisory board shall meet on a monthly basis and all meetings and recommendations of the technical advisory board shall be open and available to the public, except as provided by RSA 91-A.
- c. On an annual basis, the technical advisory board shall make a report of recommendations to the City of Nashua concerning its operations.

V. DISCRETIONARY CONDITIONS

While Nashua does not believe the following conditions are necessary to protect the public interest, Nashua offers them for the Commission's consideration. These proposed conditions are not intended to limit in any way the Commission's authority to impose any conditions it deems necessary and appropriate under RSA 38:11:

9. *Interim Commission Jurisdiction.*

Pursuant to the Commission's authority under RSA 38:11, the City of Nashua shall be fully regulated as a water utility for the purposes of accounting, auditing, reporting and rates, until December 31st of the fifth year following Nashua's acquisition and commencement of utility operations of the assets acquired as a result of this proceeding.

10. *Integration of Customer Service*

- a. Nashua shall amend its OM&M Agreement with Veolia Water so that Veolia Water shall provide all customer service functions, including billings and collections, in full compliance with all applicable, laws, rules, and regulations related to customer service, including but not limited to the Commission's Puc 1200 regulations.
- b. Veolia Water's performance of customer service shall be just and reasonable, and subject to the Commission's jurisdiction as provided by RSA 374, and the terms and conditions imposed by the Commission.

11. *Mitigation of Harm to PEU and PAC*

- a. Nashua shall acquire the assets of PEU and PAC to satisfy the public interest pursuant to RSA 38:11 at a price to be agreed upon by the parties. If the parties fail to agree upon a price, either may petition this Commission to establish a price under RSA 38:9. Nothing in this condition shall be deemed to require the sale of PEU and PAC by Pennichuck Corp.
- b. If Pennichuck Corp. shall elect not to sell the assets of PEU and PAC to Nashua, Nashua shall mitigate the harm, if any to PEU and PAC, occasioned by its acquisition of the assets of PWW, by creating a mitigation fund. The amount of the harm, if any, and mitigation fund shall be established in a new docket proceeding but shall be capped at the value of their plant in service as determined by the Commission.

12. *Final OM&M Agreement Subject to Commission Approval.*

Within 60 days of entry of the entry of a final order not subject to appeal, Nashua shall submit for approval by the Commission, a duly authorized and executed: (a) OM&M Agreement with Veolia Water; and (b) Professional Services Agreement with R.W. Beck, incorporating all conditions imposed by the Commission.