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STATE OF NEW HAMPSHIRE
BEFORE THE
PUBLIC UTILITIES COMMISSION

City Of Nashua: Petition For Valuation Pursuant To RSA 38:9

Docket No. DW04-048

REPLY TESTIMONY OF GEORGE E. SANSOUCY AND GLENN C. WALKER

Q. Please state your names, business addresses and positions.

A. My name is George E. Sansoucy, P.E. My business address is 279 Main Street, Lancaster, New Hampshire 03584. I am a consultant and my firm George E. Sansoucy, P.E., LLC has been engaged by the City of Nashua (hereinafter "Nashua" or "City") to advise it on matters concerning the City's proceeding to acquire the water utility assets of Pennichuck Water Works, Inc. ("PWW").

A. My name is Glenn C. Walker. My business address is 32 Nimble Hill Road, Newington, New Hampshire 03801. I am employed by George E. Sansoucy, P.E., LLC as a consultant specializing in the appraisal of special purpose utility and electric generating facilities for governmental agencies and institutional clients throughout the country.

Q. Have you previously submitted testimony in this proceeding?

A. Yes, on January 12, 2006. Mr. Sansoucy also submitted testimony on November 22, 2004.

Q. What is the purpose of your testimony today?

A. The purpose of our testimony is to provide the Commission with a reply testimony relating to the prefiled testimony, reports, and exhibits filed with the Commission by employees and experts for PWW and Staff. We understand that, under the procedural schedule, Nashua's reply testimony to respond to Staff's April 13, 2006 testimony is not due until July 20, 2006. However, we believe that Staff's testimony unfairly criticized Nashua's petition by adopting many of the Company's arguments without conducting or presenting its own, independent analysis. We further believe that Staff misunderstood Nashua's proposal and either ignored or failed to consider the benefits that the establishment of a municipally owned system would bring to the public interest as well as key commitments Nashua made in order to alleviate impacts to the public interest.

Our reply testimony encompasses the fair market value of the PWW system, the public interest, and the expected rate path under Nashua's ownership.

Q. How was your testimony organized?

A. Our testimony includes an introduction in Section I that provides a brief summary of the reply testimony and exhibits being presented to the Commission. In Section II, we provide a critique of the valuation testimony set forth by experts for PWW. In Section III we provide testimony on how the public interest is served by the City's acquisition of the PWW system and critique the rate path set forth by witnesses of PWW.

Section I - Introduction

Q. Please summarize your valuation testimony.

A. The valuation methodology proposed by PWW has two primary erroneous and unsupported assumptions. These include the assumption that the fair market value of the PWW system will be influenced by "not-for-profit public" entities which enjoy synergies and savings not available to the typical buyer. This assumption results in the experts for

PWW estimating the "investment value" to a particular buyer versus the appropriate fair market value as required by law in the State of New Hampshire.

Secondly, the valuation set forth by PWW assumes earnings growth that is inconsistent with both historic levels and reasonable estimates of the future growth that the PWW system is likely to experience. If the experts for PWW had used the appropriate assumptions and estimated fair market value instead of the "investment value," their conclusion would have been equal to or below the estimate of fair market value set forth in our January 12, 2006 testimony.

Q. Please summarize why it is in the public interest for the City to acquire the PWW system.

A. The acquisition of the PWW system by Nashua is the only way that there will be a true regionalization of the Merrimack River valley due to the inability of Pennichuck to work cooperatively with the other municipally owed systems that surround the PWW system. In addition Nashua will be a better steward of the watershed that is a critical source of raw water for both PWW and southern New Hampshire. The allegation by both Pennichuck and Staff that Nashua will not treat the satellites and their customers fairly is inconsistent with the City's position and not supported by any objective evidence. Finally, Nashua will provide equal or better service at a lower the cost through operating efficiencies and lower capital requirements. The City' lower cost of operation will produce lower rates for the customers receiving service from PWW than could be expected under continued PWW ownership.

Section II - Overview of Valuation Issues

Q. What valuation issues do you address in your reply testimony?

A. We are providing testimony on those valuation issues that result in the greatest impact to the value estimates set forth by the experts for PWW and included the adoption of erroneous or unsupported assumptions and result in inflated values and flawed conclusions. These issues are summarized as follows:

- The experts for PWW made an unsupported and erroneous assumption in developing its value of the PWW system by hypothesizing the artificial influence on fair market value of "not-for-profit public entities" in the population of hypothetical buyers. This assumption results in an estimate of value which is overstated and reflects "investment value" of the system to a particular buyer or group of buyers and not the fair market value estimate required by the law in the State of New Hampshire.
- The experts for PWW erroneously inflated the value of the PWW system by assuming that the earnings growth rate would be the same as the growth in customers. This assumption is both unsupported by any evidence and inconsistent with past earnings growth.
- The experts for PWW have erroneously calculated economic obsolescence and inflated the value of the PWW system by using an unsupported capitalization rate which is developed by using the influence of a "not-for-profit public" entity and an erroneous and unsupported growth rate.
- The experts for PWW erroneously employed a discount rate that concludes to "investment value" versus fair market value as required by the law in the State of New Hampshire.

- The experts for PWW used the wrong assumptions in replacing the system by assuming a "brownfield" construction approach which artificially inflates the cost new of the PWW system.
- The experts for PWW failed to recognize bonafide offers to purchase the PWW assets shortly before the valuation date and other transactions in the marketplace.

Q. What is the result of theses erroneous and unsupported assumptions made by the experts for PWW?

A. The result of these erroneous and unsupported assumptions resulting in an estimate of value that exceeds fair market value by approximately $160 million, which is demonstrated in our exhibits attached to this testimony.

Q. The first issue you mentioned is the erroneous and unsupported use by the experts for PWW of the influence that a group of "not-for-profit public" entities have on the value of the system. Explain what you mean by this?

A. Generally speaking, when one develops an estimate of fair market value, which is the appropriate value estimate for this proceeding, the appraiser analyzes the realm of possible buyers in the marketplace and the estimated price these buyers would pay for the property. Naturally, within the universe of potential buyers each will have different synergies with the subject property that result in a buyer or group of buyers being able to pay more than the typical buyer or a buyer that does not have these synergies. The ability of this buyer or group of potential buyers to pay more for the subject property is not a function of the assets being acquired, but the synergies that they possess with respect to those assets. The resulting price that the buyer(s) could pay is not fair market value, but is instead "investment value" to the purchaser(s) as the premium or discount paid is not transferable with the property to another buyer that does not share these synergies.

By assuming the synergies of a "not-for-profit public" entity that include a lower cost of capital and ability to avoid certain income and property taxes, the experts for PWW have developed an "investment value" that uses the synergistic features of these "not-for-profit public" entities to artificially inflate the value of the PWW system. The result is an estimate of "investment value" and not fair market value as the premium is not available to all buyers, but only a select handful of buyers who cannot transfer these synergies to another buyer.

The experts for PWW provide no support or evidence that the buyer will be a "not-for-profit public" entity or that such an entity would influence the fair market value of the PWW system. The only evidence given to support the claim that the "not-for-profit public" entity would influence price is a reference to the American Water Works Association website indicating the historic ownership of water systems. This website provides no evidence relative to how "not-for-profit public" entities buy and sell water systems or that when these entities do so, pay any more than for profit purchasers.

In addition, the assumption by the experts for PWW that the population of hypothetical buyers would include "not-for-profit public" entities is contrary to the potential purchasers identified by Pennichuck Corporation's ("Pennichuck") financial advisor, SG Barr Devlin ("SGBD") which was retained to provide strategic options to sell the company and seek purchasers for Pennichuck of which the PWW system represents the largest asset group. In presenting its recommendations to Pennichuck, SGBD identified groups and individual purchasers that could acquire the PWW assets. A summary of the entities identified by SGBD is found in GES Exhibit 11. None of the acquiring entities identified by SGBD are "not-for-profit public" entities. SGBD did, however, identify that Pennichuck could acquire entities considered to be "not-for-profit public" entities.

Presumably, SGBD did not identify any "not-for-profit public" entities as it either believed these entities were not "typical" purchasers or that their participation in the acquisition would have no influence on prices in the marketplace. Surely, if SGBD considered these "not-for-profit public" entities to be the typical buyers, or likely buyers that would influence the price, they would have identified them to Pennichuck.

Q. You mentioned SGBD was retained to seek purchasers for Pennichuck. Did any entities offer to purchase Pennichuck and the PWW system?

A. Yes

Q. Where any of these entities "not-for-profit public" entities?

A. No

Q. Can you explain the offers that were made for the purchase of Pennichuck?

A. Yes. In January 2002, SGBD issued a Confidential Offering Memorandum to qualified bidders for the purchase of Pennichuck which solicited non-binding indications of interest, and depending on the interest Pennichuck received, it would invite a select group of interested parties to participate in due diligence and submit binding proposals.

On February 22, 2002, four non-binding offers were made to SGBD for the purchase of Pennichuck. The offers ranged from (CONFIDENTIAL) million for the purchase of Pennichuck and are summarized in GES Exhibit 12. None of these entities was a "not-for-profit public" entity.

In the middle of April 2002, four binding offers from three for-profit entities were received for the purchase of Pennichuck and ranged from (CONFIDENTIAL) and are summarized in GES Exhibit 12 Philadelphia Suburban Corp. ("PSC") was the high bidder at $106 million.

Q. Did Pennichuck pursue a sale to PSC?

A. Yes.

Q. In your opinion, why did Pennichuck select the PSC offer?

A. The PSC offer represented a price greater than the other offers.

Q. Assuming that a "not-for-profit public" entity had wanted to purchase Pennichuck during this process, what would it have had to do to be the successful bidder?

A. The "not-for-profit public" entity would have had to make an offer that was more attractive than that made by PSC.

Q. Does this mean that it would have had to pay what it could afford to pay?

A. No, just enough to out bid the next highest bidder?

Q. Does the National Association of Water Companies offer a publication on their website entitled "Valuing a Water Utility" by David L. Hayward?

A. Yes. This publication provides guidelines for the valuation of water systems?

Q. Does this book address "not-for-profit public" entities and the influence they may have on fair market value?

A. The book does not suggest that "not-for-profit public" entities will influence fair market value when they participate in the purchase of a water system.

Q. Does this publication support your opinion that fair market value is not influenced by the existence of "not-for-profit public" entities in the marketplace?

A. Yes.

Q. Have you ever represented "not-for-profit public" entities in the purchase of assets?

A. Yes

Q. Do these entities typically pay what they can afford to pay, or fair market value?

A. In our experience, "not-for-profit public" entities approach the purchase of assets, like the PWW system, from the perspective of paying fair market value based upon prices in the market and not the value based upon what they could afford to pay. For example, our firm was recently retained to prepare a valuation of a fossil fuel generation facility by a municipal client in preparation of a bid to purchase. The group indicated that in developing our income capitalization approach we were to use a for-profit entity's cost of capital as it did not want to influence the price that it paid for this asset.

Q. How do these offers to purchase all of Pennichuck compare to the value estimate used by its experts in this proceeding for the PWW system?

A. The value estimate used by the experts for PWW for the PWW system is approximately 2.5 times the highest binding bid received for all of Pennichuck.

Q. Has there been a significant change in the assets of the PWW system that would justify this difference?

A. No

Q. Has there been a significant change in the cash flow of the PWW system that would justify this difference?

A. No

Q. Are these offers to purchase similar to your estimate of value for the PWW system?

A. Yes. Our estimate of value for the system is $85 million and is consistent with the binding offers to purchase Pennichuck that range from $86 to $106 million.

Q. Can you explain why the experts for Pennichuck in this proceeding have a value estimate that is 2.5 times the range of offers to purchase the whole company?

A. Yes. The value presented by the experts for PWW uses the wrong standard of value which is “investment value” as influenced by its assumption that the hypothetical buyer’s ability to pay will translate into value. By assuming that ability to pay equals fair market value, the experts for PWW have overestimated the fair market value of the PWW system, which is reflected by the binding offers to purchase all of Pennichuck, and estimated the value of the PWW system as influenced or enhanced by the synergies available to only “not-for-profit public” entities.

Q. The second issue you identify is the growth rate assumed by the experts for PWW. Could you explain why this growth rate is flawed?

A. Yes. The experts for PWW assume a growth rate of 2% in both the asset accumulation and income capitalization approaches to value. This growth rate appears to be based on customer growth and not earning or cash flow growth which is necessary for the adjustment of a capitalization rate. In fact, a review of documents in the data room revealed that there were no meaningful support for the estimates of earnings or cash flow growth provided to any of the experts for PWW. GES Exhibit 13.

In fact, a presentation to Pennichuck by SGBD identified that (CONFIDENTIAL) GES Exhibit 14. This statement is consistent with our analysis that demonstrates no earnings growth in the PWW system, absent capital additions.

Q. Can you give us an example of why customer growth is not earnings growth?

A. The PWW system experienced a 7.83% increase in customers between year end 1999 and year end 2004. However, net operating income declined by 10.09% demonstrating that there is little correlation between customer growth and earnings growth. These calculations are shown in GES Exhibit 15.

Q. How do regulated utilities such as PWW typically experience earnings growth?

A. Regulated utilities such as PWW typically experience growth in earnings through capital expenditures and rate increases allowed by regulator agencies to account for these capital additions.

Q. What would happen if the earnings of PWW were increased at 2% per year, absent additional capital expenditures?

A. If the earnings of PWW were increased at 2% without capital expenditures, it would soon be over-earning on its allowed rate of return and the rates would be adjusted to account for this excess earning.

Q. The third issue you identify in your testimony is the erroneous calculation of economic obsolescence by the experts for PWW. Could you explain what you mean by this?

A. The experts for PWW calculate the economic obsolescence based on an erroneous rate of return for the assets and an erroneous and unsupported growth rate for earnings which result in an inflated value estimate in the asset accumulation approach. The experts for PWW assume that the buyer paying fair market value will have a 5% cost of capital based on the synergies of a "not-for-profit public" entity. As discussed previously, this is an erroneous and unsupported assumption that results in an "investment value" versus the required fair market value.

Q. What is the impact on the asset accumulation approach offered by the experts for PWW if you use the required rate of return for a typical buyer?

A. The percentage of economic obsolescence would increase from 47% to 68% and result in a value estimate of $160 million.

Q. Can you explain how you arrived at these figures?

A. Yes. Exhibits 14 through 17 of the Report prepared by Willamette Management Associates' ("Willamette") entitled *Valuation of the Pennichuck Water Works, Inc. Operating Assets as of December 31, 2004* set forth the calculation of economic obsolescence. These Exhibits have been revised to reflect the appropriate rate of return for a typical buyer of the PWW system using the rate of return sought by PWW in Docket No. DW04-056 of 8.68%. These revised exhibits are included in this testimony as GES Exhibit 16.

Q. Did you also adjust the figures for the erroneous and unsupported growth rate?

A. Yes. In addition to correcting for the inappropriate rate of return, an adjustment was also made for the unsupported 2% growth rate assumed by the experts for PWW. This resulted in economic obsolescence of 83% and a concluded value of $89 million.

Q. Did you provide the calculation used to arrive at the 83% economic obsolescence and $89 million figure?

A. Yes. The calculations used to arrive at these figures are included at GES Exhibit 17.

Q. Does the income approach used by the experts for PWW suffer from the same erroneous and unsupported assumptions with respect to the rate of return and expected growth rates?

A. Yes.

Q. Can you explain the result of corrections just for the appropriate rate of return?

A. The income approach developed by the experts for PWW would change from approximately $240 million to $90 million using the rate of return sought by PWW in Docket No. 04-056. The calculations used in arriving at the $90 million are included as GES Exhibit 18, which is a revised version of Exhibit 21 in the Willamette Report.

Q. Can you explain the result of correcting for both the rate of return and growth rate?

A. Corrections for both the rate of return and growth rate result in a $68 million estimate using the income approach. This calculation is found in GES Exhibit 19.

Q. What method, or methods, of value did the experts for PWW conclude provide the best estimate of value for the PWW system?

A. In developing its final value estimate, or “correlation” of value, the Willamette Report weights the asset accumulation approach 60% and the income approach 40%.

Q. Using the same weighting, what would be the estimated fair market value of the PWW system using the 8.68% rate of return and appropriate growth rate?

A. The fair market value would be $81 million as of December 31, 2004. This calculation is shown in GES Exhibit 20.

Q. How does this figure compare to your estimate of value?

A. Our estimate of value was $85 million which is approximately 5% higher than the fair market value estimate using the correct assumptions with respect to rate of return and growth of earnings.

Q. How does this $81 million relate to the binding offers to purchase all of Pennichuck?

A. The $81 million estimate of fair market value for the PWW system is consistent with the binding offers to purchase all of Pennichuck that ranged from $86 to $106 million less than two years before the date of value.

Q. Do you agree with all of the adjustments that were made to the cash flows in the Willamette Report used in the asset accumulation and income capitalization approaches?

A. No. We disagree with the removal of ad valorem property taxes from the operation expenses resulting in higher Earnings Before Interest and Taxes (EBIT) and cash flows. These higher cash flows then translate into lower economic obsolescence in the asset accumulation method and a higher value in the income capitalization approach.

Q. What would be the result of correcting for the assumption that a purchaser of the PWW system would avoid certain property taxes?

A. The adjustments would result in a value estimate of $71 million and $46 million in the asset accumulation and income capitalization approaches, respectively, and a reconciled value of $61 million for the PWW system. These calculations are found in GES Exhibits 21 and 22.

Q. Are there other areas of valuation in which you disagree with the experts for PWW?

A. Yes. As stated previously, we found that using the "brownfield" construction approach is inappropriate and that failing to use the sales comparison or offers to purchase Pennichuck results in a value estimate that is less reliable.

Q. Could you please explain why it is inappropriate to use the "brownfield" construction approach in the asset accumulation approach?

A. Yes. The term “brownfield” construction used in our testimony refers to replacing or reproducing the systems as of the valuation date assuming that one would have to incur the cost of digging up the roads and working around various pieces of infrastructure as opposed to the cost actually incurred when the system was built under “greenfield” conditions. The “brownfield” construction method is rarely utilized in a valuation of utility property, and when it is done so, creates a mismatch between the cost actually incurred to build this utility infrastructure and the replacement cost developed in the appraisal. Therefore, the additional cost of construction that results from the “brownfield” construction approach would be offset and eliminated through economic obsolescence due to the fact that the system’s rates could not support the higher costs.

Q. Do the recalculations of economic obsolescence you provided as exhibits to this testimony demonstrate that an inflated cost new will ultimately be adjusted to account from the earnings limitations?

A. Yes. The exhibits demonstrate that the earnings potential of a system will adjust for any inflated cost figures since the system will not be able to earn a fair rate of return on the inflated costs.

Q. How does not using the sales comparison approach or offers to purchase the PWW system lessen the creditability of the value estimate?

A. By choosing to ignore the prices paid for similar systems, or the binding offers to purchase all of Pennichuck, the experts for PWW have failed to recognize the prices that a prudent purchaser such as PSC, Aquarion, and United Water would pay for the PWW assets which is at or around $80 million as demonstrated by the simple revisions to the Exhibits from the Willamette Report.

Q. Do eliminating the artificial influence of "not-for-profit public" entities on fair market value and applying the appropriate growth rate to the exhibits from the Willamette Report result in a reasonable estimate of fair market value for the PWW system?

A. Yes.

Q. Are the adjustments supported by other sales in the marketplace, the binding offers to purchase PWW and your estimate of fair market value?

A. Yes.

Section III – Reply Testimony on Public Interest Standards

Q. Could you provide a summary of the reply testimony you are offering with respect to how the acquisition of the PWW system by the City is in the public interest?

A. Yes. Our testimony will address how the testimony offered by PWW and Staff is flawed with respect to whether the City's purchase of the PWW system is in the public interest. Our conclusions are as follows:

A. The acquisition of the PWW system by the City is the only way that there will be a regional water system in the Merrimack River valley and continued ownership of this system by PWW will impair a successful regionalization of the various water systems in southern New Hampshire.

B. The testimony offered by PWW indicates that it has been a prudent steward of the watershed. However, our reply testimony will demonstrate how, under PWW ownership, watershed protection has been lost and that if the City is not allowed to acquire these assets, future acts by PWW, or its parent Pennichuck, will result in continued degradation of this resource.

C. The testimony offered by PWW indicates that a purchase by the City of the PWW system will impact the ability of Pennichuck to continue to purchase troubled water systems due to the lack of economies of scale or subsidies. The elimination of Pennichuck (including PEU and PAC) as a purchaser for those systems will only be a problem if the existing rate payers of PWW contributed substantially to subsidize to the acquisitions, in which case Pennichuck was being provided with an unfair advantage over other purchasers or operators of those systems. This type of subsidy is anti-competitive and does not promote efficient use of resources which would occur in a fair and competitive marketplace.

D. The testimony offered by PWW alleges that services to customers outside of the City would suffer under City ownership of the PWW system. This assumption is unsupported, inconsistent with the City's stated intents, contrary to the law and the City's own Water Ordinance, which require the City to provide equivalent service at just rates out side its municipal borders.

E. The testimony offered by PWW indicates that absent the PWW system, Pennichuck will not be a viable entity and suffer severe financial hardship. This assumption is based on Pennichuck failing to mitigate this financial hardship, ignores the realm of possible options available to Pennichuck, and presents only options that result in Pennichuck's demise.

F. Giving it the benefit of the doubt, PWW and Staff have "misunderstood" Nashua's plan for customer service.

G. PWW has misstated its cost of operation in an attempt to compare them with those of Veolia

H. Rates under Nashua's ownership will be considerably lower than under continued PWW ownership. PWW's rate path testimony is based on unsupported and flawed assumptions.

A. REGIONALIZATION

Q. What are the benefits that are gained from regional planning with respect to the region's water resources?

A. The regional approach provides for better resource protection by looking at the supply of and demand for water resources in regards to all of the stakeholders in the region. This approach will provide a cooperative approach to utilization of these resources as opposed to competition for the resources.

Q. In your opinion would the City's ownership of the PWW system promote a regional water system?

A. Yes. The City and/or the Merrimack Valley Regional Water District (MVRWD) ownership of PWW would be the first step in bringing together the water systems in the Merrimack Valley. The overwhelming majority of the water systems in southern New Hampshire are owned by towns and cities with whom Nashua could join or partner with, through inter-governmental agreements, to advance regionalization. As municipalities, these towns and cities would have greater planning capabilities and access to cheaper capital. PWW as an investor owned utility cannot partner with the other towns and cities in the same way as Nashua, nor can it get any of the benefits available to municipalities.

GES Exhibit 23 is a 2004 map prepared by the Nashua Regional Planning Commission in 2004 that shows the water system in southern New Hampshire which include the Towns of Milford, Wilton, Merrimack, Derry, Hudson, Goffstown, Hooksett, and the City of Manchester. This map demonstrates how Pennichuck is not a regional water utility and that due to its location in a region of municipal and district systems, it will be impossible for Pennichuck to become a regional utility.

Beyond the core system of PWW, Pennichuck's other systems constitute a series of isolated facilities that consist of small community systems or service to a single user. These water systems are nothing more than a hodgepodge of facilities borne out of various purchases, and subsidized by the PWW system. Pennichuck will never become a regional water utility because it will never be in a position to purchase or merge with the Cities of Manchester, Concord, Laconia, or any of the municipal systems mentioned previously.

The true impediment to the development of regional water cooperation is having the patchwork of Pennichuck systems interspersed among the municipal and district systems surrounding the southern/central part of New Hampshire as shown in GES Exhibit 23.

While Pennichuck and apparently Staff argue that the City is not the best vehicle for regionalization, and point to opposition by the Towns of Milford and Merrimack to support this argument, they fail to recognize the support of towns such as Amherst, Bedford, and other communities that have participated in the creation of the MVRWD.

PWW and Staff have also failed to note the passage of legislation by the State of New Hampshire encouraging the creation of regional water districts. The NH Legislature has concluded that the creation of regional water districts among NH municipalities, such as MVRWD, is in the public interest, notwithstanding the criticisms of PWW and Staff

Q. Do you agree with the testimony offered by PWW and Staff that municipalities have no incentive to invest in water systems outside of its boundaries?

A. No. We do not think regionalization in southern New Hampshire will be accomplished by an investor-owned utility. One only has to look at the nature of the existing water system and resources in southern New Hampshire to understand how municipal or public ownership will be the only way to realize a regional water system in southern New Hampshire. This willingness to look beyond municipal boundaries is evidenced by the City's intent to serve both the existing satellite systems of PWW that it is intending to acquire and its willingness to work with troubled systems which are discussed below.

B. WATERSHED PROTECTION

Q. What is your opinion regarding Pennichuck's management of the watershed,

A. PWW 's stewardship of the watershed has been poor, and its commitment to conservation dismal. Pennichuck has a long history of putting the interest of shareholders ahead of the watershed through the sale of land and continued to encroachment on its buffer with development and sale of land. Most recently, House Bill 1289 was proposed for the protection of the Pennichuck watershed by establishing clearly defined buffer zones. A copy of this Bill is attached as GES Exhibit 24. The State of New Hampshire Department of Environmental Services ("DES") strongly supported this legislation as evidenced by the letter of support found in GES Exhibit 25. At the last minute, Pennichuck apparently opposed the Bill and because of this opposition this important watershed protection legislation was killed in the Senate. See GES Exhibit 26. Pennichuck's opposition to HB 1289 is indicative of its continued desire to develop the watershed and not protect it.

While Pennichuck is continuing to sell its watershed land, the trend among municipal water utilities is to purchase land to protect their watersheds. For example, during the same time Pennichuck has been selling off watershed land, the City of Manchester has continued to purchase more, and now owns in excess of 8000 acres.

The sale and development of watershed land is not limited to what has already occurred but is a continued threat to the welfare of the Pennichuck Brook watershed. This is demonstrated by Pennichuck's indication that it intends to continue developing lands around the watershed. In a recent webcast of the 2005 earning results, Pennichuck notified the investing community of its intent with respect to the landholding of Pennichuck. A transcript of this webcast is provided as GES Exhibit 27 At page 5, Don Correll specifically states: "We know that historically, if one looks at what Pennichuck was doing throughout the decade of the 90's and maybe even the first two or three years of this century, there were times when as much as 50% or more of our reported income was coming from real estate, and there was a time when it was really a liquidation of almost raw land and part of the raw land portfolio. I don't believe, and it isn't certainly part of our plan, that we'll necessarily see that kind of income contribution moving forward on any kind of a sustained basis. However, we believe that our ability to perhaps have as little as 10% to as much as 25% or so of our income coming from the methodical, organized, planned liquidation of the real estate over a period of five to seven years that we might be able to see something, not just in ‘06 and ‘07, but that kind of parameter of level of income contribution over that timeframe. So I think we’d like to be able to see a contribution certainly of the level that we had in ’04 on a regular basis, and we think we can achieve that on a regular basis during that period, and there may be some years where it’s a little bit more, but I would set the parameters that I don’t think getting to a 50% earnings is something that we necessarily see on a regular basis.” It is apparent from these comments that Pennichuck is advising the investing community that it expects to develop additional land over the next several years.

Moreover, Pennichuck’s most recent Form 10K documents Pennichuck’s aspiration to develop an additional 500 acres. The only way this can be accomplished and meet the profit goals outlined by Correll stated above is by continuing to take land out of buffer and putting it into development. GES Exhibit 28. Pennichuck has generated approximately $26 million in gross revenue from the sale of lands surrounding the watershed of the PWW system which was transferred to Pennichuck’s non-regulated real estate entity, Southwood, for something less than $100,000. Since the transfer, water quality has deteriorated and additional treatment is now required. However, Pennichuck and Staff conveniently overlook the fact that the increasing need for and cost of water treatment is in part, a direct result of the development of this watershed land and poor management of the watershed, which is one of the region’s largest sources of raw water.

The City is submitting the testimony of Brian McCarthy, Katherine Hersh, John Henderson, as a panel and Dr. Allan Fuller, Ph.D. to provide further evidence of this poor watershed management by Pennichuck.

C. TROUBLED SYSTEMS

Q. Pennichuck argues that it will not be in a position to assist troubled community systems if the City acquires PWW. Could you state again Nashua's position on troubled systems?

A. The City's intention has always been to assist or purchase community water systems that are in need of assistance. The City will, on a case by case basis, review the needs of and assists any troubled system that asks the City for its assistance.

There are several examples where municipal systems extend service beyond their municipal boundaries for the common good. Examples include the Manchester Water Works providing retail water service to the Towns of Bedford, Londonderry, Hookset, Goffstown, and Auburn. The City of Portsmouth also provides services beyond its boundaries to the Towns of Madbury, Dover, Durham, Newington, Greenland, New Castle, and Rye.

In addition to water service, municipalities frequently collaborate in other areas such as education, sewer service, solid waste management, and fire and police protection to name a few.

It should not be overlooked in the discussion of troubled systems that under Nashua's ownership a new player will be introduced. Veolia is one of the largest contract operators in the world and operates systems as large as Indianapolis ID and as small any of the Pennichuck satellite systems. It would be an available alternative to Pennichuck for Staff and the owners of the troubled systems.

D. TREATMENT OF SATELLITES

Q. The testimony of Pennichuck and Staff suggests that Nashua would slight the standalone systems. Do you agree?

A. No. PWW asserts that the City, because of "inter-municipal jealousies," has no incentive to be fair to the satellites and their customers. In fact there are many successful examples of municipalities cooperating with each other for the greater good of their citizens. Some examples are cooperative and regional schools, solid waste districts that overlap municipal boundaries and police and fire mutual aid. In addition, there are municipal water systems which supply water outside their boundaries and have been doing so very successfully for some time. It is not a coincidence that the study of water rates performed by NHDES in 2005 shows that cities such as Manchester, Portsmouth and Concord, all of which provide services outside their boundaries, do so at a lower cost than PWW.

PWW and Staff have expressed concern that the City will not provide capital for the standalone systems outside the City, and that those customers will not be treated the same as those within the City. As shown in GES Exhibit 4 & 5 and provided in our January 12, 2006 testimony, the City is providing $9.5 million in annual capital which is $5.5 million per year more than PWW has spent over the last ten years. In addition, as evidenced by its response to Staff 4-33, (GES Exhibit 29) the City has absolutely committed to charge the customers of the satellite systems the same rates as it will charge its core customers.

Pennichuck and Staff have translated the City's concerns about continuing to subsidize Pennichuck's acquisition of troubled systems into a conclusion that the City will not treat the customers of the existing satellites equitably. Such a conclusion ignores the facts as well as the City's Water Ordinance, which requires equitable treatment of all customers regardless of location.

The City's commitment to the satellite systems is expressed further in the testimony of Mayor Streeter.

E. HARM TO PENNICHUCK ENTITIES

Q. Do you agree with the testimony offered by PWW regarding the effect the acquisition will have on operations of other Pennichuck companies?

A. No. PWW's testimony that PEU, PAC and PWSC will lose economies of scale and be required to hire outside consultants is inconstant with current Pennichuck practices. Pennichuck hires numerous outside consultants to perform services some of which are for these companies. The testimony offered by PWW assumes that economy of scale exists in the operation of the four Pennichuck operating companies PWW, PEU, PAC, and PWSC. However, this is really just an assumption and not supported by a cost of service analysis.

The PWW testimony identifies five major categories of operational inefficiency and increased costs that will result from the loss of PWW. These are specifically:

1. Loss of engineering expertise
2. Loss of travel efficiencies
3. Loss of emergency efficiencies
4. Loss of favorable staff ratio
5. Loss of joint use of assets

With respect to engineering expertise these companies can readily obtain engineering expertise from the same firms they already utilize. Moreover because the remaining system are largely small, unconnected developments, the need for engineering expertise will be considerably reduced.

With respect to travel time, there should be no loss of efficiency because the acquisition of PWW by the City will remove PWW as the hub of the companies' activities and the actual center of PEU and PAC will shift and move north and east. If anything there should be greater travel efficiency afterwards.

This is also true of the emergency efficiencies. In general the PEU and PAC systems are smaller with fewer pipes, buildings, and pump systems. Therefore, fewer employees and less equipment will be necessary to deal with emergencies. PEU and PAC will be able to hire construction crews when necessary as they do now to satisfy emergency efficiencies, but the relative scale of the emergencies will be different and less than the current scale necessary for PWW.

The claim that there will be a loss of the staffing ratio is unsupported and assumes that there is no efficiency gained by being smaller. There has been no support or analysis provided that quantifies these allegations. In fact, there could be efficiencies gained by contracting out certain aspects of the PEU and PAC operations and changing the staff accordingly.

The testimony is correct that PEU and PAC will lose joint use of certain assets. However, PEU and PAC can readily contract for the lease of this equipment. If PEU and PAC choose to procure their own assets the assets will be different from those necessary to operate PWW and are estimated to be considerably less expensive.

PWW asserts that PWSC could not afford to continue its existing contracts without the efficiencies from the joint operation of the Pennichuck companies. This is a clear indication that its customers both in New Hampshire and Massachusetts are being subsidized by the rate payers of the City of Nashua. The ratepayers of a regulated utility should not be subsidizing or making more competitive an unregulated, for profit service company like PWSC.

Q. Pennichuck claims it will no longer be a viable water utility if the City is allowed to acquire PWW and Staff seems to agree. What is your opinion?

A. The impact to PAC and PEU is the result of Pennichuck's unwillingness to mitigate the impact of the City's acquisition of PWW and the implication that rates in the PAC and PEU systems will increase by over 60% is hard to justify given the existing cost share arrangement and standalone nature of these systems.

Pennichuck has failed to mitigate the impact of the taking by refusing to participate in the City's solicitation of contract operators for the PWW system. If, in fact, Pennichuck were an efficient well-managed and competitive operator of water utilities, participating in a solicitation to operate the system acquired by the City would surely have been a logical means of avoiding the negative impacts it now claims are unavoidable to its remaining subsidiaries. Under this scenario, Pennichuck would have been fairly compensated for the assets that comprise the PWW system, allowing them sufficient funding to pursue purchasing or operating other troubled systems in the State and beyond, while at the same time utilizing the experience and expertise to operate the PWW system on a contract basis. This approach to continued operation of Pennichuck not only seems prudent, but is also consistent with Pennichuck's promotion of public/private partnership both here in New Hampshire as well as elsewhere. However, Pennichuck seems content to make bold statements about its dire situation and false claims regarding the impact of the City acquisition without taking a single step to mitigate these impacts. Instead of rising to the challenge and seeking to find a solution that works for both Pennichuck and the City, Pennichuck has chosen instead to claim that the City is causing it unavoidable harm and requiring PAC and PEU to incur costs that will increase its rates by over 60%.

Q. Do you agree that PEU and PAC will experience rate increases of over 60%?

A. No. However, it is difficult to fully respond to the claims made by Pennichuck in Supplemental Response to Nashua 3-11 (GES Exhibit 30) due to the lack of data and support for the adjustments made to the book review of PEU and PAC. Pennichuck indicates in its response that it will require over a 60% rate increase in operating revenue for PEU and PAC without PWW due to "... the revised personnel levels, the impacts on the purchasing discounts due to reduced volume ordering of materials and supplies, the impacts of the revised levels of customers, the impacts of the investment and depreciation of the required plant asset replacements, and the impacts on capital costs of the restructured corporate entity." If the current level of expenses charged the customers in these systems is incorrect and such rate increases would be necessary, then the expense sharing agreement currently in place between PWW and the other systems is clearly wrong and should be adjusted so that PEU and PAC pay their fair share of the cost.

In addition, there is no explanation in Pennichuck's testimony as to why these services could not be subcontracted, or that equipment Pennichuck proposes to place into rate base could not be leased or procured through a service contract.

The level of subsidy that has crept into the Pennichuck system has exceeded the levels allowed in the Commission Order 22,883 in Docket DR97-058. At the time of this order, there were 20,364 Nashua customers, and only 1,669 customers within PWW that were being subsidized and the subsidy represented $8.00 per Nashua customer, or $165,120, which was tolerable.

However, Pennichuck's claim of harm to PEU and PAC reveals that the current subsidy is approximately $3.5 million and is the difference between the appropriate PEU and PAC revenues and those that would result from the City's acquisition of PWW. This would result in a subsidy of approximately $140 for each of the 25,000 customers in the PWW system. The Commission has not addressed this level of subsidy that now exists in the rates of the PWW customers, and that has allowed Pennichuck to continue to buy systems throughout the State and it appears operate systems within and outside of the State with a subsidy from PWW as well. This growth for the sake of growth apparently has been a failure. Economies of scale have not been realized and have just created substantial subsidies that are paid by the customers of PWW.

The level of subsidy to Pennichuck for the operation of PEU and PAC makes it clear that it is either the wrong size or has become too geographically diverse to efficiently operate the systems. This is evidenced by the fact that its revenue requirements per customer for the 5,540 customers in the PWW system is $1,568 per customer without the PWW subsidy. This level of revenue requirement is higher than any other independent small water system that had financial data published in the most recent NAWC, *Financial & Operating Data for Investor-Owned Water Utilities* document. A comparison of independent water systems, with revenue of under $6 million, to the revenue and expenses for PEU and PAC in GES Exhibit 31 demonstrates how PEU and PAC already have revenue requirements that exceed these peer systems by more than 100% and that a rate increases of more than 60% is not warranted or justified when compared with expenses and revenue requirement of peer systems.

Q. Did Pennichuck also claim that the service company would lose money?

A. Yes. Pennichuck indicates that without PWW, Pennichuck Water Services Company ("PWSC") will operate at a deficit. This raises very serious concerns for the Commission about how PWW has been assigning costs to its various subsidiaries. PWSC is an entirely unregulated private company and the operating profits from this entity are not used to mitigate rates in PWW, PEU, or PAC. It is clear from its response, however, that PWW is subsidizing PWSC. PWSC operates both within and outside the State of New Hampshire as a private contract or to water systems. PWSC should stand alone and have no impact on the regulated companies.

This subsidy raises serious issues with respect to the effect PWW's subsidies have on the competitive nature of PWSC and how this subsidy has harmed competition by allowing PWSC an unfair advantage. For example, Pennichuck estimates that PWSC has underpaid PWW $383,000 in interdivisional management fees, or 42% underpayment; has underpaid maintenance expenses by $127,000, or a total underpayment of $513,000 on $1,794,000 in total expenses. All in all, PWSC has underpaid its bills to PWW by 30% according to Pennichuck's own testimony. Such significant subsidies give PWSC a tremendous advantage in its bidding and even worse mean that the PWW ratepayers are supporting the PWSC customers thereby making it profitable, all to the benefit of Pennichuck's shareholders.

The issue of PWSC goes beyond the issue of this taking and demonstrates the ease at which Pennichuck abuses the system of regulation and the ratepayers of PWW.

Q. Do you agree that PEU and PAC will be unable to raise Capital?

A. No. Pennichuck has worked closely with State agencies and communities to utilize grants, to utilize tax exempt financing, and conventional debt. There is no reason to believe that PEU and PAC will not be able to continue to do so in the future.

F. CUSTOMER SERVICE

Q. Have you reviewed the concerns about customer billing?

A. Yes

Q. What is your opinion?

A. PWW and Staff have criticized the City's level of customer service which is completely unfounded. The City manages the cash flow of some $200 million per year, compared to Pennichuck's $20 million, and manages the billing and collection of sewage, real estate taxes, and a host of other billings. The City has a fully trained staff accustomed to fielding phone calls and dealing with service related issues such as sewer, roads, schools, tax collections and assessments. The City has proposed to add 2 additional employees to its present staff of 6 and Veolia will provide 2 employees to handle service and operational calls. Nashua's billing and customer service staff will be fully cross-trained in managing water related customer service and taking care of additional billing requirements. Staff's concern about the uncertainties of customer service and billing is based on a complete misunderstanding of Nashua's proposal. For example Amanda Noonan testified that Nashua would only have 2 employees dedicated to the water system when Nashua's response to Staff's data request 4-21 (GES Exhibit 32) makes it clear that the 2 additional employees will be added to the existing department of six for a total of 8, and everyone will be cross-trained to handle water related issues.

It is important to note that the City already receives many of the same types of phone calls that Pennichuck does, such as final tax bill apportionment for real estate closings, sewer apportionment, etc. Moreover, the testimony of Ruth Raswyck , the manager of Nashua's billing department and Deputy Treasurer, indicates that Pennichuck's customer service and billing operation is not all that it is cracked up to be. The Company has experienced several problems in its meter reading and billing data provided to the City which were caused by careless employees. The most recent problem occurred in April, 2006.

G. OPERATION COSTS

Q. Staff asserts that Nashua's cost of service is speculative. Do you agree?

A. No. Nashua's projections of lower cost of service under its third party contracts are far from speculative. While rates are dependent to a large degree on value, Nashua has negotiated an agreement with Veolia that coupled with the efficiencies it has as a municipality results in significant savings for the customers of PWW PWW and Staff ignore the national trend towards public-private partnerships and third party operations of a variety of public resources. Even Pennichuck recognizes that such relationships result in real savings. See Exhibit D to Veolia's January 12, 2006 testimony. Under contract to Veolia, the customers of PWW will have a lower cost of operation than under Pennichuck. Veolia is a publicly traded company, which is substantially larger than

Pennichuck and has a track record of successfully operating water utility infrastructure. It brings competition to operations which generate savings unavailable to PWW.

Q. Did you review supplemental responses by Donald Ware in answer to Staff 4-19 (GES Exhibit 33) regarding the cost differences between Veolia and Pennichuck for the construction of new property in and around Nashua?

A. Yes, we have.

Q. Do you agree with his explanation?

A. We believe Mr. Ware is incorrect in his analysis and is trying to obfuscate the real differences. First and foremost, the comparison called for by the Request is between Veolia's total costs, which are the City's total costs, and Pennichuck's total costs. While Veolia's total costs include all direct labor expense, administrative overheads, bookkeeping, etc. Mr. Ware attempts to hide the fact that significant administrative overheads are not included in the Company's labor rates, which are charged to the customer's for repair. Mr. Ware talks about an approved and allowed direct labor overhead rate of 1.5 times. The 1.5 factor only covers the direct labor cost. These costs adjusted for the 1.5 factor do not include all of the indirect overheads which are necessary for the operation of PWW, which are included in the Veolia costs. Therefore, in order to make the proper comparison, the PWW overheads must be allocated to the wages, in the same way as Veolia. When the company does this, it is more expensive than Veolia. According to Mr. Ware, all the customers pay all administrative overheads first and then only the direct labor overhead rate for new construction and repairs is used. The end result is that the ratepayers of Nashua are subsidizing the construction of new property for others, including developers. Unlike the Veolia costs, PWW's direct labor multiplier of 1.5X does not cover all direct, indirect, and administrative expenses necessary for the operation of PWW.

It is also important to note that Mr. Ware's testimony directly conflicts wit the testimony of Harold Walker. See Nashua's Supplemental Response to Staff 4-49. GES Exhibit 34.

Q. Have you reviewed John Joyner's testimony of February 27, 2006 concerning the process of selecting Veolia and the agreement with Veolia?

A. Yes.

Q. What do you know about his prior involvement in this case?

A. Mr. Joyner and his company, IMG, approached of Nashua seeking to work for the city. They were rejected because of an apparent conflict of interest and his testimony may not be impartial.

In addition, the testimony offered by Mr. Joyner is mostly irrelevant and in some instances misleading.

The Indianapolis system, which Mr. Joyner says is not really comparable to PWW, is really a subsystem of five treatment plants and five sub basins teach of which has similarities to PWW which he has failed to clarify. He further criticizes Veolia for operating small systems which he claims are not similar. In fact, the Veolia operation of small systems is part of the reason the City chose Veolia. Distribution systems such as Sturbridge MA and Smugglers Notch, VT are very comparable to the satellite system which Pennichuck will be operating. Mr. Joyner forgets that Veolia will be operating the satellite systems of Amherst, Merrimack, Milford, Hollis, Bedford, Derry, Plaistow, Epping, Salem and New Market with customers ranging from 49 to 890.

A substantial amount of Joyner's testimony criticizes Nashua's contracting process. Yet Mr. Joyner has never participated in contract negotiations for contract operations during an eminent domain proceeding. In an eminent domain context, neither the municipality nor the contract operator is able to perform any due diligence. They must rely on whatever information is publicly available Nashua and Veolia have agreed upon a short term agreement which limits the exposure of each party and a procedure under which if the assumptions made by Veolia are incorrect the parties will renegotiate. Notwithstanding the difficulties imposed because PWW would not give them access to the property and employees, the parties believe that the agreement is comprehensive and provides significant savings to the ratepayers.

Mr. Joyner also criticizes the City for certain problems identified in the Veolia contract, all of which should be ignored by the Commission. The termination for convenience clause is an arrangement between the City and Veolia and is provided to protect both Veolia and the City, something Mr. Joyner fails to point out. The City is able under this provision compare any excess cost Veolia might charge against the cost to terminate. If it appears to the City that Veolia will overcharge it and that the overcharge will exceed the termination for convenience fee, which declines over time, termination will become an option. Likewise Veolia will be aware of the declining termination fee and be incented to keep its cost to the City reasonable.

The original agreement did not include performance standards in many instances, due to the partys' inability to perform due diligence and the uncertainties regarding the new treatment plant, which has an unproven operating history. There are, however performance standards, detailed in Veolia's Reply Testimony. Other performance standards will be adequately developed at the appropriate time when the system is taken over and the parties better understand the operational requirements.

Mr. Joyner criticizes the contract for being unclear about taxes. There is nothing unclear in the contract with respect to taxes, other than his own confusion. There will be no excise, property, disposal, franchise, or occupational taxes.

It is also irresponsible for Mr. Joyner to suggest that there should be consumption guaranties for fuel and electricity Nashua and Veolia when the efficiency of the new treatment plant is unknown.

Mr. Joyner's criticism of certain PWW activities that have not been included in Veolia's contract is without merit Customer service functions are being handled by Veolia and the City. Review of new construction will be performed by Veolia. Preparation of the hydraulic model is being handled by Veolia. Outflow tests are handled by Veolia and all maintenance of pipe, service lines and equipment is being handled by Veolia. The capital program management is being handled by Veolia and Beck. The IT support is being handled by Veolia.

It has been and continues to be the City's position to isolate and create the most efficient base operation of the PWW system and incrementally add those services as required with appropriate incentives and efficiencies built into each individual service. Veolia is providing full maintenance services of all of the properties that it is managing for the City of Nashua as a part of the annual fee. Capital repairs and replacements will be paid in the same way as PWW. Mr. Joyner criticizes Nashua for handling the services and expenses as it has. However, he forgets that PWW does the same thing. The only difference is that PWW passes everything through either as an expense or capital cost that goes into rates.

What Mr. Joyner has not told the Commission is that no matter what the cost is PWW, has no risk. All of its costs are passed through and paid for by the rate payers. The public private partnership between Nashua, Veolia and Beck, because it introduces competition, will produce significant savings over the PWW operations.

Finally Mr. Joyner criticizes Nashua for understating certain expenses. These should not be given any weight by the commission. What he fails to point out is that Pennichuck buried these expenses in its Annual Report in improper accounts. For example electricity and purchased water were both incorrectly reported in 2004.

Q. Have you reviewed the revenue requirement testimony provided by John Guastella on January 12, 2006?

A: Yes.

Q. Do you agree with how he has developed the revenue requirement if Nashua acquires the assets of PWW?

A. No. The Guastella testimony of January 12, 2006 is largely irrelevant for the purposes of these proceedings.

Mr. Guastella relies on financial information, including projections of revenue, capital additions, and operating expenses provided by PWW, which are flawed. He has not prepared independent analysis or corroboration of the information provided by PWW. In addition, Mr. Guastella assumes a valuation in the 2008-2010 timeframe, in spite of the requirement in this Docket that the valuation is to be performed as of 12/31/2004 with a true-up after that. Moreover, he has relied on PWW's growth projections, which do not relate to the actual growth within the PWW system.

GES Exhibit 35 provides a ten-year history of the customer base and growth rates that have actually occurred within PWW. The City has had a growth rate of .44% per year, Amherst has leveled off at 890 customers, Merrimack has leveled off at 203 customers, Milford has leveled off at 119 customers and actually gone down, Hollis has increased to 49, Bedford has increased to 722, Derry has leveled off at 779, Plaistow has leveled off at 194, Epping has leveled off at 78, Salem has leveled off at 72, and Newmarket has leveled off at 87. The ten-year growth rate for all of PWW has been 1.16%, but the last four years, 2001 to 2004, has, leveled off to 0.98%/year.

All of the future rate increases required for PWW will be largely through rate base increase for construction costs of the treatment plant. When the rate increases are complete for the treatment plant construction, depreciation will compete with capital improvements and net earnings will likely stay flat and stagnant or go down, unless PWW embarks on a major capital reconstruction program within the Nashua, as proposed by the City.

Mr. Guastella further assumes a financial model which does not satisfy New Hampshire law and will not work. He assumes the use of revenue anticipation notes for the first 3 years, with interest only, for the purchase and then conversion to general obligation bonds. Revenue bonds, not revenue anticipation notes, are required for the purchase under RSA 38:13. Moreover, the general obligation bonds cannot be used by Nashua. They are not available to the City for providing capital for property outside of

Nashua where Nashua has no taxing authority. This model is used solely to make $278 million as a final price ($248 million purchase price plus $30 million fees and miscellaneous costs) work. It will not. Nashua will be required to finance the entire purchase with revenue bonds and prepare appropriate rate models to provide debt coverage and reserve requirements.

In order to make his model work, Mr. Guastella has also had to take his projections out to 2011 and project operating revenues using PWW's growth rates, which are erroneous. He then uses a rate stabilization expense of $7,200,000 per year to fund operating costs with capital reserve dollars. The City of Nashua cannot use capital funds to fund operations and borrow for operating costs. Mr. Guastella's model which is set forth on Schedule C of his confidential exhibit JFG-1 is not legally permissible and will not work.

Mr. Guastella's Exhibits 18, 19, and 21 use growth rates that are not supported by any fact or analysis. They suggest annual rate increases each year from 2005 to 2009, and they underestimate operations and maintenance costs. The actual O&M costs for 2005 which are set forth in the testimony of Mark Naylor, dated April 13, 2006, are $9,127,323. The Guastella operating cost for 2005 is $8,598,000. The Company and Mr. Guastella underestimate the operating cost and appear to underestimate the depreciation expense by not adequately taking into account the new treatment plant construction built upon the existing depreciation expense. In Exhibit 21, Guastella utilizes a present value factor of 5% and a long-term growth rate of 2%. These rates are erroneous.

In summary, the Guastella's model is not legally permissible for the City of Nashua in the first instance, and is based upon erroneous assumptions.

Q. Staff questions whether Nashua can achieve lower rates. Do you agree?

A. Staff questions Nashua's claims of lower rates, but Staff is not clearly articulating Nashua's claim. Staff knows that PWW is expected to have substantial rate increases as a result of its capital program and rehabilitation and reconstruction of the treatment facilities. Nashua's claim has always and continues to be that the rates under Nashua's ownership will be less than those which would otherwise occur if PWW owned the property and received reasonable returns based on regulation. While Staff agrees with a handful of savings articulated by Nashua, Staff ignores testimony by Nashua that many additional savings will occur. The savings anticipated by Nashua, again, are:

- Lower operating costs via the Veolia contract.
- Lower management costs via the R.W. Beck contract.
- Lower billing costs via City services.
- Lower audit costs, as Nashua is not a public company.
- Lower cost of debt.
- No cost for equity.
- Lower insurance costs.
- Lower office building expenses.
- Lower vehicle, tool, and equipment costs.
- No income tax preparation cost.
- No annual report cost.
- No Sarbanes Oxley compliance cost.
- No stockholder costs.

- No Board of Directors costs.
- No CEO/CFO costs.
- No Directors/CEO insurance costs.
- No data expense to the City for sewer bills.
- No accelerated depreciation expense.
- No amortization expense.
- No employee recruiter fees.
- No legislative cost.
- No regulatory costs and rate case expenses.
- Payroll taxes reduced 95% or more.
- No Business Profits tax.
- No Statewide Property tax.
- No Federal Income taxes.
- No deferred Federal Income tax.
- No Massachusetts State tax.
- No direct payment of union dues by the City.
- No direct payment of credit union fees by the City.
- No direct payment of retirement plans by the City – Veolia cost.
- No direct payment of health benefits by the City – Veolia cost.
- No direct payment of disability benefits by the City – Veolia cost.
- No direct payment of post retirement benefits by the City.
- No direct payment of supplemental executive retirement plan by the City.
- No continued payment of regulatory liabilities.

- Reduced collection expenses.
- Reduced bad debt write offs.
- Reduced administrative and general expenses.
- Reduced office supply expenses.
- Reduced outside services.
- Reduced miscellaneous expenses, such as “non-employee spouse expenses”.
- No depreciation on AFUDC.
- No depreciation of pre 1987 CIAC.
- No charitable donations by the City.

Staff has accepted as fact the disingenuous testimony of PWW in discussing areas where it believes Nashua has understated its costs. If Nashua has understated its costs it is because PWW incorrectly accounted for them. Nashua will revise its pro forma for certain costs (electricity and purchased water) pointed out by Mr. Ware, but stands on the other costs it has used and asserts that Mr. Ware is simply wrong. For example, the GIS system mentioned by Mr. Ware is neither being developed by PWW or the City and is not in PWW rates now. It is, however, adequately covered in the City’s pro forma as a new item. Also, Mr. Ware’s testimony about costs and personnel related to billing and collections, customer service, and labor rates are inconsistent. At different times, he talks about 13, 10 and 6 people in customer service. Nashua, however, has been clear. It will have eight cross trained people and Veolia will have two full-time and four cross trained for a total of 14 people. Nashua has not underestimated the cost of unplanned maintenance by $815,000, but has moved maintenance into different categories to properly accommodate the public-private partnership that it intends to enter into with Veolia. Mr. Ware also fails to acknowledge that Nashua is proposing $9,500,000 of capital per year versus PWW's 10-year average of $4,000,000 per year. Finally, Dig Safe has quoted the City a cost less than Mr. Ware suggests.

Staff should be very concerned by Mr. Ware's testimony regarding unplanned maintenance. First, the total maintenance reported by the Company is $1,169,936 (See MAN Exhibit 1). Therefore, only $355,000 is planned maintenance by the Company. Staff should be concerned about such a level of planned maintenance by PWW, when Nashua and Veolia have budgeted for significantly higher levels of planned and unplanned maintenance in the Veolia contract and Nashua's capital budget

Staff should look carefully at the lack of planned maintenance being performed by PWW, and whether or not PWW is merely maintaining the plant on a reactive basis while it deploys its capital in other directions outside of Nashua and outside of PWW. Secondly, Staff has not even questioned what portion of the $815,000 of unplanned maintenance proposed by Ware is capitalized versus what portion is expensed. Nashua has adequately accounted for capital, repair, and maintenance of $9.5 million per year, and has adequately accounted for maintenance within the Veolia contract.

Lastly, regarding this line of testimony, Nashua has demonstrated beyond any reasonable doubt that even if all of the operating costs are the same between PWW and the City, there are significant savings in capital requirements and in municipal ownership which Staff is ignoring in its analysis.

Q. Does that conclude your testimony?

A. Yes.