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December 15, 2006

Via Hand Delivery

Debra A. Howland
Executive Director and Secretary
New Hampshire Public Utilities Commission
21 S. Fruit Street, Suite 10
Concord, NH 03301



Re: DW 04-048; City of Nashua—Taking of Pennichuck Water Works, Inc.

Dear Ms. Howland:

Pursuant to the procedural schedule in the above-captioned matter, enclosed for filing with the Commission are an original and six copies of the Opening Statement and Trial Memorandum of the Pennichuck Companies in the above-captioned matter.

We have provided an electronic copy of the filing to the PUC librarian and the parties.

Thank you for your assistance with this matter

Very truly yours,

A handwritten signature in black ink, appearing to read 'Steven V. Camerino'.

Steven V. Camerino

SVC/ksm
Enclosures

cc: Service List (by electronic mail only)
Duane C. Montopoli, CEO and President, Pennichuck Corporation
Donald Ware, President, Pennichuck Water Works, Inc.

**STATE OF NEW HAMPSHIRE
BEFORE THE
PUBLIC UTILITIES COMMISSION**

City of Nashua: Taking Of Pennichuck Water Works, Inc.

Docket No. DW 04-048

Opening Statement and Trial Memorandum Of The Pennichuck Companies

This trial memorandum and opening statement is submitted by Pennichuck Water Works, Inc. (PWW), Pennichuck East Utility, Inc. (PEU), Pittsfield Aqueduct Company, Inc. (PAC)(collectively, the "Pennichuck Utilities"), Pennichuck Water Service Corporation (PWSC) and Pennichuck Corporation (PNNW) (collectively, the "Pennichuck Companies").

I. Introduction

This case is unprecedented in the State of New Hampshire, both in the sheer size of the proposed eminent domain taking of New Hampshire's oldest continuously operating business corporation and in the breadth of legal and factual issues raised by Nashua's petition. To give the Commission a picture of the overall case, this trial memorandum focuses on the following key legal and factual points:

1. **"Net Benefit" is the Legal Standard For the "Public Interest"**—Because this is an eminent domain case affecting constitutional rights, the City must show that any purported benefits of its proposed taking outweigh the substantial harm that the taking would cause. This balancing test does not weigh solely Nashua's interests. It must also measure the interests of citizens in the many towns that have not conducted referenda and who oppose the taking.
2. **PEU, PAC, PWSC And Their Customers Will Suffer Rate Shock and Other Substantial Harm**—Nashua's proposed taking will cripple the remaining Pennichuck Companies, resulting in significant rate increases for customers of PEU and PAC and adversely affecting their service. It will also put PWSC out of business.
3. **PWW Customers Will Become Guinea Pigs and Suffer Substantial Harm**—Nashua does not have any expertise to operate PWW. Instead, it proposes to

use four different contractors plus Nashua to replace PWW's high level of service. This has never been tried before and is likely to result in lower quality service, loss of trained personnel, and no cost savings. PWW customers outside of Nashua face the additional risk of receiving service from a distant and hostile political entity.

4. **New Hampshire Will Lose A Critical Resource and Suffer Substantial Harm**—Nashua's taking of PWW will harm the State by eliminating the one company that has demonstrated the capacity and willingness to work with the Commission on a consistent basis to address the problems of troubled water systems statewide. Nashua has conceded that it has no interest in playing such a role and lacks the motivation to do so.
5. **PWW Has Presented The Only Credible Valuation Of Its Assets, While Nashua's Valuation Lacks All Credibility**—PWW's valuation of \$273 million is derived from the application of accepted valuation methodologies. PWW's valuation experts carefully studied all of the assets and professionally documented their work. Nashua's valuation pales by comparison. It lacks any credibility and should be given no weight because it reflects shoddy work, resulting in a predetermined outcome from the application of a highly biased and unprofessional process. Moreover, Nashua's "experts" lack even the rudimentary independence required of a valuation witness.

II. **Background**

PWW has provided water service in New Hampshire for 154 years, initiating service in Nashua in 1852. Within the past 25 years, PWW has expanded to provide regulated utility service in 11 communities in Southern and Central New Hampshire.¹ In 1983, PWW converted to a holding company structure, with the establishment of PNNW as its parent company. With PEU's acquisition of the troubled satellite systems of the former Consumers New Hampshire Water Company in 1998, PWW personnel have also provided regulated utility service to 16 communities throughout Southern, Central and Northern New Hampshire. PWW also staffs the utility operations of PAC. In addition, PWW personnel provide contract operations service to several municipalities and dozens of community water systems on an unregulated basis through another affiliate, PWSC.

¹ Figures used for numbers of systems, communities and customers served are all based on the testimony submitted in this case and have not been updated for additions since the date of that testimony.

The Pennichuck Utilities undertook the expansion of regulated utility service with the support and encouragement of the Commission as a means of, among other things, addressing problems that had arisen in many small, poorly capitalized water systems in the state.² All of the employees required for the operation of the utility and unregulated water service businesses of the Pennichuck Companies have been and continue to be employed by PWW. The costs associated with these employees are divided among PWW's various affiliates in accordance with a cost allocation agreement on file with the Commission.

In January 2006, nearly two years after the City filed its petition to take the PWW assets, the City filed testimony valuing the PWW assets at only \$85 million. That was almost precisely the number predicted by the City's valuation witness in 2003, three years before he conducted his valuation analysis. Nashua also submitted testimony about its plans to contract out the operations of the utility, identifying for the first time four contractors, including the French owned company, Veolia Water North America--Northeast, as the operations contractor, and RW Beck as the oversight contractor. The contracts between Nashua and its third party operators have yet to be finalized. Indeed, they contain a number of blank monetary terms, have not been signed, and remain subject to further negotiation.

On April 13, 2006, the staff of the Commission submitted the testimony of Mark Naylor, Director of the Commission's Gas and Water Division, Amanda Noonan, Director of the Commission's Consumer Affairs Division, and Randall Knepper, Director of the Commission's Safety Division. The testimony raised serious concerns regarding Nashua's plan to take over PWW and operate the utility. They warned of the consequences to the customers of PWW outside of Nashua, the customers of PEU and PAC, and the customers of troubled water systems in the state. These concerns were consistent with those raised in earlier testimony by former

² See January 12, 2006 Testimony of Douglas L. Patch at 5-6, 20-21.

PUC Chairman Douglas Patch. Nashua responded to the Staff's testimony by, among other things, asserting that the Staff's position was motivated by concern for their own jobs and by bias in favor of the Pennichuck Companies.

Although the Commission has on occasion considered issues of eminent domain, never before has it been presented with a taking that involved all of the assets of a major utility. In fact, as the testimony of Mr. Naylor, former Chairman Patch and other witnesses amply demonstrate, the continued viability of the Pennichuck Companies is at stake in this case, with the impact of the proposed taking extending well beyond the customers of PWW. The Commission's ruling in this proceeding will have profound consequences for the 30,000 regulated customers of the three Pennichuck Utilities, the more than 16,000 unregulated customers of PWSC, the 3,000 shareholders of PNNW and the countless customers of troubled water systems in New Hampshire.

III. Public Interest

A. Standard of Review

Given the devastating financial and/or operational impact that a taking of PWW's assets is likely to have on PWW customers, the other Pennichuck Utilities and their customers, PWSC and its customers, and the 3,000 PNNW shareholders, it is critical that the Commission apply the correct legal standard of review. Pursuant to RSA 38:10, the Commission is charged with determining whether Nashua's condemnation of PWW is in the public interest. If Nashua fails to meet this burden, the Commission's inquiry ends, and a value for PWW's assets need not be determined.

1. Nashua must demonstrate that the benefits of its proposed taking outweigh the substantial harm it will cause.

Although the term “public interest” is well familiar to the Commission, this case applies the term in a manner that is significantly different from its usage in cases involving the consensual transfer of utility stock or property or involving the grant of a utility franchise. In a proposed transfer of a utility, the transaction is analyzed using the “no net harm” test. The no net harm test is founded on the principle that a private company’s use of investor capital generally should not be constrained if such a use would not result in harm to the public.³ By contrast, this case requires the Commission to determine whether utility assets that have been purchased with private capital should be taken by eminent domain and transferred to a governmental entity. Because this case involves a proposed governmental taking of private property, public interest must be analyzed consistently with other takings cases, including those considered by this Commission under RSA 371 and those considered by courts and the Board of Tax and Land Appeals.

The burden imposed on a governmental entity seeking to take private property by eminent domain has been considered frequently by the New Hampshire Supreme Court. It requires the governmental body to demonstrate a public purpose and a public benefit. The precise statutory terminology varies among the various condemnation statutes-- from public interest (RSA 38:10) to necessity (RSA 205:1; 371:1) to occasion (RSA 231:8)--but each term reflects the same constitutional requirement, and the supreme court has applied uniform standards in interpreting

³ See *Grafton County Electric Light & Power v. State*, 77 N.H. 539, 540 (1915); *Re: Eastern Utilities Assoc.* 75 NH PUC 188, 190 (1990); *Re: Eastern Utilities Assoc.*, 76 NH PUC 236, 252 (1991).

them.⁴ The supreme court has defined this standard as follows: "a public necessity exists if the city demonstrates a public purpose for the taking and that, on balance, 'a probable net benefit to the public [will result] if [the] taking occurs for the intended purpose.'" *Appeal of City of Keene*, 141 N.H. 797, 802 (1997) (citations omitted.); *Petition of Bianco*, 143 N.H. 83, 86 (1998) (governmental unit seeking authority to proceed with taking must demonstrate that "the taking will result in public benefit.").

To determine whether there is a net benefit from the taking proposed in this case, the Commission must engage in a balancing test. "In conducting the appropriate balancing test to determine public necessity, the taking authority must consider all public benefits of the proposed taking against all burdens and social costs suffered by every affected property owner." 147 N.H. at 87; *Merrill*, 127 N.H. at 237. Thus, the Commission is charged with identifying all of the impacts of the City's proposal—not just those on Nashua, but also the impact on the customers of all three Pennichuck Utilities, on the state, on the shareholders of PNNW, on the customers of PWSC and on the public generally.

In *Rodgers*, the supreme court reached a similar conclusion, but went on to clarify that the extent of the necessity of a proposed taking will affect the weight that should be given to the burdens imposed by the taking, noting that "public interest" exists on a spectrum that consists of levels of necessity ranging from mere convenience to exigency. *Rodgers*, 147 N.H. at 60. In discussing how this spectrum should affect a tribunal's analysis of whether to authorize a proposed taking, the Court explained that a taking for mere convenience justifies only a slight

⁴ See, *Rodgers Dev. Co. v. Tilton*, 147 N.H. 57, 59 (2001) ("we have used different terms to describe our consideration of the same basic question – referring variously to the "need", "necessity", "exigency", "convenience", and "interest" of the public"); *Merrill v. Manchester*, 127 N.H. 234, 238-39 (1985) (applied road condemnation "occasion" standard to blighted property condemnation "necessity" case). See also RSA 498-A:9-b. (uniform process in BTLA cases for superior court referral on issue of necessity, net public benefit, public purpose (changed as of January 1, 2007 to public use)).

imposition on private rights, and that only a compelling public need would justify a significant invasion of rights. *Id.* The evidence in this case will demonstrate that Nashua's proposed taking will result in a significant invasion of both private rights and public interests, and therefore Nashua must demonstrate a truly compelling need for the taking.

Nashua can be expected to argue that, as a public utility, PWW has been subject to a possible taking by eminent domain for decades, and that the mere existence of RSA Chapter 38 is enough to allow the taking to proceed. But the threat of a possible taking is different from the determination that a *particular* taking is in the public interest. PWW, as a private company, and the shareholders of PNNW, as private individuals, are entitled to the same protections from the taking of their property as any other private party in our state. Investors did not lose those rights when they invested in a business venture, simply because that business provides service to the public. In fact, there are good policy reasons to suggest that the Commission should be *more* concerned about protecting the interests of shareholders in utility companies, rather than less concerned as Nashua would have the Commission believe. The public interest surely will not be served by sending a message to the investment community that when they invest in New Hampshire utilities, their capital can be taken by the government more readily than if they were to invest in other types of businesses.

Because the taking of all of PWW's assets would result in an indisputably significant invasion of private property rights, under *Rodgers* only a showing of compelling public need would justify authorizing Nashua to proceed with condemnation. Furthermore, in addition to the private rights that will be harmed by the taking proposed in this case, there are also substantial public interests that will be harmed. Thus, in considering the evidence, the Commission must first determine whether a compelling public need for the proposed taking exists and, if so, then

determine whether that purported need outweighs the significant burdens that a taking would impose on the Pennichuck Companies and the harm that would be done to the public from such a taking. The evidence in this case will show unambiguously that Nashua's proposed taking of PWW is not necessary to further a compelling public need. Nashua has never claimed that PWW provides inferior or unsafe water service to its customers and in fact it has conceded that the opposite is true. Thus, there can be no compelling need for the taking based on the current operation of the company. Because Nashua cannot satisfy its heavy burden of proof, the taking of PWW's assets must be found to be not in the public interest and Nashua's petition should be denied.

2. The public interest to be considered by the Commission extends far beyond the narrow interests espoused by the City of Nashua.

Nashua can also be expected to argue that the Commission should limit its consideration of the public interest primarily to the interests of Nashua, and should give little weight to the broader public interest of all the customers served by PWW, PEU and PAC, the interests of the municipalities and other customers served by PWSC, the interests of the State and the interests of PNNW's shareholders. Nashua believes that it can convince the Commission to determine the public interest by simply concluding that, because Nashua residents make up the majority of PWW's customer base, there is no need for the Commission to give substantial weight to the interests of customers outside of Nashua or to examine more closely whether Nashua can deliver on its claims to its own citizens. It is clear that the public interest standard has a far broader scope than Nashua has recognized in its testimony. "In conducting the appropriate balancing test to determine public necessity, the taking authority must consider all public benefits of the proposed taking against *all* burdens and social costs suffered by *every* affected property owner." *Bianco*, 143 N.H. at 87 (emphasis added).

3. The statutory presumption of public interest has no meaningful impact on this case because Nashua's proposed taking extends well beyond its municipal borders.

The City relies on the statutory rebuttable presumption of public interest in RSA 38:3 in an attempt to relieve it of the heavy burden of establishing that the claimed benefits of its proposed taking outweigh the substantial harm that such a taking will cause. In doing so, Nashua seeks to rely on a four year old vote at a special election as the basis for its attempt to take utility assets located in 11 different communities, despite the fact that the other communities have not voted for such a taking.⁵ While RSA 38:3 may provide a rebuttable presumption that the taking of the system in *Nashua* is in the public interest, a presumption that is more than amply rebutted by the evidence in this case, it certainly does not create a presumption that Nashua should be allowed to take PWW's assets in Merrimack, Amherst, and other surrounding towns. The Commission recognized this in Order No. 24,567, where it stated that at least in the context of Nashua's franchise request, "[t]he rebuttable presumption extends only to the public interest analysis for Nashua itself, as only voters of Nashua had a voice in the vote that gave rise to that presumption. For service beyond Nashua's municipal bounds, Nashua must obtain a franchise." Order No. 24,567 at 5. Further, the Commission has already noted in this case, eminent domain statutes must be strictly construed.⁶ This principle of narrow interpretation has even greater application in situations such as this one, where a municipality is seeking to exercise authority to

⁵ Although the Town of Bedford voted to municipalize at one point, it has made clear that it does not support a proposal under which it would be served by Nashua. July 19, 2005 deposition of Michael Scanlon at 39.

⁶ Order No. 24,425 (January 21, 2005) at 11-13 (citing to *Maine-New Hampshire Interstate Bridge Authority v. Ham*, 91 N.H. 179, 181 (1940); *Fortin v. Manchester Housing Authority*, 133 N.H. 154 (1990); RSA 498-A; and 26 Am Jur2d, Eminent Domain §20). See also, 4 Tiffany, *The Law of Real Property*, § 1252 (3rd ed. 1975); *Orono-Veazie W. Dist. v. Penobscot Cty. Water Co.*, 348 A.2d 249, 253 (Me. 1975); *Ronci Mfg. Co., Inc. v. State*, 403 A.2d 1094, 1097 (R.I. 1979).

condemn property outside its corporate limits.⁷ Because Nashua is proposing to take the assets of an integrated utility system extending far beyond its municipal borders, the statutory presumption should be given no weight here in determining whether the proposed taking is in the public interest.

B. Nashua's Proposed Taking of PWW is Not in the Public Interest.

1. A taking of PWW's assets will have a substantial negative impact on PEU, PAC and PWSC and their customers.

As Messrs. Ware, Guastella and Correll explain in detail in their testimony, a taking of PWW's assets would have a devastating impact on PNNW, its remaining subsidiaries and their customers because those entities are critically dependent upon PWW's assets and personnel. The Pennichuck Companies operate as a closely integrated whole, achieving significant economies of scale by sharing common assets and personnel, rather than replicating them within each entity. Together they operate more than 130 different regulated and unregulated water systems which serve over 46,000 customers in dozens of communities throughout the state.

PWW's employees are solely responsible for providing the services required to operate PAC, PEU, PWW and PWSC as well as PNNW. Similarly, PWW owns many of the most critical assets used to serve the customers of PEU, PAC and PWSC—computer systems, engineering resources, vehicles, computer software and customer billing and information systems. The costs of the employees and assets that provide service to the other Pennichuck Companies are allocated by PWW to each of its affiliates in accordance with a cost allocation agreement that has been subject to Commission review. Without access to those shared assets, the other Pennichuck Companies could not operate. And if the assets could be replaced without

⁷ See *Village of Arlington Heights v. Gatzke*, 428 N.E.2d 947, 949 (Ill. App. 1981)(prohibiting a municipality from using drainage condemnation authority to create a reservoir outside of city limits); *McQuillan, Mun. Corp.* § 32.66 (3rd ed. 1991).

throwing the operations of PEU, PAC and PWSC into total disarray, the cost of replacement would be crushing when compared to the cost currently reflected in rates.

As Mr. Ware discusses in his direct testimony, PWW and all of the Pennichuck Companies and their customers derive a significant benefit from this integrated approach to operations, because it results in a substantially lower cost of service per customer.⁸ The taking of PWW assets would reverse that. According to Mr. Guastella, after PEU and PAC purchased replacements for the taken PWW assets and then spread the cost over their remaining customer base, PEU's customers would suffer a 64% increase in rates and PAC's customers would suffer a 66% increase.⁹ The impact on PWSC would be still more severe because, as an unregulated business providing contract operations to municipal and private water systems, it would have little or no ability to increase its revenues to compensate for the higher costs. As a result, it would operate at a loss and would almost certainly go out of business, resulting in an even smaller customer base over which PEU and PAC would have to spread the new higher costs. All told, Nashua's taking, if approved, would cause a ripple effect across the State of New Hampshire, affecting customers in 35 regulated water systems in 16 communities plus thousands of customers served by PWSC.

2. The state would lose a critical resource for solving water quality problems if PWW were taken by eminent domain.

The direct impact of a taking on the customers of the Pennichuck companies would be just the beginning. As Mr. Correll and Mr. Ware explain, without the continued existence of PWW, neither PEU nor PAC could play the same critical role that they and PWW have played in

⁸ Nashua asserts that the economies of scale that result from the Pennichuck Companies' use of a combined workforce and shared asset base amount to a subsidy from PWW to its affiliates. But Mr. Ware's testimony explains that the economies of scale actually create a benefit to PWW and its customers by enabling them to spread over a larger customer base costs that PWW would otherwise have had to incur on its own January 12, 2006 Testimony of Donald L. Ware at 6-8.

⁹ See May 22, 2006 Testimony of John F. Guastella at 4.

addressing problems of troubled small water systems. Those companies would simply lack the necessary capital, scope of expertise and overall capacity to continue in that role. They would lack the larger asset base, access to capital markets and employment base enjoyed by PWW. No other utility in the State of New Hampshire has ever undertaken the extensive efforts of PWW in helping to address water system problems in the state, and there is no basis to believe that in the absence of PWW any other company would do so in the future. Nor is it reasonable to expect Nashua, a highly politicized governmental entity, would play a similar role in place of the Pennichuck Companies. In fact, Nashua's mayor has made plain even in the context of this case that his concern is the people of Nashua, not those of other municipalities, stating "I'm not concerned with Epping or Newmarket,"¹⁰ two of the communities now served by PWW. Perhaps even more incredibly, the evidence will show that, when asked "is it good policy for Nashua to be operating water systems far flung from its core," the City's Director of Community Development responded "It is not. It doesn't make a whole lot of sense for Nashua to be operating it."¹¹

Former Chairman Patch has expressed similar concerns about Nashua's ability or willingness to work with the Commission to address water systems beyond the City's boundaries. In his testimony, Mr. Patch is clearly troubled by the impact on the state if PWW were to be acquired by Nashua, characterizing PWW as the premier water utility in New Hampshire. He noted that, without the Pennichuck Utilities' acquisition of smaller water systems over the years, those customers would face higher rates and/or inferior service. Mr. Patch's testimony concluded that Nashua's taking of PWW would have multiple negative effects both

¹⁰ See Attachment DLC-3 to January 12, 2006 Testimony of Donald L. Correll.

¹¹ July 21, 2006 deposition of Katherine Hersh at 131.

inside and outside of Nashua arising out of the loss of scope and scale resulting from a separation of the PWW assets and operations from those of the other Pennichuck Companies.

The Staff echoed these concerns. Mr. Naylor's conclusions were particularly pointed, eviscerating Nashua's claim that a taking by eminent domain is in the public interest:

PWW's approach to regional cooperation and its willingness to work with various parties contributes to the development of solutions, a role which has been invaluable to the State.... It is also clear from a reading of that report [a report to the Legislature entitled "Regulatory Barriers to Water Supply Regional Cooperation and Conservation in New Hampshire"] that municipal water suppliers are not only not the answer to greater regional cooperation; many contribute to the lack of cooperation. Municipal entities by their nature look inward. In the case of PWW as an investor-owned utility, it is essentially blind to municipal boundaries and is largely unrestrained by politics. An investor-owned utility has the incentive to look outward to expand its business opportunities; municipalities worry about control of "their" water. A true regional utility with a profit motive is incited by effective regulation to get the product to the people who need it and want it under rates and conditions that are just and reasonable for all who are served. April 13, 2006 Testimony of Mark A. Naylor at 51-52.

The fact is PWW and its affiliates have a proven track record of bringing diverse parties together to solve difficult water issues. Whether municipalities, businesses, other water providers, or governmental agencies, it has been the Pennichuck companies that have brought parties together to find answers. *Id.* at 55.

Based on the evidence in this docket Staff has little doubt that the public benefit to the region and the State of Pennichuck acquiring and rehabilitating small water systems would end with a municipalization of the water system owned by PWW. *Id.* at 56

Staff's concern about the quality of service to the satellite systems is fueled by Nashua's complaint that it is subsidizing non-Nashua customers. However one interprets Nashua's stated intentions resulting from its concern over providing a subsidy to customers in other municipalities as discussed earlier, it is indisputable that PWW today is itself serving in the role as a regional utility with some 3,000 customers outside of Nashua. Thus, a taking of PWW means that the City of Nashua would have water customers in other municipalities who would not have the Commission to turn to, would not have a municipal vote for mayor and alderman, i.e. the "management" of their water supplier, as customers do in unregulated municipal systems, and whose water supply would not be physically interconnected with the core system serving Nashua. This leads to a concern that those customers would be continually at risk for their water systems to receive fewer capital improvements and less attention from the City, which ironically is the same argument Nashua makes with respect to its desire to ensure future local control of the water system. This very concern is articulated in the testimony of Mr. Hinch, chairperson of the Merrimack Board of Selectmen. *Id.* at 63

In the face of these overwhelming concerns, Nashua would have the Commission believe that taking the assets of PWW is somehow its birthright.¹² Far from it, the assets owned by PWW serve customers throughout dozens of communities in the state. No better example exists of a utility that has worked cooperatively with this Commission to solve utility problems throughout the state while at the same time providing unquestionably excellent service to its customers. Nashua simply has not, and cannot, demonstrate that its takeover of PWW will benefit the public. In fact, the evidence demonstrates that it is likely that substantial harm will be caused by such a takeover.

3. Municipal ownership of water systems is no panacea. Here, Nashua's own politics give little grounds for comfort. Nashua's proposal to hire four contractors to run the water system is convoluted, untried and likely to be more costly and result in decreased service.

Nashua argues that, because a large number of other communities operate their own water systems, the Commission should accept Nashua's assurance that it will be able to do so successfully. The problem with Nashua's assertion, however, is that it is completely unsupported by any facts relevant to this case.

First, Nashua implies that, because other communities operate their own water systems, those systems operate better and cheaper than they would under private ownership. But Nashua has provided no evidence of that, and in fact the opposite is likely to be true for Nashua. Mr. Patch noted that PWW and its related companies have repeatedly demonstrated that they have the ability to provide such service and that Nashua has no such track record. Mr. Patch cited a report prepared by the Maine Public Utilities Commission regarding municipal acquisitions of private utilities, which stated that "While the cost of operation is important, the ability to provide

¹² Whether a taking is in the public interest is not a foregone conclusion. See *The City of Pekin*, 2004 WL 2914054 (Ill.C.C.) (January 22, 2004)(finding municipal taking of a water utility not to be in the public interest).

a safe, adequate and reliable source of water, now and in the future, should be the primary consideration of any utility” and, presumably, utility regulators. As Mr. Patch concludes, given the proven qualifications of PWW, the absence of any question about the company's ability to provide such service and the real risk that quality of service will decline under ownership by Nashua, there is a significant risk that customers will be harmed by allowing Nashua to take over ownership of PWW’s assets.¹³ The evidence will demonstrate that Nashua’s constant internal political wrangling combined with its complex proposal for operating the utility make it highly susceptible to problems that are likely to threaten the quality and cost of service to PWW’s customers.

(a) Nashua’s proposed multi-tier structure for its contractors is likely to result in fragmented service.

Contracting out operations is no panacea for a municipality. As Mr. Patch stated in his testimony, Dr. Janice Beecher, Director of the Institute of Public Utilities at Michigan State University, found that when local governments take over water system ownership and use third party contract operators, problems often result with regard to the deployment of capital and operating resources. There is confusion as to responsibility for environmental compliance, resolution of customer service complaints and long range planning. Mr. Patch contrasted the fragmentation of responsibilities created by the use of outside contractors to operate municipal water systems with ownership by an investor owned utility. He noted that an investor-owned utility must satisfy the scrutiny of regulators through prudence reviews. Mr. Patch also noted

¹³ In his May 22 and November 14, 2006 testimony, Mr. Guastella demonstrates that any difference in rates between PWW’s and those under City ownership is likely to be negligible. As Mr. Guastella points out, regardless of the weight that the Commission gives projected rate levels under the two ownership scenarios in determining whether a taking is in the public interest, the difference is so minimal and uncertain that it should not affect the outcome.

that, because of the profit motive, investor-owned utilities have a clearer incentive to achieve efficiencies in their investments, operations and other matters.

Not surprisingly, Nashua has failed to point to a single municipality that operates, either on its own or through a third party operator, a system as geographically diverse as the one Nashua seeks to take from PWW. Nashua has also failed to provide a single example of any other municipality that has established the complex contractual structure that the City proposes in order to operate PWW's water systems. In fact, the City would have the Commission believe that it is typical for a municipality to hire four contractors to run its water system. Ironically, Nashua's lead contractor, Veolia, has stated that it does not believe this is the most effective way to operate a utility.

Unlike PWW, which indisputably bears sole responsibility to provide safe, adequate and reliable water service in accordance with state and federal law, these contractors' obligations would be limited and circumscribed by their contractual arrangements. The Veolia contract lacks typical performance standards. As a result, there is no assurance that customers will receive quality service.¹⁴ As soon as a situation arises that is not expressly contemplated by the various contracts or there is a quality problem, the finger-pointing, refusal to undertake work, delays and attempts at cost shifting can be expected to begin—meanwhile the public will wait for a resolution and have little or no recourse to regulators to protect them. Such delays and failure to take responsibility are inherent in such a complex contractual arrangement, and are simply unacceptable with something as important as the public drinking water supply.

Moreover, Nashua has no municipal infrastructure to operate a utility as vast as PWW and has presented no evidence that it intends to create one. The evidence will show that Nashua has no plans to set up a separate water department or to hire any significant new staff to address

¹⁴ See February 27, 2006 Testimony of John F. Joyner at 7-8.

issues relating to the system. The only role for City employees will be to handle billing functions, and to coordinate customer service with the outside contractors. Needless to say, none of the City employees has any experience in such complicated operations or any technical knowledge in the water industry. Instead, the City intends to rely on its employees' experience processing sewer bills, a function that is vastly different from addressing customer service concerns associated with an ingestible product, water.

It is remarkable that this poorly staffed, complex arrangement is Nashua's proposal to replace a company that is broadly recognized for its high level of customer service. It is easy to imagine a customer experiencing a problem will be bounced from person to person to person under Nashua's proposed structure, lost in the labyrinth of City employees and their four contractors in a vain attempt to find the right person to answer her question or solve her problem. In contrast, a customer calling Pennichuck – day or night – receives the attention of a highly trained customer service representative or an employee at the water treatment plant, whose business it is to know and respond to the customer's inquiry.

The Commission Staff has expressed significant concerns about this issue, noting that the layers of bureaucracy in the City's proposed structure and the inherent difficulties of coordinating among all the parties involved pose a significant threat to the level of service provided to customers. As Mr. Naylor states in his testimony:

Based on Staff's experience with water utilities, Staff sees the absence of effective internal oversight by Nashua, and more particularly the delegation of both operations and oversight to contractors, as not creating an effective ownership and management approach for a major business. Even with the most experienced contractors, there is considerable risk that their lack of ownership or other long term interest in the assets may cause inefficient and uneconomic operation. Nashua proposes to create a structure that risks a reduction in overall efficiency and effectiveness over time.

April 13, 2006 Testimony of Mark A. Naylor at 62. Running a utility as diverse as the 22 systems owned by PWW takes more than a theoretical operational structure jotted down on a piece of paper. It takes experienced, committed people who are accountable and subject to close oversight. Nashua's proposal provides no such assurances, only words that can be forgotten the day the City owns the assets it so covets.

Of equal concern, while Nashua relies heavily on the assertion that it has entered into a fixed price contract with Veolia to operate the water system, the reality is that over and above the base annual fee for routine services, the contract provides for additional unlimited charges for capital costs, unplanned maintenance, electricity and fuel costs and many other critical expenses that will be charged on a supplemental basis. The result is that Nashua's projections of its costs to operate the utility are completely speculative and unreliable. Add to that Nashua's use of its discount asset purchase price in its revenue requirement projection and Nashua's entire analysis proves to be irreparably flawed. As Mr. Naylor noted,

It appears that Nashua has underestimated the cost of unplanned maintenance, utilities such as fuel and electricity, purchased water, and costs related to the Dig Safe program or Nashua's alternative to that program. ...Any value set by the Commission higher than the value suggested by Nashua will also reduce the savings that Nashua believes PWW customers will realize going forward under municipal ownership.

Id. at 43-44.

Worse yet, the operations contract that Nashua has put forward is subject to change at the whim of the parties. As if to illustrate the undefined nature of the relationship between Nashua and Veolia, the draft contract submitted by Nashua includes blanks in a number of key provisions, making it clear that the City and its contractors still do not have a firm grasp of a number of material aspects of their relationship. Nashua will argue that it cannot know what to put in the contract until the Commission has indicated what it desires, but Nashua's burden in

this case is to make a proposal for the Commission to analyze and judge. It is not the Commission's job to tell Nashua how to structure its proposal. Certainly Nashua could have signed a contract with Veolia and reserved the right to renegotiate specific provisions if required to do so by the Commission. Utilities do just that all the time when they enter into special contracts that require subsequent Commission approval. But Nashua chose not to, instead proceeding with a draft contract that it plans to complete at some time in the indefinite future.

4. Nashua's takeover of PWW would result in significant workforce disruption that will inevitably threaten the service provided to customers.

Nashua has repeatedly stated that the employees of PWW provide a high level of service and that it hopes to utilize those employees if it takes over the utility. Similarly, Veolia has promised a smooth transition by employing PWW personnel to operate the utility. Whether PWW personnel would want to work for Veolia is questionable, because Veolia has made it clear that it will eliminate the defined benefit pensions and retirement health benefits which PWW employees now enjoy.

Apart from the concessions which Veolia will demand of any PWW workers hired, Nashua's approach ignores the fact that PEU, PAC and PWSC are entirely reliant on those same employees. Thus, Nashua's proposal, as it does in so many other ways, would pit the interests of some of the Pennichuck Companies' employees and customers against those of others. However, as with other issues in this case, the Commission can avoid these Hobson's choices by leaving the Pennichuck Companies intact in their current form and enabling all customers to benefit from the expertise and efficiencies that come from being served by the same experienced employee base.

5. Nashua's attempt to take PWW by eminent domain is not supported by key public constituencies.

Ironically, Nashua's efforts to take the assets of PWW are not supported by the broad mandate that one would expect for such an audacious undertaking. The Town of Merrimack residents and businesses, along with the Merrimack Village District, purchase 20% of the average daily flow of water sold by PWW. The Town has expressed its strong opposition to such a taking:

Merrimack does not have the confidence that Nashua could provide that same good level of service, based upon the evidence Nashua has presented. Merrimack also worries that Nashua will favor its own residents in terms of rates and capital investments, at the expense of Merrimack residents and businesses. I am concerned that Nashua cannot be counted on in the future to act in a manner that would give appropriate weight to the interests of Merrimack businesses and residents. Currently, Merrimack customers are billed at the same rate as Nashua customers, and receive the same consideration in terms of new connections. Merrimack remains insecure at this point about ownership of the water system by Nashua; especially since Nashua's water operations would likely become exempt from Commission oversight should Nashua and/or the District take over PWW. Merrimack's citizens have not voted for municipalization of the water system, and we are not comfortable with Nashua voters and elected officials making decisions that would directly affect Merrimack water customers.

January 12, 2006 Testimony of Richard Hinch at 4. The Town of Milford, which purchases water at wholesale from PWW has also opposed the taking. *See* January 12, 2006 Testimony of Gary L. Daniels (citing six reasons why the Milford Board of Selectmen voted to oppose Nashua's proposed taking, including Milford's concern that it could not "count on the same level of commitment [as Pennichuck's] from municipal management."). The Town of Bedford's view is that it "do[es] not believe Bedford is well served by being a customer of the City of Nashua."¹⁵

In addition, scientific polling conducted by RKM Research, demonstrates that there is little support even within Nashua for a public acquisition of PWW when voters are made aware that such an acquisition would occur by eminent domain. As Mr. Myers's testimony notes, the

¹⁵ July 19, 2005 deposition of Michael Scanlon at 39.

referendum in January 2003 did not include the words eminent domain in referring to the possible acquisition of PWW. RKM's research indicates the inclusion of that information greatly affects the public's view of the issue. Beyond that, RKM's polling results reveal that the supposed mandate that Nashua claims its voters gave four years ago no longer exists, if it ever did, and that the majority of voters would oppose condemning PWW if they were asked today. Such a result is not surprising given the strong public sentiment against eminent domain evidenced recently both in New Hampshire, with the adoption of an amendment to New Hampshire's state constitution tightening eminent domain requirements, as well as nationally, in response to the United States Supreme Court opinion in *Kelo v. New London*, 545 U.S. 469 (2005). The evidence in this case will unambiguously demonstrate that there is simply no basis to believe that there is broad support either inside or outside Nashua for taking over the largest investor owned water utility in the state, despite Nashua's efforts to create the appearance of a mandate for its efforts.

6. Pennichuck's stewardship of the Pennichuck Brook Watershed is second to none.

As part of its effort to whip up public opinion, Nashua has claimed that Pennichuck has allowed development within the Pennichuck watershed and thus has not been a good steward of natural resources. As the evidence will show at hearing, over the years, Pennichuck has implemented substantial measures to protect the watershed.¹⁶ The reality is that Nashua remains unhappy with a decision made by this Commission and affirmed by the New Hampshire

¹⁶ Eileen Pannetier of Comprehensive Environmental, Inc. testified as to PWW's 1998 watershed management plans and the significant efforts PWW has undertaken to implement that plan. In Ms. Pannetier's opinion, PWW is one of the best water utilities in the nation – municipal or private – when it comes to watershed management.

Supreme Court some 25 years ago allowing the transfer of land out of PWW.¹⁷ To the extent the land has been developed, it has come with the express approval of Nashua and other municipalities. Thus, this issue is a red herring and provides no basis to support a taking by Nashua.

7. Nashua has failed to prove that the public interest permits the taking of PWW's assets.

Mr. Naylor's testimony perhaps most succinctly states the reasons that Nashua's proposed taking of PWW is not in the public interest. As he testified:

There are a number of reasons why Staff reaches the conclusion that Nashua's proposal is not in the public interest, but it is important to note that it is a combination of factors which lead Staff to this conclusion. In summary, these reasons are in order of importance:

- 1) PWW and its regulated affiliates, and to some degree PWSC, constitute a true regional water utility with a track record of pro-active cooperation on water supply and water distribution issues; the evidence clearly shows that a taking of PWW's assets will eliminate this important benefit to the State;
- 2) The evidence clearly shows that the taking of PWW's assets will adversely affect rates in the other regulated water utilities owned by Pennichuck, and will cause substantial harm to PWSC;
- 3) Nashua's proposal contains uncertainties and lacks evidence demonstrating that important functions such as customer service and billing and collections will be adequately addressed;
- 4) Acquisitions of small troubled water systems by PWW and its affiliates are not likely to continue if PWW ceases to exist;
- 5) Nashua's projection of a lower cost of service under its contracts with its third party operator and oversight contractor is speculative considering that Nashua's rate projections are based on the City's estimate of value for the assets and this value has yet to be established; and
- 6) PWW is a water utility that serves customers in stand-alone systems far beyond the boundaries of the City, and Nashua's attitude toward PWW's acquisition of those systems as evidenced in the discovery responses raises concerns with Staff

¹⁷ See *Appeal of City of Nashua*, 121 N.H. 874 (1981)(allowing PWW to remove 1,490 acres of land from the water utility's rate base); *Re: Pennichuck Water Works*, 68 NH PUC 253, 254-55 (April 29, 1983).

as to whether the level of service and capital improvements those systems would receive would be compromised by Nashua's ownership.

April 13, 2006 Testimony of Mark A. Naylor at 41-42. Further, as Mr. Naylor pointedly observes:

This proposed taking does not arise out of circumstances where a municipality wishes to take over a poorly run private water company so that service to its own citizens can be improved. This taking is not of a utility that is a stand-alone operation, providing water service in one municipality as its only business. This is not a poorly run water company; even Nashua acknowledges that. This is a well-run, healthy business with various operations centered primarily on water service. Pennichuck has earned a reputation with regulators, both at the Commission and at NHDES, as well as among municipal and business leaders as a good company, with intelligent and pro-active leadership.

Id. at 66-69. Mr. Naylor's conclusion is plain and simple.

Staff has reviewed the testimony provided by all parties in this case, and has participated in extensive discovery. After consideration of all of this evidence, Staff does not believe the proposed taking is in the public interest. *Id.* at 41.

Because Nashua has failed to meet its burden of proof in this case, the Commission need not determine a value for the PWW assets proposed to be condemned by the City. The evidence presented unambiguously supports a finding that a taking of PWW's assets by eminent domain will harm the customers of that company, the customers of PEU, PAC and PWSC, the shareholders of PNNW and the interests of the state, and therefore Nashua's petition should be denied.

IV. Valuation of PWW Assets

A. The Commission's Task is to Determine the Fair Market Value of the PWW Assets Being Taken Through Eminent Domain.

If the Commission determines that Nashua's proposed condemnation of PWW is in the public interest, the Commission will then decide the amount Nashua must pay to compensate PWW for the taking of its property. RSA 38:9. As in all governmental takings of private property, the federal and state constitutions require that PWW receive just compensation, which

is defined as the fair market value of the property being taken.¹⁸ In determining the fair market value of the PWW assets to be condemned, the Commission must look beyond the ratemaking principles that guide the Commission's decision in regulatory matters and instead determine the fair market value of the PWW assets consistent with the constitutional guarantee of just compensation.

B. Rate Base is Not the Same as Fair Market Value.

Fair market value is defined as the price at which an asset would change hands between a willing buyer and a willing seller, when the buyer is not under any compulsion to buy and the seller is not under any compulsion to sell, and both parties have reasonable knowledge of the relevant facts.¹⁹ A utility's rate base does not equate to the utility's fair market value, and in fact, has little logical relation to the fair market value. Rate base is an accounting and regulatory concept that represents a statement of the historical cost of some, but not all, specified utility plant in service assets less accounting (or "book") depreciation. Conversely, fair market value is an appraisal concept of the current value in exchange between a willing buyer and a willing seller. As PWW's lead appraiser, Robert Reilly, explained in his direct testimony, the difference between rate base and fair market value is fundamental and distinct:

- Rate base is an *income concept* that governs the relationship between the regulatory Commission and the utility; and
- Fair market value is an *exchange concept* that governs the relationship between the utility owner and the entity purchasing the utility.

January 12, 2006 Testimony of Robert F. Reilly at 10-11.

¹⁸ *Opinion of the Justices*, 131 N.H. 504, 509 (1989); Nichols, *Law of Eminent Domain*, § 16.01[1] (3rd ed. 2000).

¹⁹ *Opinion of the Justices*, 131 N.H. at 509-10 (1989).

Due to the significant conceptual and practical differences between rate base and fair market value, commentators and courts in several states, including New Hampshire, unanimously agree that a utility's rate base used for ratemaking purposes has little rational relation to that utility's fair market value.²⁰ Instead, it is universally recognized that original cost rate base must be rejected as "unreliable in determining a current fair market value."²¹

C. PWW Has Presented the Only Objective and Valid Appraisal of the Fair Market Value of the Assets to be Condemned.

The valuation process conducted by PWW in this case required multiple experts with diverse areas of expertise because of the differing nature of the assets and the multiple tasks involved in performing such a valuation. Recognizing this challenge, PWW engaged a team of nationally recognized experts led by Robert Reilly. Mr. Reilly is an established expert in the field of business valuation, who co-authored the leading text on business valuation, and who has extensive experience in valuing utilities. Mr. Reilly's status as one of the pre-eminent experts in the field prompted counsel for Nashua to comment at his deposition that Mr. Reilly was "probably one of the most qualified people [Mr. Upton] ever had the privilege of deposing."

June 27, 2006 Deposition of Robert Reilly at 5.

²⁰ *Washington Suburban Sanitary Com'n v. Utilities, Inc. of Maryland*, 775 A.2d 1178, 1196-97 (Md., 2001) (noting the "complete lack of similarity between the original cost used in rate making and the just compensation for purposes of taking") (internal citations omitted); *Dade County v. Gen'l Waterworks Corp.*, 267 So. 2d 633, 640 (Fla. 1972) ("[T]he complete dissimilarity between rate-making concepts and the just or full compensation standards which govern eminent domain have resulted in rejection of attempts to equate rate-making with eminent domain as a basis for determining fair market value"); *City of Phoenix v. Conso. Water Co.*, 415 P.2d 866, 870 (Ariz. 1966) (noting that "while original cost is admissible in evidence, it should have little if any value for the determination of what is fair and equitable in a condemnation action"); *Onodaga County Water v. New York Water Serv. Corp.*, 139 N.Y.S.2d 755, 768 (1955) (rejecting rate base as an indicator of fair market value); see generally Nichols § 15.06[2]. Accord, *In re Public Service of NH*, Order No. 24,086 (November 15, 2002) at 24, 26-27 (public interest order on Brodie Smith hydroelectric dam, fair market value and not book value to be looked at in valuation phase); *Southern New Hampshire Water Co., Inc. v. Hudson*, 139 N.H. 139, 142 (1994) (holding that PUC regulation has "nothing to do" with determining fair market value of a utility); *PSNH v. New Hampton*, 101 NH 142, 151-52 (1957) (holding that PUC ratemaking valuations do not limit fair market value assessments for tax purposes).

²¹ See generally, Nichols § 20.01.

A key component of Mr. Reilly's valuation was a complete and thorough assessment of the existing condition of the PWW system assets. This component was performed by Richard Riethmiller, a professional engineer licensed in the State of New Hampshire. Mr. Riethmiller supervised an accurate inventory of all tangible system assets and quantified the existing condition of the assets in an observed depreciation analysis. The valuation process, methodologies and conclusions are thoroughly explained in the testimony and expert reports of Mr. Reilly and Mr. Riethmiller.²²

Mr. Reilly determined that the fair market value of the PWW operating assets as of December 31, 2004 was \$248,400,000. Pursuant to the Commission's procedural schedule, Mr. Reilly performed an updated appraisal using the most currently available information through December 31, 2005 and determined that the fair market value of the PWW operating assets as of December 31, 2005 was \$273,400,000. Mr. Reilly's appraisal correctly applies recognized approaches to valuing utility property and is fully compliant with all professional appraisal standards and New Hampshire law.

The City of Nashua retained George "Skip" Sansoucy as its lead appraisal witness. Mr. Sansoucy was assisted by Glenn Walker, an employee of Mr. Sansoucy's company. As discussed more thoroughly below, Mr. Sansoucy also served as the City's condemnation consultant and public interest witness. The evidence will demonstrate that the appraisal presented by Mr. Sansoucy and Mr. Walker ("Sansoucy Appraisal") fails to meet the minimum professional appraisal standards and does not correctly employ recognized approaches to valuing

²² See January 12, 2006 Testimony of Richard Riethmiller and Robert Reilly. In addition, Harold Walker of Gannet Fleming performed the inventory and pricing analysis of the assets under the supervision of Richard Riethmiller. Russell Thibeault, a New Hampshire real estate appraiser, performed the appraisal of the PWW real property assets.

utility property. Therefore, Mr. Reilly's appraisal provides the only reliable indication of the fair market value of the PWW assets to be condemned.

D. The Sansoucy Appraisal Should Not Be Given Any Weight Because The Appraisal Does Not Comply With the Standards Applicable To Appraisal Experts And Does Not Correctly Employ Methodologies Consistent with Recognized Approaches To Valuing Utility Property.

The evidence in this case will unambiguously demonstrate that the City's valuation witnesses are not independent, their work does not meet applicable professional appraisal standards, and their expert report reflects nothing more than an after-the-fact justification of a value espoused by them even before they undertook their valuation analysis. Their conclusions, therefore, are entitled to no weight.

On May 22, 2006, Mr. Reilly issued a written report and testimony in which he identified 14 fundamental errors in the Sansoucy Appraisal. As Mr. Reilly notes in his testimony:

The Sansoucy Appraisal is one of the most fundamentally flawed appraisals I have reviewed. It would be impossible to correct the Sansoucy Appraisal, as the number and extent of the errors renders the conclusion totally unreliable. If I were asked by a client, my advice would be that the Sansoucy Appraisal is useless for the purposes of determining the fair market value of the PWW operating assets, and should therefore be discarded in its entirety.

May 22, 2006 Reply Testimony of Robert Reilly ("Reilly Reply Testimony") at 2-3. The extensive letter report attached to the Reilly Reply Testimony outlines the numerous errors in the Sansoucy Appraisal. *Id.*

As the evidence will demonstrate, Sansoucy and Walker agree that at least two industry appraisal standards are applicable to their valuation testimony—the Uniform Standards of

Professional Appraisal Practice (“USPAP”)²³ and the standards set forth in *The Appraisal of Real Estate* (12th ed. 2001) published by The Appraisal Institute. Yet their appraisal fails to comply with critical aspects of both of these standards. For that reason, their testimony is not deserving of any weight, and their appraisal should be rejected.

(a) Sansoucy and Walker did not set out to do a fair market value appraisal.

Messrs. Sansoucy and Walker cannot meet one of the most fundamental requirements applicable to their valuation testimony—that they be unbiased and impartial when preparing the appraisal.²⁴ The Conduct section of the USPAP Ethics Rule states that “advocacy [except as to one’s appraisal report] in appraisal practice is a violation of the Ethics Rule.” The evidence in this case will unambiguously show that Mr. Sansoucy is not an independent, unbiased appraiser, as is required by USPAP, and that he and Mr. Walker did not set out to perform a fair market value appraisal. Rather, Mr. Sansoucy is a creator, implementer, strategist, valuator, negotiator, and advocate for the City. Quite simply, it is fair to say that Mr. Sansoucy is the “chief cook and bottle washer” for the City’s entire condemnation attempt, from public interest to valuation, and beyond. Consistent with that role, Mr. Sansoucy and Mr. Walker did not set out to perform a fair market value appraisal of the PWW system. Instead, the objective of the Sansoucy Appraisal was to deliver to the City the predetermined result Mr. Sansoucy promised -- a value the City could afford to pay without raising water rates.

²³ The Appraisal Foundation is the body given the authority by Congress to promulgate and enforce standards for all appraisal disciplines. The USPAP standards, which are endorsed by numerous appraisal organizations, are the most widely accepted and stringent professional standards for the appraisal industry as a whole. Federal regulations require that all business valuations prepared for any federally-related purpose comply with USPAP standards. See George Hawkins, *Evaluating Valuation Reports and Testimony*, Business Valuation Alert Vol 3, Issue No. 1 (Sept. 2001). For a discussion of the applicability and history of USPAP standards, see *id.*

²⁴ A thorough discussion of the considerable evidence demonstrating the extent of Mr. Sansoucy’s and Mr. Walker’s illegal bias and conflict of interest was previously set forth in the PWW Motion in Limine filed November 26, 2006, and therefore will not be repeated here.

As the evidence will show, Mr. Sansoucy presented the City of Nashua with a package deal: he advocated to the City that they should condemn the water company, and that they should hire him to lead the effort. Mr. Sansoucy promised that if the City hired him, he would conduct an appraisal that would value the system at \$81 to \$82 million – a price the City could afford to pay without raising water rates. Mr. Sansoucy proposed to help the City obtain PUC approval, noting that if the PUC set the value too high, the City could always use his appraisal to raise the water company's property taxes. Mr. Sansoucy's pitch was successful. In addition, the evidence will show that under his contract with the City, Mr. Sansoucy will be paid additional fees if the condemnation is approved – he will assist the City with the transition, including negotiating contracts for operation of the system.

An appraiser's job is to objectively and impartially appraise the market value of the subject property, it is not to advocate for a particular outcome with the goal of benefiting a particular party or, worse yet, the appraiser himself. The appraiser's job is certainly not to simply deliver the value the client has decided it wants to pay. The Sansoucy Appraisal fails to meet the most basic standards for professional appraisals. The following chart summarizes some of the most egregious violations.

USPAP VIOLATIONS

USPAP (INDUSTRY) STANDARD: <i>THE APPRAISER MUST <u>NOT</u>....</i>	SANSOUCY/ WALKER VIOLATED?	SANSOUCY AND WALKER VIOLATED BY...
Misrepresent His Role	<u>Yes</u>	Representing Themselves As Impartial Appraisers When Interested in Advocating the Takeover
Have Predetermined Opinions and Conclusions	<u>Yes</u>	Seeking to “Make the Numbers Work” and Reaching the Conclusion Promised at the March 2004 Budget Review
Be Biased or Partial	<u>Yes</u>	Advocating that the Takeover Was in the Public Interest (Both in Testimony and Other Actions) and “Proven Loyalties” to the City
Advocate (Except For One’s Own Report)	<u>Yes</u>	Advocating and Recruiting Support for the Takeover, Conducting Public Relations, and Guiding the City and Negotiating the Pay-Off Contracts
Accept An Assignment Contingent upon the Outcome	<u>Yes</u>	Having an Expectation of Fees for Post-Takeover Work if Condemnation Successful

(b) Sansoucy and Walker manipulated the components of their appraisal to avoid reaching the true fair market value of the PWW system.

In order to deliver on Mr. Sansoucy’s promise to conclude a value in the \$80 million range, the Sansoucy Appraisal did not correctly apply recognized approaches to valuing a utility, but instead eliminated some necessary components, and manipulated others in order to reach the pre-determined result. The following is a summary of some of the most glaring errors and omissions. A complete list of all of the errors and omissions in the Sansoucy Appraisal is set forth in the testimony and reports of Mr. Reilly.

The Sansoucy Appraisal Discards the Fair Market Value Standard in Favor of “No Net Harm.”

Although the Sansoucy Appraisal claims to apply the Fair Market Value standard, the conclusion of value is actually based upon a “no net harm” theory devised by Mr. Sansoucy. Under Mr. Sansoucy’s “no net harm” theory, value should be determined by picking the number that causes rates to remain the same as before the sale. Mr. Sansoucy’s “no net harm” theory is

not a legitimate appraisal methodology. Even more troubling is that, if adopted, Mr. Sansoucy's "no net harm" subjective valuation analysis would directly interfere with the constitutionally protected valuation process, which requires that a party receive fair market value for any property taken.

The Sansoucy Appraisal Fails to Give Any Weight to the Cost Approach, Which is the Generally Accepted Preferred Method to Value Special Purpose Utility Property.

Perhaps more troubling, as the evidence will show, the Sansoucy Appraisal completely abandons the cost approach, not because of a methodological problem, but simply because it would have yielded a higher value than Mr. Sansoucy promised the City. Mr. Sansoucy's decision in this regard is all the more remarkable because it is the cost approach that Mr. Sansoucy consistently applied during his earlier days valuing utility property for his municipal clients for property tax purposes. This convenient change in methodologies completely undermines any credibility that could be attributed to the Sansoucy Appraisal.

The Sansoucy Appraisal's failure to consider the cost approach is particularly egregious given the status of the PWW assets as special purpose property. Although the weight given each appraisal approach depends on the facts of each case, certain principles are commonly applied by courts and public utility commissions in valuing utility property in eminent domain proceedings. Most significant, it is generally recognized that public utilities are *special purpose properties*.²⁵

Special purpose property is property:

- (1) with a unique physical design, special construction materials, or a layout that restricts its utility to the use for which it was built and (2) that has relatively limited market at any particular time.²⁶

²⁵ *Massachusetts-American Water Co. v. Grafton Water Dist.*, 631 N.E.2d 59, 61 (Mass. App. Ct. 1994); *Town of Oxford v. Oxford Water Co.*, 463 N.E.2d 330, 336 n. 7 (Mass. 1984); *Nichols, supra*. at §12C.01[1].

²⁶ *The Appraisal of Real Estate*, at 25.

As the evidence will show, there is no real dispute in this case that PWW's assets are indeed special purpose property.

Because of its nature as special purpose property, a water utility such as PWW typically cannot be valued by using the comparable sales approach.²⁷ Even when a few sales of other water companies are found, they are often rejected or given little weight by courts on the basis that the properties involved are so different that they cannot be properly utilized in a comparable sales approach,²⁸ something that is plainly the case here, as Mr. Reilly's testimony demonstrates.

It is generally accepted that the cost approach is an important, if not the best, appraisal approach to valuing special interest property such as that of a public utility.²⁹ Thus, in cases involving special purpose property, the cost approach is commonly given the most weight, provided the appraiser finds a way to include intangibles and business value.³⁰ Mr. Sansoucy acknowledges that if the property qualifies as special purpose property, the cost approach to valuation is "an appropriate approach to consider and rely upon."³¹

In the present case, PWW's assets were plainly built for the unique purpose of supplying potable water and fire protection to the residents of Nashua and the ten other communities served by the company. Moreover, the PWW system is property of a type that is not frequently exchanged in the market.³² Since both requirements of special purpose property are met, the operating assets of PWW must be found to be special purpose property, making the comparable sales method inapplicable and suggesting that the cost approach to valuation should be given the

²⁷ *Nichols* at §12C.01[3][a].

²⁸ *Id.* at 15.06[1].

²⁹ *The Appraisal of Real Estate*, at 25-26, 354.

³⁰ See *Washington Suburban Sanitary Com'n*, 775 A.2d 1183 N. 5, *supra*; *Massachusetts-American Water Co.*, 631 N.E.2d at 61, *supra*. See generally, *Nichols on Eminent Domain* § 20.01 (3rd ed. 2000)(noting that the cost approach "is one of the better methods of determining value of a public utility.")

³¹ July 12, 2006 Deposition of George Sansoucy at 315.

³² The evidence will show that, although the City's valuation witnesses point to other sales of water companies, the sales are infrequent and plainly lack comparability to PWW.

dominant weight in this case. Mr. Sansoucy's failure to consider the cost approach, therefore, renders his conclusions unreliable.

Mr. Sansoucy's failure to give any weight to the cost approach is no surprise: he told the City before he was hired that he would not give the cost approach any weight in his final value conclusion. Given those statements, it is also not surprising that Mr. Sansoucy failed to conduct a thorough and correct cost approach, and instead relied on a trended original cost analysis of data he knew to be inaccurate and incomplete.

The Sansoucy Appraisal Does Not Contain a Valid Sales Approach Analysis.

The Sansoucy Appraisal reaches a value conclusion relying exclusively on the sales and income approaches, yet he failed to conduct either approach correctly. The analysis within the Sansoucy Appraisal which purports to constitute a sales approach simply arrives at an average value from a list of sales transactions, without making any effort to determine if the transactions were in any way comparable to the proposed sale of the PWW system. Extrapolating averages and means from a list of transactions, as the Sansoucy Appraisal does, without performing any analysis to determine whether the transactions are comparable, is not a generally accepted appraisal approach, and provides no evidence of fair market value. In fact, the evidence will demonstrate that none of the transactions listed in the Sansoucy Appraisal is sufficiently comparable to the PWW system to permit the sales approach to be relied upon as an indicator of fair market value.

The Sansoucy Appraisal Fails to Consider the Appropriate Hypothetical Buyer of the PWW Assets.

One of the most fundamental determinations an appraiser must make in conducting a fair market value appraisal is determining the likely composition of the population of hypothetical buyers for the subject property. The composition of hypothetical buyers will determine the range

of prices the subject property will bring on the market. The Sansoucy Appraisal contains no analysis of the likely population of willing buyers for the PWW operating assets, but assumes, without any support or explanation, that the likely population of hypothetical willing buyers of PWW includes only private investor-owned utility (“IOU”) buyers with characteristics identical to those of PWW. This unsupported assumption allows Mr. Sansoucy and Mr. Walker to manipulate the income approach analysis within the Sansoucy Appraisal to reach a value conclusion within the range of value Mr. Sansoucy promised the City.

Contrary to the unsupported assumption in the Sansoucy Appraisal, the evidence will demonstrate that the likely population of hypothetical willing buyers of PWW includes not-for-profit public entities, like the City of Nashua. This fact is significant because in any acquisition of a going concern business, the population of buyers with the greatest expected synergies will set the range of market prices that all serious potential bidders will have to match. In the case of PWW, a not-for-profit public entity buyer (1) will not have to pay income taxes, (2) will have access to low-cost municipal financing, and (3) will not be subject to the same regulatory environment as a private IOU buyer. Therefore, public entity buyers can pay more, and will set the range of market prices in which all potential buyers (both public entity and IOU) will have to bid. By ignoring the hypothetical municipal buyers that can pay more and that will set the price other bidders have to beat, the Sansoucy Appraisal reaches a conclusion under the income approach that grossly undervalues the PWW system, and does not provide any indication of true fair market value.

Mr. Sansoucy has acknowledged in previous appraisals he has performed of the PWW system that the population of hypothetical buyers includes both IOU buyers and municipal buyers. The supreme court, in *Southern New Hampshire Water Co.*, 139 N.H. at 142, a case in

which Sansoucy testified, has also confirmed that the pool of hypothetical buyers for water companies in the state consists of both municipalities and private companies regulated by the PUC. The court also recognized that if an appraiser fails to account for both types of hypothetical purchasers, as Mr. Sansoucy has done in this case, the valuation will result in a conclusion that is not representative of fair market value.

The errors outlined above are just some of the significant and fatal flaws within the Sansoucy Appraisal. These errors demonstrate that Mr. Sansoucy did exactly as he promised – he conducted an appraisal that concluded the precise value the City determined would allow it to proceed with the condemnation. Mr. Sansoucy did not set out to perform a fair market value appraisal, and his value conclusion provides no evidence of the true fair market value of the PWW system. The appraisal conducted by Mr. Reilly, on the other hand, applies generally accepted methodologies and approaches to valuing utilities and fully complies with all professional appraisal standards. Therefore, Mr. Reilly’s appraisal provides the only reliable evidence of the fair market value of the PWW operating assets and should be adopted by the Commission if it determines a value at all in this proceeding.

V. Conclusion

For the reasons set forth above, the Pennichuck Companies request that the Commission find that Nashua’s proposed taking is not in the public interest. In the event that the Commission determines that a taking should proceed, the PWW assets should be valued at \$273,400,000 as of December 31, 2005 based on the appraisal presented by Mr. Reilly.

Respectfully submitted,

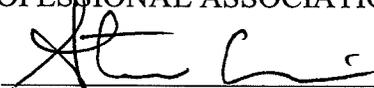
Pennichuck Water Works, Inc.
Pennichuck East Utility, Inc.
Pittsfield Aqueduct Company, Inc.
Pennichuck Water Service Corporation
Pennichuck Corporation

By Their Attorneys,

McLANE, GRAF, RAULERSON & MIDDLETON,
PROFESSIONAL ASSOCIATION

Date: December 15, 2006

By:

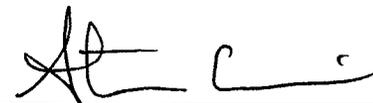


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Certificate of Service

I hereby certify that on this 15th day of December, 2006, a copy of the foregoing Opening Statement and Trial Memorandum has been forwarded by electronic mail to the parties listed on the Commission's service list in this docket.



Steven V. Camerino