

**STATE OF NEW HAMPSHIRE
PUBLIC UTILITIES COMMISSION**

DW 04-048

CITY OF NASHUA

RSA 38 Proceeding re Pennichuck Water Works

Order Approving Taking and Determining Value

ORDER NO. 24,878

July 25, 2008

APPEARANCES: Upton and Hatfield, L.L.P. by Robert Upton II, Esq. and Justin C. Richardson, Esq. for City of Nashua; McLane, Graf, Raulerson & Middleton, P.A. by Steven V. Camerino Esq., Sarah B. Knowlton Esq., and Thomas J. Donovan, Esq. and Baker, Donelson, Bearman, Caldwell & Berkowitz, P.A. by Joe A. Conner, Esq. for Pennichuck Water Works, Inc., Pennichuck East Utility, Inc., Pittsfield Aqueduct Co., Pennichuck Water Service Corp. and Pennichuck Corp.; Ransmeier & Spellman, P.C. by Dom S. D'Ambruoso, Esq., Daniel J. Mullen and John T. Alexander, Esq. for Anheuser-Busch, Inc.; Eugene F. Sullivan III, Esq. for Town of Bedford; Boutin Associates, P.L.L.C. by Edmund J. Boutin, Esq. for Town of Merrimack; Waidleigh, Starr, and Peters, P.L.L.C. by Stephen J. Judge, Esq. for Merrimack Valley Regional Water District; Brown, Olson & Gould, P.C. by Bryan K. Gould Esq. and E. Maria Reinemann, Esq. for Town of Milford; Barbara Pressly, pro se; Claire McHugh, pro se; Office of the Consumer Advocate by Meredith A. Hatfield, Esq. and Rorie Hollenberg, Esq. on behalf of residential ratepayers; and Marcia A.B. Thunberg, Esq. of the Staff of the New Hampshire Public Utilities Commission.

I. INTRODUCTION

RSA 38 authorizes a municipality, with the approval of the Commission and at a value set by the Commission, to take public utility property for the use of its citizens and others. The City of Nashua (Nashua) has invoked RSA 38 in an effort to municipalize its local water utility, Pennichuck Water Works, Inc. (PWW) and certain affiliates. In this order, based on an extensive evidentiary record developed over twelve days of hearings, we grant Nashua's petition, solely as to PWW, with conditions, and provide our valuation of the assets to be taken by the municipality.

II. STATUTORY AUTHORITY

Chapter 38 of the New Hampshire Revised Statutes sets forth a detailed statutory scheme that municipalities may invoke in order to establish, or to assume the ownership of, “suitable plants for the manufacture and distribution of electricity, gas, or water for municipal use, for the use of its inhabitants and others, and for such other purposes as may be permitted, authorized or directed by the commission.” RSA 38:2, I.

In the case of a city such as Nashua, RSA 38:3 authorizes the municipality to move forward with such a plan “after 2/3 of the members of the governing body shall have voted, subject to the veto power of the mayor as provided by law, that it is expedient to do so,” and provided that within one year of such decision, it is “confirmed by a majority of the qualified voters at a regular election or at a special meeting duly warned in either case.” *See also* RSA 38:3-a (describing similar procedure as to regional water districts), 38:4 (as to towns or village districts) and RSA 38:5 (as to unincorporated towns and unincorporated places).¹ All four sections providing for a confirming popular vote specify that the effect of such a vote, if affirmative, is to create “a rebuttable presumption that such action is in the public interest.”

Within 30 days of the confirming vote, the municipality must provide written notice of the action to “any utility engaged, at the time of the vote, in generating or distributing electricity, gas or water for sale in the municipality.” RSA 38:6. The notice must “include an inquiry as to whether the utility elects to sell . . . that portion of its plant and property located within or without the municipality which the municipality has identified as being necessary for the municipal water service.” *Id.*

¹ The authority granted by these three sections of RSA 38 is described therein not as the authority to take private property but, rather, the authority to “initially establish . . . a plant.” It is clear from the overall language of RSA 38 that, in appropriate circumstances, a municipality may exercise this establishment authority by instituting condemnation proceedings.

The utility or utilities must provide a response within 60 days. RSA 38:7. When, as here, the utilities indicate an unwillingness to negotiate a sale, “the municipality may proceed to acquire the plant as provided in RSA 38:10.” *Id.* Section 10, in turn, allows the municipality to take the property by condemnation if, after notice and hearing, the Commission determines such taking to be in the public interest. RSA 38:10. Moreover, pursuant to RSA 38:11, the Commission “may set conditions and issue orders to satisfy the public interest.” The Commission is also tasked with determining just compensation for the taking, pursuant to authority set forth in RSA 38:9. Section 9 vests in the Commission not only the responsibility to fix the price to be paid for the plant and property in dispute but also to determine “the amount of damages, if any, caused by the severance of the plant and property proposed to be purchased from the other plant and property of the owner.” *Id.* The Commission must also assess the expenses of its investigation to “the parties involved.”

III. BACKGROUND AND PROCEDURAL HISTORY

A. November 2002 to March 2004: Pre-Petition Events

On November 6, 2002, by a vote of 14-1, Nashua’s Board of Alderman decided pursuant to RSA 38:3 to establish a municipal water works system and to acquire all or part of the privately owned water works system serving Nashua’s inhabitants. The mayor approved the aldermanic resolution on December 2, 2002. Nashua conducted a special meeting of its voters on January 14, 2003, at which the voters confirmed the resolution by a vote of 6,525 to 1,867. Nashua provided RSA 38:6 notice on February 5, 2003 to three affiliated public utilities, all

subsidiaries of the Pennichuck Corporation (Pennichuck): PWW, Pennichuck East Utilities, Inc. (PEU), and Pittsfield Aqueduct Company (PAC).²

PWW serves customers in Nashua as well as in the towns of Amherst, Hollis, Merrimack and Milford. PWW also owns and operates community water systems in Bedford, East Derry, Epping, Milford, Newmarket, Plaistow and Salem. PEU serves customers in Atkinson, Derry, Hooksett, Londonderry, Pelham, Plaistow, Raymond, Sandown and Windham. At the time of Nashua's notice, PAC served customers in Pittsfield; it has since expanded and now also serves customers in Barnstead, Conway, and Middleton.

All three utilities responded in the negative to Nashua's inquiry on March 25, 2003. Negotiations ensued, without success, terminating in January 2004. Pennichuck thereafter instituted civil proceedings against Nashua in Superior Court, alleging, *inter alia*, that RSA 38 was unconstitutional because it did not provide utilities subject to condemnation under the statute with the right to a jury trial, and that Nashua had unreasonably delayed the institution of RSA 38 proceedings before the Commission.³ Nashua responded by filing its RSA 38 petition with the Commission on March 25, 2004.

B. April 2004 through April 2005: Preliminary Proceedings

Although the next procedural step in such circumstances is ordinarily the issuance by the Commission of an order of notice, other developments intervened. Specifically, on April 5, 2004, PWW, PEU, and PAC jointly moved for dismissal of the petition or, in the alternative, for a stay. In the wake of the motion, the Town of Milford filed an intervention request, Nashua

² In most instances throughout the proceeding, both Pennichuck and its subsidiaries have appeared jointly. Therefore, except where specifically indicated by the context, we use the term "Pennichuck" as shorthand to describe all of the Pennichuck-affiliated entities that have appeared in the proceeding.

³ Pennichuck instituted two parallel proceedings in Superior Court, one seeking a declaratory judgment and the other an action for damages. The former proceeded to the summary judgment stage; Nashua removed the latter to federal court on May 17, 2004.

filed a pleading in opposition to the utilities' joint motion, Nashua moved to disqualify the law firm representing the utilities on the ground that the firm was also representing a different municipality in an unrelated RSA 38 proceeding, and, on May 3, 2004, the Commission indicated by secretarial letter that it would stay the docket pending the Superior Court's resolution of a request by Pennichuck to enjoin Nashua from proceeding before the Commission on its petition.

PWW, PEU, and PAC submitted a pleading in opposition to the disqualification motion on May 10, 2004. The Town of Milford submitted a motion asking for a determination that its bulk water contract with PWW would remain in effect; PWW, PEU, and PAC asked the Commission to hold the motion in abeyance. The Superior Court denied the utilities' request for an injunction against Nashua on June 7, 2004. Accordingly, the Commission issued an order of notice on June 22, 2004, scheduling a pre-hearing conference for July 28, 2004 and establishing a deadline for intervention requests. The Office of Consumer Advocate (OCA) entered an appearance on behalf of residential customers pursuant to RSA 363:28 and the Commission received intervention petitions from the Town of Bedford, PWW customer Barbara Pressly, the Town of Hollis, the Town of Raymond, the Town of Hudson, the Town of Pittsfield, the Town of Amherst, the Merrimack Valley Regional Water District, the Town of Londonderry, the Nashua Regional Planning Commission, PWW customer Fred S. Teeboom, the Town of Litchfield and the Merrimack River Watershed Council. PWW, PEU, and PAC objected to the regional water district's intervention request on the ground that its constituent towns had separately sought intervenor status.

The pre-hearing conference took place as scheduled on July 28, 2004. Thereafter, the Commission received late intervention requests from Rep. Claire B. McHugh of Nashua, PWW customer Anheuser-Busch, Inc., and the Town of Merrimack.

The Superior Court rendered its decision in the related declaratory judgment action on August 31, 2004. *See Pennichuck Corp. v. City of Nashua*, 2004 WL 1950458. The Court determined that: (1) Pennichuck had not been deprived of its right to due process by virtue of the absence in RSA 38 of an opportunity for a Superior Court hearing, as opposed to a hearing before the Commission, *Id.* at *4 to *5; (2) the question of whether Pennichuck is entitled on equal protection grounds to a jury trial on the issue of damages was not yet ripe for adjudication, *Id.* at *5; (3) a declaratory judgment was unnecessary on Pennichuck's as-applied claim raising the issue of inverse condemnation⁴ because an adequate alternative remedy, in the form of damages, was available to Pennichuck in other proceedings, *Id.* at *6; (4) RSA 38 was not facially unconstitutional on inverse condemnation grounds, *Id.*; (5) Pennichuck was not entitled to judgment in its favor based on the doctrine of laches,⁵ *Id.* at *7; and (6) based on the doctrine of primary jurisdiction, the Commission, by virtue of its expertise, is the appropriate forum for determining, at least in the first instance, whether Nashua could municipalize Pennichuck subsidiaries other than PWW itself, *Id.* at 8. The trial court therefore entered summary judgment

⁴ Inverse condemnation, unconstitutional because it amounts to a taking without just compensation, occurs "when a governmental body takes property in fact but does not formally exercise the power of eminent domain." *Pennichuck Corp. v. City of Nashua*, 152 N.H. 729, 733 (2005) (also noting that inverse condemnation can occur "through either physical act or by regulation") (citations omitted). As distinct from Pennichuck's separate claim that RSA 38 is facially unconstitutional on this ground, the as-applied claim argued that inverse condemnation had occurred here based on the specific facts of the case.

⁵ Laches is "derives from contract principles which require that performance must be within a reasonable time when no time for performance is specified by statute or agreement." *Pennichuck Corp.* 152 N.H. at 736 (citations omitted). In rejecting Pennichuck's laches claim, the Superior Court determined that the City had not waited too long to pursue RSA 38 in light of ongoing negotiations between the parties. *Cf. Greenwood v. New Hampshire Public Utils. Comm'n*, 527 F.3d 8, 15-16 (1st Cir., 2008) (concluding that laches barred federal preemption claim that lay unasserted for 17 years).

in favor of Nashua but dismissed without prejudice the as-applied inverse condemnation claim as well as the claim challenging the extent of Nashua's RSA 38 municipalization rights.

Soon after the Superior Court's decision in the declaratory judgment action, the U.S. District Court for the District of New Hampshire issued its ruling on the merits of the separate damages action. Specifically, on September 13, 2004, the federal court dismissed without prejudice Pennichuck's federal claims (raising issues of substantive due process and inverse condemnation), deeming them to be unripe. *Pennichuck Corp. v. City of Nashua*, No. 2004 DNH 134, slip op. at 7 (D.N.H. Sept. 13, 2004). Declining pursuant to 28 U.S.C. § 1367(c) to exercise supplemental jurisdiction over the non-federal claims (raising similar issues but invoking the New Hampshire Constitution, common-law intentional interference with contractual relations, and the state Consumer Protection Act, RSA 358-A), the U.S. District Court remanded the case back to the New Hampshire Superior Court where it was first instituted. *Id.* at 8.

The Commission issued its order following a pre-hearing conference on October 1, 2004. *See City of Nashua*, Order No. 24,379, 89 NH PUC 565 (2004). In Order No. 24,379, the Commission granted all pending intervention requests, suspended the motion to disqualify the utilities' counsel pending resolution of the unrelated RSA 38 proceeding, decided to hold the Town of Milford's motion in abeyance, directed the parties to submit briefs on the issues raised by the pending motion to dismiss, directed Nashua to file testimony by November 22, 2004 with regard to its technical, financial, and managerial capability as well as on public interest issues, and scheduled an additional pre-hearing conference. *Id.* at 571.

On November 30, 2004, the Superior Court dismissed without prejudice the remaining claims in the damages action that had been remanded from the federal court. The Superior Court characterized the damages action as follows:

The upshot of all of Pennichuck's claims . . . is that the City has not invoked the RSA 38 procedures in good faith and for the legitimate purpose of actually acquiring some or all of Pennichuck's property. Pennichuck avers that the City has never had any real intention of acquiring Pennichuck's property but instead has used the specter of eminent domain proceedings to upset Pennichuck's attempt to merge with Philadelphia Suburban Corporation.

Pennichuck Corp. v. City of Nashua, No. 04-C-169, slip op. at 2-3 (N.H. Super. Ct., S. Hillsborough Div., Nov. 30, 2004). The Superior Court ruled that these claims are not ripe for adjudication until the proceedings before the Commission are concluded. *Id.* at 3-4. Pennichuck did not appeal this decision.

Nashua filed testimony with the Commission as directed, extensive briefing took place, the Business and Industry Association of New Hampshire submitted an intervention request and, on December 9, 2004, the second pre-hearing conference took place, followed by a technical session.

The Commission issued Order No. 24,425 on January 21, 2005. *See City of Nashua*, 90 NH PUC 15 (2005). In Order No. 24,425, the Commission concluded that "the eminent domain authority delegated by the Legislature in RSA 38:2 should be narrowly construed and that the notice requirement in RSA 38:6 should be given full effect." *Id.* at 23. Therefore, the Commission ruled that Nashua could not condemn the property of PEU and PAC, inasmuch as these utilities did not provide water service in Nashua. *Id.* However, the Commission also concluded that Nashua was entitled to "pursue" all assets of PWW, even those assets located in other municipalities and regardless of whether those assets are interconnected with the system serving Nashua. *Id.* at 24. In so ruling, the Commission stressed that "[w]hether it is in the

public interest to allow Nashua to take any or all of PWW's assets . . . remains a factual determination of the public interest for the Commission to make." *Id.*

The Commission also ruled in Order No. 24,425 that Nashua had followed the requirements of RSA 38:3 with regard to the confirmatory vote, rejecting arguments to the contrary advanced by intervenor Teeboom and by Pennichuck. *Id.* at 25-26. Finally, the Commission made certain procedural determinations: that the intervention request of the Business and Industry Association be granted, that the utilities should have until January 31, 2005 to file the motion for summary judgment they had indicated they would submit, that responses to the summary judgment motion would be due on March 2, 2005, and that the Commission would entertain pleadings on or before March 8, 2005 on the question of whether to bifurcate the proceeding into separate "public interest" and "valuation" phases. *Id.* at 26. The Commission scheduled a technical session and laid out certain ground rules for the centralized "data room" under discussion by the parties and Commission Staff (Staff) as a means of expediting discovery. *Id.*

PWW filed a motion for rehearing of Order No. 24,425 on February 18, 2005, joined thereafter by the Town of Merrimack. Nashua objected in writing on February 28, 2005, joined thereafter by the Merrimack Valley Regional Water District. Neither PWW nor any of its affiliates filed a summary judgment motion, but the Commission received extensive pleadings from the parties on the bifurcation question, which the Commission resolved on March 31, 2005 in Order No. 24,447. *See City of Nashua*, 90 NH PUC 126 (2005). The Commission declined to bifurcate the proceedings and directed the parties and Staff to develop a proposed procedural schedule to govern the remainder of the proceeding. *Id.* at 129-30. On April 4, 2005, the Commission denied PWW's motion for rehearing of the previous determination with regard to

the extent of the assets Nashua could potentially municipalize. *City of Nashua*, Order No. 24,448, 90 NH PUC 130 (2005).

On April 5, 2005, the Commission received a jointly-filed intervention request from PWW's parent company, Pennichuck Corporation, as well as PEU, PAC (both no longer directly subject to the municipalization petition, per Order No. 24,425) and a third affiliate, Pennichuck Water Service Corporation (PWSC). The pleading noted that PWSC is not a public utility but, rather, operates community and municipal water systems in New Hampshire and Massachusetts under contract. Staff submitted an agreed-upon procedural schedule on April 12, 2005, Nashua objected to the pending intervention requests on April 15, 2005, and intervenor Pressly submitted an unsigned pleading, captioned as testimony, on April 20, 2005. The Town of Bedford and intervenor McHugh submitted testimony on April 22, 2005.

By Order No. 24,457 (April 22, 2005) *see City of Nashua*, 90 NH PUC 157 (2005), the Commission approved the proposed procedural schedule, granted a rules waiver that had the effect of lengthening the applicable time for objecting to discovery requests from four to ten days, and granted the pending intervention requests of the four PWW affiliates. The schedule, as approved, called for several rounds of pre-filed direct testimony, punctuated by extensive discovery, culminating in hearings in September 2006. *Id.* at 158-59.

C. April 2005 to November 2006: Discovery and Motion Practice

Over the course of the ensuing 20 months, the parties conducted discovery, developed and submitted pre-filed written testimony, and presented the Commission with numerous discovery disputes, other procedural issues and a summary judgment motion. *See* secretarial letter of June 24, 2005 (amending certain discovery deadlines); Order No. 24,485, 90 NH PUC 289 (July 8, 2005) (denying Nashua's request to limit discovery requests of PWW); Order No.

24,487, 90 NH PUC 294 (July 8, 2005) (allowing PWW and affiliates to include claims about monetary damages and other financial contentions in their “public interest” testimony); Order No. 24,488, 90 NH PUC 297 (July 18, 2005) (granting PWW motion to compel discovery of Nashua); Order No. 24,489, 90 NH PUC 300 (July 18, 2005) (denying PWW motion to compel discovery of Town of Amherst and Merrimack Valley Water District); Order No. 24,494, 90 NH PUC 314 (July 29, 2005) (denying Nashua motion to compel discovery of PWW); Order No. 24,495, 90 NH PUC 316 (July 29, 2005) (protective order as to certain information produced by PWW and affiliates); secretarial letter of October 3, 2005 (revising procedural schedule); Order No. 24,555, 90 NH PUC 568 (December 2, 2005) (denying rehearing of Order Nos. 24,487 and 24,488, and clarifying Order Nos. 24,489 and 24,494); Order No. 24,567, 90 NH PUC 619 (December 22, 2005) (denying PWW motion for summary judgment and PWW motion to bar late-filed testimony, and revising procedural schedule); secretarial letter of January 11, 2006 (revising procedural schedule and postponing hearings to January 2007); Order No. 24,583 (January 27, 2006) (granting protective treatment of certain PWW information); Order No. 24,596 (March 3, 2006) (denying Nashua motion to consolidate DW 04-048 with Docket No. DW 05-179, concerning proposed waiver of certain provisions of Uniform System of Accounts for Water Utilities for PEU and PAC); Order No. 24,605 (March 24, 2006) (granting request for protective treatment of certain information to be produced by Nashua); secretarial letter of April 19, 2006 (designating Staff witness Mark A. Naylor, Director of the Gas & Water Division, as Staff advocate pursuant to RSA 363:32); Order No. 24,654 (August 7, 2006) (denying PWW motion to compel discovery of Nashua); secretarial letter of September 7, 2006 (establishing 20 business-day deadline for motions to compel discovery); secretarial letter of September 7, 2006 (suspending deadline for submission of “capstone” testimony); secretarial letter of September 14,

2006 (revising procedural schedule); Order No. 24,667 (Sept. 22, 2006) (denying, without prejudice, PWW motion to strike pre-filed testimony of Nashua witnesses Hersh, McCarthy, Henderson, Fuller, Anderson, and Raswyck); Order No. 24,671 (Sept. 22, 2006) (denying PWW motion for rehearing of Order No. 24,654); Order No. 24,681 (Oct. 23, 2006) (granting in part and denying in part PWW motion to compel discovery responses of Nashua); and Order No. 24,699 (Nov. 8, 2006) (granting PWW motion to compel discovery responses of Nashua and denying Nashua motion for protective treatment of related documents). To the extent any of these determinations bear upon the outcome of the proceeding, we discuss them *infra*.

Pennichuck also pursued an appeal of the Superior Court decision during this period. On November 16, 2005, the New Hampshire Supreme Court affirmed the trial court's decision. *See Pennichuck Corp.*, 152 N.H. at 741. *Inter alia*, the appellate tribunal held on the issue of inverse condemnation that Pennichuck had not to date been "deprived of the economically viable use of its property, nor will such a deprivation occur unless and until all necessary steps to the condemnation process have been completed." *Id.* at 734. The justices also rejected Pennichuck's argument that certain time limits, absent from RSA 38 but present in other eminent domain statutes, should apply. *Id.* at 735-36.

Thus, with Pennichuck having exhausted its appellate remedies in civil court, and with discovery here having been completed, by late November of 2006, more than four years after the aldermanic vote that began RSA 38 proceedings and some 30 months after Nashua filed its petition with the Commission, the case finally stood at the threshold of administrative hearing.

D. November 2006 to January 2007: Motions *in Limine* and Opening Hearings

On November 22, 2006, the Commission issued a secretarial letter that set forth how the agency intended to proceed with final hearing preparations and the hearings themselves. Specifically, the Commission: (1) scheduled a view of certain PWW facilities, pursuant to N.H. Code Admin. Rules Puc 203.28, for December 6, 2006; (2) adopted, with certain modifications, the hearing schedule agreed upon by the parties during a conference with the Commission's general counsel, providing for nine days of hearings between January 10 and February 1, 2007; (3) ruled that the Commission would not entertain opening statements at hearing but, instead, would receive pre-hearing briefs on or before December 15, 2006; (4) determined the order in which the parties would present their witnesses, (5) set forth the order of cross-examination of such witnesses; (6) required the parties to confer prior to hearing and pre-mark exhibits to the extent possible; (7) established, in light of pending issues that had the potential to consume hearing time if left unresolved, a deadline of December 12, 2006, with responses due ten days later, for motions *in limine*; (8) scheduled argument, if necessary, on any such motions for January 4, 2007; and (9) described how the Commission would handle any discussion of confidential materials at hearing.

On November 27, 2006, Nashua submitted a pleading captioned as a "compliance filing" and motion for confidential treatment pursuant to Order No. 24,699. In this pleading, Nashua asked the Commission to reconsider its determination that certain materials being produced in discovery by Nashua were not entitled to protective treatment, also requesting that the Commission determine that Nashua not be required to produce to PWW any additional materials relative to a federal grand jury investigation in Indiana relative to the operations contractor Nashua plans to employ upon assuming ownership of PWW's facilities. Also on November 27,

2006, PWW filed a motion in limine seeking to disqualify and strike the testimony of George E. Sansoucy and Glenn C. Walker, Nashua's expert witnesses on the issue of valuation.

PWW and the Pennichuck Corporation jointly filed an objection to Nashua's November 27, 2006 pleading on December 4, 2006. They requested that Nashua be directed to produce the disputed information within 24 hours.

On December 6, 2006 the Commission's view of certain PWW facilities was conducted as scheduled, with most parties present.

The Commission issued Order No. 24,706 on December 8, 2006, ruling that, rather than await responsive pleadings to PWW's motion to disqualify and strike the testimony of Nashua's valuation witnesses, the Commission would deny the motion summarily but without prejudice. The Commission described the issues raised in PWW's disqualification motion as "essentially, and obviously, unripe," stressing that it was expressing no view as to the substance of PWW's motion.

Nashua filed three motions *in limine* on December 8, 2006. The first sought to exclude the testimony of PWW witness R. Kelley Myers, which concerned the extent to which the municipalization proposal continued to enjoy public support in Nashua. The second sought to exclude evidence concerning severance damages, also requesting a determination that both PWW and the Pennichuck Corporation were precluded from seeking severance damages pursuant to RSA 38:9. The third motion sought to exclude certain supplemental testimony of two PWW witnesses, Donald Ware, President of Pennichuck Water Works, and John F. Guastella, Pennichuck's revenue expert.

On December 13, 2006, the Commission's general counsel filed a letter reporting on his efforts to resolve the dispute between PWW and Nashua over the discoverability of information

related to the grand jury investigation of Nashua's operations contractor in Indiana. Later the same day, the Commission issued a secretarial letter adopting the general counsel's recommendation, agreed to by PWW and Nashua, and which involved production of the documents to PWW at a specified location.

Anheuser-Busch, Inc., the Merrimack Valley Regional Water District, Nashua, Commission Staff, Pennichuck, and OCA filed opening statements on December 15, 2007. PWW filed objections to Nashua's three motions *in limine* on December 18, 2006.

On December 21, 2006, Nashua filed a motion asking the Commission to postpone the hearings for at least 180 days and to convene a settlement conference. Appended to the motion was a copy of Nashua's written settlement proposal to PWW, for which Nashua requested confidential treatment pursuant to N.H. Code Admin. Rules Puc 203.08. The general counsel submitted a letter on December 27, 2006, summarizing certain hearing-related technical arrangements as agreed to by Nashua and PWW.

PWW filed a pleading in opposition to Nashua's motion for postponement on December 28, 2006. Also on that date, Nashua submitted: (1) a letter stating that Nashua had a good-faith basis for requesting confidential treatment of the previously submitted settlement proposal, expressing an intention to file a formal motion for confidential treatment; and (2) a letter discussing certain of the logistical arrangements, related to exhibits, described in the general counsel's letter of the previous day. PWW responded by letter filed on January 3, 2007. Also on January 3, both Nashua and PWW filed an agreed-upon witness schedule.

PWW filed a motion seeking reconsideration of Order No. 24,706, relative to Nashua's valuation witnesses, on January 4, 2007. On January 5, 2007, the Commission issued: (1) a secretarial letter, denying Nashua's motion to postpone the hearings; and (2) Order No. 24,722,

granting Nashua's motion to exclude PWW witness Myers, also excluding the testimony of Brendan Cooney, the witness Nashua had proffered to rebut Mr. Myers. Order No. 24,722 otherwise denied the pending *in limine* motions and their requests to exclude certain evidence. Nashua filed an opposition to the pending reconsideration motion of PWW on January 10, 2007.

January 10, 2007 also marked the opening of the merits hearing in the proceeding. The Commission also heard testimony on January 11, 2007.

E. January 2007 through July 2007: Agreed-to Stay

On the morning of the third scheduled hearing day, January 16, 2007, Nashua and Pennichuck filed a joint motion to continue the hearing for 120 days. According to the motion, the signatories had agreed upon such a continuance for the purpose of facilitating settlement discussions. The movants also indicated that they may, upon expiration of the 120 days, seek a further continuance of at least 60 days. They further requested that, during the stay period, all parties be enjoined from submitting additional pleadings. The Commission granted the motion at hearing on January 16, 2007, indicating that it expected to receive only submissions related to the progress of the negotiations during the stay, and that any other submissions would be held in abeyance absent extraordinary circumstances.

On February 22, 2007, the Commission issued a secretarial letter scheduling a status conference for May 17, 2007, one day after the expiration of the 120-day stay. On April 23, 2007, the Commission rescheduled the status conference to May 16, 2007. Pennichuck, jointly with Nashua, filed a motion on May 15, 2007 for an extension of the stay until July 16, 2007. By letter of May 16, 2007, Nashua reported that intervenors Town of Milford, Town of Amherst, Merrimack Valley Water District, Barbara Pressly, and Claire McHugh concurred in the request

for a further stay. The Commission conducted the scheduled status conference on July 16, 2007, granting the requested stay on May 18, 2007.

By secretarial letter of June 7, 2007, the Commission advised the parties of how it intended to proceed in the event no agreement was reached by the expiration of the stay on July 16, 2007. The letter listed a series of hearing dates in August, September, October, and November it had reserved for possible use in this docket, scheduling a technical session for July 17, 2007. On July 16, 2007, by separate letters, Nashua and Pennichuck reported that they had been unable to reach agreement and that the Commission should proceed with plans to resume the hearings.

F. July 2007 through December 2007: Resumed Hearings and Briefing

The technical session took place as scheduled on July 17, 2007. The Commission's general counsel thereafter filed a report, setting forth the parties' agreed-upon recommendations for resuming the hearings and rescheduling witnesses. Deviating somewhat from these recommendations, for scheduling reasons exogenous to this docket, the Commission by secretarial letter on July 20, 2007 specified eleven days in September 2007 on which it would conduct the resumed merits hearing. The parties were given until August 10, 2007 to submit proposed witness schedules.

Pennichuck filed such a schedule, but it became clear that not all issues had been resolved. Specifically, Pennichuck objected to Nashua's plan to substitute two witnesses, Stephen Siegfried and Alyson Willans, both associated with Nashua's operations contractor, for witnesses who, according to Nashua, were no longer associated with the contractor (David Ford and Robert Burton). Nashua filed a motion to that effect on August 10, 2007, to which Pennichuck objected on August 13, 2007. In addition, Pennichuck moved on August 15, 2007

for leave to substitute Donald Ware as the witness sponsoring a portion of the testimony previously submitted by Donald Correll, who presented the testimony as president of PWW but had since left that post to become CEO of American Water. Nashua later acceded to Pennichuck's witness substitution request.

On August 21, 2007, the Commission issued a secretarial letter granting Nashua's request to add Mr. Siegfried and Ms. Willans to the list of those testifying, but also required Nashua to tender them for deposition, further indicating that the Commission still expected Mr. Ford and Mr. Burton to testify as well. The Commission explicitly declined to rule on an issue raised by Pennichuck, concerning the participation of the two new Nashua witnesses in due diligence efforts associated with the failed settlement negotiations, characterizing PWW's concerns about such participation as speculative. The Commission stressed that it would rule on any such issues as they arose at hearing.

By secretarial letter issued on August 24, 2007, the Commission added an additional half-day of hearing time to the schedule, on September 7, 2007. The purpose of the change was to accommodate a scheduling exigency related to one of Nashua's witnesses.

Hearings took place as scheduled on September 4, 5, 7, 10, 11, 12, 13, 18, 19, and 26, 2007. PWW renewed its objection to Nashua offering testimony from Mr. Siegfried and Ms. Willans, which the Commission overruled. On September 25, 2007, Nashua filed a written motion to strike Mr. Ware's testimony on behalf of PWW, arguing that Mr. Ware had given "material false testimony" concerning PWW's use of a so-called "computerized maintenance management system" (CMMS). According to Nashua, Mr. Ware contradicted himself when he stated that Nashua's contractor would make no efficiency gains by implementing a CMMS (because such a system was already in use at PWW) but later stated that he had little or no

knowledge of such a system. According to Nashua, this had the effect of depriving Nashua of the opportunity to cross-examine Mr. Ware fully on the question of PWW's ability to manage maintenance costs.

The parties thereafter made several filings in response to record requests posed during the hearings. On October 11, 2007, PWW filed a list of 33 exhibits that were still subject to disagreement among the parties as to admissibility. Chairman Getz, in his capacity as presiding officer, took up these remaining evidentiary issues at a hearing held on October 12, 2007. He issued his rulings by letter of October 17, 2007. In his ruling, the Chairman noted that 29 of the disputed exhibits consisted of responses made by Nashua to data requests interposed during discovery. PWW had objected to admitting these documents on the ground that Nashua was seeking to use them as an unfair means of supplementing the direct testimony of its witnesses. The Chairman agreed that admission of these exhibits would be unfair and, therefore, he excluded them. He also excluded three other disputed exhibits from the record, one, no. 1117A, that had been excluded at hearing and two others, nos. 1145 and 3258, concerning bidding by multiple government entities for the purchase of an investor-owned utility. He admitted the remainder of the disputed exhibits into evidence.

The Chairman's letter fixed November 16, 2007 as the deadline for submission of post-hearing briefs. This was based on a prior agreement of the parties to establish a due date that was 30 days from the Commission's ruling on disputed exhibits. By secretarial letter of October 29, 2007, the Commission established December 3, 2007 as the due date for reply briefs.

On February 22, 2008, the Town of Milford filed a water supply contract into which Milford had entered with the City of Nashua. In essence, Nashua agreed that if the RSA 38 taking proceeds, Nashua would honor Milford's current contract with PWW for backup water

supply in connection with Milford's own municipal water system. As recited in the motion, Milford and Nashua jointly requested that the Commission approve the contract as part of its consideration of the underlying municipalization request.

Staff filed a letter on February 22, 2008 commenting on Milford's submission. Staff took the position that the Commission lacks jurisdiction to consider the bulk water supply contract in light of RSA 362:4, III-a(a)(2) (providing that a municipality selling water under a bulk supply contract executed after July 23, 1989 is not thereby a public utility). Staff also raised concerns about the potential necessity of reopening the evidentiary record to consider the contract and possible due process issues. Pennichuck filed a pleading in opposition to the Milford motion on February 27, 2008.

On February 29, 2008, the Town of Milford responded to Staff's concerns. The Milford letter stated that: (1) Nashua and Milford have simply asked the Commission to approve the agreement pursuant to RSA 38:11 and :17 as a condition of approving the underlying municipalization request, as distinct from resolving the question of whether the Commission has jurisdiction to enforce the Milford-Nashua agreement; (2) neither Milford nor Nashua was seeking to reopen the record in light of the agreement; and (3) the agreement simply "resolves some of the issues in dispute between Nashua and Milford in this docket."

IV. APPLICABLE LEGAL STANDARD

There is disagreement among the parties and Staff concerning the manner in which RSA 38 is applicable to this case. Accordingly, we begin our analysis with a discussion of the legal framework.

A. Pennichuck

It is the position of Pennichuck that we cannot grant Nashua's RSA 38 petition unless Nashua has demonstrated that the benefits of the proposed taking outweigh what Pennichuck characterizes as "the substantial harm such a taking would cause." Pennichuck Brief at 2. According to Pennichuck, the authority for this proposition is found in the various New Hampshire statutes governing condemnation and reflects the constitutional requirement that property be taken by the government only for a public purpose.

Pennichuck further contends that the rebuttable presumption contained in RSA 38:3 has "no meaningful application" to this case. *Id.* at 5. In the view of Pennichuck, this is because Nashua is proposing to take utility property that extends into ten other municipalities, none of which have themselves approved municipalization under RSA 38 and two of which have actively opposed Nashua's efforts. Indeed, according to Pennichuck, to accord Nashua the RSA 38:3 rebuttable presumption in these circumstances would amount to an interpretation of the statute that would allow a single municipality such as Nashua to take all of Public Service Company of New Hampshire (PSNH), simply because Nashua is within the PSNH service territory.

B. Town of Milford

The Town of Milford, which opposes the transaction, contends that the RSA 38:3 rebuttable presumption is simply a presumption that the taking is in the interest of Nashua citizens as opposed to New Hampshire as a whole. According to Milford, for the Commission to allow Nashua to take advantage of the presumption in the circumstances of this case would be to deprive every other municipality affected by the transaction of its due process rights. According to Milford, Pennichuck has correctly asserted that in order for the transaction to receive approval Nashua must demonstrate that the taking would result in net benefits to the public in general.

C. Staff

Staff states that RSA 38:3 creates a rebuttable presumption that Nashua's taking is in the public interest. When faced with determining the public interest, Staff contends the Commission has historically conducted a balancing of benefits which is nearly identical to the common law balancing of benefits in eminent domain matters. With respect to Nashua's contention that Order No. 24,567 requires that it obtain franchise approval to serve customers outside of Nashua, Staff stated the public interest determination under RSA 374 is subsumed in the public interest analysis of RSA 38 and does not create undue complication. According to Staff, as long as the Commission balances all benefits against the "harm and social costs," both the public interest standard of RSA 38 and the public exigency requirement applicable to all eminent domain cases will have been appropriately addressed.

D. City of Nashua

Nashua has a much different view of the statutory and constitutional framework. According to Nashua, to prevail in this case Pennichuck bears the burden of affirmatively rebutting the RSA 38:3 presumption that the proposed taking is in the public interest. Nashua contends that this rebuttable presumption in its favor applies not simply to the PWW assets within Nashua's borders but also the assets of the utility located in other municipalities.

In taking that position, Nashua contends that the Commission should revisit the determination made on December 22, 2005 in Order No. 24,567 that Nashua is obliged to obtain a utility franchise under RSA 374:26 and RSA 362:4, III-a(a) with respect to areas outside of Nashua that it would serve as the successor to PWW. In Order No. 24,567, the Commission ruled that the RSA 38:3 rebuttable presumption applies only to the PWW assets and franchise within Nashua because "only voters of Nashua had a voice in the vote that gave rise to that

presumption.” Order No. 24,567 at 5, 90 NH PUC at 621-22. According to Nashua, this ruling conflicts with the language in RSA 38:9 authorizing a municipality to petition the Commission to determine “how much, if any, of the plant and property lying within and without the municipality the public interest requires the municipality to purchase.” Nashua also invokes RSA 38:14, which makes explicit reference to a municipality acquiring and operating utility property located in another municipality, and which provides that the acquiring municipality “may operate within such other municipality as a public utility with the same rights and franchises which the owners of such outlying plant, as purchased, would have had such purchase not been made.”

In support of this argument, Nashua directs the Commission’s attention to *Appeal of Ashland Electric Department*, 141 N.H. 336 (1996), in which the New Hampshire Supreme Court ruled that RSA 38 required a municipal utility to obtain Commission approval prior to expanding the utility’s facilities into the service territory of a public utility within the municipality’s borders. According to Nashua, the *Ashland Electric* case supports its position because, in its ruling, the Court made no reference to franchise approval but, instead, quoted approvingly a Commission order describing the RSA 38 process as “comprehensive.”

According to Nashua, the rebuttable presumption that the transaction is in the public interest applies not simply to the acquisition of assets located within Nashua but to all assets of PWW. In support of this argument, Nashua contends that Sections 2, 6, 9, and 14 of RSA 38 give the Commission authority to determine how much property outside municipal boundaries it is in the public interest for the municipality to acquire. In the opinion of Nashua, the Legislature could have limited the effectiveness of the rebuttable presumption to areas within the municipality itself, but chose not to do so. Therefore, according to Nashua, citing *Hinsdale v.*

Chesterfield, 153 N.H. 70, 889 A.2d 32 (2005), it would be inappropriate for the Commission to infer the existence of such a requirement.

E. Commission Analysis

We conclude that, because the Nashua Board of Alderman (by the requisite two-thirds vote) and thereafter the voters of Nashua (by majority vote) have endorsed the proposed municipalization of PWW, the plain language of RSA 38:3 entitles Nashua to a rebuttable presumption that the proposed taking of the assets located within Nashua is in the public interest.⁶ We therefore reject Pennichuck's contention that the presumption has no meaningful application to this case. Accordingly, it is the burden of Pennichuck, and the other parties who oppose the petition, to demonstrate that the taking is *not* in the public interest as to the assets lying within Nashua.

Unlike many eminent domain cases, this is not a proceeding in which the underlying purpose of the proposed taking is being challenged as insufficiently public (as distinct from private) in nature as to raise constitutional difficulties. *Cf. Kelo v. City of New London, Conn.*, 545 U.S. 569 (2005) (holding that furthering city's economic development plan was valid public use under U.S. Constitution); *Rockingham County Light & Power Co. v. Hobbs*, 72 N.H. 531 (1904) (establishing constitutionality in New Hampshire of takings by electric utilities). That the provision of public water supply is a public purpose of constitutional sufficiency requires no discussion here. Indeed, the Legislature has decided as much by enacting RSA 371 (authorizing public utilities to institute condemnation proceedings before Commission).

⁶ As noted by Nashua, RSA 38:3 actually authorizes a municipality to "initially establish" a utility "plant" as opposed to explicitly allowing the taking property of a functioning utility. No party has suggested that this phraseology, which recurs elsewhere in RSA 38, raises any issues. Indeed, the Commission has previously declined to interpret the phrase "initially establish . . . a plant" as limiting a municipality's authority to acquire existing utility facilities. *See City of Manchester*, Order No. 23,350 (Nov. 22, 1999), 84 NH PUC 624. We thus need not address Nashua's argument about the meaning of the phrase in question.

Similarly, by enacting RSA 38 the Legislature has explicitly endorsed the propriety of municipalities taking utility property, further making the policy choice that such a taking is presumed to be in the public interest in the circumstances of this case. Consequently, we are called upon to allocate the burden of proof here to the municipalization opponents as to the assets lying within Nashua.

To the extent necessary, we reaffirm Order No. 24,567 that the rebuttable presumption of public interest applies only to utility property within Nashua's municipal boundaries. Since it is the confirming vote that generates the presumption, it follows that the Legislature's intent was to require us to accord a measure of deference to decisions arising out of the democratic process at the municipal level. Obviously, it would run counter to that principle if the democratic process in one municipality could have a potentially dispositive effect on the municipalization of property in one or more other municipalities. Thus, as to assets located outside of Nashua, Nashua bears the burden of proving that the taking of those assets is in the public interest.

One additional issue requires discussion. There has been extensive argument, in various contexts, about our authority to subject Nashua to ongoing regulatory oversight and set conditions as part of an approval of the proposed transaction. In general, Nashua has proposed such ongoing oversight as a means of protecting municipalities that currently rely on PWW for wholesale water, Anheuser-Busch (which likewise purchases water from PWW on a wholesale basis) and PWW customers not located in Nashua and thus not constituents of the municipal officials who would have ultimate responsibility for the municipalized system. Opponents of municipalization contend that we lack the authority to set certain conditions because they would have the effect of expanding our regulatory jurisdiction without legislative authority.

It is well established that the Commission “is a creation of the legislature and as such is endowed with only the powers and authority which are expressly granted or fairly implied by statute.” *Appeal of Public Service Co. of N.H.*, 122 N.H. 1062, 1066 (1982) (citing *Petition of Boston & Maine Railroad*, 82 N.H. 116, 116, 129 A. 880, 880 (1925)). In this instance, RSA 38:11 expressly grants the Commission authority, in making a public interest determination, to “set conditions . . . to satisfy the public interest.” While this authority is not limitless, it surely allows us to bind an acquiring municipality, especially to commitments it has made that have the effect of causing it to function in some respects as if it were a regulated public utility, as long as a reasonable nexus exists between those commitments and the public interest considerations at issue in the proceeding.⁷ For this reason, we proceed with our analysis of the record with the assumption that it is lawful to set conditions which fall squarely within the realm of utility regulation, and that we will maintain continuing authority to enforce any conditions.

Lastly, as stated in Order No. 24,567, we conclude that Nashua must comply with RSA 374 relative to franchise approval for service it provides outside its corporate boundaries. RSA 362:4, III-a specifically states that although a municipal corporation furnishing water service to customers outside its municipal boundaries, shall not be considered a public utility in certain circumstances, “[n]othing in this paragraph shall exempt a municipal corporation from the franchise application requirements of RSA 374.” Furthermore, we do not agree with Nashua that franchise approval for service outside of Nashua is impliedly granted by RSA 38:14, nor do we see a conflict between RSA 38:9 and the franchise application requirement of RSA 374. In fact,

⁷ This reading of RSA 38:11 is consistent with RSA 38:2, which explicitly authorizes a municipality to take utility property not simply to provide water for its inhabitants and other but also for “such other purposes as may be permitted, authorized, or directed by the commission.” RSA 38:2, I. Likewise, section 2 of RSA 38 authorizes municipalities to “[d]o all other things necessary for carrying into effect the purposes of this chapter.” RSA 38:2, III. See *In re Watterworth*, 149 N.H. 442, 445 (2003) (noting that statutes should be interpreted “in the context of the overall statutory scheme and not in isolation”).

any practical difference between the two is moot since review of Nashua's franchise for service outside Nashua has been accommodated in the instant proceeding. As such, we will consider in this order whether it is for the public good for Nashua to be granted a franchise to provide water service to customers located outside Nashua.

V. PUBLIC INTEREST ISSUES

We thus turn to the question of whether the proposed transaction is in the public interest as required by RSA 38:3 and RSA 38:9, including what conditions are necessary pursuant to RSA 38:11. At hearing, all parties were afforded an opportunity to present evidence and examine witnesses. Post-hearing, however, only Pennichuck, the Town of Milford, the Town of Merrimack, Anheuser-Busch, Inc., Staff, and Nashua submitted argument on the issue of public interest. Their positions appear below.

A. Pennichuck

According to Pennichuck, since PWW was restructured in 1983 to a holding company structure, Pennichuck has, with the encouragement of the Commission, grown into a regional utility willing to expand its operations and thereby solve endemic water supply problems. Pennichuck further contends that, throughout this period of expansion, Pennichuck has consistently demonstrated an ability to provide safe, adequate, reliable drinking water at reasonable rates. This record, according to Pennichuck, "should not be taken for granted or considered lightly." Pennichuck Brief at 8.

Pennichuck contends that, if Nashua were allowed to condemn PWW, the core of Pennichuck's financial and operational structure would be gutted and Pennichuck would no longer be able to play the role of regional utility. In support of this proposition, Pennichuck cites the testimony of Messrs. Naylor, Patch, Correll, Guastella, and Ware. According to Pennichuck,

PWW is the financial engine that generates most of Pennichuck's earnings, which enables the Pennichuck companies to invest in upgrades and new systems.

It is further the contention of Pennichuck that if the taking were to go forward the result would be a significant loss of technical capability, both to the remaining Pennichuck entities as well as, possibly, to Nashua's contract operator. Pennichuck points out that all of the employees who provide service to the non-PWW utilities are PWW employees and Nashua has indicated a desire to hire PWW field staff and other operational personnel (as distinct from PWW management). Thus, according to PWW, either Nashua and its contractors will be successful in attracting PWW employees, in which case the remaining Pennichuck utilities will be drained of vital experience, or Nashua and its contractors will be unsuccessful, in which case Nashua will lack key operational capability. Pennichuck also raises the specter of PWW employees seeking employment elsewhere to ensure that their positions are not among those that Veolia or Nashua eliminate following the transition to municipal ownership.

Pennichuck dismisses as "not credible" any assurances from elected officials in Nashua that as owners of the PWW system they will act in the best interests not only of Nashua's residents but also of residents of nearby and regional municipalities. *Id.* at 12. Pennichuck's point is that, once the system belongs to Nashua, there would be no more regional utility because Nashua has no motivation to invest beyond its borders. Pennichuck further asserts that Veolia has no interest in owning other systems (as opposed to operating them under contract). In that regard, Pennichuck draws the Commission's attention to Mr. Naylor's testimony to the effect that small water systems become troubled not because they lack qualified operators but because they lack capital. Pennichuck also dismisses as speculation the notion that some other, unidentified utility might come forward to provide the kind of regional assistance Pennichuck

has provided. The requisite economies of scale would simply be lacking, according to Pennichuck.

Pennichuck criticizes Nashua's plans for management and operations post-takeover, describing them as unprecedented, inefficient, and ineffective. According to Pennichuck, Nashua plans to turn over PWW's water systems to a pair of private contractors – Veolia and R.W. Beck, which in turn would engage numerous subcontractors – without Nashua itself employing anyone who knows anything about running a water utility. According to Pennichuck, although Nashua has characterized R.W. Beck's role as owner's representative, Veolia as the system operator plans to report directly to municipal officials. This, according to Pennichuck, means that ultimately any disagreements between the two contractors would have to be resolved by politicians. Pennichuck contends that such issues would be resolved “in a highly politicized forum where decisions are frequently made for reasons other than purely business considerations.” *Id.* at 16. Pennichuck also hypothesizes that such a paradigm would make it difficult to operate the PWW system on a day-to-day basis.

Pennichuck criticizes Nashua for having a “single-minded focus on reducing the operating costs in its model” causing Nashua to “sacrifice prudent operational considerations.” *Id.* at 16-17. Conceding that Veolia is a multinational conglomerate with considerable expertise, Pennichuck nonetheless points out that Veolia's direct experience in operating combined water supply and distribution systems at the scale of PWW is limited to Veolia's work in Indianapolis. Similarly, Pennichuck contends that Beck has never played the role of owner's representative in connection with a water distribution system, as opposed to a water supply facility or a construction project.

Relying on the testimony of Mr. Burton on behalf of Veolia, Pennichuck maintains that the customer service structure planned by Nashua conflicts directly with the advice Nashua received from Veolia. According to Pennichuck, Veolia advised Nashua to use only one entity to receive and address customer service inquiries, on the theory that requiring customers to call multiple contact numbers (e.g., depending on whether the call concerns billing or service) is confusing and frustrating. Pennichuck notes that Nashua's plan (at least up until the last day of hearings) called for billing and collection to be handled at City Hall with service issues directed to Veolia.

Pennichuck argues that the operational paradigm contemplated by Nashua would replace efficiency and accountability with the kind of complexity that is likely to cause problems to fall through the cracks. According to Pennichuck, Veolia has experienced this sort of dispute as demonstrated by litigation between Veolia and municipalities with which it had contracted. Exh. 3181. According to Pennichuck, Nashua has already had disputes with both Veolia and R.W. Beck about the scope, nature, and cost of each contractor's obligations to Nashua. Pennichuck foresees "a mind set under which each party to the contract does only what it thinks is required under their legal arrangement," as opposed to "looking at each situation from the eyes of the recipients of the water service." *Id.* at 22.

Additionally, Pennichuck warns that internal political disputes are a significant risk to the operation of the system under municipal ownership in Nashua. The utility directs the Commission's attention to witness Paul Doran's use of the word "feisty" to characterize Nashua's Board of Aldermen. *Id.* at 23. Pennichuck points out that differences and factions within Nashua's city government have led to harsh public allegations, litigation, and labor

disputes. In these circumstances, according to Pennichuck, there is great potential that the interests of customers in other communities will be compromised.

Pennichuck foresees an “immense” impact on rates if the municipalization goes forward, one that would eclipse any cost savings (e.g., income taxes, compliance costs) that would be achieved as the result of public ownership. *Id.* The source of this impact, according to Pennichuck, would be the constitutional requirement for Nashua to pay the fair market value for PWW assets, as opposed to the book value (i.e., depreciated original cost value) that is currently the basis for PWW’s rates. Pennichuck contends that the testimony it proffered from witness John Guastella demonstrates that at nearly any plausible purchase price any rate benefit posited by Nashua is effectively eliminated. Pennichuck contends that Nashua has significantly underestimated operating costs, the addition of which would cause rates under Nashua ownership to be significantly in excess of those that currently apply under PWW ownership. Pennichuck also asserts that, because the proposed contract between Nashua and Veolia shifts so many costs into the “supplemental” category, it is simply impossible to ascertain the true cost to Nashua of operating the utility. *Id.* at 25.

Relying on the testimony of Philip Ashcroft, a Veolia official, Pennichuck notes that the contract presented at hearing will change significantly before it is finalized and Veolia has conducted its due diligence. According to Pennichuck, Mr. Ashcroft made clear that Veolia kept its base price down by shifting pricing risk to the municipality.

Pennichuck contends that even the cost projections of Nashua’s own valuation witness, Mr. Sansoucy, demonstrate that the PWW system will be less efficient under municipal ownership than that of the utility. Pennichuck points to his testimony that operating expenses would total in excess of \$10.4 million in 2008. According to Pennichuck, this figure would

increase by more than \$146,000 by adding amounts that Nashua witness Paul Noran of Veolia indicated would need to be added to the base fee assumed by Mr. Sansoucy.

Pennichuck notes that one of its witnesses, John Guastella, offered an estimate of annual municipal operating expenses that were more than \$1 million lower than Mr. Sansoucy's projection. According to Pennichuck, this is not evidence that Nashua will actually be able to achieve the same efficiencies as PWW. Rather, in the view of Pennichuck, even assuming that Nashua could operate the system as efficiently as Mr. Guastella estimated, using a rate base that reflects the fair market value of the PWW system (as opposed to Nashua's proposed valuation) would result in rates that are effectively no different under municipal ownership than the rates that PWW charges.

Pennichuck asserts that it is simply not possible to fairly and completely compare the rates under Nashua's proposed ownership with PWW rates. But, according to Pennichuck, if one were to undertake such a comparison it would be critical to adjust the estimate of municipal rates to reflect changes the municipality had itself proposed over the course of the case, known operating costs that Nashua omitted or understated, and "additional costs that the Veolia contract structure will impose but that are not reflected in the base fee." *Id.* at 28.

Pennichuck accuses Nashua of adopting a "cavalier" attitude about PWW customers located outside of Nashua. *Id.* at 29. In the view of Pennichuck, Nashua has adopted an ever-changing position about the effect of municipalization on those customers, originally contending that their rates should go up because they subsidize other customers and later agreeing to maintain rate parity. Noting the municipality's agreement during the course of hearings to subject itself voluntarily to regulation by the Commission with respect to the non-Nashua customers, Pennichuck still contends that Nashua has offered nothing credible to divert a fact

finder from the notion that non-Nashua customers will be victims of the vicissitudes of Nashua's often contentious political process. According to Pennichuck, the proposal for voluntary submission to Commission jurisdiction is contrary to applicable law. To that end, Pennichuck cited a series of federal cases to the effect that jurisdiction cannot be conferred on an administrative agency by consent of the parties.

According to Pennichuck, beyond the effects on the non-Nashua customers of PWW, municipalization of PWW will trigger substantial rate increases for customers of PEU and PAC, compared to the rates those PWW affiliates would be able to charge if PWW remains a subsidiary of Pennichuck. Pennichuck points to the analysis of Mr. Guastella for evidence of lost economies of scale. According to Pennichuck, Nashua's disagreement with Mr. Guastella's detailed analysis, as laid out in the testimony of Mr. Sansoucy, is unsubstantiated and speculative.

Pennichuck criticizes Nashua for offering up changes to its municipalization plan over the course of the proceeding. Noting that Nashua did not submit a plan when it filed its initial petition in 2004, Pennichuck contends that Nashua's plans have evolved continuously from the point at which they were first submitted in early 2006 to the hearings themselves, at which Nashua proposed various conditions in response to evidence that had been adduced. According to PWW, the evolving nature of Nashua's plans not only presents a public policy problem but also has the effect of depriving Pennichuck, as the owner of the property proposed for condemnation, of its right to due process.

Finally, Pennichuck rejects Nashua's assertion that it would be a better steward of the public water supply than Pennichuck has been. According to Pennichuck, Nashua approved all of the development plans (undertaken by a non-regulated affiliate of PWW after transfer of land

previously held for resource protection purposes) that Nashua has criticized in this proceeding. Moreover, according to Pennichuck, Nashua is seeking to rewrite history by suggesting that stewardship concerns were the driving force behind its legal battle over this development, which culminated in the New Hampshire Supreme Court decision reported as *Appeal of City of Nashua*, 121 N.H. 874 (1981). Pennichuck asserts that Nashua's concern had to do with money – specifically, the regulatory treatment that had the effect of allowing Pennichuck shareholders, as opposed to customers, to receive the financial benefits of the real estate's appreciation over the years of its utility ownership.

Pennichuck directs the Commission's attention to the testimony of its witness Eileen Pannetier to the effect that Pennichuck's stewardship program is one of the best in the region, the best conducted by an investor-owned company, and superior to that of any government-operated system of comparable size. Pointing out that control of development for watershed protection purposes rests not with the utility but with the municipalities in which the watershed lies, Pennichuck contends that Nashua has deliberately ignored the fact that the utility's decisions on which lands required continuing protection from development were based upon an extensive environmental study. According to Pennichuck, Nashua provided no expert testimony to undermine the reasonableness of Pennichuck relying on this report. The utility dismisses Nashua's testimony about watershed protection as non-credible because it came from people who lacked expertise and were merely expressing personal opinions that are hostile to development.

In its pleading of February 27, 2008, Pennichuck expresses opposition to the joint motion, discussed supra, to approve the post-hearing contract entered into between Nashua and the Town of Milford. According to Pennichuck, submitting the contract following the hearings

amounts to an improper attempt to supplement the record without affording other parties an opportunity for cross-examination. Pennichuck also contends that, notwithstanding the terms of the agreement, New Hampshire law provides that the Commission would have no jurisdiction to regulate the provision of wholesale water service by Nashua to Milford.

B. Town of Milford

The Town of Milford operates its own municipal water system and has a bulk water supply contract for backup purposes with Pennichuck. It asks the Commission to rule that the proposed municipalization of PWW would not be in the public interest. According to Milford, the municipalization would leave Milford without a backup water supply, inasmuch as the contract automatically would terminate in those circumstances. Milford notes that it currently relies on two wells for its primary water supply, and would not be able to assure its citizens reliable water supply if one of the two wells should go out of service, even for routine maintenance, after Nashua has taken over the PWW system. Noting the testimony of Alderman McCarthy of Nashua to the effect that Nashua would continue to honor the contract, Milford points out that the alderman had no authority to bind Nashua on this question.

The contract Milford filed on February 22, 2008, Milford's cover letter to that contract, and Milford's letter of February 29, 2008 make clear that the town's position on this issue has changed somewhat. Milford and Nashua agreed that, should the municipalization proceed, Nashua would essentially adopt the Milford-PWW contract for backup water supply. Milford asks the Commission to treat the contract as a condition of approving the underlying petition, suggesting that such a condition would have the effect of rendering its objections based on this issue moot.

Although the contract does not preclude Nashua from assigning its obligations under the agreement, Nashua cannot relieve itself of its obligations under the contract by delegating its obligations to another entity, particularly a water district. Concern about Nashua transferring the system to a water district was an issue raised by Milford during and after the hearings. The Nashua-Milford agreement also provides that Nashua will submit to, and will not challenge, the jurisdiction of the Commission with respect to provision of water service to Milford. The terms of the agreement are severable, i.e., if any provisions were declared invalid the overall agreement would not become void.

While the contract appears to address all of the issues raised by Milford, the agreement does not require Milford to support the underlying petition. The motion in support of the contract indicates that the purpose of the agreement was simply to avoid an interlocutory appeal of issues related to the Commission's regulatory jurisdiction should Nashua proceed with municipalization and, as noted *supra*, Milford's February 29, 2008 letter indicates that the contract resolves only some of the issues in dispute between the two municipalities.

C. Town of Merrimack

The Town of Merrimack opposes Nashua's plan to municipalize the PWW system. According to Merrimack, the Commission must reject Nashua's petition because Nashua's valuation of the utility property was "predetermined," "unethically performed," and "totally unreliable."⁸ Merrimack Brief at 1.

Merrimack further contends that the asserted benefits of the transaction are largely illusory. Specifically, according to Merrimack, the record reveals that Nashua's claimed savings from lack of overhead, tax expenses and administrative costs will not, by Alderman McCarthy's

⁸ Merrimack's concerns about the valuation, which are similar to those expressed by Pennichuck, are summarized and discussed in the section of the order discussing valuation issues.

own admission during his testimony, materialize. Merrimack questioned the legality of Nashua's plans to finance the acquisition by issuing municipal bonds, given that some of the assets to be acquired by Nashua are outside Nashua limits.

According to Merrimack, once Nashua assumed control of the PWW system it would no longer be subject to Commission regulation, even as to bulk water contracts with municipalities and others. Merrimack also objects to Nashua's assertion that PWW would be subject to local control under Nashua's ownership. In that regard, Merrimack notes that Veolia, as the outside contractor Nashua plans to use to operate the system, is the corporate successor of Vivendi, the entity that held a majority interest in Philadelphia Suburban, whose ultimately unsuccessful effort to purchase Pennichuck was opposed by Nashua and formed the backdrop to this proceeding.

Merrimack urges the Commission to give great weight to the Commission Staff's "independent, impartial, and unequivocal" opinion that the taking should not proceed. *Id.* at 18. In particular, Merrimack pointed to Staff testimony to the effect that Nashua ownership of the PWW system would cause harm to PWW customers outside Nashua, including customers in Merrimack.

Finally, Merrimack asks the Commission to reject the notion that conditions agreed to by Nashua over the course of the hearings mitigate any public interest concerns. According to Merrimack, there is no guarantee that Nashua will honor the conditions or that the Commission can enforce them.

D. Anheuser-Busch, Inc.

Anheuser-Busch, whose Merrimack brewery acquires water for use in its production process pursuant to a special contract with PWW that expires in 2015, expressed concerns about

the proposed municipalization and requests that the Commission, at a minimum, impose and enforce certain conditions on the transaction.

Noting that its facility is not located in Nashua, Anheuser-Busch raised the issue of whether ratemaking decisions by a municipal water utility in Nashua would be influenced by political pressures unfavorable to large industrial customers located beyond the municipal borders. Anheuser-Busch noted with approval Nashua's commitments at hearing to continue to serve Anheuser-Busch according to the terms of the special contract with PWW, and to submit future disputes to the Commission for resolution. Anheuser-Busch requested that the Commission condition approval on the fulfillment of these conditions.

Anheuser-Busch expressed concerns about Nashua's stated inability to continue to serve the brewery pursuant to a special contract, as distinct from a tariff that embraces the terms of the special contract. Anheuser-Busch notes that, unlike a tariff, contract terms are subject to negotiation and are judicially enforceable. According to Anheuser-Busch, to the extent Nashua is not a regulated utility there is no mechanism for preventing Nashua from modifying or revoking the applicable tariff unilaterally.

It is the contention of Anheuser-Busch that applicable New Hampshire law effectively creates a presumption that when a municipal utility serves customers beyond its borders, such service remains subject to utility regulation absent a specific statutory provision to the contrary. A specific statutory provision that concerns Anheuser-Busch is RSA 362:4, III-a(a)(1), with its rule exempting municipal utilities from rate regulation if the municipality offers "new customers" outside municipal borders the same service it offers within the municipality, at rates that are no more than 15 percent higher. According to Anheuser-Busch, this provision affords no protection to an outside, industrial customer with high usage.

According to Anheuser-Busch, it presumes that Nashua could provide reliable water service of appropriate quality while serving as an effective steward of the watershed and achieving some cost savings. However, Anheuser-Busch expressed concern that no neighboring municipality supported the municipalization plan unconditionally, a situation the intervenor views as possibly portending future conflicts that will not serve the interests of the region as a whole. Additionally, although Anheuser-Busch indicated it presumes Veolia could be a capable system operator with which it could work effectively as an industrial customer, there is no guarantee that some other, less reliable operator could eventually succeed Veolia. Anheuser-Busch also expressed concerns about what it characterized as a lack of experience on the part of Nashua's other contractor, R.W. Beck.

E. Staff

Staff opposes Nashua's bid to municipalize PWW. According to Staff, the evidence does not support a Commission determination that municipal ownership will lower rates. Staff agrees it is possible that Nashua could achieve some savings in the realms of capital costs, income taxes, compliance costs, and corporate overhead, but Staff points out that nothing would require Nashua to apply these savings to rate reductions.

According to Staff, relying on the testimony of Mr. Ware for Pennichuck, costs related to billing and collections, customer service, labor rates and the development of a geographic information system were either not accounted for or underestimated by Nashua. Staff further contends, based on the testimony of its own witness, that Nashua had underestimated the costs of unplanned maintenance, fuel, electricity, purchased water, and compliance with the DigSafe program. Further, Staff contends that certain per-unit costs are missing from Nashua's proposed operating agreement with Veolia. Staff raises the possibility that the base fee to be charged by

Veolia had been artificially reduced by inappropriately allocating foreseeable costs to variable fees as opposed to the fixed base fee. In the view of Staff, PWW customers will experience rate increases in the future regardless of which entity owns the system, but such increases will likely be less under municipal ownership because of municipal access to less costly debt financing. But Staff warns that uncertainties prevent making any reliable projections of future rates.

Staff is particularly concerned about possible rate effects with respect to the so-called “satellite” systems and their roughly 3,000 customers. This refers to water systems that are owned and operated by PWW, serve customers outside of Nashua and are not interconnected with the system that serves the Nashua customers. Staff sees conflicting responses from Nashua about how it will calculate rates for these customers, noting that Nashua has complained that its citizens are subsidizing water service to the satellite customers outside Nashua. Therefore, Staff dismisses Nashua’s indication that it will continue to charge these customers the same rates all other customers will pay. According to Staff, the general notion of a municipal water system owning satellite systems outside its municipal boundaries is a poor model and not in the public interest.

It is Staff’s view that municipalization will also adversely affect rates for PEU and PAC. Like Pennichuck, Staff contends that PEU and PAC will suffer from the loss of efficiencies and economies of scale when they are no longer affiliated with PWW. Although conceding that certain predictions of Pennichuck witness John Guastella – rate increases of 66 percent for PEU and 64 percent for PAC – are worst-case scenarios, Staff nevertheless foresees some harm to these customers as the result of rate increases.

Staff rejected any contentions by Nashua that its citizens are currently subsidizing the PEU and PAC customers. In fact, Staff contends that Pennichuck’s ownership of PEU and PAC

actually benefits Nashua customers of PWW because of operating efficiencies and the sharing of common assets over a large customer base. Staff points out that such efficiencies are the reason Nashua originally sought to acquire not just PWW but PEU and PAC as well. Staff further rejects any suggestion that Nashua customers are subsidizing Milford or Anheuser-Busch and these entities' wholesale acquisition of water from PWW. In that regard, Staff points to Commission orders approving the contractual arrangements as consistent with the public interest. Staff also notes that the Commission regularly reviews PWW's cost allocations in connection with rate cases and the submission of affiliate agreements.

Noting that the regionalization of water service has consistently been the public policy of the state, particularly as a means of addressing problems arising out of small and undercapitalized water systems with aging facilities, Staff indicates that it places Nashua and PWW "on an equal footing" with regard to which owner of the system would be likely to promote and enter into regional solutions to water supply problems outside the PWW service territory. Staff notes that municipalities have historically been unwilling to assist water users outside their boundaries, but notes that the Legislature passed RSA 362:4, III-a in 2002, which allows municipalities to charge a rate premium to such users, as a means of encouraging municipalities to enter into regionalization plans.

In the view of Staff, Nashua's support of regionalization will be greatly constrained in practice. Staff points out that Nashua's initial filing contemplated the transfer of the PWW system to the newly formed Merrimack Valley Regional Water District, but Nashua has since deferred that plan to some unspecified point in the future. Further, according to Staff, Nashua expressed an interest only in working on regional approaches with adjoining municipalities, as opposed to systems that are remote from Nashua's or are investor-owned. Moreover, according

to Staff, even if the Nashua area delimits the appropriate scope of regionalization efforts for the PWW system under municipal ownership, the evidence suggests that Nashua is reluctant to play even this relatively limited role.

Staff contends that Nashua's assertions about its superiority to PWW as a potential steward of the watershed do not provide a basis for finding municipalization to be in the public interest. Staff points out that only part of the Pennichuck Brook watershed is actually within Nashua's borders and, thus, Nashua's ability to address watershed issues would be limited.

According to Staff, it is likely that Veolia and R.W. Beck, as the contractors Nashua plans to use to operate and oversee the PWW system, have the capability to discharge their functions effectively. However, Staff characterizes as "disconcerting" the "incompleteness of the contracts and Nashua's position that it can simply amend the documents later to ameliorate any deficiencies." *Id.* at 29. Staff expresses concern that Nashua plans no actual day-to-day contact with Veolia and instead plans to rely on R.W. Beck to oversee Veolia's work.

Staff also does not approve of Nashua's planned allocation of customer service functions between municipal employees and Veolia, which involves the former handling bill-related queries and the latter fielding service-related concerns. Staff noted that many customer calls raise both kinds of concerns. Thus, Staff foresees frustrated callers, bounced between Veolia and City Hall. Staff conceded that Nashua raised the possibility of having Veolia handle all customer calls, which would address Staff's concern, but Staff nevertheless suggests that the Commission ignore this possibility on the ground that it had not been subject to discovery and full inquiry at hearing. Staff also contends that the evidence is unclear at best about how many employees Nashua plans to devote to receiving and acting on customer inquiries.

Staff also expressed concern about whether Nashua would participate in the state's RSA 374 Underground Utility Damage Prevention System – also known as DigSafe – because municipalities, unlike utilities, are not required to do so. Conceding that Nashua agreed at hearing that either it or Veolia would voluntarily join DigSafe, Staff nevertheless notes that only Nashua would be eligible for membership. Staff also argues that the prohibition on unfunded state mandates in the New Hampshire Constitution is a significant obstacle to the Commission requiring Nashua to participate in DigSafe.

Staff characterized as “inappropriate” and “contrary to law” Nashua’s proposal to add Commission-imposed conditions to the transaction in exchange for approval. *Id.* at 40. According to Staff, Nashua has not met its obligation “to make a clear and definitive proposal to the Commission.” *Id.* at 42.

F. City of Nashua

In urging the Commission to approve its petition, Nashua draws the Commission’s attention to the language of RSA 38:2, I and its reference to municipal authority to “establish” facilities for the distribution of water. According to Nashua, use of the word “establish” means the Legislature did not require the petitioning municipality to have in place, at the time of the petition, a fully realized plan with technical and managerial qualifications specified. In the view of Nashua, Pennichuck has consistently failed to recognize this statutory reality and, in effect, has argued that in order to prevail in a proceeding such as this a municipality would have to have a fully functioning water department in place prior to invoking the RSA 38 municipalization process before the Commission.

Nashua contends that, if the Legislature had intended to require a petitioning municipality to address all of the issues concerning qualifications, operating and managerial parameters and

other concerns prior to filing the petition, the Legislature could have done so. According to Nashua, the Legislature in essence decided to take the opposite approach, by creating in RSA 38:3 a rebuttable presumption in favor of the transaction when it receives a two-thirds majority by the governing body and has been subject to a confirming vote by municipal voters.

According to Nashua, it has been diligent since filing its petition about implementing concrete plans for municipalizing the PWW system, to the point of entering into detailed agreements with contractors for operation and oversight of the system. Nashua concedes that it is impossible to describe with absolute certainty what municipal operation would entail, but it blames Pennichuck itself for the uncertainties. Specifically, Nashua points to what it characterizes as Pennichuck's refusal to permit Nashua to conduct due diligence or to contact Pennichuck employees about the terms and conditions of their employment, as well as errors in the costs Pennichuck reported to the Commission for items such as energy, fuel, and chemicals.

Nashua contends that its selection of Veolia as system operator brings significant technical and managerial advantages over a small, investor-owned utility like PWW. Nashua notes that the Veolia subsidiary that will be directly involved is Veolia Water North America – Northeast LLC, a wholly owned subsidiary of Veolia Water North America. According to Nashua, Veolia Water North America is the largest water services partnership company in the U.S. and provides services in more than 600 communities, has annual revenue of \$530 million, 1.4 million water customers, and 3,150 employees of which 1,200 are licensed operators and 400 are licensed water operators. Nashua further points out that the parent company of Veolia Water North America – Veolia Environment – is the largest water service provider in the world with 55,000 employees serving 110 million people. According to Nashua, it is in the public interest for PWW's customers to be served by an operator with such skills, experience, and

qualifications. Further, according to Nashua, what Nashua characterizes as its “public-private partnership” with Veolia will also reduce substantially the overhead that PWW customers currently pay for services that are not related to the actual operation of the water system. Nashua Pre-Hearing Brief at 18-19 and Post-Hearing Brief at 5-6.

According to Nashua, the much smaller PWW cannot bring the same level of insight and sophistication to the job, and as evidence Nashua cites PWW’s ongoing water treatment plant upgrade project. According to Nashua, what was originally represented to the Commission in 2002 as a project of \$6 million to \$14 million had become a project in excess of \$40 million by 2006, not including AFUDC (allowance for funds used in construction, a recoverable expense for ratemaking purposes), which Nashua contends will continue to accrue at 8 percent annually until the upgraded facilities are finally placed into service. Nashua complains that cost-of-service utility regulation actually rewards PWW for failing to control the cost of the project, as long as the utility convinces the Commission that the costs are reasonable. According to Nashua, the Commission and its Staff are not qualified to second guess a utility that lacks the technical resources to control the costs of such a project. According to Nashua, by way of contrast it is Veolia’s practice to deliver projects of this sort for a specified contract price.

Nashua also directs the Commission’s attention to the record evidence concerning PWW’s use of CMMS (computerized maintenance management software), which Veolia also plans to use. Nashua points to the pre-filed direct testimony of Donald Ware, to the effect that PWW had used a CMMS software package for more than five years so that the advent of Veolia as system operator would not, in that respect, achieve any new efficiencies. However, according to Nashua, in February 2007 a Commission audit revealed that despite an expenditure of \$600,000 PWW had not been making effective use of the software.

According to Nashua, its proposed operations, maintenance, and management (CM&M) agreement with Veolia will provide service that exceeds what is currently being provided to PWW customers. Nashua accuses Pennichuck of incorrectly claiming that the terms of this contract are not enforceable; according to Nashua, the agreement's draft status merely reflects the fact that its terms may need to be amended to accommodate any conditions added by the Commission in this order. Nashua contends that, if Veolia fails to live up to its service commitments, it can be replaced as contractor in a competitive marketplace, whereas utility customers are not similarly free to replace their utility. Thus, according to Nashua, Veolia will be a more accountable operator than PWW.

Citing evidence as to letters of deficiency issued by the Department of Environmental Services to PWW, Nashua contends that it will do a better job than PWW has in complying with federal and state drinking water standards. Nashua accuses PWW of being reluctant to make investments to comply with such regulations, suggesting that Veolia will be more proactive because, should it fail to identify necessary improvements, it will be required to indemnify Nashua for any resulting fines and penalties.

Nashua asserts that its record of customer service will be superior to that of PWW. According to Nashua, its existing billings and collections department is highly efficient and capable of adding municipal water to its list of responsibilities, which currently include property taxes, wastewater, and vehicle registrations. Nashua notes that the department currently employs six full-time customer service agents and one part-time data entry person, all with experience in using PWW's water consumption data because it is employed to generate bills for use of Nashua's wastewater system. Nashua notes that it plans to add two additional customer service representatives to the department upon acquisition of the water system. Nashua also stresses that

Veolia plans to devote two customer service representatives of its own to fielding service-related (as opposed to billing-related) inquiries and that, in any event, Veolia will be contractually required to provide an appropriate level of service regardless of how many employees it has.

According to Nashua, beyond actual customer contacts, it and Veolia will be working “behind the scenes” to enhance customer service. Nashua Post-Hearing Brief at 25. Nashua notes that Veolia plans to maintain detailed call logs to keep track of operational inquiries, with a system of work orders and process charts used to ensure that all such inquiries are resolved.

Nashua complains that both Pennichuck and Staff have criticized Nashua’s customer service plans based on fundamental errors and misunderstandings. According to Nashua, Pennichuck and Staff: (1) failed to consider that nearly half of Pennichuck’s customers do not receive service from PWW and will thus not require customer service from Nashua post-acquisition; (2) conducted no analysis of Veolia’s experience providing customer service in Indianapolis, under a similar arrangement with that municipality; (3) ignored the fact that Nashua’s customer service will be subject to Commission jurisdiction because it will serve customers outside Nashua itself; and (4) indulged in unwarranted speculation by opining about a lack of coordination and delineation of responsibilities.

According to Nashua, for the years 2008 through 2017, PWW customers would save \$360 million in rates under municipal ownership of the system, assuming Nashua’s valuation estimate is appropriate and further assuming that Nashua issues a system repair and replacement bond of \$18 million every three years. Nashua contends that its operations and maintenance expenses will be \$1.7 million less than PWW’s in the first year, increasing thereafter, in light of Nashua’s ability to eliminate PWW’s “bloated administrative and overhead expense and the unique benefits and synergies available to municipalities.” *Id.* at 56. Nashua disputes any

Pennichuck contention that there are areas not covered by the Veolia contract that will amount to additional, unaccounted-for expenses. According to Nashua, what this overlooks is that the Veolia contract was designed to mirror PWW's current operations. Thus, in Nashua's view, if there truly are any overlooked expenses they amount to additional costs that both PWW and Nashua would incur.

Concerning the effects of municipalizing PWW on PEU, PAC, and PWSC, Nashua contends that any harm alleged by Pennichuck is both overstated and self-inflicted. Nashua begins this argument by noting that in its original petition it proposed to acquire PEU and PAC, and PWW – and that it stands prepared to move forward with its original proposal. Nashua then contends that Pennichuck's successful effort to dismiss PEU and PAC as parties is the cause of the harm Pennichuck now alleges to those affiliates. In the view of Nashua, as Pennichuck has acquired affiliates outside the PWW service territory it has allocated centralized costs of Pennichuck and PWW to those affiliates arbitrarily. According to Nashua, in these circumstances any determination by the Commission that harms to PEU and PAC preclude municipalization would, in effect, mean that PWW could never be subject to acquisition under RSA 38.

Nashua urges the Commission to reject the testimony of PWW witness John Guastella concerning likely rate effects on PEU and PAC. According to Nashua, Mr. Guastella's analysis is flawed because he simply allocated costs based on the model used by PWW without considering whether the model itself is appropriate and cost-effective in comparison to other ways of organizing utility operations. Indeed, according to Nashua, even assuming Mr. Guastella's analysis to be reasonable, this merely proves that PEU and PAC are providing an unreasonable subsidy to PWW under the current ownership and cost allocation regime.

The last issue raised by Nashua concerns Pennichuck's record as steward of the watershed and Nashua's likely record as successor to those stewardship responsibilities. According to Nashua, it has already taken significant steps toward watershed protection by adopting exemplary regulations and acquiring 483 acres of land. Nashua accuses Pennichuck of continuing to transfer land held for conservation purposes to its unregulated real estate development affiliate even as a draft watershed management plan was in circulation 11 years ago that recommended preservation of existing undeveloped land. According to Nashua, Pennichuck's own experts concluded in a 2003 report that the estimated yield of Pennichuck Brook had declined by more than 75 percent over the preceding century. All of this, in Nashua's view, illustrates a key difference between a publicly owned water system and an investor-owned water utility.

Nashua proposes a series of eight conditions that the municipality contends are appropriate and responsive to concerns raised in the course of this proceeding. They are: (1) a requirement that Nashua serve all PWW customers, inside or outside Nashua, at the same core rates; (2) service to customers outside Nashua remaining under the regulatory jurisdiction of the Commission for purposes of addressing quality-of-service issues; (3) service to all customers according to its Water Ordinance, including its Main Extension Policy, as amended and the Water Ordinance will be subject to the Commission's jurisdiction.; (4) mandatory Commission approval of any franchise transfers; (5) Nashua's adoption of the obligations arising out of existing wholesale contracts, subject to Commission jurisdiction; (6) Nashua's compliance with Commission regulations concerning customer service; (7) the availability of technical advisors on a 24-hour basis to industrial and wholesale customers, with technical information about the

water treatment process available electronically at least daily; and (8) the establishment of a technical advisory board, which would make periodic recommendations to Nashua.

Nashua also lays out what it characterizes as four “discretionary conditions” that the municipality contends are not necessary but that Nashua is willing to adopt to address the concerns of others. These conditions are: (1) full regulation of the system as a water utility through December 31 of the fifth year after municipalization; (2) amendment of the OM&M agreement with Veolia to provide that all customer service functions will be compliant with N.H. Code Admin. Rules Puc 1200, governing customer relations of regulated utilities; (3) acquisition by Nashua of PEU and PAC or, in the alternative, creation of a mitigation fund pursuant to a future Commission proceeding with the value of the fund capped at the value of the two utilities’ plant-in-service; and (4) making Nashua’s final contracts with Veolia and R.W. Beck subject to Commission approval, with the agreements being submitted by Nashua for review within 60 days of final resolution of this docket.

G. Commission Analysis

Upon a careful review of the record, it is our finding that neither Pennichuck nor any other party, including Staff, has rebutted the RSA 38:3 presumption that the proposed municipalization of Pennichuck Water Works is in the public interest as to the PWW plant and property within Nashua. In addition, we find that the taking of plant and property outside Nashua is in the public interest and, as a result of certain conditions which we make a part of our determination, we conclude that impacts with respect to customers outside Nashua’s municipal boundaries have been satisfactorily addressed. Lastly, in order to provide some additional context for the discussion below, we note that of the approximately 25,000 PWW customers, 22,000 receive service from the core system and 3,000 receive service from satellite systems that

are not physically interconnected to the core system. Furthermore, of the 22,000 core customers, roughly 21,700 are within the city of Nashua and 300 are outside the city. Thus, approximately 87 percent of PWW's customers are within the City of Nashua.

1. PWW Customers Within Nashua

In an effort to overcome the public interest presumption in RSA 38:3, opponents to the taking argue that PWW has a strong record as a regional presence and that it is better able than Nashua to solve regional water supply problems. We are unable to agree with Pennichuck's general assertion that because PWW, in conjunction with its regulated affiliates PEU and PAC, is a successful regional utility the public interest would not be served by allowing a municipality to acquire it. As testified by Mr. Naylor and others, Pennichuck has provided safe and reliable water service to its customers for many decades, and it has also been willing to make investments in systems elsewhere in the region that were experiencing operational and financial difficulties. Staff acknowledges assertions by Nashua that it is willing to contribute to solving water supply challenges that arise regionally, but Staff views this willingness as too limited because, according to Staff, it covers only the immediate Nashua area, and too speculative because it would be done through a municipal water system that does not enjoy regional support and by a city that has been hostile to PWW's regional role. Staff Brief at 20-25.

In our judgment, the presumption that the proposed municipalization is in the public interest cannot be rebutted by assertions that the municipalized water system will be unwilling or unable to acquire service territories for which the system being taken is not currently responsible. It is laudable that Pennichuck and its subsidiaries have been willing to expand into new areas when that result was consistent with good public policy, but ultimately an investor-owned utility cannot be expected to do so unless such a decision is in the best interests of shareholders, who

expect to maximize return on their investment within certain risk parameters. In short, while the testimony at hearing would arguably suggest that Pennichuck is more willing than Nashua will be to acquire troubled water systems, we find, ultimately, that the testimony is speculative. In this sense, arguments concerning Nashua's future role in the region are not adequate to rebut the statutory presumption in favor of municipal ownership.

As noted above, Mr. Naylor testified about Pennichuck's positive record as a utility. Although this evidence is credible, it is not the type of evidence that can form the basis for denying Nashua's petition. In other words, the opponents of an RSA 38 petition cannot, in our view, rebut the presumption in favor of the taking by demonstrating that the utility has a good record.

Pennichuck also asks us to consider the workforce implications for PEU, PAC, and PWSC of municipalizing PWW. As the record before us demonstrates, all of the employees who operate PEU, PAC, and PWSC are employees of PWW. These employees provide services to PEU, PAC, and PWSC pursuant to affiliate agreements. Pennichuck notes that Nashua and Veolia will attempt to hire PWW's field staff in the event that municipalization moves forward and that, if successful, these efforts will drain PWW's current affiliates of badly needed expertise. Pennichuck notes a second possibility is that many PWW employees will opt not to change employers, and thus Nashua will operate the water system without the very individuals who know the system best. In reality, principles of supply and demand suggest that, post-municipalization, Nashua and the remaining Pennichuck companies will be able to compete successfully for the workforce each needs. If Nashua's contractors are unsuccessful in hiring PWW's employees, they have testified that they will bring in their own experienced employees. We do not view as likely the possibility that the water system will be operated by inexperienced

employees, as Pennichuck contends, and we conclude that Pennichuck has not overcome the presumption that the taking is in the public interest. The issue of potential harm, in terms of the added cost to PEU and PAC of replacing these employees, is an issue we will address below.

Pennichuck asks us to reject Nashua's municipalization plans because, in Pennichuck's view, Nashua's proposed relationship with the contractors Veolia and R.W. Beck is flawed. We find, however, that the proposed arrangements are reasonably calculated to lead to an effective operation of the PWW system. Pennichuck points out that Veolia's experience, though perhaps extensive as a general proposition, is actually quite limited when it comes to operating a water system (as distinct from a wastewater system) for a municipality. In fact, the only such system Veolia has operated is the one in Indianapolis. We do not find this to be a disqualifying level of experience that overcomes the presumption in RSA 38:3. Indianapolis is a city of significant size and many of the operational tasks Veolia must perform are not unique to municipal water systems. Staff itself opined that Veolia and Beck likely have the resources to fulfill their obligations under the proposed contracts with Nashua. Staff Brief at 29. As Pennichuck has noted, Veolia's performance would improve in the event it hires PWW employees. Additionally, we find that the prior experience of R.W. Beck as an owner's representative is adequate, even if it has been limited to design/build projects and water supply facilities as opposed to distribution systems.

Singled out for particular criticism by Pennichuck and Staff was Nashua's proposal that it perform billing and collection functions while Veolia performs the remaining customer service functions. Pennichuck was critical that separating customer service functions between Veolia and City employees was fraught with uncertainty and would cause customers to suffer. Pennichuck noted Veolia's initial response to Nashua's request for proposals was for Veolia to

perform all the customer service functions. Staff testified that many customer calls involve a combination of operational issues and billing and collection issues. Exh. 5003 at 5 lines 1-6. Thus, it contends that customer service functions should be integrated. At hearing, Nashua proposed to have Veolia perform all of the customer service functions and Staff opined in its brief that this proposal would likely address Staff's concerns. Both Pennichuck and Staff expressed reservation, however, that the parties had not had sufficient discovery opportunity on Nashua's proposal.

With respect to discovery, the record shows numerous instances where the parties examined whether Nashua should perform some of the customer service functions or whether it should be entirely performed by Veolia. See, e.g., Exh. 1005, Exh. 1006, Exh. 1013, Exh. 3013, Exh. 3043, Exh. 3045, and Exh. 3257. As such, we find that this issue has been adequately examined.

Nashua's commitment, as set forth in its brief, states:

Nashua shall amend its OM&M Agreement with Veolia Water so that Veolia Water shall provide all customer service functions, including billing 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.

We interpret Nashua's commitment to mean that Veolia will perform customer service functions as described in Exhs. 3043 and 3045. We find this approach to be reasonable and note that no party has shown it to be contrary to the public interest. Although we agree that Nashua may structure its customer service functions solely with Veolia, we nonetheless believe it useful to condition our approval on Nashua's commitment to not bifurcate the customer service functions.

Objections to Nashua's provision of customer service are also addressed by the facts that Nashua: commits to providing service according to its Water Ordinance; will have technical

advisors on call 24-hours per day for industrial and wholesale customers; and will establish a technical advisory board. The technical advisory board will include representatives of retail and wholesale customers, regulatory agencies, municipalities served by the system, developers and public interest organizations. Lastly, pursuant to RSA 362:4, III-a(b), Nashua will continue to be subject to the Commission's jurisdiction; although it will be exempt from accounting, reporting, and auditing functions pursuant to RSA 362:4, II. In light of the Commission's continued jurisdiction and commitments by Nashua, we find that there has been no showing that Nashua's customer service function will be performed in a manner contrary to the public interest.

Pennichuck has also been critical of elected officials being the ultimate decision makers once the PWW system is city-owned. According to Pennichuck, this is likely to "throw such issues into a highly politicized forum where decisions are made for reasons other than purely business considerations." Pennichuck Brief at 16. Pennichuck asserts that Veolia has "ample experience" with disagreements between it as an operations contractor and the municipality for which it works. *Id.* at 21 (noting that "[i]n some cases it sued its municipal partner first" and in others "the municipality sued first"). It would be inappropriate for us to adopt such a skeptical view of the ability of elected officials to make good decisions. In essence, Pennichuck's perspective amounts to a disagreement with the policy choice implicit in the RSA 38:3 rebuttable presumption favoring municipal ownership.

With respect to arguments that Nashua's contracts are incomplete, we do not share Staff's view that the contracts with Veolia and R.W. Beck are too incomplete or tentative to support a finding in favor of municipalization. As Nashua has noted, much of the uncertainty is the inevitable result of the indeterminacy of the scope of the relevant responsibilities pending resolution of disputed issues in this proceeding. Opponents of municipalization have complained

that Nashua and Veolia have sought to exploit the uncertainty by failing to include essential tasks in the proposed contract with Veolia, thus obscuring the true cost of the contractual relationship. The record does not support a finding that Nashua has done this to intentionally gain an advantage over its opponents. Moreover, given the delay from the time the contracts were drafted to the time the contracts will be implemented, it is reasonable for certain costs, such as labor rates, to not be fixed. As we stated in Order No. 24,567, “[i]t would strain credulity to expect, in the context of a statutory scheme that allows the petitioner to forestall a final determination on whether to proceed with a taking until after valuation is determined ...that Nashua should have had final contracts developed.” *City of Nashua*, Order No. 24,567, 90 NHPUC 619, 622 (2005).

We next turn to the issue of rates under Nashua ownership and note that, unlike most issues, the parties appear to be in general agreement that rates under municipal ownership would likely be lower than under private ownership at certain valuations. Nashua contends that under its ownership, cost advantages, operating efficiencies, and lower capital requirements available to it would allow it to operate the water system with a lower revenue requirement than PWW. Exh. 1015 and Hearing Transcript of January 10, 2007 (1/10/07 Tr.) at 29 lines 13-21. Pennichuck’s witness, Mr. Guastella, testified that at a valuation of \$248.4 million, Nashua’s revenue requirement would be lower than PWW’s. 9/18/07 Tr. at 101 lines 12-24. Mr. Guastella was careful to note that a lower revenue requirement would only result in lower rates if the savings were actually applied to the rates. 9/18/07 Tr. at 102 lines 1-10. In its brief, Nashua states that “at any value that is less than what PWW has proposed, there will be lower rates under Nashua’s ownership and the differential will continue to grow over time.” Nashua Brief at 13. From this, we conclude that Nashua intends to use its lower revenue requirement to lower

customer rates. And from our valuation analysis, we conclude that the value of PWW's assets as of December 31, 2008, is \$203 million, which is lower than the \$248.4 million threshold that Pennichuck and Nashua contend would produce a rate advantage for municipal ownership.

Finally, inasmuch as we find that the presumption that the taking by Nashua is in the public interest has not been rebutted, we need not resolve various factual allegations made by Nashua as to PWW's conduct of its affairs as a public utility. Nevertheless, we deem it appropriate it to address two specific allegations. First, Nashua charges that PWW has done a poor job as a steward of the watershed that is the ultimate source of its customers' water supply. We find that this allegation is not supported by the facts presented here. Second, Nashua charges that Mr. Ware testified falsely as to PWW's use of certain management software. Again, we find the allegation is not supported by the facts.

2. PWW Customers Outside Nashua

We now turn to questions relating to PWW customers not located in Nashua and how much property it is in the public interest for Nashua to take outside its municipal boundaries. There are two distinct categories of customers and property outside Nashua's boundaries: one group of customers is connected to the core system, and the second group of customers is served by satellite systems. Between the two, the clearer case concerns the property and customers physically interconnected to the core system, i.e., the non-Nashua core customers. Physical separation from the core system would likely have negative effects both on the integrated system and the customers cut off from it. Consequently, keeping the integrated system intact serves the public interest.

The public interest concern with respect to non-Nashua core customers goes to the fact that they are not citizens of Nashua and therefore lack a voice in Nashua's decisionmaking. The

Commission, however, can effectively protect such customers inasmuch as Nashua, to the extent it provides service outside its municipal boundaries, will be regulated by the Commission, pursuant to RSA 362:4,III-a(b), and Nashua, therefore, may not raise rates unless there is a cost basis for doing so and the Commission approves such an increase. As to ensuring these customers receive the same quality and quantity of water as customers located within Nashua, we note that being on the core system these customers take service from the same distribution system that supplies inside customers. Thus, core customers residing outside Nashua will receive the same quality and quantity of water as customers residing inside Nashua.

With respect to the satellite systems, the issue of the physical interconnectedness to the core system does not apply. The core system could be taken without any adverse hydrological impact upon the satellite systems. As a result, the public interest inquiry devolves essentially to a consideration of whether the customers of such systems would be better served by remaining associated with the core system or by being divorced from it. Divorcing the satellite systems from the core system involves substantial uncertainty as to whether those systems would constitute a new, independent utility within the Pennichuck holding company structure, or be attached to one of the existing utility companies. There are untested legal questions as well concerning the Commission's authority to require melding the satellites into one of the other Pennichuck subsidiaries and there are other effects to consider concerning the possible rate impacts on such customers.

In Order No. 24,425 (January 21, 2005) the Commission concluded that extra-territorial takings were intended by the Legislature to be limited but that ultimately the extent of such a taking required a factual determination as to what the public interest required. In this instance, the focus of what constitutes the public interest is not on the physical interconnectedness of the

water systems but on what best serves the approximately 3,000 customers of the satellite systems. As with the non-Nashua customers of the core system, we find that the customers of the satellite systems are better served by remaining part of the PWW system for purposes of rate and service continuity and because they will retain the protections of state regulation pursuant to RSA 362:4,III-a(b), which means that Nashua may not increase these customers' rates unless Nashua can prove that an increase is justified on the basis of reasonable and prudent costs.

Opponents to the taking argue that customers of PWW that are not constituents of Nashua's elected officials would have no recourse if those officials treated them less favorably than customers within Nashua. Such concerns appear to be based on a misunderstanding of the extent of the Commission's authority pursuant to RSA 362:4, III-a. Furthermore, Nashua addresses any such concerns by proposing that the Commission condition approval of the taking on the continued use of a consolidated rate design whereby "core" rates are applied to all retail customers, regardless of their location. Nashua agrees to apply its water ordinance, including the main extension policy in the ordinance, in a manner that does not discriminate between customers inside and outside of Nashua. We find the proposed conditions to be reasonable. Finally, RSA 38:11 grants the Commission broad content to set conditions.

Additionally, Nashua agrees that service quality issues should remain subject to the Commission's oversight pursuant to RSA 374 and that the Commission should have jurisdiction relative to any service quality complaints, and that it should not sell, lease or otherwise transfer its franchises without prior Commission approval. Nashua Post-Hearing Brief at A-1 and A-2. We acknowledge Nashua's commitments, but we do not agree with its underlying premise that the Commission lacks jurisdiction in these regards. To the contrary, RSA 362:4 clearly provides that all municipal corporations serving outside their corporate boundaries are not exempt from

the franchise requirements of RSA 374. Thus, any future transfer of Nashua's franchise would remain subject to Commission jurisdiction. Furthermore, any complaints brought under Chapter 365 pertaining to the safety and adequacy of water supplied to customers are also subject to the Commission's jurisdiction.

3. Wholesale Contracts

Some opponents to Nashua's petition argue the taking is not in the public interest because Nashua has no obligation to honor PWW's existing wholesale contracts and that municipal wholesale customers in particular will be left without the protections of Commission jurisdiction. They cite RSA 362:4,III-a(a)(2) which states that municipal corporations furnishing water service pursuant to wholesale contracts to another municipality shall not be considered public utilities for purposes of the Commission's enabling statutes. To overcome these concerns, Nashua has agreed to abide by the terms of existing wholesale contracts "or, if required for bonding purposes," to "create a wholesale tariff that incorporates the rates and provisions of the existing wholesale contracts." *Id.* This agreement pertains both to municipal purchasers, e.g., Milford and Merrimack, as well as to PWW's wholesale commercial customer, e.g., Anheuser-Busch.

We agree that in the ordinary course of Commission oversight of municipal water systems, a municipal corporation furnishing bulk water to another municipal entity "shall not be considered a public utility" for purposes of the Commission's enabling legislation. RSA 362:4, III-a(a)(2). This statutory provision has been in existence since before the Legislature most recently codified RSA 38 in 1997. We also note that the ability of the Commission to set conditions to satisfy the public interest, pursuant to RSA 38:11, has survived recent modifications to both RSA 38 and RSA 362:4 in 2002 and 2003. In light of the Legislature's

activity in these areas, we cannot conclude that the Legislature intended RSA 362:4 to limit, as opponents contend, the Commission's ability to ensure the public interest is satisfied under RSA 38:11. As already noted, *supra*, we conclude that we have broad authority to set conditions pursuant to RSA 38:11, which allows us to subject Nashua to the same oversight with respect to wholesale water supply contracts as that to which PWW is currently subject.

Subsequent to the hearings, Nashua strengthened this condition further by entering into a written agreement with the Town of Milford that has the effect of: (1) precluding Nashua from taking advantage of PWW's contractual right to terminate the water supply agreement, and (2) precluding Nashua from changing positions and challenging the Commission's authority to provide regulatory oversight of the wholesale relationship. In our judgment, the effect of this agreement is to resolve any doubt that Milford will continue to enjoy the legal protections it currently enjoys with respect to its bulk water purchases from the PWW system. Accordingly, we deem Milford's Motion to Consider and Maintain Effectiveness of Existing Contract to be moot. We therefore approve the agreement and incorporate its terms here as a part of our public interest determination.

4. DigSafe

We next turn to the issue of Nashua's compliance with the state's Underground Utility Damage Prevention System, the so-called DigSafe law, under RSA 374:48-56, which protects the public safety by requiring excavators and operators of public utilities to take certain precautions when digging near buried public utility facilities. As Staff testified, the statute does not require municipalities to join, although Concord, Dover, Hudson, Portsmouth are voluntary members. 9/26/07 Tr. at 26 lines 2-3. The City of Nashua is not currently a member, but it has agreed to become a member of DigSafe. 9/26/07 Tr. at 21 lines 21-24 and at 22 line 1.

We find that Nashua's municipal membership in the state's DigSafe program is necessary to our finding that its taking of PWW is in the public interest. We specify that Nashua itself, as opposed to its contractors, must become and remain a member of the DigSafe program. We also condition approval of Nashua's taking on Nashua hiring a PWW employee familiar with PWW's facilities, although we do not condition our approval on Nashua hiring any specific employee of PWW.

5. Franchise

We next address the issue of franchise authority for Nashua to serve customers outside its municipal boundaries. Based on the evidence presented in this docket, we find that Nashua has effectively demonstrated the financial, managerial, and technical capabilities required for a public water utility to receive permission to commence business pursuant to RSA 374:22, I. In the event Nashua proceeds to commence such business, it must also receive the requisite approvals from the Department of Environmental Services as required by RSA 374:22, III and receive final, formal approval from the Commission.

6. PEU and PAC

In making our public interest determination, we must also consider the effects of the transaction on PEU, PAC and their approximately 7,000 customers. In our judgment, the evidence demonstrates that, upon a taking by Nashua of PWW, there will be a loss of synergies and capabilities to these two smaller utilities that will impact them adversely, in the form of rate increases that customers would not otherwise sustain. However, as Nashua points out, to preclude the transaction on this basis would be to determine, in effect, that Pennichuck Water Works (or any other utility with such affiliate relationships) is simply not amenable to municipalization under RSA 38. We do not believe this is consistent with legislative intent.

Accordingly, it is our determination that the appropriate method for resolving the public interest issues that concern PEU and PAC is to treat the effects as remediable through a mitigation fund established as a condition pursuant to RSA 38:11. Payments from such a fund should be payable for the benefit of PEU and PAC customers pursuant to our ongoing authority over these utilities as discussed in Section VII.

7. Conclusion

In summary, the opponents of municipalization have not rebutted the presumption that Nashua's planned municipalization of Pennichuck Water Works as it applies to customers within the municipal boundaries of Nashua is in the public interest pursuant to RSA 38:3. Furthermore, in light of the conditions we will set pursuant to RSA 38:11, the taking as it applies to PWW customers outside the boundaries of Nashua and customers of PEU and PAC is in the public interest. Accordingly, we turn to the question of valuation.

VI. VALUATION

Pursuant to RSA 38:9, the Commission is charged with determining the price "of the plant and property lying within or without the municipality that the public interest requires the municipality to purchase." Constitutional principles require just compensation for the property taken. *Opinion of the Justices*, 131 N.H. 504, 510 (1989). Just compensation is defined as fair market value. *Id.* It is "the price which in all probability would have been arrived at by fair negotiations between an owner willing to sell and a purchaser desiring to buy, taking into account all considerations that fairly might be brought forward and reasonably be given substantial weight in such bargaining." *Edgecomb Steel Co. v. State*, 100 N.H. 480, 487 (1957). Furthermore, the condemnee is entitled to a valuation "for the most profitable purpose, or advantageous use, to which [the property] could be put on the day it was taken." *Opinion of the*

Justices, 131 N.H. at 510 (citing *Emmons v. Power Utilities Co.*, 83 N.H. 181, 184 (1927)). The fair market value of a public utility includes the “value of its property and franchises taken together as a going concern.” *Washington Suburban Sanitary Comm. v. Utilities, Inc. of Maryland*, 775 A.2d 1178, 1193 (Md. 2001).

A. Summary of Values

Nashua employed the firm of George E. Sansoucy, P.E., LLC (GES) to provide valuation testimony. GES determined the value of PWW’s real, personal, and intangible property as of December 31, 2004. Exh. 1007A at 7. Specifically, witness George Sansoucy of GES determined the value of PWW using a cost approach. Witness Glenn Walker of GES determined the value of PWW using a sales comparison and an income capitalization approach. Frederick H. Smith provided assistance in costing of improvements and Philip L. Munck assisted in sales research. See generally Exh. 1007A. GES determined the value of PWW’s assets as of December 31, 2004 to be \$85,000,000. Pursuant to the procedural schedule, the parties filed testimony updating their initial valuations so as to be more current than December 2004. In testimony filed November 14, 2006, GES updated this value to \$139,000,000 as of December 31, 2007. GES arrived at this value by adding \$54,000,000 in “new property, plant and equipment” at rate base value to its initial \$85,000,000.

PWW employed various experts in its effort to value its assets. Richard Riethmiller, an independent consultant, with the assistance of Harold Walker III of Gannett Fleming, Inc. determined the replacement cost new (RCN) of PWW’s tangible personal property and performed the depreciation analysis reflected in the replacement cost new less depreciation (RCNLD). Russell W. Thibeault of Applied Economic Research determined the fair market value of PWW’s real estate assets. Robert F. Reilly, managing director of Willamette

Management Associates, determined the fair market value of PWW's net working capital and intangible property and determined the fair market value of PWW's assets in their entirety. *See generally* Exh. 3007A. Mr. Reilly determined the value of PWW's assets as of December 31, 2004 to be \$248,400,000. In testimony filed on November 14, 2006, Mr. Reilly updated his value to \$273,400,000 as of December 31, 2005. Exh. 3021 and 3021A. This figure excludes approximately \$37.1 million in plant additions related to the water treatment plant.⁹

B. Valuation Methods Employed

The record reflects that, as a general matter, three types of valuation methods are traditionally used in determining fair market value: the asset or cost approach, the sales comparison approach, and the income approach. In the asset based or cost approach, a value is derived for the fee simple interest in a property by estimating the current cost to construct a reproduction of, or replacement for, the existing structure plus any profit or incentive; deducting depreciation from the total cost; and adding the estimated land value. Appraisal Institute, *The Appraisal of Real Estate* (12th ed., 2001) at 349. Other adjustments may be made to the indicated fee simple value of the property to reflect the value of the property interest being appraised. The cost approach supports two methods for estimating cost and three methods of estimating depreciation. *Id.* "The cost approach is based on the principle ... that a purchaser would likely not pay more for a property than the cost of replacing it." Exh. 1007A at 34.

In the sales comparison approach, an opinion of market value is developed by comparing properties similar to the subject property that have recently sold, are listed for sale, or are under contract. *The Appraisal of Real Estate* at 417. "[C]omparisons are made to demonstrate the

⁹ Exh. 3009A at 16 ("future liability yet to be expended - \$37,087,391").

price at which the subject property would most likely be sold if it had been offered for sale in the market place” Exh.1007A at 34.

The income approach to value consists of methods, techniques, and mathematical procedures that an appraiser uses to analyze a property’s capacity to generate future monetary benefits of income and convert these benefits into an indication of present value. *The Appraisal of Real Estate* at 471. The analysis of cost and sales data is often an integral part of the income capitalization approach, and capitalization techniques are frequently employed in the cost and sales comparison approaches. *Id.*

The accepted valuation practice involves use of a combination of these methods to derive a fair market value, although each method may be given different weight in the overall determination of value. In this case, Nashua and PWW’s appraisal experts considered all three approaches in their analyses but, as explained below, they differed in the weighting they attributed to each approach and how they performed the underlying calculations.

C. Nashua’s Valuation Testimony

In determining its figure of \$85 million, GES considered all three approaches to valuation. GES calculated an indicated valuation of \$104 million under the asset based approach but assigned it zero percent weighting. GES gave no weight to this approach because it concluded that the value was over estimated as a result of the “existence of external obsolescence such as the limitations on earnings potential due to cost of service rate regulation and other factors.” Exh. 1007 at 3. Using the sales comparison approach, GES determined an indicated valuation of \$89 million. It determined a value of \$80 million using the income approach. GES assigned an equal weighting to the sales and income valuations and determined the overall appraisal valuation of \$85 million as of December 31, 2004.

As stated earlier, GES concluded that approximately \$54 million in new property, plant, and equipment should be added to PWW's assets to reflect activity between December 31, 2004 and December 31, 2007. GES did not perform an amended appraisal but, instead, suggested that the property additions made since December 31, 2004 be added to fair market value "in the same amount as their contribution to rate base." Exh. 1017 at 4.

We next describe GES's analysis within each of the valuation methods employed.

1. Nashua's Asset Approach/Trended Original Cost Method

In the asset approach, GES used a trended original cost method. This method estimates the cost new of property by adjusting the historic cost with a multiplier factor derived from a construction cost index. In this case, GES used PWW's Generally Accepted Accounting Principles (GAAP) Taxable Asset Reports and Main Pipe Inventory and applied a multiplier factor obtained from the Handy-Whitman Index of Public Utility Construction. Exh. 1007A at 43. GES recognized the existence of limitations to using the asset reports and inventory, but considered them to be a reasonable estimate of the original cost of PWW that would produce a reasonable estimate of the PWW system. Exh. 1007A at 42.

From this adjusted calculation of original cost, GES deducted for curable physical deterioration, incurable physical deterioration, and functional obsolescence.¹⁰ GES did not quantify or deduct for economic obsolescence for PWW's assets because, as stated earlier, when

¹⁰ Curable physical deterioration concerns property that is in need of repair or replacement at the time of appraisal. Exh. 1007A at 45. Incurable physical deterioration is decay of items that cannot be reversed and must be replaced or be subject to major repair. *Id.* Functional obsolescence is a curable or incurable flaw in the property when compared with the highest and best use and most cost effective functional design requirements at the time of appraisal. Five types of functional obsolescence exist. *The Appraisal of Real Estate* at 403-404.

economic obsolescence is applied to the formula, it reduces the value and approximates the sales and income approach values.¹¹ *Id.* at 48. Exh. 1007 at 3. 9/10/07 Tr. at 44 lines 7-11.

To calculate curable physical deterioration, GES reviewed PWW's known capital budget items contained in the Fay, Spoffard, and Thorndike Capital Improvement Plan for deferred maintenance as of the valuation date. GES considered the deferred maintenance items to represent \$10 million of curable physical deterioration. Exh. 1007A at 45. To establish incurable physical deterioration, GES developed a percent relationship of estimated age of the property to the useful lives of the property, or 36.2 percent. *Id.* at 46. For calculating functional obsolescence, which GES defined as deficiencies in the system caused by assets not complying with required water quality regulations, GES assembled cost estimates for the water treatment plant upgrades, security costs, and other items from information provided in PWW's 2004 rate case, Docket No. DW 04-056. *Id.* at 46. These three categories of depreciation result in a combined percentage of 53.4 percent of cost new.

GES then estimated the market value of PWW's land as of December 31, 2004 by reviewing the 2004 assessment values established by the individual towns and adjusting for the corresponding equalization ratio. GES considered the equalized assessment of each land parcel "a reasonable estimate of PWW's land value for the purposes of this report." *Id.* at 48.

2. Nashua's Sales Comparison Approach

In valuing PWW's assets using the sales comparison approach, GES reviewed the sale of 28 water systems around the country. Exh. 1007A at 52. These sales occurred between 1995 and 2006. According to GES, the "sales comparison approach is most applicable in an active market where the prices paid serve as accurate indicators of the most probable selling price of the

¹¹ Economic obsolescence is the reduction in the value of the asset caused by factors beyond the owners' control such as regulatory change or inflation. Exh. 1007A at 47.

subject property as of the valuation date.” Exh. 1007A at 49. In comparing the sales, GES used numerous units of comparison.

One unit of comparison involved computing the ratio of the sale price to net plant, minus net contributions in aid of construction (CIAC). This reflects the relationship between the sale price of the utility and its plant-in-service rate base. GES determined the ratio to be 1.6. GES used only Class A-1 water utilities (as classified by the National Association of Water Companies) with gross annual revenues of \$10 million or more. GES also used data relating to PWV’s net plant minus net CIAC which it obtained from PWV’s 2004 rate case proceeding. Exh. 1007A at 41. GES applied the ratio to the net plant minus net CIAC and determined the indicated valuation of \$81.6 million, rounded. Exh. 1007A at 55.

GES also calculated another unit of comparison: a value estimate based on a ratio of sale price to earnings before interest, taxes, depreciation and amortization (EBITDA). As with the earlier ratio, GES based its analysis on Class A-1 water utilities with gross annual revenues of \$10 million or more and on amounts relating to EBITDA found in PWV’s 2004 rate case proceeding. GES calculated an indicated valuation of \$96 million, rounded. Exh. 1007A at 56. GES did not compute any other unit of comparison.

GES then determined a composite valuation by assigning an equal weight to the ratio determined by comparing sale price to net plant minus CIAC and the ratio determined by comparing sale price to EBITDA. With this even weighting, GES arrived at a value estimate of \$89 million. Exh. 1007A at 56. As with the asset based approach, GES did not specifically update this value in its November 14, 2006 update testimony.

3. Nashua's Income Approach

GES identified two methods generally used to capitalize future income: direct capitalization and yield capitalization. For purposes of valuing PWW, GES considered both methods but states it ultimately chose only to use the yield capitalization method. Exh. 1007A at 54. According to GES, this method converts future benefits into present value by discounting each future benefit at an appropriate yield rate or by developing an overall rate that explicitly reflects the investment's income pattern, value change and yield rate. Exh. 1007A at 58.¹² Within this method, GES reviewed PWW's *pro forma* cash flows presented in PWW's 2004 rate case proceeding and adjusted it by using an average annual IRS depreciation rate of 4.5 percent. GES also deducted income taxes (calculated before expensing interest on debt) to determine income to be capitalized, or \$5,804,889. Exh. 1007A at 62 and 63. GES divided this income amount by a weighted average cost of capital of 7.20 percent which included an adjustment to the debt rate for the deductibility of interest expense. GES's analysis yielded a value estimate of \$80,623,452. *Id.* at 64.

D. PWW's Valuation Testimony

In determining PWW's initial overall valuation, Mr. Reilly considered the asset based approach/asset accumulation method, income approach/discounted cash flow (DCF) method, and the sales comparison approach/guideline merged and acquired company method. Mr. Reilly determined an indicated valuation of \$253.8 million as of December 31, 2004 under the asset based approach/asset accumulation method and assigned it a 60 percent weighting. Exh. 3007A at 4. Mr. Reilly explained that he gave the asset based approach value a 60 percent weighting

¹² Although GES purports to use the yield capitalization method, the supporting schedules appear to use the direct capitalization method. Exh. 1007A at 64.

because of PWW's assets being special purpose property.¹³ In testimony filed on November 14, 2006, Mr. Reilly updated this value to \$266.4 million as of December 31, 2005. Under the income approach/DCF method, Mr. Reilly initially determined an indicated fair market value of \$240.2 million. He assigned it a 40 percent weighting because, in his opinion, a buyer would rely heavily on the income generating capacity of these assets in making a purchasing decision. Exh. 3007 at 35-36 and Exh. 3007A at 5. In testimony filed on November 14, 2006, Mr. Reilly updated this value to \$283.9 million as of December 31, 2005. Using the 60/40 weightings, Mr. Reilly determined an overall fair market value of PWW, as of December 31, 2005, of \$273.4 million. Exh. 3021A at 3.

Mr. Reilly assigned no weight to the sales comparison approach. His search of recent acquisitions yielded 12 companies that had been acquired within four years prior to the valuation date. Five of the 12 sales were purchases by investor-owned entities and Mr. Reilly found them either too small, too large, or involving both water and sewer operations. The remaining seven sales involved purchases by public entities and Mr. Reilly found them either too small, involving a forced sale, or involving other utilities in the sale such as gas, electric, or sewer. Exh. 3007A at 41-46. In his opinion, because of these differences as well as the uncertainty regarding the condition of the guideline assets, the comparative sales were not sufficiently comparable to provide meaningful valuation guidance as to the PWW assets. For these reasons, Mr. Reilly assigned a zero weighting to the sales comparison approach.

1. PWW's Asset Approach/Asset Accumulation Method

According to Mr. Reilly, the asset based approach/asset accumulation method is relied upon by most appraisers valuing special purpose property. It is a multi-step process and involves

¹³ Special purpose property is a "limited-market property with a unique physical design, special construction materials, or a layout that restricts its utility to the use for which it was built." *Appraisal of Real Estate* at 25.

the addition of values for tangible personal property, operating real estate and real property interests, and intangible personal property to estimate the fair market value of a subject's total operating assets. Exh. 3007 at 22.

For tangible assets, Mr. Riethmiller, with the assistance of Mr. Walker, conducted a Replacement Cost New Less Depreciation (RCNLD) analysis. Mr. Riethmiller defined RCN (i.e., replacement cost new) as the estimated cost of replacing, under current conditions, the water treatment, storage, and distribution assets of the PWW system with new property that has the nearest equivalent material or utility compared to the property being valued. Exh. 3008 at 6. This appraisal method assumes construction of the entire system in one continuous effort. *Id.* In some instances, the replacement material may be functionally superior to the property being valued and thus adjustments may be necessary to account for the functional obsolescence in the observed depreciation portion of the analysis. Mr. Riethmiller testified that observed depreciation is a manner of quantifying the existing condition of the property in terms of its physical deterioration and functional obsolescence and is generally expressed as a percentage of RCN. Exh. 3008 at 8.

To start the RCNLD analysis, Mr. Walker prepared a detailed inventory of PWW's tangible assets: the treatment plant, wells, pump stations, tanks, and transmission and distribution mains and services. PWW's mains include asbestos, cement, cast iron lined, cast iron unlined, ductile iron, concrete, copper, PVC, and galvanized steel. PWW has a limited amount of 6" and 72" Swiss steel pipe, which is a spiral wound, riveted mild steel pipe with a bitumastic coating on the exterior and interior. Exh. 3008 at 16. The 72" Swiss steel main was installed in 1898 and was unlined until the early 1970's when it was cleaned and lined. Mr. Walker determined, at current prices, what it would cost to replace those assets. This calculation comprises the RCN

portion of the calculation. Mr. Riethmiller then took Mr. Walker's detailed inventory and RCN and quantified the observed depreciation of the current condition of the assets.

Mr. Riethmiller conducted 18 sampling digs to confirm the observed depreciation of PWW's mains. According to Mr. Riethmiller, the samples confirmed that the mains were in remarkably good condition. Exh. 3008 at 18. Mr. Riethmiller calculated the observed depreciation percentage for each asset category and determined an overall observed depreciation percentage of 25 percent. By applying the observed depreciation to the RCN, Mr. Riethmiller completed the RCNLD analysis. Exh. 3007 at 23; and Exh. 3009A at 16-87.

For real estate and real property interests, Mr. Thibeault appraised the fee interest of 60 real estate parcels and 67 cross country easements owned by PWW. Exh. 3011 at 3-4. He determined a value of \$12,038,800 for real estate PWW owned in fee and \$863,700 for easements. Combined, Mr. Thibeault determined PWW's real estate and real property interests had a fair market value of \$12,902,500.

For intangible assets, Mr. Reilly determined the value of PWW's distribution maps, water pumping rights, databases, company records, and a trained and assembled workforce using the RCNLD method. Since he deemed PWW's water pumping rights to be of a special nature, he determined that value by using an income approach/direct capitalization method. In total, Mr. Reilly determined a fair market value of PWW's intangible assets of \$41.8 million. Exh. 3007 at 28.

Mr. Reilly then determined the amount of economic obsolescence and subtracted it from the values for the tangible assets, real estate and real property interests, and intangible assets. He determined economic obsolescence by capitalizing, at 7 percent, the difference between the required return on the RCNLD valuation amount and the projected earnings. Exh. 3007A at 36.

Based on the accumulation of all of the above, Mr. Reilly determined an indicated value of PWW's assets using the asset based approach to be \$253.8 million. Exh. 3007A at 37. In testimony filed in November 2006, Mr. Reilly updated this value to be \$266.4 million as of December 31, 2005. Exh. 3021A at 5.

2. PWW's Income Approach/Discounted Cash Flow Method

As already noted, the income based approach assumes that the value of a business is the present worth of its future income. To value that income, Mr. Reilly used the DCF method, which uses a company's financial projections to estimate the present value of the future cash flow. He determined the net cash flow portion of the method by taking the EBIT and adding depreciation and amortization expense, subtracting capital expenditures, and subtracting required increases in working capital. Exh. 3007A at 38. He determined the appropriate present value discount rate to apply in the DCF by determining the WACC.

In Mr. Reilly's opinion, the WACC should reflect the cost of capital of the likely population of willing buyers, and those buyers include not-for-profit public entities. Exh. 3007A at 38. The not-for-profit entities enjoy advantages such as no income tax, low cost financing, no regulation, and reduced property taxes and these advantages allow these entities to set the range for the purchase price. According to Mr. Reilly, the market price for a business valued as a going concern will be set by the purchasers with the greatest expected synergies. Exh. 3007 at 17.

As to the net cash flow, Mr. Reilly adjusted PWW's financial projections for December 31, 2005 through December 31, 2009 for the expected financial performance of the hypothetical purchasers; specifically he used a not-for-profit purchaser. Exh. 3010A at 2-5. The 2005 to 2009 projections were followed by a normalized year. *Id.* Mr. Reilly defended this adjustment

as being necessary because the buyer with the most synergies will set the range of market prices for the group.

As to WACC, Mr. Reilly used a build-up model and incorporated the capital structure of a hypothetical buyer. He calculated an 18.7 percent cost of equity and a cost of debt of 4.6 percent. He weighted the cost of equity at 5 percent and cost of debt at 95 percent which yielded a 5 percent WACC. Exh. 3007A at 68. Mr. Reilly then took the present value discount rate of 5 percent and subtracted an expected long-term growth rate of 2 percent to produce a 3 percent direct capitalization rate. *Id.* at 69. These factors produced an indicated value of \$240.2 million using the DCF method. In November 2006, Mr. Reilly updated this figure to \$283.9 million.

E. Critiques of Valuation Testimony

1. Pennichuck

Within the sales approach, Pennichuck criticized Nashua for choosing comparable sales based on one comparability factor alone. Four of the nine transactions were stale; one was not a transaction; three were part of multi-state transactions; and the remaining transaction was a multi-state water/sewer transaction. Pennichuck stated that Mr. Walker admitted he made certain errors in identifying some of the sales transactions as comparable. 9/4/07 Tr. at 159-160, 166-169, and 270. Nashua's reliance on the sales data was erroneous because its experts never made any personal review of the assets. In addition, Nashua applied a stock and debt method, which is used to value stock, not assets. Pennichuck was critical of Nashua characterizing the market approach as "active and transparent" and affording it a 50 percent weighting.

Within the income approach, Nashua relied on a WACC of private regulated water utilities. It did not analyze the pool of hypothetical buyers and instead assumed a buyer would be like PWW. In essence, Nashua assumed that the pool of hypothetical purchasers consisted

only of regulated private companies, which understates fair market value. Pennichuck asserts that this assumption was unlike past appraisals in which Nashua's experts acknowledged a municipal buyer in the hypothetical pool. In this instance, Pennichuck contends that Nashua's experts knew that using a regulatory rate of return and capitalization rate would result in a value that would approximate rate base. Exh. 3061 at 16 n.3.

According to Pennichuck, Nashua's cost approach contained numerous errors: arbitrarily assigning lives to assets; arbitrarily making a \$10 million deduction for "curable physical depreciation"; and valuing the existing water treatment plant at \$5,500,000. Pennichuck also asserts that there were failures to: value intangible assets or real property; perform an appraisal of operating real estate and real property; and assign any weight to the asset valuation approach, relying instead on inaccurate and incomplete tangible personal property original cost data.

Nashua did not update the appraisal with the most current financial and asset information so the valuation is based on December 31, 2004 data. Nashua's experts recognized that the trended original cost method will not result in an accurate and reliable estimate of the current cost of the system if the original cost data is not accurate. 9/4/07 Tr. at 203-204. They admitted that more accurate records "will get a higher trend." 9/4/07 Tr. at 230. Exh. 3102. Pennichuck argues that at least two documents were used by Nashua's expert that he knew were unreliable in preparing his cost approach: (1) PWW's CPRs, and (2) PWW's engineering inventory. 9/4/07 Tr. at 205-208 and Pennichuck post hearing brief at p. 48 (11/16/07).

Pennichuck was critical of Nashua's age-life depreciation method and stated that it essentially produced a theoretical depreciation. Exh. 3018 and Exh. 1007A at 45-46. Pennichuck's expert, Mr. Reithmiller explained that unless an asset is new, the estimate of observed depreciation is rarely simple and requires: (1) the analysis of multiple factors,

(including historical system information), and (2) the application of engineering experience and professional judgment. Nashua's experts, instead, used an age-life method to determine what he calls the "incurable physical deterioration" of the property, which he defined as the "decay of items over the course of time that cannot be reversed or eliminated without replacement or major repairs to the property." This age-life method relied on: (1) the expected useful physical life, or economic life expectancy, as compared against, (2) the actual age of the asset as reflected in the PWW records. Thus, Mr. Reithmiller concluded Nashua's depreciation calculation is only as credible as: (1) the data used for the expected life of the PWW assets, and (2) the data used to conclude the actual age of the PWW assets.

As to the reliability of the expected life data, Nashua assumed a straight line basis over the course of its economic life, although Mr. Reithmiller notes that age-life is not appropriate since a water system does not physically deteriorate on a straight line basis and transmission and distribution piping has a long life. As to the actual age of the assets, Nashua states that three factors were considered in calculating the useful physical life for the assets of PWW: (1) the materials and design used to construct the assets, (2) the regulatory service lives, and (3) the age of the property. Pennichuck asserts that some information can be garnered on how an asset will perform over time from the type of material that was used to construct it, but significant additional information is needed to accurately determine its current condition. It concludes that regulatory service lives do not equal actual service lives for sale price valuation purposes.

Lastly, Pennichuck noted that Nashua did not dispute the inventory underlying Mr. Reilly's cost approach; the pricing of the direct and indirect construction costs of the water system; the observed depreciation applied to the assets; or the valuation of any of the intangible assets developed by Mr. Reilly; the appraisal of real estate by Russell Thibeault; or the

discounted cash flow formula Mr. Reilly employed in performing the income approach. Exh. 1015 at 15; 9/4/07 Tr. at 39-41. Further, Nashua did not challenge Mr. Reilly's detailed descriptions of the comparable transactions that he considered and ultimately rejected. Exh. 1015 at 15-16. Finally, Nashua acknowledged that for special purpose property the cost approach is an appropriate approach to consider and rely upon, yet it assigned zero weight to that approach. 9/4/07 Tr. at 248 and Exh. 3206 at 4.

2. Nashua

Nashua criticized Pennichuck's fair market value analysis as containing: an erroneously calculated economic obsolescence, use of an erroneous discount rate, wrong assumptions that included assumption of a "brownfield" construction approach which artificially inflated the cost new of the PWW system, and failure to recognize bona fide offers to purchase the PWW assets shortly before the valuation date and other transactions in the marketplace. Exh. 1015 at 4 and 5.

Nashua contended that PWW's fair market value is not influenced by "not-for-profit" entities since those entities enjoy synergies and savings not available to the typical buyer. Exh. 1015 at 2 and 4. According to Nashua, by assuming the synergies of a "not-for-profit public" entity and by considering these synergies in developing the capitalization rate, Mr. Reilly developed an "investment value" that artificially inflates PWW's fair market value by \$160 million. Exh. 1015 at 5 and 6.

Nashua contends that a market for PWW's special purpose property existed in 2004 but that Mr. Reilly ignored this market evidence. Nashua's expert, Mr. Walker, used twenty-eight sales comparisons and concluded the most important characteristic was size, and sales were grouped according to the National Assoc. of Water Companies classification for revenue. He 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. He concluded the larger systems command a premium over smaller systems and thus he used those sales of systems with gross annual revenues of \$10 million or more. Nashua points out that Mr. Reilly failed to complete or weight the sales method.

Nashua observes that buyers of income producing property view cash flow as a critical element affecting value and that under the income capitalization method a value is estimated by capitalizing the cash flow available to satisfy debt and equity with a market based rate of return. Because Mr. Walker's capitalization rate assumed no further earning growth, it is considered a yield capitalization method. Nashua states that Mr. Walker used a typical buyer and Mr. Reilly used a not-for-profit or special buyer, which has certain benefits or synergies available to it that a typical buyer would not. Nashua argues that these benefits should not be considered and it contends that Mr. Walker's scatter graph for sale price to EBITDA ratio was the only empirical evidence that municipalities pay more than IOUs. Exh. 1007A, at 54.

Nashua criticized Mr. Reilly's inclusion of a growth rate in his income approach and stated that assuming an earnings growth rate will be the same as the growth in customers is inconsistent with both historic levels and future estimates. It further opines that earnings growth without capital expenditures will result in over earning. Pennichuck's witness, Mr. Guastella, does not support the 2 percent growth rate since his schedule reflects a declining rate base 2009-2015. Exh. 3010A at 3. Absent the 2 percent growth rate, Nashua argues PWW's fair market value would be \$89 million.

Mr. Reilly assumed a 5 percent rate of return (ROR) to establish the capitalized income shortfall from which he calculated economic obsolescence attributable to his cost method. Citing the *Appraisal of Real Estate*, 12th Ed., Pages 487-493, Nashua states the cost of capital and rate

of return of a typical buyer or investor should have been used and it argues that PWW's 8.68 percent ROR is a good proxy. If Mr. Reilly used 8.68 percent, the economic obsolescence would have been 68 percent, not 47 percent and would have yielded a cost method value of \$160,000,000.

Nashua asserts that Mr. Reilly's valuation exceeds that of Pennichuck Corporation alone as follows: On December 31, 2005, Pennichuck Corporation's stock sold for \$20.45 per share. When multiplied by 4,200,000 outstanding shares and adding outstanding debt of \$41,456,000, an enterprise value of Pennichuck Corporation of \$127,346,000 results. Nashua contends that this enterprise value is consistent with the SG Barr Devlin 2002 auction and Philadelphia Suburban's bid. Nashua further contends that whenever Mr. Reilly made a choice, it was always to increase the value by: using a hypothetical buyer that would result in the greatest value, adding a long term growth rate, using municipal capitalization, and not weighting the sales approach.

F. Pennichuck Motion to Disqualify Messrs. Sansoucy and Walker

On November 27, 2006, the Pennichuck Companies filed a motion to disqualify Messrs. Sansoucy and Walker as valuation expert witnesses. Pennichuck argued that: (1) Sansoucy and Walker were biased in favor of Nashua in a manner that is inconsistent with the Uniform Standards of Professional Appraisal Practice (USPAP) because they stood to profit personally from an outcome favorable to Nashua and specifically sought their engagement by promising to recommend a predetermined outcome; and (2) that the two witnesses failed to follow the USPAP standards when they conducted their actual valuation by employing a "no net harm" approach that bears no relationship to accepted valuation methodologies as well as misapplying the accepted methodologies. In support of the motion, Pennichuck cited the leading U.S. Supreme

Court case on the admissibility of expert testimony, *Daubert v. Merrill Dow Pharmaceuticals, Inc.*, 509 U.S. 579 (1993), and the state-law codification of the *Daubert* principles found at RSA 516:29-a. Pennichuck argued that the Commission “should not lower the bar to allow Sansoucy and Walker to testify as to their opinion of value if such an expert opinion would not be permitted in court.” Pennichuck also relied upon RSA 310-B:18-a, which concerns disciplinary proceedings for licensed or certified real estate appraisers and adopts the USPAP ethical and professional conduct standards in effect at the time of the appraisal assignment as the relevant standard for adjudicating such proceedings. This standard became effective August 18, 2006.

On December 8, 2006, in Order No. 24,706, we denied the motion without prejudice, noting that *Daubert* did not apply to the Commission’s proceedings and concluding that the credibility of these witnesses would be best determined at hearing.

At hearing, the Pennichuck Companies presented evidence that Mr. Sansoucy’s firm, GES, was hired by Nashua to advocate that acquiring PWW’s assets was in the public interest. Exh. 3036. GES’s compensation was estimated to be \$538,000. *Id.* at 8. As part of the same contract, GES would assist Nashua in preparing contracts for the operation, maintenance, and management of the water system assets. *Id.* at 6. GES would assist with closing activities and would participate “in the preparation of materials to facilitate the optimum debt structure and cost for the acquisition, and the placement of tax exempt debt.” *Id.* On July 20, 2006, Nashua submitted the joint testimony of Mr. Sansoucy, Mayor Bernard Streeter, and Alderman Brian S. McCarthy, positing that Nashua’s taking of PWW’s assets was in the public interest. Exh. 1016. On January 12, 2006, Nashua filed a self-contained appraisal report performed by GES and on November 14, 2006, Nashua filed testimony of GES intended to update the appraisal. Exh. 1007A and Exh. 1017. The appraisal report contained a certification signed by Messrs. Walker

and Sansoucy that “[w]e have no present or prospective interest in the property that is the subject of this report, and no personal interest or bias with respect to the parties involved.” Exh. 1007A at 66.

We understand the concerns raised by Pennichuck, however, it is the responsibility of the Real Estate Appraiser Board under RSA 310-B, and not the Public Utilities Commission, to determine whether violations of the professional standards applicable to appraisers have occurred. Accordingly, we do not express any opinion as to whether Messrs. Walker and Sansoucy have failed to comply with the USPAP standards. Moreover, while the multiple roles played by Mr. Sansoucy in this transaction could arguably be construed to be in conflict, in our view the Commission’s rules, Puc 202.03, do not require the exclusion of the testimony of Messrs. Walker and Sansoucy from the record. Accordingly, we will assess their testimony solely on its merits.

G. Commission Analysis

Nashua and PWW are in agreement that a fair market valuation price must be fixed for Pennichuck Water Works and, pursuant to New Hampshire law, such a value would be “the price which in all probability would have been arrived at by fair negotiations between an owner willing to sell and a purchaser desiring to buy, taking into account all considerations that fairly might be brought forward and reasonably be given weight in such bargaining.” *Edgecomb Steel* at 487. Nashua and PWW are also in agreement that there are three general approaches to calculating fair market value, namely, the cost or asset based approach, the comparable sales approach, and the income based approach.

However, there is little agreement between Nashua and PWW as to the application of these general concepts. Among other things, Nashua relies on a 50-50 weighting of the sales and

income approaches and assigns zero value to the cost approach, while PWW relies on a 60-40 weighting of the cost and income approaches and assigns zero value to the sales approach. Also of consequential dispute between the parties is Nashua's discounting of the effect of public entities as willing buyers and PWW's conclusion that the "likely population of hypothetical buyers for the PWW system will include the market influences of not-for-profit entities" and that such entities "will set the market price" under the income approach. Exh. 3007 at 22 and 39.

Among the critiques of the various approaches are the arguments that the sales approach does not accurately value public utility property and that a drawback to the asset or cost approach is that it does not value intangibles, which must be added separately. In this case, PWW's expert used an income approach to value water pumping rights and other intangible assets, which he then added to the asset approach. Exh. 1007B1 at 30. As to the asset approach, there is a distinction between fair market value and rate base, and some items are not included in rate base but should be included in fair market value. This is true for items of value such as CIAC, still functioning but fully depreciated machinery, and appreciated assets. Thus, "whatever approach, premised on a regulatory rate base that excludes significant utility assets, almost without exception results in less than full or just compensation for all property taken." *Washington* at 1194 (citing 4A J.L. Sackman, *Nichols* (3d ed. rev.2000) § 14A.06[1][6], at 14A-17). Because each approach must be adjusted to overcome items of value not inherently included in it, we will not treat one approach as conclusive. Rather, we will evaluate each approach and then weight them accordingly.

1. Sales Approach

Experts for both Nashua and PWW testified that PWW's assets are special purpose property. 9/4/07 Tr. at 241 lines 17-20; Exh. 3007 at 10. The value of special purpose property

is not as accurately determined using the sales approach as compared to the asset and income approaches. According to *The Appraisal of Real Estate*:

When the market is weak and few market transactions are available, the applicability of the sales comparison approach may be limited, for example, the sales comparison approach is usually not applied to special purpose properties because few similar properties may be sold in a given market even when it is geographically broad. For valuing special purpose properties, the cost approach may be more appropriate and reliable.

The Appraisal of Real Estate at 419. Further, according to Nichols' *The Law of Eminent Domain* §12C.01[3][a], special purpose property cannot typically be valued using the sales approach.

We find that PWW's operating assets are special purpose in nature. We also note that the record documented few comparable sales. For instance, of the 28 potential sales that Nashua's experts identified, they only found nine comparable sales based on size. Exh. 1007A at 30-33. Of those nine sales, four were more than five years old, three were part of multi-state transactions, one was a stock transaction, and the remaining sale was not sufficiently comparable. Exh. 3017A at 32-38. As a result, we agree with PWW that the lack of sales that are comparable on more than one factor to PWW's assets makes the sales approach less useful than the asset and income approaches. Given the paucity of comparable sales, we find that the sales comparison approach is not useful in determining the market value of PWW's assets. Accordingly, we will afford this approach no weight in our valuation.

2. Asset Approach

The elements ordinarily considered in the fair market value of a public utility are the current value of the tangible property, present and future earnings, the "going value" of the plant, and the amount of money required to put the plant in good condition. *Washington* (citing 4A J.L.

Sackman, *Nichols* (3d ed. rev. 2000). Various methods are traditionally relied on to determine the value of these elements and each has its own drawbacks but, of them, greater weight seems to be placed on the asset approach. *Id.* at 1193 citing *Nichols* §15.06[2], at 15-47.

PWW's use of the asset approach is more credible than Nashua's for a number of reasons. First, with respect to land, PWW valued its real estate and easements through a certified land appraisal and included in its analysis 2005 tax assessment data, before any current use deduction. Exh. 3011A. Nashua, however, extrapolated PWW's land value by taking the 2004 assessment values and adjusted for the corresponding equalization ratio set by the Department of Revenue Administration. Nashua did not adjust for current use impact.

PWW's experts valued PWW's land at \$12.9 million while Nashua's experts valued PWW's land at \$4.5 million. Exh. 3011A at 13-18 and Exh. 1007A. At the level of individual parcels, the differences can be seen as follows: a 16-acre parcel on Narrows Road was listed by Nashua as having a 2004 assessed value of \$74,800 while PWW's expert listed the same property as having a 2005 assessed value, before current use, of \$353,500; two 2-acre parcels on Ferry Road were valued by Nashua using 2004 assessed values of \$1,200 and \$1,400 while PWW's expert used 2005 assessed values, before current use, of \$2,400 each. Additionally, PWW's land appraisal was developed with a greater attention to detail and specifically identified the highest and best use characteristics of 60 parcels and 67 easements, located in Amherst, Bedford, Derry, Hollis, Merrimack, and Nashua. Exh. 3011A. Nashua made no such highest and best use notations. Nashua's approach is lacking as a reasonable basis for determining just compensation for condemnation purposes when more accurate data and methods existed. Consequently, we are persuaded that PWW's method is superior to Nashua's method and we adopt PWW's appraisal valuation amount of \$12.9 million for land.

Furthermore, there was a significant difference between Nashua's and PWW's appraisal valuation for intangible property. Nashua's appraisal valuation for intangible property is \$176,833. Exh. 1007B1 at 30. By comparison, PWW's appraisal valuation for intangible property is \$41,800,000. Exh. 3007A at 62. Intangible property was an integral part of PWW's operating assets and each component of intangible property should be identified and incorporated in the overall valuation of the operating assets. PWW's valuation was estimated based on an appraisal of each of the individual discrete intangible assets, *i.e.*, distribution maps, engineering drawings, water pumping rights, water system records and reports, Synergen work order database, laboratory reports, SCADA computer software system, and a trained and assembled workforce. By comparison, Nashua's estimate did not identify individual components. Thus, it is impossible to determine its credibility. For these reasons, we adopt PWW's asset approach and related appraisal valuation, subject to certain modifications as discussed below.

With respect to water pumping rights, PWW assigns a value of \$24.5 million to water pumping rights associated with its permit to draw water from the Merrimack River. PWW used the cost approach whenever possible to appraise intangibles. Exh. 3007A at 55, 57, 58, 59, 60, and 61. However, Mr. Reilly used the income approach for water rights. He specifically used what looks like a direct capitalization method to determine that PWW's water rights were worth \$24.5 million, except that instead of capitalizing the value of a stream of revenue or cash flow, an assumed avoided expense is capitalized. Exh. 3007A at 56. He used this method because, in his opinion, water rights were of a special nature, although he did not elaborate on the basis for that opinion. Exh. 3007 at 25. To assign a value, Mr. Reilly calculates valuation based on a proxy expense derived from the average volumetric charge of \$1.11 per cubic foot that PWW pays to Manchester Water Works and Merrimack Village District for water it purchases for its

Bedford and Merrimack franchise areas. He then divides the expense (earnings) by a capitalization rate of 3 percent to calculate the valuation amount of \$24.5 million.

The value assigned to water rights is substantially higher than the values given to other intangibles. Mr. Reilly used a proxy charge of \$1.11 but provides no justification for this multiplier other than it appears to be the going rate PWW pays for water in the geographic vicinity of its pumping rights. Further, PWW fails to provide any persuasive evidence regarding: (1) whether such permits are difficult or easy to acquire, or (2) the costs of acquiring such a permit. Although we agree that water rights in theory have value, based on the record we find no reasonable basis for assigning the value of \$24.5 million to the water pumping rights as proposed by PWW.

With respect to depreciation, PWW's experts determined observed depreciation to be \$139.3 million, or 25.0 percent of RCN-tangible personal property. Exh. 3021A at 20. Nashua's experts determined depreciation to be approximately 53.4 percent of RCN-tangible personal property tangible. Exh. 1007A at 43. We note further that PWW's experts corroborated depreciation through 18 sampling digs on PWW's mains; thus the depreciation factor is based more on fact than on assumed probabilities. The observation method is recognized as the preferred method of determining depreciation. *See State v. Hoquiam*, 155 Wash. 678, 687 (1930). Here, we find PWW's depreciation analysis to be more credible; however, we will modify PWW's observed depreciation percent from 25 percent to 25.7 percent to comport with the observed depreciation approved in PWW's most recent rate case, Docket No. DW 06-073, in which Nashua participated. In that proceeding, depreciation was 25.7 percent of original cost and incorporated the impact of physical and functional deterioration and was thoroughly reviewed by Staff and the parties. We find that the rationale for depreciation reserves in PWW's

recent rate case is compatible with the rationale for observed depreciation as used in appraisal valuation. Since PWW's rate case and appraisal occurred near in time to one another, it cannot be said that the passage of time accounts for PWW's use of 25 percent rather than 25.7 percent.

With respect to economic obsolescence, we first note that it addresses the question of whether the operating assets are generating enough income to support a required rate of return. Exh. 3007 at 27. This factor can have a significant impact on the asset-based approach. PWW's appraisal experts determined economic obsolescence to be \$205.2 million as of December 31, 2005. Exh. 3021A at 18. Nashua's appraisal experts did not determine economic obsolescence and explained only that adding economic obsolescence would have brought the asset valuation more in line with the sales and income valuations. Exh. 1007A at 48. We find the absence of economic obsolescence in Nashua's approach inconsistent with established law recognizing it as relevant to determining fair market value. *See Southern New Hampshire Water Co. v. Town of Hudson*, 139 N.H. 139, 142 (1994).

As noted above, according to PWW, as of December 31, 2005, economic obsolescence is a deduction of \$205.2 million to the indicated valuation under the asset based approach. Exh. 3021A at 19. This deduction measures the difference between the required return on the appraised valuation of the assets and the net present value of the projected earnings. PWW divides the income shortfall of \$14.366 million by the capitalization rate of 7 percent, which is the 5 percent WACC plus the 2 percent growth rate, to determine the capitalized value of the income shortfall of \$205,233,000. Exh. 3021 at 18. Although we agree with this method, we do not find it reasonable to use a 7 percent capitalization rate as an input. We employ instead the 5 percent capitalization rate determined reasonable in the income approach. Recalculating the required return and the projected earnings yields an income shortfall of \$14,084,662. We divide

this income shortfall by the capitalization rate of 5 percent to calculate the capitalized value of the income shortfall of \$281,693,242.

In addition, we must modify PWW's appraisal to bring the valuation date forward from December 31, 2005. Accordingly, we incorporate an adjustment for additions and retirements and accumulated depreciation reserves for the years 2006, 2007, and 2008 as identified in PWW's annual reports, filed with the Commission, for 2006 and 2007. Bringing the valuation date forward to December 31, 2008, we determine the value of PWW's assets using the asset approach to be \$210,349,285 as of December 31, 2008.

3. Income Approach

We begin our analysis of the valuation testimony employing the income approach by noting that estimates for earnings and capitalization rates are key components in the determination of valuation amounts in this approach. The income approach using the direct capitalization method involves dividing earnings by the capitalization rate. Thus, a change in the capitalization rate has a substantial effect on valuation.

Consistent with its position that not-for-profit entities in the pool of hypothetical buyers will set the range of the purchase price, PWW used a not-for-profit cash flow as the measure of earnings in its DCF analysis. PWW began with PWW's projected financial statements and made adjustments to account for certain not-for-profit cost advantages. In contrast, Nashua discounts the effect of not-for-profit buyers.

Mr. Reilly's testimony on behalf of Pennichuck is persuasive in contending that the cost of capital will reflect the likely population of willing buyers and it comports as well with fair market valuation theory and New Hampshire law concerning the propriety of focusing on a

population of hypothetical buyers as opposed to any particular likely buyer or buyers. Mr.

Reilly testifies to these points as follows.

A fair market value appraisal must look to the likely composition of the population of hypothetical buyers in order to determine the range of market prices. As the definition of “fair market value” looks to the hypothetical buyer, a fair market value appraisal may not assume any specific or identified buyers. The characteristics of the population of potential buyers is considered in a two-step process:

- (1) The appraiser determines what types of buyers comprise the population of hypothetical buyers; and
- (2) The appraiser determines which type of buyer within that population will set the range of market prices.

In the case of a going concern business, the buyers with the greatest expected synergies will set the range of market prices for the acquisition.

The most likely population of hypothetical willing buyers of PWW would include not-for-profit public entities. This conclusion is based on several facts, including: (1) that the vast majority (around 80%) of the water systems in the United States are owned by public entities; (2) that Pennichuck Corporation is the principal investor owned utility in the geographic territory where PWW is located; and (3) there are a number of public entities in New Hampshire that could acquire the PWW system. These not-for-profit public entities would include a city, town, or district (including yet-to-be-formed districts). Thus, the likely population of hypothetical buyers for the PWW system will include the market influences of not-for-profit entities.

What any particular public entity has or has not indicated about its interest in the PWW system is not relevant to a fair market valuation... Appraisal literature and appraisal courses never insert the subjectivity of asking what any particular person's interest is in property subject to a fair market valuation.

Exh. 3007, at 21 and 22.

We find Mr. Reilly's testimony to be persuasive and we conclude that so long as it is legally permissible for not-for-profit buyers, that is, more than one such buyer, to buy PWW, which is

the case here, their influence on valuation as part of the population of willing buyers must be given full effect.¹⁴

With respect to the capitalization rates proposed by PWW and Nashua, PWW recommends a rate of 5 percent, from which it deducts a 2 percent growth rate to apply a 3 percent capitalization rate in calculating its income valuation, while Nashua recommends a rate of 7.2 percent with a 0 percent deduction for growth. Consistent with the discussion above, it is appropriate to rely on the PWW approach inasmuch as it better reflects the influence of not-for-profit entities in the hypothetical population of willing buyers, but there is an issue of fact concerning the amount of the deduction for growth that should be credited. PWW's growth rate appears inflated for purposes of the calculation here, insofar as it applies to the normalized year 2010, a year for which there is some question about the 2 percent growth rate. In fact, the record indicates the 2 percent growth rate is the growth rate included in the PWW appraisal that goes through 2009, not 2010. 9/12/07 Tr. at 103 lines 6-8. Further, the record indicates that the 2 percent growth rate represents inflation only. *Id.* at 99 lines 6-7. Yet, there is no support for the

¹⁴ The dissent misconstrues our view in one important respect. We do not conclude that the presence of one not-for-profit buyer will be entirely determinative of value. Rather, we conclude that, so long as it is legally permissible for more than one not-for-profit entity to purchase, fair market value must be determined based on the hypothetical presence of such willing buyers.

In contrast, the dissent does not give full effect to the influence of not-for-profit buyers but, rather, posits a negotiation between a single willing buyer (the condemnor) and a seller (who we know to be unwilling) that effectively averages PWW's and Nashua's respective valuations. Such an approach is not supported by the record and produces a value that is not fair market value.

Furthermore, the dissent's analysis of the value that would result from the negotiation between a single willing buyer and a single willing seller, inappropriately excludes the effect a second willing not-for-profit buyer would have on such a negotiation.

Ultimately, the dissent calculates a value akin to a forced sale by limiting the hypothetical population of willing buyers to the City of Nashua. The dissent's reliance on the so-called typical case therefore errs by equating "typical" with "likely", as that term is used in a fair market value appraisal, and by effectively considering the City of Nashua as the particular buyer in this case.

Finally, the dissent's line of reasoning renders the fair market value valuation exercise meaningless because, taken to its logical conclusion, there is no fair market value that can be derived in the case of one willing not-for-profit buyer and one unwilling seller.

conclusion that earnings will grow by 2 percent. Consequently, we find that Nashua's use of a 0 percent deduction for growth is the better input to the formula. Accordingly, we use a 5 percent capitalization rate.

We now turn to the hypothetical buyers' influence on earnings. We note that both PWW and Nashua indicated that a not-for-profit entity buyer will have certain cost advantages over a for-profit counterpart. According to PWW, these cost advantages include: (1) income tax savings, (2) access to low-cost municipal financing, (3) property tax savings and, (4) relief from regulatory expense. Exh. 3007 at 17 and 18. PWW increased earnings to reflect these cost advantages and used the present value of the earnings of the not-for-profit entity in its income approach.

As with our discussion of the capitalization rate, we find that PWW's approach to earnings is reasonable because it properly accounts for the influence of not-for-profit entities in the population of willing buyers and we find as well that PWW's estimate of the cost advantages to such entities is reasonable and appropriate. Dividing earnings of \$8,540,012 by a capitalization rate of 5 percent yields an income valuation of \$170,800,230. We deduct \$826,099 from this net present valuation to account for the present value discrete period negative net cash flows for the years 2006-2009 and determine that the indicated value for PWW's assets under the income approach is \$169,974,131 million, as of December 31, 2005.

Further, we note that in eminent domain proceedings, the relevant date for valuation purposes is "the day of the taking." *Dow v. State*, 107 N.H. 512, 514-15 (1967) (quoting *Edgcomb Steel of New England, Inc. v. State*, 100 N.H. 480, 486 (1957)). Of course, a specific date for the taking, or closing, has not been established. Any date after December 31, 2004, which was the date the parties set for initially valuing PWW's assets, requires an update to the

valuations. The procedural schedule called for updates to the valuation testimony and the parties filed updates on November 14, 2006 to bring the values forward to 2005. We now modify PWW's appraisal to bring the valuation date forward from 2005 to 2008. We take this step in anticipation of additional procedural steps that, to the extent Nashua prevails in any rehearing or appeal and elects to proceed, would likely result in a ratifying vote pursuant to RSA 38:13 in the last quarter of 2008 or the first quarter of 2009. Accordingly, we apply the same present value factor of 5 percent that PWW used to discount 2008 amounts to 2005 amounts. PWW used .8850 to discount 2008 to 2005. The reciprocal to bring 2005 amounts forward to 2008 is 1.1299, (i.e., $1/.8850 = 1.1299$). The adjustment brings the values forward to 2008 from \$169,974,131 to \$192,053,771.

4. Reconciliation of Asset and Income Values

We now turn to the issue of what weight to attribute to each valuation approach. We agree with PWW that the 60 percent weighting of the asset approach is appropriate. The asset approach discretely identifies and fairly values the relevant tangible and intangible property. The income approach is based on the premise that the value of the operating assets of a going concern business is the present value of the economic income expected to be derived from the assets. The income approach, however, is less data intensive and only indirectly values the total of a company's tangible and intangible assets. Thus, we afford the income approach a 40 percent weighting. Accordingly, we find the overall fair market value of PWW's assets as demonstrated at hearing to be \$203,031,079 as of December 31, 2008. This amount is exclusive of the mitigation fund discussed below.

VII. MITIGATION FUND

RSA 38:9, III requires the Commission, when valuing a utility for municipalization purposes, to “determine the amount of damages, if any, caused by the severance of the plant and property proposed to be purchased from the other plant and property of the owner.” This codifies an aspect of the constitutional protection from taking without just compensation. *See City of Manchester v. Airpark Business Center Condominium Unit Owners’ Assn*, 148 N.H. 471, 473 (2002). In addition, RSA 38:11 provides that the Commission may set conditions to satisfy the public interest.

Pennichuck proposes the creation of a mitigation fund to protect customers of PEU and PAC from lost economies or synergies resulting from the taking. Nashua proposes that the amount of this fund not be decided here but that it be determined, assuming Pennichuck does not opt to sell the other two utilities to Nashua, in a separate proceeding. Nashua further proposes to cap the mitigation fund at the value of the two utilities’ plant in service. While the lost economies are arguably in the nature of damages caused by severance, we treat the effects here as related to our general public interest inquiry and, to the extent the effects negatively affect PEU and PAC customers, an issue to be considered within our authority to set conditions pursuant to RSA 38:11.

We do not agree with Nashua that it is beyond the scope of this proceeding to address the effects of the municipalization on PEU and PAC customers. RSA 38:11 plainly permits us to undertake that analysis here. See Order No. 24,487 (July 8, 2005) and Order No. 24,555 (December 2, 2005). Both Nashua and PWW had an opportunity to provide testimony and other evidence on the effects of the taking on PWW’s affiliates. PWW in fact provided detailed analysis of the harms to PAC and PEU customers. Nashua did not provide much detailed

analysis but, regardless of its litigation strategy, we find that there is sufficient evidence in the record quantifying the harm to customers of PAC and PEU such that we deem a separate proceeding unnecessary. Furthermore, whether it is more properly characterized as severance or a condition required as a matter of the public interest pursuant to RSA 38:11, the net effect is essentially the same.

The record demonstrates that PWW, PAC, and PEU are highly interdependent companies sharing resources through Commission-approved affiliate agreements. PWW supplies the majority of the shared resources that PAC and PEU rely on to provide water service to customers. PAC and PEU will lose the efficiencies inherent in sharing resources, and replacing those resources will cause PAC and PEU to incur greater expense. This greater expense would be passed along to customers in the form of rate increases.

As to Nashua's suggestion that the mitigation funds be capped at the limits of PAC and PEU's respective plant in service, we do not find any logical reason for such a limitation. Nashua has acknowledged that PWW, PAC, and PEU enjoy efficiencies in the shared use of resources. The purpose of the mitigation fund is to compensate customers for the loss of those efficiencies. Thus, limiting the mitigation fund to a value not to exceed the regulatory concept of plant in service of each company is arbitrary and bears no connection to the ability of the fund to fairly compensate customers for those lost efficiencies.

Pennichuck offered evidence of harm through its expert, John Guastella, who testified that \$3.4 million in additional annual revenue requirements would be needed by PEU and PAC if Nashua takes PWW. Exh. 3016 at 4. He determined this figure after reviewing operations and maintenance expense projections for water supply and distribution, engineering, customer service, and administrative and general. He also reviewed the companies' 2005 operations

summaries. For each category, Mr. Guastella adjusted for items such as changes in vendor charges due to reduced volume, changes in the number of employees, and changes in salaries. He also included a return and depreciation expense on assets PEU and PAC would need to acquire to replace the common assets lost with the taking of PWW. Mr. Guastella concluded that PAC would need a revenue increase of \$409,873.09. Exh. 3016A at 9. This translates into an approximately 66 percent rate increase for Pittsfield customers in order for PAC to earn a reasonable rate of return. The increase is also in addition to rate increases PAC would normally obtain in a rate case. He concluded PEU would need a revenue increase of \$2,992,059.64. Exh. 3016A at 8. For PEU customers, this translates into an approximately 64 percent rate increase. Id. at 3. The combined shortfall in annual revenue requirement for both PAC and PEU is \$3.4 million. We accept these figures as representing the harm to PEU and PAC customers from losing the synergies associated with PWW's assets and we find that the public interest requires as a condition of our approval that Nashua establish an appropriate mitigation fund.

As to the issue of what specific mechanism would produce \$3.4 million annually, we note that Mr. Guastella testified that assuming a capitalization rate in the range of 6.5 percent to 8.5 percent, an initial fund investment of approximately \$40 to \$50 million would be required to generate annual earnings of \$3.4 million. Commission Staff contended that the customer impact is on the low end asserted by PWW and we agree with Staff that a mitigation fund of \$40 million is reasonably calculated to insulate PEU and PAC customers from the effects of the taking. We will address the specific method for implementing this result as a compliance matter in this proceeding after the City makes a ratifying vote and all rehearings and appeals are exhausted.

VIII. CONCLUSION

This proceeding has been complex, contentious and long. It involves a proposed taking by eminent domain by the second largest city in the state of the state's largest privately-owned public water utility. From the outset, there have been serious legal questions of first impression concerning the application of the governing statute, RSA 38, and every step in the proceeding has been hotly contested. For the reasons set forth above, and based on our careful consideration of the extensive record, we find that it is in the public interest for the City of Nashua to take the assets of Pennichuck Water Works provided that the City complies with certain conditions.

In making our decision, we have sought to keep faith with our obligation under RSA 38:3 to presume the taking to be in the public interest, considering whether opponents of the taking have rebutted the presumption. They have not, although it is clear that the issues raised by the opponents and Nashua's efforts to address those issues through conditions have had the effect of enhancing the extent to which municipalization of PWW serves the public good.

The RSA 38:3 presumption, however, extends only to the borders of the petitioning municipality, whereas PWW's operations extend beyond Nashua both through physically interconnected services to some areas as well as satellite systems that are not interconnected. As to the territories outside its borders, Nashua was required to demonstrate that the taking is in the public interest and that the City meets the requirements for franchise authority pursuant to RSA 374. We have determined that such authority is consistent with the public good provided that Nashua continues to operate the entire PWW system according to a unified rate structure, providing all customers with the same quantity and quality of water.

Once we have determined that the proposed taking is for the public good, RSA 38:9 requires us to fix the price to be paid by Nashua to acquire the utility facilities being condemned.

For the reasons set forth above, we have determined the fair market value of the assets in question to be \$203,031,079 as of December 31, 2008, which we round to \$203 million. However, the public interest requires Nashua to pay an additional sum to account for costs ultimately incurred by customers of Pennichuck's other utility subsidiaries arising out of the loss of the affiliation with PWW.

The conditions to our approval are as follows, and are explicitly determined to be prerequisites to our decision that the taking is in the public interest:

1. Nashua shall provide service to all customers within the current PWW service territory, regardless of location, with the same service at the same rates, terms, and conditions. Such service shall be in accordance with Nashua's Water Ordinance and Main Extension Policy.
2. Nashua shall provide service to all PWW's wholesale users in accordance with the rates, terms, and conditions of all existing wholesale contracts either by adopting those contracts outright or, if required for bonding purposes, by filing with the Commission a wholesale tariff that incorporates the rates and provisions of the existing wholesale contracts.
3. Nashua shall not bifurcate its customer service functions. It shall amend its contract with Veolia to provide that Veolia, as system operator, handles all customer inquiries whether related to billing, service, or both. The provision of customer service by Veolia on behalf of Nashua shall be in compliance with the Commission's rules governing customer service, including N.H. Code Admin. Rules Puc 1200.
4. Nashua shall have technical advisors on call 24-hour per day available to industrial and wholesale customers of the system.
5. 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.
6. 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. 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 be subject to the open meeting and public document availability provisions of the Right-to-Know Law, RSA 91-A. The technical advisory board shall annually make written recommendations to the City of Nashua concerning its operations, providing a copy to the Commission and the Office of Consumer Advocate.

7. Nashua shall mitigate the harm to customers of PEU and PAC occasioned by the City's acquisition of the assets of PWW by creating a mitigation fund as described above.

8. Within 60 days of the order on the merits of this case becoming final and no longer subject to appeal, Nashua shall submit for approval by the Commission duly authorized and executed agreements with Veolia Water and R.W. Beck, incorporating all conditions imposed by the Commission.

9. Nashua shall be obligated to participate as an operator in the Underground Utility Damage Prevention System (Digsafe) described in RSA 374:48 et seq. and N.H. Code Admin. Rules Puc 800. Nashua shall hire a PWW employee familiar with PWW's facilities.

Finally, although it is neither a condition nor otherwise a direct component of our decision on the merits of this case, we note that RSA 38:9, IV provides:

The expense to the commission for the investigation of the matters covered by the petition, including the amounts expended for experts, accountants, or other assistance, and salaries and expenses of all employees of the commission for the time actually devoted to the investigation, but not including any part of the salaries of the commissioners, shall be paid by the parties involved in the manner fixed by the commission.¹⁵

In our judgment, it is not appropriate to determine the manner in which the Commission's costs will be allocated among the parties until the merits of the case are finally concluded and it has been determined whether the taking will actually proceed. At the appropriate time, we will give the parties an opportunity to be heard on this issue.

¹⁵ The expenses of the investigation attributable to Commission Staff's participation in the proceeding, as of June 30, 2008, total approximately \$120,000.00.

Few proceedings conducted before the Commission over its many decades of existence have been as challenging to the participants as this one has been. The need to conduct wide-ranging discovery, the desirability of allowing the major parties to explore settlement as carefully as possible, the importance of holding extensive hearings for the purpose of developing a complete record, and the appropriateness of allowing the parties a full opportunity to make their respective cases in writing after the close of hearings all contributed to the length of this proceeding. In our view, the parties and the public can thereby derive confidence that the important matters in this case have been fully and fairly considered.

We are aware that the decision we make today does not end the matter nor necessarily resolve all issues in controversy. Ultimately, the decision of whether to take the utility property at issue in this case is subject to municipal ratification pursuant to RSA 38:13. Accordingly, we conclude this order with an expression of confidence in the City of Nashua's ability to own and operate the PWW system responsibly, as well as our confidence in the current ownership's ability to do so as well.

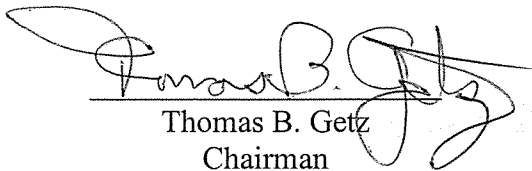
Based upon the foregoing, it is hereby

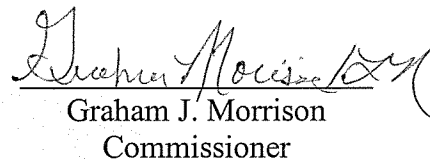
ORDERED, that the taking of the plant and property of Pennichuck Water Works, Inc. lying within or without the municipality of Nashua, New Hampshire, in particular, plant and property as described in Exhibit 3021 and Exhibit 3021A, by the City of Nashua is in the public interest, subject to the conditions set forth herein; and it is


FURTHER ORDERED, that the price to be paid for such plant and property is \$203 million; and it is

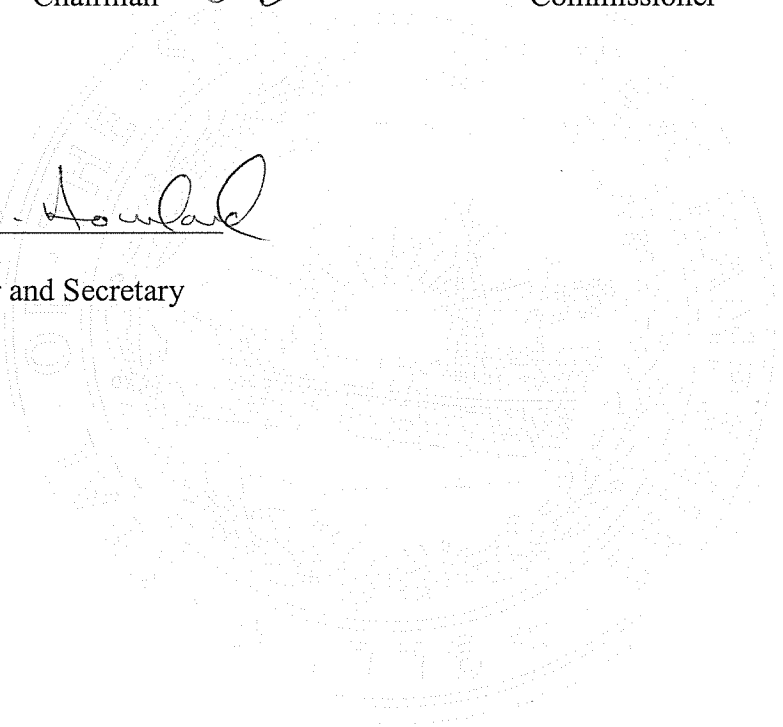
FURTHER ORDERED, that the City of Nashua shall establish a mitigation fund for the benefit of the customers of Pennichuck East Utilities, Inc. and Pittsfield Aqueduct Company as described herein.

By order of the Public Utilities Commission of New Hampshire this twenty-fifth day of July, 2008.


Thomas B. Getz
Chairman


Graham J. Morrison
Commissioner


Debra A. Howland
Executive Director and Secretary



Concurring and Dissenting Opinion of Commissioner Below

I concur with the analysis and decision of the Commission with regard to public interest issues (Section IV) and the conditions of approval, including the establishment of a mitigation fund for the benefit of PEU and PAC customers. However, I respectfully dissent with regard to valuation because I reach a different conclusion based on the record in this case and how I understand the law to apply.

Without question, the most difficult part of this case has been the determination of a fair market value of the assets to be taken, prospective to the date of the taking, which is not known at present. As the New Hampshire Supreme Court has noted, “[i]t has been said that ‘(t)he search for ‘fair market value’ is a snipe hunt carried on at midnight on a moonless landscape.’” *Fusegni v. Portsmouth Housing Authority*, 114 N.H. 207, 211 (1974), (citation omitted). This analogy seems particularly true with investor-owned public water utilities for which there is a limited market with very few and infrequent asset sale transactions of the type and scale being valued here (compared with stock acquisitions or mergers, that are also relatively few in number), and a substantial effect and constraint of value due to government regulation, with regard to not only rates, but also the financing and sale of assets, including limitations on the discontinuance of service and termination of the franchise and obligation to serve. *See* RSA 369:1, 7, and 8 and RSA 374:28, 30, and 33. The New Hampshire Supreme Court has also observed that “[t]he unlikelihood of sale is, after all, the reason why valuation of public utilities is so extraordinarily difficult.” *Southern New Hampshire Water Co. v. Town of Hudson*, 139 N.H. 139, 142, (1994). Certainly this is an area where reasonable people can disagree, even given the same set of the facts.

My dissent concerns four issues. First is the exclusive reliance on the hypothetical possibility of one or more not-for-profit municipal buyers in the determination of earnings and capitalization rates under the income-based approach to valuation. This also affects the determination of value under the asset based approach due to the calculation of economic obsolescence. Second is the choice to exclude most property taxes from the assumed expenses in determining the amount of earnings to be capitalized. This also affects the calculation of economic obsolescence. Third is the exclusion of payroll taxes from the assumed expenses in determining the amount of expenses to be capitalized. The fourth issue concerns the method used in the income-based approach and some minor adjustments to the asset-based approach.

With regard to the first issue, the majority adopts Pennichuck's position that the potential of one or more hypothetical not-for-profit or municipal buyers in a fair market-based negotiation will be entirely determinative of the value under the income-based approach, both with regard to the assumptions about the expenses and earnings or net cash flow available for capitalization and with regard to the capitalization rate. While I conclude that the potential of a municipal buyer in such a transaction will more likely than not be a factor and influence the value, I cannot agree that it will be entirely determinative.

Strong evidence in support of my conclusion comes from the testimony of Pennichuck's own valuation expert, Mr. Reilly, who was the lead proponent in this case for using the municipal, rather than for-profit capitalization rates, expenses, and earnings in the income based approach. In response to a question as to whether there would be a different price effect "if the universe of potential willing buyers only included one possible nonprofit entity" instead of multiple non-profit bidders, 9/12/07 Tr. at 205, Mr. Reilly answered:

It may. That hypothetical is the hardest question to answer. ... If you assume one, there's uncertainty, and it really becomes a bidding contest – it becomes more of

an issue of psychology than economics, will the for profits assume the not for profits are going to put all the chips on the table at one time and they'll have to bid up against the not for profit.

We've seen cases where that happens, where just having one not for profit can increase the bidding, but we've also seen cases where that didn't happen, where the not for profit was perhaps astute enough or well advised enough to say everyone around here other than me is a for profit corporation, they will have a higher cost of financing, they will pay income taxes, they're going to bid down here, I just need to be one dollar above them.

Id. at 206. Then, when asked how many situations he had seen involving multiple not-for-profit or governmental bidders, Mr. Reilly responded: "It has occurred. I would say that's the minority of cases. When there's a municipality involved, typically there's one municipality, and typically it's a friendly negotiation." *Id.* at 211.

This testimony illustrates for me what is the crux of the matter: whether the market for this type of investor-owned water utility typically or likely consists of multiple municipal buyers that are more likely than not to drive the price up to the maximum that they would be willing to pay for a given rate and earnings level based on their lower expenses and cost of capital, or whether typically there is only one or no serious municipal buyers in the market such that their influence on price is more limited or even non-existent. In such a case, the market-price is more likely to be primarily determined by the projected operating expenses, earnings, and cost of capital of a for-profit entity or investor and their markets economics. PWW and the Commission adopt the view that fair market value will be set by one or more hypothetical municipal buyers, apparently regardless of whether such hypothetical buyers are typical of potential or likely buyers. In my judgment, this essentially makes the fair-market value the same as the full "investment value" to a municipal buyer, which is not necessarily typical of the market. Carried to its logical extreme, use of a hypothetical municipal or not-for-profit buyer to determine value under the income approach whenever such entity might be a legally permissible buyer, even if

not plausible, likely or typical, could result in substantially increased (roughly doubled) valuations for large numbers and types of income producing properties.

The Appraisal of Real Estate defines investment value as “[t]he specific value of a property to a particular investor or class of investors based on individual investment requirements; distinguished from market value, which is impersonal and detached.” *The Appraisal of Real Estate* at 26. The treatise goes on to note that fair market value can, at times, be the same as investment value “[i]f the investor’s requirements are typical of the market.” *Id.* (emphasis added). In chapter 20, “The Income Capitalization Approach,” the treatise elaborates: “To develop an opinion of market value with the income capitalization approach, the appraiser must be certain that all [of] the data and forecasts used are market-oriented and reflect the motivations of a typical investor who would be willing to purchase the property at the time of the appraisal. A particular investor may be willing to pay a price different from market value, if necessary, to acquire a property that satisfies other investment objectives unique to that investor.” *Id.* at 476 (emphasis added). However, as Mr. Reilly’s own testimony indicates, the market for PWW’s type of property does not typically consist of multiple municipal buyers and even when there is one potential municipal buyer, such hypothetical buyer need only offer one dollar more than what a for-profit investor would economically be willing to pay in order to set the market price.

Potential municipal buyers are not conventional investors and the majority’s income approach sets the value to PWW based on a calculation of what a municipal entity can theoretically afford to pay, even though such a price would likely mean that such a municipality would forgo any potential savings in water rates from what they would otherwise be. I do not agree that this is the market value of PWW, nor that it is the transferable or transmissible value

that a municipality could realize should it, in turn, opt to sell the system back into the market place where potential buyers would likely be for profit investors.

Other jurisdictions have grappled with this same concern. In *Onondaga County Water Auth. v. New York Water Service. Corp.*, 139 N.Y.S.2d 755 (N.Y. App. Div. 1955), the Appellate Division of the New York Supreme Court noted that “the capitalization of earnings method is a proper consideration in arriving at the value of a regulated public utility” but held that an appraisal commissioners’ award was based on an erroneous theory of valuation according to the price condemnor could afford to pay the property, rather than the value to the condemnee. *Id.* at 767-78. By basing earnings on a tax exempt bond issue the Court held that “this approach in effect capitalizes and confers upon the company the enormous advantage of tax-free operation.” *Id.* at 764. Citing *Monongahela Navigation Co. v. United States*, 148 U.S. 312 (1893) and a series of other cases, the New York Court noted that, “[r]egardless of the principle of valuation adopted, all of the cases agree that ‘the question of just compensation is not determined by the value to the government which takes, but the value to the individual from whom the property is taken’.” In *Monongahela*, the U.S. Supreme Court also found the “[t]he value of property, generally speaking, is determined by its productiveness, -the profits which its use brings to the owner.” *Id.* at 328.

In *Gray Line Bus Co. v. Greater Bridgeport Transit Dist.*, 449 A.2d 1036, 1982 (Ct. 1982), the Supreme Court of Connecticut, while recognizing that a condemning authority “must compensate a public utility company for the ‘going concern value’ of the enterprise,” further observed that “a public body in an eminent domain proceeding ought not to be required to pay more for property than would be raised in an ordinary sale between private parties.” *Id.* at 423

(citing Searl v. School District No. 2, 133 U.S. 553, 562, 10 S.Ct. 374, 377, 33 L.Ed.2d 740 (1890); 4 Nichols, Eminent Domain (1981) § 12.1.).

The New Hampshire Supreme Court has observed the price to be paid in a taking “is customarily taken to mean fair market value ... determined after considering the ‘highest and most profitable use for which the property is adaptable and needed or likely to be needed in the reasonably near future ..., not necessarily as the measure of value, but to the full extent that the prospect of demand for such use affects the market value while the property is privately held.’” *Opinion of the Justices*, 131 N.H. 504, 509 (1989) (citations omitted and emphasis added). Use by a hypothetical municipal buyer is, by definition, not for profit and not profitable.

My conclusion that the universe of likely potential buyers is unlikely to include more than one municipal entity is further supported by New Hampshire law, particularly as it has been interpreted and applied by this Commission during an earlier phase of this case in *City of Nashua*, Order 24,425 (Jan. 21, 2005) , 90 NH PUC 15. RSA 38 is the grant of authority for municipalities to acquire water systems, whether by purchase or taking. In Order No. 24,425, the Commission concluded that “the eminent domain authority delegated by the Legislature in RSA 38:2 should be narrowly construed and that the notice requirement in RSA 38:6 should be given full effect.” *Id.* at 23. That notice requirement states that a municipality “may purchase all or such portion of the utility's plant and property located within such municipality that the governing body determines to be necessary for the municipal utility service, and shall purchase that portion, if any, lying without the municipality which the public interest may require, pursuant to RSA 38:11 as determined by the commission.” Thus this Commission concluded that Nashua did not have the authority to try to take any portion of PWW affiliates PAC or PEU as those utilities did not provide any municipal utility service within Nashua. The same

authorizing language in RSA 38 regarding takings also applies to voluntary purchases and acquisitions. While PWW provides some utility service in towns outside of Nashua, the core of the system and some 87 percent of the customers are within Nashua. Thus it seems unlikely, even in a voluntary sale, that the Commission would find that the public interest *requires* a prospective municipal purchaser of such peripheral or detached satellite systems to also purchase a much larger (by roughly a factor of ten or more in this instance) core of the system in another municipality.

Pennichuck argued that a regional water district, a form of non-profit municipal entity under New Hampshire law, is another permissible buyer that might compete in a market-based sale and tend to drive the price up to the maximum that a non-profit could afford to pay. I find that this is unlikely as RSA 38:2-a, which establishes the authority for regional water districts to purchase or acquire (but not take by eminent domain) as well as maintain and operate water utilities, specifies that such acquisition be for the purpose of manufacturing and distributing “water for the use of municipalities that are members of the regional water district and for such other purposes as may be permitted, authorized, or directed by the commission.” It seems unlikely in a typical voluntary sale that a regional water district would actively compete in a sale against a member municipality.

In the one case where such a voluntary sale has occurred in New Hampshire in recent years, the Tilton and Northfield Water District was created by the two towns as a village district serving residents in both towns pursuant to RSA 52 in order to acquire the investor owned Tilton and Northfield Aqueduct Company, Inc. in a voluntary sale that was approved by this Commission in Order No. 24,562 (December 9, 2005). In that case, the acquisition was clearly

for the use of the members of two municipalities, i.e., Tilton and Northfield, and not a case where multiple municipal bidders were competing and driving up the sale price.

Other evidence that the population of potential buyers may not include any not-for-profit buyers lies in the fact that Pennichuck's financial advisor, SG Barr Devlin, did not identify any municipal or other non-profit entities as potential strategic partners that could acquire or merge with Pennichuck before a proposed merger with Philadelphia Suburban Corporation was announced in 2002. Exh. 1094 at 33, 9/12/07 Tr. at 71.

Nashua argued for the opposite approach to that advocated by Pennichuck: to only utilize the earnings and capitalization rate for a regulated for-profit entity in the income based approach to valuation. In following this approach, Nashua would have us completely ignore the influence of a potential not-for-profit municipal buyer. Not accounting for this influence would be contrary to the conclusion of the New Hampshire Supreme Court that it would be an error to not consider a potential unregulated municipal buyer in determining valuation of a water utility. *See Southern New Hampshire Water Co. v. Town of Hudson*, 139 N.H. 142, 143, (1994). Under Nashua's income approach, the value would essentially be that of rate base or net book value. Exh. 3061 at 16, n.3. While some troubled water systems and small community water systems may sell at or below net book value, it is not unusual for well-operated public utilities, such as PWW, to sell at a premium above rate base, even though this Commission has had a long standing policy disfavoring the recovery of acquisition premiums from ratepayers. *See, e.g., Iberdrola, S.A.*, Order No. 24,812 (Dec. 28, 2007) (concerning indirect acquisition of New Hampshire Gas. Co. through parent company transaction); *National Grid plc*, Order No. 24,777 (July 12, 2007) (concerning indirect acquisition of KeySpan); *EnergyNorth Natural Gas, Inc.*, 85 NH PUC 360, 367-368 (2000); *Aquarion Water Co. of New Hampshire*, Order No. 24,691 (Oct.

31, 2006), 91 NH PUC 509 (concerning indirect transfer of Aquarion to Macquarie Utilities, Inc.); and *Hampton Water Works, Inc.*, Order No. 23,924 (March 1, 2002), 87 NH PUC 104, 109, (2002).

Instead of the choosing between the position adopted by the majority (and advocated by Pennichuck) and that of Nashua, I would give equal weight to the expenses and cost of capital that would be typical for both municipal buyers and regulated for-profit investors. In free market negotiations bargains are usually struck somewhere in the broad middle between the value perceived by the seller and that perceived by the buyer when there is a substantial difference between the two. In such a hypothetical bargain freely negotiated between an investor owned water utility and a single municipal buyer, taking into account all considerations that might fairly be brought forward and given substantial weight in such bargaining, it seems reasonable to conclude that such bargaining might likely result in a price being agreed upon around the mid-point of investment value that each might be able to realize given the expenses, resulting earnings, and the cost of capital likely to be incurred by each going forward. The mechanics of affording municipal and for-profit entities equal weight in the income approach would require calculating PWW's value using the municipal earnings, expenses, and capitalization rate and then calculating the same using the for-profit earnings, expenses, and capitalization rate. Then each determined value would be weighted 50 percent. An approach that averages municipal and for-profit capitalization rates has been identified as an acceptable consideration in at least one other jurisdiction. *See, Washington Suburban Sanitary Commission v. Utilities, Inc. of Maryland*, 775 A.2d 1178, 1201-1202 (2000).

Given the voting requirements under RSA 38 and RSA 33:8 (for approval of the issuance of bonds), which apply even in the case of a voluntary municipal purchase, it seems unlikely that

a super majority of those who vote to approve such a purchase would be willing to forego all potential savings and synergies from municipalization and approve the maximum theoretical price they might be able to justify for the same water rates, especially considering the risk and uncertainty that comes with such a change in ownership and operation. For the investors or stockholders in a for-profit utility, other similar utility investment opportunities exist, and a value that represents a substantial premium or capital gain over the ongoing return on regulated rate base would seem difficult to refuse, even if it falls short of the maximum amount that a municipal buyer might hypothetically be able to pay. Thus, between a willing buyer and a willing seller, a bargain seems more likely than not to be struck towards the mid-point in values.

Likewise, if the potential buyers were only for-profit entities, it seems unlikely that the existing owner would be willing to undertake the substantial transaction costs and risks of a sale without some significant acquisition premium above and beyond the book value and ongoing investment value to the present owner of the assets. As noted above, acquisition premiums for a well-run and sizable utility such as PWW are not that unusual, notwithstanding their exclusion from rate base. Therefore I find that an even weight to the likely earnings and capitalization rates of both for-profit and non-profit potential buyers is a more likely indicator of fair-market value than giving either possibility exclusive weight and the other no weight in the income approach to valuation.

The second point that I dissent from the majority on is their exclusion of property taxes from the assumed expenses of the hypothetical non-profit municipal buyer. Pennichuck argues, and the Commission agrees, that RSA 72:11 only requires municipal water systems to make payments in lieu of taxes on water utility land owned in other towns, so most property taxes (such as those on buildings and improvements) can be excluded from the assumed operating

expenses of the municipal buyer, thus increasing the projected earnings to be capitalized.

Nashua testified that they placed no value on the legal possibility of a municipal system being able to avoid paying most property taxes and that they intend to make payments in lieu of taxes for the water system. 1/11/07 Tr. at 89. An observation of the New Hampshire Supreme Court in *Southern New Hampshire Water Co.* quoting from the trial court's opinion, sheds some light on this issue:

[S]ince taxes are a legitimate operating expense, the utilities are allowed to include them in rate base, and thus simply pass along any tax increases to ratepayers in the form of higher utility bills. On the other hand, in those instances where the utility is fortunate enough to win a battle and reduce its tax payments, the town's other taxpayers must make up the difference. When one considers that ... ratepayers and taxpayers are likely to be one and the same persons, it becomes obvious that the only real winners in this game are the lawyers and expert witnesses, who collect their fees regardless of the outcome. To avoid this needless waste of time and money, I join with the [Board of Tax and Land Appeals] in urging the legislature to consider the adoption of a uniform method of utility valuation for ad valorem tax purposes.

Although we understand that ratepayers and taxpayers are not inevitably "one and the same," we find the trial court's point well taken.

Southern New Hampshire Water Co., 139 N.H. at 144-45 (citations omitted).

Although the context of this observation is the valuation of water utility property for *ad valorem* property tax purposes, there is a similarity with the question at hand: whether the legislative body and elected leaders of a municipality would place and pay for a value on the ability of a municipally owned water utility to avoid payment of property taxes. Unlike most other taxes, municipal, school district, and county property tax rates are set annually based on the revenue needs and the grand list of taxable property of the taxing district. Thus a reduction in the amount of taxable property on the tax roll, all other things being equal, directly results in a proportional increase in the property tax rate and consequentially a dollar-for-dollar increase in property taxes paid from the remaining property taxpayers. While the population of property

taxpayers in towns where PWW pays property taxes is not exactly the same as the universe of ratepayers on the system nor the same as those who might vote to approve a purchase and issuance of revenue bonds, there is likely a strong connection between the three, with most, if not all, such voters being taxpayers and/or ratepayers as well (and/or elected by such).

It is difficult to imagine that a super majority of such voters would be so naïve as to place a value on paying property taxes out of the left pocket rather than the right one, even if there is some difficult to discern difference in how much change remains in some people's pockets compared to others, knowing that the overall sum shifting from right pockets to left pockets within the overall district is about the same. This is not a value that is in anyway transmissible with the property to an investor-owned buyer, nor is this a small number.¹⁶ Thus, taking into account all considerations that might fairly be brought forward and given substantial weight in a voluntary negotiation of sale price, and the likely motivations of such a buyer, I find that it is extremely unlikely that the elected leaders and a super majority of those persons who would be required to vote to ratify a purchase and issue revenue bonds to pay for it would place any significant value on the ability to reduce property taxes paid through their water bills only to have to make up for that savings through an approximately equal increase in overall property taxes on the community. This being the case, I do not agree that it is appropriate for Mr. Reilly and the majority to remove property taxes from expenses in their hypothetical. Federal and state income taxes are different, as the tax rate is fixed and it is truly an expense that a municipal

¹⁶ The difference in assumed property tax expense in Mr. Guastella's projection of operating expenses under PWW ownership versus municipal ownership for 2009 is just over \$2 million per year. Exh. 3016X, at 3 and 4. Dividing this assumed increased net income or cash flow by the assumed municipal capitalization rate of 5 percent yields an increase in market value of \$40 million.

buyer can avoid without discernable consequence, so I do deduct those from the projected expenses under municipal ownership.¹⁷

The third issue on which I dissent is the exclusion of payroll taxes from the Commission's projection of expenses that a municipal buyer would incur. The Commission mimics Mr. Reilly's calculation in this matter, which is clearly erroneous in my judgment. In his calculation of earnings to be capitalized, Mr. Reilly added back in PWW's projected "Non-Income Taxes," which consists of property taxes and payroll taxes, but excluded from that add back "taxes assessed on land," elsewhere termed payments in lieu of taxes, or PILOT. Exh. 3021X, at 19, n. (a). I suspect that this is a simple error that the Commission decision adopts by default. Nowhere in the record does Mr. Reilly, Pennichuck, or anyone else suggest that a hypothetical municipal owner will not incur payroll tax expense, whether directly through employees to operate the system or indirectly through contracted services. On the contrary, Pennichuck's revenue and expense expert, Mr. Guastella, provided testimony that a municipal owner would properly be projected to incur payroll taxes. Exh. 3016X, at 3 and 4. Mr. Guastella projected payroll tax expense under municipal ownership for 2008 and 2009 and subsequent years. *Id* at 4. In my judgment excluding this expense from the projected expenses of a hypothetical municipal buyer improperly inflates the valuation for such a buyer by an amount on the order of \$9 million.¹⁸

The fourth issue on which I dissent is the method for the income approach to valuation, and consequently to an aspect of the calculation of economic obsolescence or depreciation in the

¹⁷ It is interesting to note, however, that to the extent that a hypothetical municipality were to choose to have a private for-profit entity operate and maintain the system under contract, as Nashua has proposed to do in this case, some amount of income taxes on the vendor's profit margin for goods and services provided could reasonably be expected to be passed through in the contract price and rates.

¹⁸ Using an assumed ongoing excluded present value expense or increase in earnings to be capitalized of roughly \$450,000 per year divided by the municipal capitalization rate of 5% equals \$9 million in value.

asset-based approach. I concur with the majority finding that the record on the sales comparison approach simply does not indicate sufficient reliable, comparable, and timely sales data to make a meaningful valuation determination based on other sales. I also concur with the finding of the majority that Mr. Reilly's expense and earnings calculation, based on financial statements projected by Pennichuck for Moody's, Exh. 3021X at 18, is, overall, the more reliable of the two income-based valuation analyses, with the three exceptions on which I dissent noted above and with the exceptions noted by the majority, in particular with regard to their rejection of reduction of the capitalization rate by the 2 percent "growth rate" asserted by Mr. Reilly.

The valuations in this case were originally made as of December 31, 2004, with some subsequent limited updates. Pennichuck used a discounted cash flow (DCF) method while Nashua used a yield capitalization method. Both methods attempted, to some degree, to adjust lumpy projected future cash flows into a present value. For the period from 2005 through 2009 PWW was projected to have, and has in fact experienced, rather uneven or lumpy growth in revenue, expenses, rate base, earnings, and cash flow. This is due in large part to major investments in its water treatment plant and certain other facilities resulting in a near doubling of net plant in service (or rate base) over this period and a number of actual and projected rate increases, including step increases and related regulatory lags. These irregular investments were projected to be substantially complete by the end of this year. Exh. 3016A at 5. A close examination of the PWW "Projected Capital Budget, Calendar Years 2005-2009 with 2004 Actuals" reveals that the capital expenditures projected for 2009 represent a normalized capital expenditure program. Exh. 1075X. at 2. Also, a series of rate increases to recover the lumpy additional investments through 2008 were projected to be complete and in place at the start of February, 2009. Exh. 3016 at 3 and Exh. 3010 at 9.

With a minor adjustment, including the income tax effect, to bring the projected rate increase back to the start of January, the projected revenue for all of 2009, as well as ongoing expenses and capital expenditures, can be considered to be a normalized or good approximation of the net present value of projected steady state earnings and cash flow going forward, a solid basis for a direct capitalization of income. The nature of a regulated water utility, as well a self-regulated municipal system, particularly considering the constraints of RSA 38:28-29, is that significant increases or decreases in expenses and capital expenditures usually flow through as a proportional adjustment in rates that maintain approximately the same overall net earnings or cash flow relative to the amount of invested capital. Thus a single normalized prospective year from the date of valuation is a reasonable basis for direct capitalized valuation, even if actual results, due to changes in expenses or capital expenditures, prove to be significantly different.

Pennichuck in their DCF income valuation started with earnings before interest and taxes (EBIT) (the taxes being income taxes) and added back depreciation and amortization, but deducted capital expenditures and required increases in working capital to figure net cash flow to be capitalized. This was done for projected calendar fiscal years 2006-2009 plus a normalized or terminal 2010 year (representing the assumed future cash flow for future years), which was the average of 2006-2009. The 2006-2009 discrete projections were then discounted to present values as of the end of 2005 and added to the capitalized value of the 2010 normalized net cash flow. The majority follows this approach, with their own adjustments including the capitalization rate, to determine a value as of December 31, 2005 and then brings that value forward to December 31, 2008, using an inverse of the discount rate.

Instead, I would simply do a direct capitalization of a normalized calendar year 2009 net cash flow as representative of the expected normalized net cash flow going forward, which also

fully accounts for the projected additional capital investments through the end of this year. This approach is supported by Reilly's text on "Business Valuation Approaches and Methods," entered as Exhibit 1081, where he describes on page 210; "some generalizations about the relative attractiveness of the two basic income approach valuation methods:"

1. *Stable or evenly growing economic income flow.* If the economic income flow is either stable or growing (or declining) at a fairly even rate, the [direct] capitalized economic income method should conclude as accurate a value indication as the discounted economic income method.
2. *Predictable but uneven changes.* If there are reasons to believe that changes will be significant but predictable, even though uneven, the discounted economic income model should produce a more accurate valuation.

The evidence in this case indicates that the latter was projected to be the case from 2005 through 2008, while the former is expected to be the case going forward from the end of this year. Guastella's Revenue Requirement Analysis, Exh. 3016X at Sch. B, clearly confirms this.

Thus to determine the present value of net cash flow to be capitalized, I would simply use the normalized net cash flow for calendar year 2009, the 12 months immediately following the date of valuation,¹⁹ which is December 31, 2008, with a minor tax-adjusted assumed increase in revenue for the rate increase projected for February 1, 2009 to bring the projected rate increase back to January 1, 2009, eliminating an assumed one-time regulatory lag. For both the municipal and for-profit buyer I assume full property tax payments, but deduct state and federal income taxes from a municipal buyer's expenses, yielding net cash flow of about \$7.7 million for the for-profit buyer and \$10.3 million for the municipal buyer. For the capitalization rate I use the same weighted average cost of capital (WACC) for the municipal buyer as Pennichuck and the majority, namely 5.0 percent, which, though Nashua questioned it, is also supported by Nashua's

¹⁹ This is the time period indicated in *The Appraisal of Real Estate* at 493: "Direct capitalization, on the other hand, requires a one-year cash flow estimate (date of valuation plus next 12 months) to use for application of an overall [capitalization] rate to estimate value."

own expert witness and financial advisor to the City, Steven A. Adams of First Southwest Company, who stated in his pre-filed testimony that in modeling municipal bonds for the proposed acquisition, his company used a 5.0 percent interest rate for the cost capital. Exh. 1004 at 9. For the for-profit capitalization rate I would use the WACC last approved by this Commission for PWW, namely 7.9 percent, per Order No. 24,751 (May 25, 2007). This results in an indicated value under the income approach of \$97.6 million to a for-profit buyer and \$206 million to a municipal buyer. Using the confluence or mid-point of these two values as the best approximation of the price that would be arrived at by fair negotiations between a willing owner and typical willing potential buyers, which more likely than not will include no more than one potential municipal buyer, results in an overall indicated market value of about \$151.8 million for the income-based component.

Turning to the asset based approach to value, I don't dissent from the analysis of the majority in method or in most other aspects, except that for purposes of calculating economic obsolescence, I would use the average of a municipal and for-profit buyer's WACC (for both the capitalization rate and the required rate of return) and their net operating income (which is EBIT in the case of a municipal buyer and EBIT less income taxes in the case of a for-profit buyer) instead of just EBIT. I would also observe that a close examination of Mr. Reilly's Exhibit 3007A, at 14, in which he calculates economic obsolescence or depreciation, also called capitalized economic shortfall or capitalized excess earnings, for his asset based approach to valuation, reveals that this approach can be considered to be just another income approach to valuation using a slightly different measure of earnings or cash flow to be capitalized.

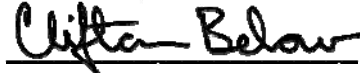
To be clear, though much ado was made in this case over the importance and weight to be given to an asset-based approach to value, in the end, using Reilly's method for calculating

economic obsolescence, it doesn't really matter what particular value, if any, is given to water pumping rights, or land,²⁰ or any other particular asset item. This is because whatever the asset values are, they are multiplied by the assumed required rate of return (which is the same in this case as the WACC) to calculate the required economic income which is then totaled and compared with the present value of projected EBIT (as a measure of economic income). The difference in this case is termed income shortfall, that is then capitalized by dividing it by the capitalization rate resulting in the capitalized income shortfall (which, though a large negative number in this case, is also called "intangible value in the nature of goodwill") that is in turn subtracted from the nominal sum of assets values as economic obsolescence or economic depreciation to determine valuation under this asset approach.

Following this same approach to asset valuation as Pennichuck and the majority, but with the modified measures of earnings, required rate of return and capitalization rate described above, I calculate an indicated value of \$150.4 million. Using either a 60 percent weight to the asset based approach and 40 percent weight to the income based approach, or equal weight to each, the result is an overall indicated fair market value of \$151 million (rounded) for the assets of PWW to be taken. With the addition of \$40 million for a mitigation fund, as discussed by the majority, for impacts to PEU and PAC customers (which is like a negative acquisition premium for removal of synergies, economies of scale and severance of service agreements) that the public interest requires as a condition of our approval of this taking, the total amount that I would

²⁰ In reviewing Pennichuck's valuation of land prepared by Mr. Thibeault, I had some concern that in valuing PWW land and easements, all presently used in support of providing water service, that he did not take into account the effect of government regulation as the *Opinion of the Justices*, 131 N.H. 504 (1989), suggests would be appropriate. For instance, he valued a parcel on which is located a water storage tank, presumably necessary for the water system, as having a highest and best use as a residential parcel, thought is seems very unlikely that it could be permissibly be put to that use on the day it was taken or in the reasonably near future. However, for practical purposes in this case that doesn't really matter since the asset based valuation is the same in the end, due to the way in which economic obsolescence is calculated, regardless of the particular value placed on land under the methodology advocated by Pennichuck and adopted by the majority and myself for purposes of the asset based component of valuation.

require Nashua to pay for the taking of PWW is \$191 million as of the end of 2008 or early 2009.

A handwritten signature in black ink, reading "Clifton Below", written over a horizontal line.

Clifton C. Below
Commissioner