

EXHIBIT 12

BUDGET REVIEW COMMITTEE

MARCH 16, 2004

A meeting of the Budget Review Committee was held Tuesday, March 16, 2004, at 7:04 p.m. in the Aldermanic Chamber.

Alderman-at-Large Steven A. Bolton, Chair, presided.

Members of Committee present:

Alderman-at-Large David W. Deane
Alderman-at-Large Paula I. Johnson
Alderman David D. Lozeau
Alderman Lori Cardin
Alderman David MacLaughlin
Alderman Robert G. Shaw, Jr.

Members not in Attendance:

Also in attendance:

Alderman-at-Large James R. Tollner
Alderman-Kathryn D. Vitale
Alderman Richard LaRose
Alderman Marc W. Plamondon
Alderman Robert A. Dion
Alderman-at-Large David Rootovich
Alderman-at-Large Brian S. McCarthy
Mayor Bernard A. Streeter
David Connell, Corporation Counsel
Carol Anderson, Chief Financial Officer/Comptroller
Mr. George SanSoucy
Attorney Robert Upton
Alderman Kevin E. Gage (@ 8:30 p.m.)

COMMUNICATIONS

UNFINISHED BUSINESS – RESOLUTIONS

R-04-13

Endorser: Alderman-at-Large Brian S. McCarthy

AUTHORIZING THE MAYOR AND CITY TREASURER TO ISSUE BONDS NOT TO EXCEED THE AMOUNT OF ONE MILLION THREE HUNDRED THOUSAND DOLLARS (\$1,300,000) TO FUND THE PURCHASE AND INSTALLATION OF FIRE ALARM AND FIBER OPTIC CABLE AND RELATED HARDWARE TO CONNECT FACILITIES THROUGHOUT THE CITY

Chairman Bolton

I received a communication indirectly through Sue Lovering, originated with Maureen Lemieux, informing us that Ken Tyrell from Information Technology Department remains unavailable. He

Most likely Pennichuck, if you do go forward with this acquisition, will argue that it is not in the public interest so the PUC will have to make that determination. In a prior case, when a utility made this argument what the PUC did when it received the petition was bifurcate the issues, in other words split them up, initially dealt with the question of public interest first and then to the extent that the city wanted to go through with the acquisition after that determination was made it looked at value. I think that I prefer if we can to do public interest and valuation at the same time. It may be that the PUC is not going to let us do that. They are creatures of habit generally. Having bifurcated these issues in a prior proceeding it is likely that they would do that again, but I would prefer in this case to see value and public interest dealt with simultaneously because those questions are largely the same in this case because they are driven by rates. Rates are going to determine the value that you will have to pay for it and it will determine whether or not it is in the public interest. I think they are much more closely connected in a case like this where rates are going to be so important and I would hope that the PUC would deal with them together.

The resolution of those issues before the PUC is similar to litigation of any kind in any forum – there is a significant amount of discovery that occurs, there is a motion practice that occurs, and ultimately there is a trial. The only thing unusual are the time limits I think that the PUC generally puts on for discovery. They are more immediate than the Superior Court would require. It is a much faster turnover of discovery. The other thing that is a little bit unusual about it is the way direct evidence is presented. It is all done with written pre-filed testimony that everybody gets a chance to review before you actually have a trial.

Both of those questions and issues are expert driven – that is that the testimony of the experts is largely going to determine the outcome, and that is generally true with these kinds of cases. There are a couple of things the City can do I think to improve its position especially in the issue of public interest. The first I think is to complete the negotiations for the formation of the Regional Water District. We want those communities, those other communities, lined up to support our petition, and the Regional Water District will be I think the key to getting their support. The PUC and its staff has for a long time supported the idea of regionalization. If they think that will be one of the results of the acquisition I think that will work in the city's benefit if it goes forward with this acquisition. Likewise if we don't become a part of the Regional Water District I think it might work against us. What I am most concerned about are those other towns in which Pennichuck property is located not supporting us and have the PUC ask what is the benefit of just having the city acquire those assets and simply replace Pennichuck in the scheme of things.

Secondly it is important that the city present a united front. It is very important that the PUC in all of this see that the city has the political will to carry this acquisition through if the price is going to be right. If you decide to do this I hope that there won't be public second-guessing. The PUC reads the papers and it won't like that. Anyway after a trial the PUC makes a decision, which is appealable by either party to the New Hampshire Supreme Court. There aren't many reasons I can think of why the city would want to appeal unless they do something very unusual in setting the price or if it concluded that for example that the city couldn't acquire property outside of Nashua – I think that might be an appealable issue, but short of something like that I can't see a lot of reasons why I would ever recommend appealing a decision. The company on the other hand might appeal for a variety of reasons. Don't forget that we're taking

– if we do this we are taking their operational companies, their regulated operational companies. They will be concerned about price. They will be concerned about trying to delay the process. They will be concerned about trying to preserve their assets.

After the price is finally set, RSA:38-13, which is a great and important provision permits you to decide within 90 days whether or not to acquire the property at that price. This is I think an extremely important right and it was built into the Statute in 1997 during that time that I was representing those towns that were seeking to acquire the PSNH hydros. Under eminent domain procedure, which was in effect at the time, a municipality when it took property – any kind of property, took a title to it immediately and then it would go fight about the value. Whatever price was set by the court the municipality was stuck with it. I thought especially having dealt with utility value for a fair bit of time that these were pretty enormous values for a municipality to get simply stuck with so I encouraged the legislature and they did it to give municipalities a second look at the acquisition after the price was set so that if it was too high, if everybody thought it was too high, that there was a procedure for an out. The city or town could say this is just too much money we don't want to do it at this price. I thought that was very important to have just because of the enormous values that you are dealing with when you are dealing with utility values.

Just as an example say the PUC sets a price of \$200 million for these assets and after they set that price and Mr. SanSoucy and the financial people conclude that in order to pay that you would have to raise rates enormously you probably aren't going to want to do this. There is that opportunity for you to then get out. I know immediately what you are thinking because it is the first thing that always comes to my mind is if we go all the way through this and they set a price of \$200 million or anything that is above where we want to do it we are going to have spent a lot of money on guys like me and SanSoucy and the other experts in this thing and we will not get it back because the only way you get it back is if you actually go forward with the purchase you can bond all of that – you can put all of that into your revenue bonds and then that gets paid for instead of by taxpayers it gets paid for by the ratepayers. **While that is true if you get to the end of the day and decide not to go forward that money has been spent and you don't get it back remember why you are getting out – you are getting out because that value has been set too high. You can now use that value, that too high value that was too high for you to buy it – that is a determination of fair market value that you can use for setting your assessment level.**

What I tried to do was give you an example – your current assessment of property in Nashua is about \$54 million at a 75% ratio. I didn't know what your tax rate was – it used to be around \$23 so I used \$23 as that tax rate. The tax on \$54 million is \$1.2 million. If the PUC set the value of the Nashua property for example at \$100 million essentially doubling so that you didn't want to get out that tax would be \$2,300,000 for an increase of about \$1.1 million. I think what I am saying is the increased tax that you might get – that you would get from that increased value is one method that you might use to make sure you get yourself paid back for what you spent on acquisition costs. It is an interesting double sword. The company is in the position where it wants to get the absolute most that it can get from the PUC, but if it gets too much and you back out that upper level is then going to be the level of taxation and they will get hammered with taxes so it is a double-edged sword.

Assuming you vote to acquire the property following the setting of the price by the PUC you then have to move forward and issue revenue bonds and close the purchase and that always

are the municipality, which will file the RSA:38 petition. There are none of those other communities, which are in a position to do that. If that falls apart you will be – you will do it and we will do it regardless of that. I don't think that is a deal breaker, but I think it sweetens the deal if you are part of a regional effort.

George SanSoucy

If I may we're jumping way ahead to the end, but in that instance you are setting the rates – 65% roughly of the revenue to this company comes out of Nashua, 35% comes out to the balance. You will put your costs into these bonds and you will charge these other towns 35% of that cost as a minimum. We will be designing the rate structure for you in this process. The process is going to become very formal if you proceed. The regional endeavor, and I didn't want to go this far, but I will at this point, the regional district is going to find itself in a very formal process very quickly because they are going to have to begin to address the needs of the PUC and the needs of the PUC are going to be formal rate design, formal transfer of costs/money, and from my – I am the expert as Rob said, I am your engineer and your appraiser and your expert – it will fall to the appraiser and to the expert – I work for the City of Nashua. **My charge will be to present a plan that offers no net harm to any ratepayer or the company.** That is the ultimate goal to prove the public interest. No net harm will be to transfer legitimate costs. In a very short period of time it will be in their best interest to be at the table with the City of Nashua to iron this out or they will be subject to my/your rate design.. I will be presenting the city's rate design to the Public Utilities Commission.

It has been a friendly negotiation process so far. We know that. It has been a long 14 months bringing everybody together and it is admirable. New Hampshire is not known for regionalization, but if you look at the great regionalization events that have occurred in this state they have been highly successful. The Winnepesaukee River Basin Commission for example, the New London/Sunapee Interceptor System, but because it hasn't been formalized we are concerned, but we are concerned in two ways – number one we would like to see it finalized and number two they are going to have to begin to agree to some very formal principals they are going to have not advance under, as Rob said, a very quick schedule at the Public Utilities Commission. I will advance a set of rates that does not harm Nashua, does not harm anyone outside of Nashua and does not harm the company. That is a transfer of those legitimate costs. For example you will get an opportunity to see those. The process becomes public pretty much tonight.

We have been asked by the Mayor and Mr. Connell to advance some hard number tonight and they are going to be publicly advanced. The process at the PUC will ultimately essentially be almost all public. It will be the Pennichuck that will ask for privacy of the numbers not Nashua. It will be completely public from hereon in. If I may we are jumping way ahead and I will gladly discuss any questions, but as you had pointed out should you elect to proceed you are proceeding without the regional charter in your name. There is a third element now – the Public Utilities Commission, that will enter into this process and myself. I will be reviewing and developing no net harm consensus with the City of Nashua and if they don't like it they better get to the table now not later.

Robert Upton, Esq.

We are the city's consultants. We're not the regional district's consultants, and if an agreement isn't concluded with the regional district that is to the benefit of the city we are going ahead for the city.

Alderman McCarthy

A question for Attorney Upton regarding the 800-pound gorilla. Would you consider a Charter in which Nashua and Nashua alone gets to set the rates and in which Nashua and Nashua alone gets to determine the capital improvements plan, and in which Nashua and Nashua alone gets to determine whether bonding is issued to pay for anything one in which we are the 800 pound gorilla?

Robert Upton, Esq.

Yeah, and that is where I understood that the negotiations largely were getting to. The key thing is who controls the rates, who controls the spending. That is what is important in the regional district, and as long as Nashua can ultimately have that control I think the other issues are probably to some degree maybe window dressing. The important thing is who will set the rates. It should be – that is the benefit you get for your risk is that you get to set them.

Chairman Bolton

Unless there are other questions now this might be a good time to let Mr. SanSoucy proceed with his presentation to us.

George SanSoucy

What I have prepared tonight at the request of the Mayor's office and Mr. Connell your attorney is a very concise presentation on where we are, what we are proposing to purchase should you go ahead, and some very hard numbers on what that purchase is going to look like and why those numbers are the price. We are going to throw out the price tonight – it is a shot over the bow so to speak. I will guarantee you by 8:00 a.m. tomorrow morning everything I say tonight they will say is wrong and that is the way this process works.

I am the expert that was involved with Hudson – did the deal for the Town of Hudson and we actually took Consumers Water in the State of New Hampshire completely and basically threw them out of the State. I negotiated the sale of what is now Pennichuck East to Nashua so I do know what is involved in that sale. I also know how those towns got that system and I am going to hopefully enjoy helping you possibly resolve some of the regionalization issues to everyone's benefit hopefully because I know what is involved in that sale for example. While Philadelphia Suburban was trying to buy Pennichuck I had the good fortune of being hired by the County of Ashtabula, OH – the County took by eminent domain Philadelphia Suburban in Ashtabula, OH with the exception of the city of Geneva. It was the Consumer System – Philadelphia bought all of Consumer. Philadelphia bought the company that we ran out of Hudson in May. They have a division in OH and they had county property in Ashtabula. We successfully bought that system. The Judge in that case ordered the parties into a room with his personal mediator, Mr.

Pittsfield Aqueduct Company serves 630 people in the center core of Pittsfield. It was owned privately by a family and bought by Pennichuck a few years back. Pittsfield I believe has voted to acquire if possible this asset from either Nashua – the company has also refused to sell it to them – publicly refused. They have expressed an interest to buy this from whatever owns it as a cash reimbursement. That is a good thing. This is a disconnected unit from the regional. Their goal to purchase this is a very good thing. There are some good assets. Pennichuck has improved the assets. They also have some very important land that is important to the Town of Pittsfield – very similar to where you were 30-40 years ago – a pond and hundreds of acres right off the edge of town. They don't want anything to happen to that. My presumption is as we go forward that we will be trying to marry the needs of Pittsfield with the needs of the City of Nashua and get this sold to Pittsfield in the process so it would be a cash reimbursement. You don't want to go up and operate this, they don't want you to, they don't need you to. You may have to take it temporarily, hold title, and then transfer it to them under the proper votes.

Pennichuck Water Services is a service company. This is a private company. It does utilize the assets of Pennichuck Corporation, and there is a sharing of fees and costs, but here again I am going to repeat this should be and no severance cost to severing this from the regulated assets. It is supposed to be no subsidy of this company by any regulated rates.

Southwood again we spoke about. Southwood is down to I think only 1 parcel left in the City of Nashua. I believe the 310 acres as we speak today is about to be knocked down about 250 in Merrimack, but it is most of the land is gone in Southwood. The hay day of Southwood is over. There are buildings, leases, operating income at Southwood. It was part of the Philadelphia Suburban package and it created part of the \$106 million. We estimated between \$15-16 million of the \$106 million was Southwood with its buildings, rent role, and its income. The hay day of Southwood balancing the cashflow of Pennichuck and aiding the dividends is over in our view. That is our opinion.

Nashua has about 21,000 or 65% of the total system in rough numbers. There is very little growth potential in this part of the company. This system is build out. Replacement pipes or capital improvements don't produce a lot more income or new cash flow – they require cash for the same income.

Valuation analysis – we go to the PUC we are going to have to present a value. Value generates rates. The rates will determine part of the public interest standard. The public interest standard and consequently your approval is two fold – number 1 the rates and number 2 to have you put together a sufficient infrastructure of people, company or contracts to operate, maintain, and serve the public interest equal to or better than the existing utility. That will be the second test. The test of value – the ultimate test of value is no net harm. What is the no net harm standard – it is a very practical standard that we applied in Hudson, we applied in Ashtabula where the rate payers are not asked to carry a greater rate because of the sale, the company is not asked to give up or constrict assets, we pay fair market value for the assets, but we don't overpay those assets so that there is a rate increase. We will be going in with no rate increase as the standard of transfer of the value.

The PUC will discuss value – might think differently. There is about \$15 million worth of soft issues like taxes that we will discuss in a moment, but we will be looking for no net harm across the boards.

Cost Approach – there are three approaches to value - cost, sales, and income. Those are the three conventional approaches for all property. You use them when you value all of your commercial property in the City of Nashua. We use them to value utility profits. Other than basically a lot more work digging out date it is the same process. The cost approach is the replacement cost new of all of the pipes and the treatment plant, the dams, the ponds, the water supply system less appreciation. **In this instance, the replacement cost new less depreciation would be a very high number - \$120 - \$150 million before market based depreciation – economic depreciation as a result of sales and income. This sale and this market can't afford \$150 million. That is a ludicrous number. Can't afford it.** What happens in a valuation is you test the cost approach against your other indicators of value and if the cost approach is higher then you ascribe additional economic depreciation to the cost approach.

This is true in mature assets. You have a lot of old pipe and you have a lot of contributed pipe that the developers have given the company. There is \$20 million worth of pipe that has been donated to the company that when you do a cost approach gets costed, but it provides no income because it was donated. The cost approach has been for water in New Hampshire not considered the final reliable indicator of value. Your tax assessment, which we originally did in '96 for Pennichuck went off the cost approach in into income and market and is below the cost approach by 30-40% for example as is the other assessments for Pennichuck around the State.

The cost approach is used and we will do one. It will be part of the package. The PUC will want to consider it and look at it, but most importantly it will be used to help allocate value between towns, cities, and the three companies. It allocates value based on actual pipe. It will not be weighted for value in our analysis, but it will be presented because it is a very important tool in determining and spreading out the costs and assisting in no net harm standard.

The important indicator is the sales – market sales approach. We have unearthed in your behalf that will be presented to the PUC 16 sales in the New England area in the last 5 years of water companies. When sales begin to occur the cost approach sort of takes second place to sales. It is just like your house. You can say my house costs \$300,000 but I have sales of \$200,000. If I had no sales I could only come up with \$300,000 because that is the cost but now I have sales and the house is \$200,000 or the house is \$400,000. Sales begin to take precedence. We have a lot of water company sales. It has been very active. The Europeans are trying to buy. There have been a lot of mergers to create larger companies. The Philadelphia Suburban offer was no secret. Nashua has been a plum that they have talked about for years to try to buy.

When we look at sales we ultimately come down to in raw data the price of the sale to the net book asset less the contributed profit. Price the net book less CIAC is one ... tape flipped ...

The PUC works on a net book basis. The book value, the amount of cash the company has in it, and they earn their rate of return on the amount of cash remaining in the company for the pipes that it hasn't been returned and I have a chart to show you that. When the PUC looks at

The income approach is the second approach that will be given considerable weight by the PUC. I have summarized this for you, but this is actually a detailed income based valuation, long term growth rate estimates and projections for Pennichuck Water Works, Pennichuck East, and Pittsfield separately. Pennichuck Water Works by income on its own with its existing rate structure and its future rate increases including the new 10% that is coming is \$70 million. The Pennichuck East is \$9 million. Pennichuck East has not gone up much in value. It is fundamentally under-performing, and so isn't Pittsfield Aqueduct. There hasn't been a lot of growth in Pittsfield Aqueduct that is \$2 million. For a total of \$81 million by an income approach.

The market sales of 1.31 times book or \$81 million and the income approach are very close and they are close because there are a lot of sales. You have some good data with which to present to the PUC. We would be proposing on your behalf as of 9/30/03 and 12/31/02 based on the most recent set of books, will be proposing a value of \$81-\$82 million for this taking. What is the PUC likely going to find for range – like I said there is \$15 million of very good argumentative fuzz in the pile? It is not fuzz perse. The company claims that you have to pay its capital gains taxes. They have thrown that out. In my experience we have negotiated those down to zero. This is an involuntary taking and they are allowed to reinvest their capital gain without paying taxes on it. They will have a company left over with which to reinvest it. We do not believe it will be in the public interest to reimburse the company for these types of costs.

It is also important to note that as we sit here today the company must continue. If closing were, and we are projecting closing of 1/1/06 take over – they close their books 12/31/05 you take over the books 1/1/06 they will have had to put another \$8-9 million of property in the normal course of business lately because they had to do tremendous capital improvement lately and these numbers will have to be tried up closer to \$90 million 18 months from now. Eighteen months from now, but it will also have more income 18 months from now so it is almost a wash in that regard.

We feel the PUC will likely be finding a value in the range of \$82 – 100 million. I don't particularly like to be saying publicly, but that is as public as we can get. That is where we believe the value should be. We know of a number that is our threshold that we will advise the council of what we believe the threshold is. I will leave it up to the council strategically with Mr. Upton if they want to discuss that number privately or publicly – it is your take if you want to know the number or not. What we have as of now we have established a threshold number for the city that if it is equal to or begins exceeding that number we would have to have some very serious discussions amongst the councilors, amongst the City of Nashua as to whether or not we should proceed. There is a price that this is not worth doing. Eighty two million is not that price, but there is a price.

We in our experience have had the fortune of being able to negotiate a final settlement/price that has not reached that ultimate threshold. Hudson reduced rates as a result of their final price. Ashtabula reduced rates 5%. We were very proud of that and when we did that we had a little headroom left in the price. I think Philadelphia is a little mad because I think they realized at 8:00 p.m. that they hadn't reached our headroom and they had agreed.

What sets the rates – the rates are set by the purchase price or cost. Either the price you pay or the cost to the company to build its assets – that is a capital basis. One of the reasons that 85% of all water companies are owned by municipalities is because they are the most highly

manned so people could go ask questions – without having to come to Nashua to look at Pennichuck stuff. You will require whether it is regional or city a minimum staff. A minimum staff of at least 1 manager and 1 assistant or clerical staff to prepare reports, documents, and these sorts of things under your or the Board's direction. If it is the Alderman owning this as the City if Nashua or the regional district owning it you will require probably 2 people, an upper person and a mid level person just to do all of that stuff. The contractor is not going to do that. You lose your audit trail if he does. That is what you can't lose. You can't lose that money audit trail. You have to have somebody looking over the shoulder administering that because you people are volunteer and elected people. You have jobs and everything else. You are not going to sit there and try to run that water company. That is a big water company.

A minimum of the two people. We recommend that the primary person be brought on board at the end of the PUC finding that it is in the public interest and the pricing you decide – to immediately assist in the transitioning phase to be brought up to speed and begin transitioning so approximately 6 months before the transition we would recommend that limited staff be interviewed, chosen, put on board, that cost is an asset transfer cost – the initial cost to the transfer is in the bond for that person, it is financed in the bond so everybody pays for it. That is what that means sir. That has been successful in all three that we have done.

Alderman Deane

This is great. I had another question - please explain why an analysis is being done for contract operations, and you went through that where the regional and municipal operations with hopefully Pennichuck coming back so that question was answered earlier.

Please define the City of Nashua's financial advisors – are you referring to our bond council as well as our CFO and her staff?

George SanSoucy

Your financial advisory start with Carol. I answer and discuss directly with her all of these issues, and then we interface directly with First Southwest, which is your chosen financial advisor on this instance, and then we expect to interface with your chosen bond council, Palmer & Dodge – Palmer & Dodge of course we have worked with in the past. First Southwest our initial phase of working with them has been very positive. You choose the financial advisors we don't. We are required to provide them tons of stuff. I need to keep them informed, but I also need to keep them on the straight and narrow on your behalf. In other words if I am going to propose something to the PUC on your behalf as a settlement on an issue I need to get through Carol, through Palmer & Dodge, and through First Southwest that it doesn't affect the bond negatively or whatever because I am the guy that is testifying on your behalf. They are a critical player, but that is the team that I would expect to be working with and asking for advice. They step up to the plate. When I have done my job – my job if all goes well I come back to you with a price that you can accept and a deal and a structure that you can live with to go forward.

Then we start the asset transfer – First Southwest starts the preparation of the bond documents with Palmer & Dodge and that kind of stuff. In the interim we don't want to do something that hurts or harms the bond rating so to speak. Does that answer the question Mr. Deane?