STATE OF NEW HAMPSHIRE
BEFORE THE
PUBLIC UTILITIES COMMISSION

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

Docket No. DW 04-48

MOTION FOR RECONSIDERATION AND/OR REHEARING REGARDING ORDER NO. 24,878

Pennichuck Water Works, Inc. ("PWW"), Pennichuck Corporation, Pennichuck East Utility, Inc. ("PEU"), Pennichuck Water Service Corporation ("PWSC") and Pittsfield Aqueduct Company, Inc. ("PAC") (collectively, "Pennichuck") respectfully request that, pursuant to RSA 541:3, the Commission reconsider or conduct a rehearing of Order No. 24,878 (the "Taking Order") for the reasons set forth below. In support of this Motion, Pennichuck states as follows:

This Motion for Reconsideration and/or Rehearing arises out of the Commission's order on the merits authorizing the City of Nashua ("Nashua") to take the assets of PWW by eminent domain, subject to nine conditions, in exchange for payment to PWW of $203 million plus the establishment of a mitigation fund of $40 million for the benefit of the customers of PWW's affiliated utility companies, PEU and PAC.

Pennichuck seeks reconsideration or a rehearing of the Taking Order because the order, among other things, fails to meet the legal standard required by RSA 38 and the New Hampshire and United States Constitutions for the condemnation of utility property, fails to make the factual findings required to support such an order for a taking and for the valuation of PWW's assets, and fails to consider or misunderstands relevant evidence presented by Pennichuck.

In reviewing the Taking Order, PWW has identified the following errors that require rehearing:

a) the Commission erred by failing to apply the public interest standard applicable for eminent domain takings in New Hampshire and by failing to articulate any cognizable public interest standard at all;

b) the Commission erred by interpreting RSA 38 to give it the authority to allow Nashua to take water systems located entirely outside of Nashua even though those systems are not connected to the system that serves Nashua and are not necessary to supply water service within Nashua;

c) the Commission erred by conducting separate public interest analyses for the taking of PWW's core and satellite systems, where the only proposal before it called for the taking of all systems together;

d) the Commission erred in previously ruling that Nashua's petition did not exceed the scope of the January 14, 2003 confirming vote of its residents, and by not informing its residents that Nashua would use eminent domain to take PWW assets;

e) the Commission's decision failed to consider or weigh properly evidence of the public interest, including the interests of the broader public, the interests of the state, and the democratic interests of residents of towns outside of Nashua;

f) the Commission's decision failed to consider the harm to Pennichuck Corporation and its shareholders in its public interest analysis;

g) the Commission erred by failing to conduct its public interest analysis based upon Nashua's pre-filed proposal, which was the proposal on which PWW conducted discovery, and instead based its ruling upon Nashua's altered proposals submitted during the hearing;

h) the Commission erred by treating the statutory presumption of public interest as irrebuttable by imposing numerous significant substantive conditions in an attempt to overcome the substantial defects that the Commission found in Nashua's proposal;

i) the Commission erred by imposing numerous conditions to satisfy substantial defects in Nashua's proposal that are beyond the Commission's authority and thus are not enforceable and cannot support a public interest finding;

j) the Commission erred by imposing conditions subsequent to the taking of PWW's assets to satisfy substantial defects in Nashua's proposal and which Pennichuck will be unable to challenge should those conditions not be met because the Taking Order will have become final;

k) the Commission's determination that Nashua is financially capable of acquiring and operating the assets of PWW is flawed because the Commission did not consider whether Nashua could finance the acquisition under the conditions prevailing in the financial markets and on the terms set forth in the Taking Order

l) the Commission's rate comparability analysis between PWW and hypothetical Nashua rates, even assuming the Commission's taking price of $203 million, failed to account for the $40 million mitigation fund and failed to consider evidence of additional costs that were not included in Nashua's revenue requirement model;

m) the Commission's finding that a $40 million mitigation fund would generate $3.4 million annually to benefit customers of PEU and PAC is not supported by the evidence because, among other things, it fails to consider tax consequences and the achievability of an annual rate of return of 8.5%, and it fails to consider whether Nashua can legally establish such a fund;

n) the Commission erred by relying upon information outside of the record, including a water supply contract between Nashua and the Town of Milford filed on February 22, 2008, and PWW's 2006 and 2007 annual reports;

o) it is difficult to determine how the Commission arrived at its valuation numbers and whether the Commission correctly performed the valuation analysis it purported to adopt because the Taking Order lacks detail as to a number of numerical components;

p) the Commission wrongfully excluded from its asset and income approach valuation analysis a 2% long term growth factor in the applicable capitalization rates;

q) in the asset approach to valuation, the Commission brought forward the value of PWW from December 31, 2005 to December 31, 2008, without showing the underlying data it used and by relying upon incomplete and extra-record financial information;

r) RSA 38 violates Pennichuck's equal protection rights, since it does not provide for a trial by jury on all valuation matters.

I. APPLICABLE STANDARD

Motions for rehearing and/or reconsideration of a Commission order are governed by RSA 541. RSA 541:3 provides that the Commission may grant a motion for rehearing if "good reason for the rehearing is stated in the motion." *See Connecticut Valley Electric Co. v. Public Service Co. of New Hampshire*, DE 03-030, Order No. 24,189 dated July 3, 2003 at 2. As stated in *Dumais v. State*, 118 N.H. 309 (1978), the purpose of a rehearing is to provide consideration of matters that were either overlooked or "mistakenly conceived" in the original decision. *See also*, *Investigation as to Whether Certain Calls are Local*, DT 00-223/00-054, Order No. 24,218 dated October 17, 2003 at 8 ("Motions for rehearing direct attention to matters 'overlooked or

mistakenly conceived' in the original decision and require an examination of the record already before the fact finder.").

In reviewing any motion for rehearing, the Commission thus analyzes each and every ground that is claimed to be unlawful or unreasonable to determine if there is a basis to grant the request, i.e., if there is "good reason" shown. *In re Wilton Telephone Company and Hollis Telephone Company*, DT 00-294/DT 00-295, Order No. 23,790 dated September 28, 2001; *see also*, *Petition for Approval of Statement of Generally Available Terms Pursuant to the Telecommunications Act of 1996*, DT 97-171, Order No. 23,847 dated November 21, 2001 at 11-12.

II. ARGUMENT

A. Lack of Any Public Interest Standard

The Taking Order explains its entire public interest analysis in terms of burdens of proof, with the statutory presumption of public interest in favor of Nashua appearing to be given an overwhelming and insurmountable weight because, as the Commission stated, "approximately 87 percent of PWW's customers are within the City of Nashua." (Taking Order, p. 51). Because of the extreme weight that the Commission gave to Nashua's municipal vote to confirm an aldermanic resolution to acquire PWW's water systems, the Commission failed to engage in the balancing approach required by New Hampshire law. Specifically, the Commission failed to apply the net benefit test by weighing the "public benefits... against all burdens and social costs suffered by every affected property owner." *Petition of Bianco*, 143 N.H. 83, 86 (1998); *see*, *Merrill v. Manchester*, 127 N.H. 234, 237 (1985). The New Hampshire Supreme Court has held that "public interest" is measured on a spectrum, and takings for convenience justify only slight impositions on private rights, *Rodgers Dev. Co. v. Tilton*, 147 N.H. 57, 59(2001). In this case,

the proposed taking imposes significant burdens on private rights. In addition to putting the State's largest investor-owned utility essentially out of business, the tax impact of the taking is likely to reduce the "just compensation" ordered by the Commission so that the ultimate owners of the property being taken—the shareholders of Pennichuck Corporation—will never be adequately compensated for the property being seized. Despite this devastating burden on private property rights, the Commission failed to require any substantial justification for Nashua's proposal, instead deferring at every turn to the insurmountable weight it gave the municipal vote. The Taking Order ignores the Constitutional and policy principles which require heightened vigilance to protect the property interests of business ventures providing regulated service to the public.[1]

Even if the Commission believes that it conducted the balancing required by *Bianco*, *Merrill* and *Rodgers*, it certainly failed to set forth its methodology in the Taking Order, contrary to general New Hampshire administrative law, *Appeal of Conservation Law Foundation*, 127 N.H. 606, 683 (1986)(agency obligated to set forth its reasoning and conclusions so that the court may effectively review its "methods, findings and order"); *Appeal of Newington*, 149 N.H. 347, 352 (2003)(administrative body must set forth its reasoning sufficient for appellate review) and the specific "reasoning" requirement of RSA 363:17-b for all Commission decisions.

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[1] The Commission may have erroneously relied upon the "no net harm" standard, which applies solely to the exercise of private rights with potential public consequences, such as from a consensual utility asset transfer. *See*, *New England Elec. Sys.*, 84 NH PUC 502, 510 (1999). Because the Commission did not articulate the standard it applied, it is impossible to tell.

B. Systems Entirely Outside of Nashua

The Commission earlier in this case ruled as follows: "Based on the overall statutory scheme, the construction of the statute as a whole, and the legislative history and intent, the related threads of the analysis of RSA Chapter 38 lead to the conclusion that the eminent domain authority delegated by the Legislature in RSA 38:2 should be narrowly construed...." Order No. 24,425, p. 16. The Commission went on to rule in that order that the statute did not permit Nashua to take the assets of PEU and PAC, and that its attempt to take PWW assets outside of Nashua would depend upon a factual inquiry. Specifically, the Commission stated: "Our reading of the legislative history of the re-enactment of RSA Chapter 38 persuades us that the Legislature intended that the extent of the taking power that could be exercised beyond municipal boundaries would be limited. This conclusion is driven in good part by [then-]Representative Below's stated concern that a municipality may have to take some property outside its boundaries in order to prevent the stranding of some customers. The fair inference to be drawn from his statement is that extra-territorial takings were presumed and intended to be limited." *Id.* pp. 14-15. *See also*, Order No. 24,448 (order on Nashua's Motion for Rehearing).

Despite that earlier ruling, the Commission gave short shrift to its narrow construction of RSA 38 and determined in the Taking Order that the public interest permitted the condemnation of PWW satellite systems (i.e. those not hydraulically connected to the Nashua core system) based solely upon a finding that those customers would be "better served by remaining part of the PWW system for purposes of rate and service continuity". (Taking Order, p. 59). In other words, the Commission reasoned that since it had already made a public interest finding for a taking of the Nashua assets and since, according to the Commission, "[d]ivorcing the satellite

systems from the core system involves substantial uncertainty" (Taking Order, p. 58), PWW must forfeit its satellite systems allegedly to assure rate and service continuity for its satellite system customers. That is a long way from the "stranding" of customers. As the Commission rightly stated, the Legislature intended that the taking authority of municipalities be narrowly construed. There is no indication that the Legislature intended that a single condemning municipality should be authorized to take forcibly an entire utility's operating assets without regard to whether those assets were necessary to provide service within the municipality or to any portion of the system serving the municipality. Moreover, the harm to the satellite systems identified by the Commission was the result of the very taking it claimed to be in the public interest.

The exercise of such broad and devastating powers by a municipality and this Commission require a more specific and unambiguous authorization from the Legislature, something that is wholly lacking here. The constitutional and policy reasons that the Commission previously articulated for a narrow construction of RSA 38 call for just the opposite result here: there may be no taking of PWW's satellite systems unless it is "*require*[d]". RSA 38:6. Where the excuses for taking the satellite systems are the avoidance of uncertainty and rate and service continuity, matters regarding which there was no meaningful evidence during the hearing, there are less drastic alternatives available than condemnation to protect the interests of satellite system customers. Those alternatives include finding that Nashua's proposal to take PWW's assets is not in the public interest. Pennichuck previously raised these issues in its April 5, 2004 Motion to Dismiss and its Motion for Rehearing that resulted in Orders No. 24,425 and 24,448, and Pennichuck hereby incorporates those arguments by reference. To the extent that

the Taking Order now also includes a finding of public interest as to the taking of the satellite systems, Pennichuck now includes that issue in its request for rehearing.

C. The Segmented Public Interest Analysis

Even though Nashua's entire case was premised on a single taking of all of the assets of PWW together, the Commission did not look at PWW's assets as a whole, but rather in parts. First, the Commission took pains to rely upon the presumption in favor of municipal ownership in RSA 38:3 as it analyzed the taking of PWW's system within Nashua. (Taking Order, pp. 50-57). Acting as if the taking of PWW's Nashua assets was a separate proposal, the Commission concluded that PWW had not met its burden of proof. Next, the Commission analyzed the proposed taking of the assets outside Nashua, treating the taking of the Nashua system assets as a given and concluding that a taking of the satellite system assets would also be in the public interest because of what it claimed was the uncertainty and potential negative rate impact that would be caused by splitting the ownership of those assets from the Nashua water system. The Commission did this despite having previously ruled that the rebuttable presumption does *not* apply to Nashua's proposal to take PWW assets outside of the city. (Taking Order, p. 25; Order No. 24,567, p. 5).

The fallacy with the Commission's piecemeal analysis is its failure to consider Nashua's proposal for taking PWW as a whole. That was Nashua's sole proposal before the Commission. If the Commission considered PWW as a whole, it would have needed to confront – without the benefit of any rebuttable presumption – whether the satellite systems would be better off with PWW remaining as owner of all the assets. Given that the satellite system communities had no vote, and many feared Nashua's control, the result would have been very different. Moreover, the fallacy of the piecemeal analysis is proven by considering what the result might have been

had the Commission conducted its piecemeal analysis in reverse order, by first considering whether Nashua could meet its public interest burden of proof for it to take approximately two dozen unconnected water systems in nearly a half dozen municipalities outside Nashua and then deciding whether the harm caused by severing the core from those satellites was in the public interest.

D. Nashua Lacked a Valid Municipal Vote for the Taking

Pennichuck argued, in its April 5, 2004 Motion to Dismiss and its related Motion for Rehearing, that the January 14, 2003 confirming vote in Nashua pursuant to RSA 38:3 is inconsistent with and more narrowly defined than Nashua's petition in this docket. Specifically, Pennichuck argued that the voters at most considered acquiring assets of PWW comprised of the core system centered in Nashua. The Commission previously denied Pennichuck relief on this issue in its Orders No. 24,425 and 24,448. Because this issue was previously ruled upon by the Commission and has been preserved for appeal, Pennichuck will not repeat its argument here and hereby incorporates the arguments from its Motion to Dismiss and Motion for Rehearing by reference. The vote also wrongfully failed to inform the public that Nashua planned to use its eminent domain authority to take PWW assets.

E. The Commission Did Not Consider All of the Relevant Evidence

The Taking Order explicitly states, with no legal or factual support, that evidence submitted by PWW and Commission staff concerning "Pennichuck's positive record as a utility" and its "willing[ness] to expand into new areas" is not adequate evidence or is speculative and cannot rebut Nashua's public interest presumption. The Commission's refusal to accord any weight to the credible evidence from Commission staff, Veolia staff, and Bedford and Milford town officials (Ex. 5001, p. 69; Noran, Tr. Day 4, p. 129; Ex. 3022, p. 16; Ex. 4001, p. 1) that

Pennichuck is a well run utility points out the superficiality of the Commission's consideration of the evidence. (Taking Order, pp. 51-52).

In addition, the Taking Order fails to weigh the damage to the public interest of the state as a whole from losing access to the state's largest investor-owned water company, with the capital and operational capability necessary to assist and take over troubled water systems statewide. *See*, Naylor Test., Ex. 5014, pp. 49-53; Ware, Tr. Day 7, p. 62. Indeed, there is nothing "speculative" about Pennichuck's role, given the Commission's track record of approving Pennichuck's water system acquisitions.[2] Beyond the statewide harm to PEU and PAC, the undisputed evidence was that New Hampshire would also lose PWSC, which operates 86 water systems serving 19,230 customers in private and municipal water systems. It would have little choice but to go out of business, because of the loss of economies of scale. Correll Test., Ex. 3001, pp. 9, 13, 15-16; Ware Test., Ex. 3004, pp. 17-18.

Rather, it is Nashua whose interest in acquiring other water systems is at best speculative. *See, e.g.*, Naylor, Tr. Day 12, p. 119. *See*, *Blair v. Manchester Water Works*, 103 N.H. 505, 507 (1961)(Commission cannot force municipal water service extensions). The Commission's statement that PWW would not acquire troubled water systems unless it believed it to be in its shareholders' interest is unremarkable and misses the point entirely. As former Commissioner Patch testified, it is the very fact that such acquisitions are in the interests of an investor owned utility's shareholders and are unlikely to be in the interest of a municipal utility that should lead

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[2] In fact, Pennichuck is prepared to demonstrate that since the hearing it has been approached to acquire Lakes Region Water Co., a New Hampshire water utility facing challenges familiar to the Commission. With the threatened loss of PWW, and the lost economies of scale, the remaining Pennichuck entities cannot address this business opportunity, to the detriment of Lakes Region customers and the state.

the Commission to conclude that the taking proposed here by Nashua is not in the public interest. *See* Ex. 3002, pp. 16-20.

The Taking Order also ignores the interest of Pennichuck shareholders, an interest that the Commission is required to address under both applicable statutory and common law. First and foremost, the order gives no weight or even any consideration to the massive harm that is likely to be inflicted on Pennichuck Corporation's shareholders because of the multi-million dollar corporate level income tax liability that will reduce the "just compensation" ordered by the Commission. As Mr. Correll testified, those shareholders are unlikely to ever receive the $203 million calculated by the Commission, but rather a figure that, in addition to any capital gains tax paid by each individual shareholder, would first be reduced by "the imposition of state and federal income taxes [at the corporate level] totaling approximately 40% on the difference between the purchase price and the original cost less depreciation of the assets." Ex. 3001, p. 20. The Commission properly considered the negative impact on customers of PEU and PAC in conducting its public interest analysis, but inexplicably ignored the interests of shareholders. This omission is particularly ironic in light of the fact that in the middle of the hearing on the merits, the Commission stayed the proceeding to allow the parties an opportunity to explore a settlement and, as part of that process, to seek special legislation that was intended to allow a stock acquisition by Nashua as a means of addressing the tax impact of a taking of PWW's assets. See, 2007 Laws, Ch. 347:5. That legislation permitted a solution to Pennichuck's massive tax liability which the Taking Order ignores, and demonstrates the public interest harm from an asset taking.

The Taking Order also accords great deference to the "ability of [Nashua] elected officials to make good decisions", despite significant evidence to the contrary with respect to its

plans to take PWW. (Taking Order, p. 55). While the Commission noted the opposition of the Towns of Milford and Merrimack to the taking (Taking Order, pp. 35-37), the Commission in its public interest analysis gives no similar deference to the ability of Merrimack or Milford elected officials also to make good decisions. In fact, the Commission ignores their opposition in its public interest analysis, and with it the astute observation of Merrimack Selectman Daniel McCray: "...elected people, they're always going to cater to the people that elect them, and no one in Merrimack has a vote in there." (McCray, Tr. Day 11, p. 66).

F. The Commission Ignored the Revenue and Taxation Harm to Pennichuck Shareholders

While the Commission did consider the harm to customers of PEU and PAC in its analysis of Nashua's proposal, it ignored the real harm that Pennichuck Corporation shareholders will suffer from the Taking Order. For instance, the inevitable loss of PWSC's business from the shrinking of Pennichuck's operations will result in the loss of a substantial non-regulated source of profits, which directly harms its shareholder owners. (Correll Test., Ex. 3001, pp. 15-16). Furthermore, as set forth above, the taking of PWW assets is likely to trigger a substantial income tax liability at the corporate level, in addition to an eventual capital gain tax at the shareholder level, neither of which is contemplated in the valuation analysis, but which will significantly diminish any distribution the shareholders would ultimately receive for their shares as a result of the taking ordered by the Commission. (*Id.*, pp. 17-20).

As the Commission is aware, it is "the arbiter between the interests of the customer and the interests of the regulated utilities." RSA 363:17-a. As such it is required to consider the interests of shareholders in determining whether Nashua's proposal is in the public interest. *Appeal of Pinetree Power*, 152 N.H. 92, 100 (2005)(balancing of customer and utility interests

not only legally permitted but required).. The Commission has a long history of balancing the interests of customers and utility shareholders, and has held that "RSA 363:17-a states an important public policy principle and we take seriously our obligation to serve as an arbiter as opposed to a defender or advocate of either utility shareholders or utility customers." *Re PSNH*, 90 NH PUC 542, 559 (2005).

Even Nashua acknowledged earlier in this case that the Commission must weigh the interests of Pennichuck's shareholders in determining whether the taking is in the public interest. ("Nashua urges the Commission to define the public interest broadly and review the interests of customers, ratepayers, the will of Nashua voters, PWW's shareholders, regional water supplies, and the effect on smaller systems that might be retained by the Pennichuck Utilities." Order No.24,425, p. 3.) Yet in the Taking Order, the Commission failed to even consider the interests of Pennichuck's shareholders. Its failure to do so was plain error.

G. Nashua's Changing Proposal

Pennichuck defended this case the only way it could, by responding to Nashua's original petition and its prefiled testimony. During the course of discovery, Pennichuck uncovered numerous public interest defects in Nashua's proposal. It retained expert witnesses, incurred significant expense and submitted extensive prefiled testimony countering Nashua's position. When confronted with the weight of Pennichuck's evidence leading up to and at the hearing, Nashua changed its proposal in significant ways, including extensive proposals to submit voluntarily to Commission jurisdiction, to serve satellite system customers at core rates, to alter its operating contract, to consolidate all customer service functions with Veolia and to create a mitigation fund for PAC and PEU. The Commission's conduct sanctioned Nashua's approach of

creating an ever-moving target. Each time Pennichuck shot a hole through the middle of Nashua's last proposal, the Commission allowed Nashua to reconfigure its taking proposal.

This occurred even at the last day of the hearing, when Nashua proposed numerous new conditions for the first time. The Commission summarized twelve new conditions proposed by Nashua in the Taking Order, pp. 49-50. The Commission then adopted most of those conditions in its order, stating that they "are explicitly determined to be prerequisites to our decision that the taking is in the public interest". (Taking Order, p. 98). None of those conditions was part of Nashua's proposal prior to the hearing, and Pennichuck therefore could not conduct discovery on or respond meaningfully to Nashua's post-hearing proposal, which the Commission ultimately chose to adopt in the Taking Order.

Permitting Nashua to alter its taking proposal after the fact and up through the last day of trial and including those changes in the Taking Order deprives PWW of its due process rights under Pt. 1, Art. 2 and 14 and Pt. 3, Art. 83 of the New Hampshire Constitution and the Fourteenth Amendment of the United States Constitution. "A fundamental requirement of the constitutional right to be heard is notice of the impending action that affords the party an opportunity to protect the [legally protected] interest through the presentation of objections and evidence." *Appeal of Concord Steam*, 130 N.H. 422, 427-28 (1988). See, K. Davis, Administrative Law Treatise § 14:11, at 50 (2d ed. 1980). It also runs directly contrary to longstanding civil procedure principles for the orderly disposition of disputes. See, *Keshishian v. CMC Radiologists*, 142 N.H. 168, 176 (1997) (late filed addition of claims should be denied).

H. The Commission's Conditions Made the Presumption Irrebuttable

The Commission imposed nine conditions in the Taking Order. (Taking Order, pp. 98-99). Those conditions include Nashua's creation of a $40 million mitigation fund for the benefit

of PEU and PAC customers, a requirement that service to customers outside of Nashua be maintained at the same rates as for Nashua customers, a requirement that Veolia handle all customer service functions, the creation of a technical advisory board, and a requirement for Commission approval of the final Veolia and R.W. Beck contracts. As the Commission stated, these conditions are "prerequisites to our decision that the taking is in the public interest." (Taking Order, p. 98). In other words, without these conditions, the Commission determined that Nashua's taking of PWW would *not* be in the public interest.

In effect, the Commission substantially altered Nashua's woefully inadequate proposal, transformed it into a very different structure, imposed costly new obligations upon Nashua, and then proclaimed that costly, changed structure would meet the public interest. Pennichuck in effect became a mere ombudsman, relegated to pointing out deficiencies in the proposed taking for Nashua and the Commission to remedy, rather than the property owner proving its case that Nashua's proposal clearly was contrary to the public interest. This transformed the Commission's RSA 38:11 authority to set conditions for a municipal taking into a mechanism that made it impossible for PWW ever to overcome the presumption of RSA 38:3. In so doing, the Commission badly overstepped its RSA 38:11 authority to impose conditions, using it to convert the statutory rebuttable presumption into one that was effectively irrebuttable. The Commission exceeded its quasi-judicial obligation to serve as a neutral arbiter of the public interest under RSA 38 and adjudicate the proposal before it. Instead, it performed as a super-legislature to enact (under the guise of imposing "conditions") a complicated ownership and operational scheme that then served as a basis for the Commission to determine that Nashua met its public interest requirements to take PWW assets. Surely the Legislature by adding the "condition" language to RSA 38:11 never conceived that the Commission would some day

become a dealmaker, cobbling together the terms for an acceptable municipalization proposal because the City proposing the taking had failed to do so itself.

I. Conditions Beyond the Commission's Authority

As discussed above, the Taking Order includes nine conditions that are "prerequisites" to its public interest finding. (Taking Order, pp. 98-99). Many of those conditions require the Commission to exercise ongoing regulatory authority over the new municipal utility that Nashua proposes to create. Specifically, the Commission, among other things, asserts that it will assure that customers of PWW outside of Nashua continue to receive the same rates, terms and conditions as Nashua customers. (Taking Order, pp. 59, 98); that it will continue to oversee service quality issues, *id.*, that it will continue to have oversight of PWW's wholesale contracts (Taking Order, pp. 60-61; 98); and that it will require Nashua's membership in DigSafe. (Taking Order, pp. 61-62, 99).

The Taking Order recognizes that RSA 362:4 exempts municipalities from utility regulation and that the Commission has only "the powers and authority which are expressly granted or fairly implied by statute." *Appeal of Public Service Co. of N.H.*, 122 N.H. 1062, 1066 (1982). *See*, *Gould v. N.H. Div. of Motor Vehicles*, 138 N.H. 343, 347 (1994). Over the years, RSA 362:4 has been amended to lessen Commission oversight over municipal water operations, but even before that, the supreme court has made clear that the Commission's authority over municipal utilities is limited and thus, for example, it cannot force a municipality to increase its service territory. *Blair*, supra.

The Commission employs three rationalizations for its seizure of authority not granted to it by the Legislature. It somehow finds solace in the residual requirement that municipalities must obtain an upfront franchise to serve geographic territory outside of their boundaries (RSA

374:22); in its generic right to impose conditions on municipal taking of utilities (RSA 38:11); and in Nashua's stated willingness to accept voluntarily the assertion of expanded Commission jurisdiction.

The franchise territory requirements of RSA 374:22 and 26 are barebones, and in the case of privately owned utilities, are supplemented by ongoing Commission oversight. In the case of a municipal utility, once the franchise is granted, there is no ongoing Commission oversight of the municipality. The Commission's authority to regulate is gone once the franchise is granted, other than to the extent specified by statute, and is only restored when and if the franchise is transferred or revoked. Issuance of a franchise for a territory outside of Nashua certainly cannot trump the explicit municipal exemption in RSA 362:4 from ongoing regulation. Similarly, the Commission's authority under RSA 38:11 to impose conditions on a taking serves a limited purpose, and cannot be read to trump the explicit municipal exemption of RSA 362:4.

Finally, the Commission cannot expand its jurisdiction by Nashua's agreement, since its jurisdiction is limited to that granted by statute. *See*, *Appeal of Public Service Co.*, *supra*; *Plaquemines Port, Harbor and Terminal Dist. v. Fed. Maritime Comm'n*, 838 F.2d 536, 542, n. 2 (D.C. Cir. 1988)(consent of parties cannot add to administrative agency jurisdiction); 2 Am Jur 2d Administrative Law § 283 (...deviations from an agency's statutorily established sphere of action cannot be upheld based upon an agreement, contract, or consent of the parties).

J. Conditions That Are Triggered After the Taking

Several of the "prerequisite" public interest conditions that the Commission has imposed upon Nashua will come into play only when the Taking Order becomes final, or thereafter. For instance, condition 8 requires Nashua to submit for approval its agreements with Veolia and R.W. Beck within sixty days after the Taking Order becomes final, condition 3 requires Nashua

to include in its Veolia agreement that Veolia will provide all customer service functions, condition 7 requires Nashua to create a $40 million mitigation fund to benefit PEU and PAC customers, and condition 9 requires Nashua to hire a PWW employee familiar with its facilities. (Taking Order, pp. 98-99).

In its argument that Nashua's proposed taking was not in the public interest, Pennichuck highlighted the inadequacy and changeability of the contractor agreements, the inadequacy of Nashua's planned bifurcated customer service structure, and the harm to PEU and PAC customers. The Commission agreed, and required changes to the agreements, review of their final content and creation of a $40 million mitigation fund, but Nashua's satisfaction of these conditions will not be reviewed and adjudicated until **after all PWW appeals have been exhausted**. (Taking Order, pp. 96, 99). This post-appellate review process, however, raises the issue of what protection Pennichuck and the public have if the Commission is faced with the reality of significant, but necessary, cost changes to those agreements in the latter proceeding such that it has an impact on rates and renders the taking no longer in the public interest? What if the $40 million mitigation fund is not adequate to yield the desired $3.4 million in annual revenue or is determined to be unworkable either because Nashua is legally unable to finance or establish such a fund? By the time the Commission finishes its review, Pennichuck's appeals will have ended and PWW's assets may well have been taken or, at a minimum, its appeal rights will have expired. Mr. Naylor testified on this very issue at the hearing, point outing that "if the Commission were to set conditions on approval, I don't now how the ... shareholders of the Company are put back into their original position, if the City subsequently was not meeting the conditions." (Naylor, Tr. Day 12, p.77). Yet the Commission failed to even consider this issue.

It is not overstating matters to say that this is a corporate death penalty case. But here, the Commission proposes continuing its review of public interest "prerequisites" after the sentence has been carried out. In other words, the Commission has turned several of its conditions precedent, i.e. "prerequisite" matters needed to find public interest, into conditions subsequent, evaluated after the taking has occurred. This placement of the cart before the horse – or more appropriately the placement of the gallows before the conviction -- is the very essence of the denial of due process to which PWW has a right under Pt. 1, Art. 2 and 14 and Pt. 3, Art. 83 of the New Hampshire Constitution and the Fourteenth Amendment of the United States Constitution. See, *Bianco*, *Merrill*, *Concord Steam*, supra.

K. The Commission Did Not Consider Nashua's Ability to Finance the Acquisition.

The Commission was required to find that Nashua has the financial, managerial and technical capability to acquire and operate the utility it proposes to take from PWW, yet the Commission completely bypassed the financial analysis at the $243 million acquisition cost it determined. The City presented no evidence whatsoever that it is capable of issuing bonds to finance such a purchase price. Rather, its case regarding its ability to issue bonds was based on the City's proposal and valuation. It presented no witnesses nor any documentary evidence that funding for the acquisition and any necessary additional costs was feasible at the acquisition cost ultimately determined by the Commission. As the Commission is well aware, the difficulty of financing such an acquisition has increased significantly since the hearing on the merits concluded eleven months ago. See, e.g., *Public Service Corp. of N.H.*, Order No. 24,845 (Dkt. DE 07-070 4/14/08). To that point, Nashua's financial advisor, Steven A. Adams, testified that the bond market is the most important factor in municipal financing. (Ex. 1004, p. 9). The lack of any Commission finding on this point constitutes clear error.

L. The Commission Understated Nashua Rates

The Commission considered the change in rates for PWW customers under Nashua ownership and found that the rates would be lower under Nashua ownership, a critical basis for its finding of public interest. In so doing, it relied upon Mr. Guastella's testimony that a $248.4 million price tag for PWW assets would likely generate a Nashua revenue requirement about the same as that for PWW.[3] The Commission then compared that amount with its valuation of PWW assets at $203 million and concluded that municipal ownership "would produce a rate advantage".

Leaving aside Pennichuck's criticisms, set forth in sections N-Q, *infra*, of the $203 million valuation amount, there are three problems with the Commission's rate comparison analysis. First, the correct comparison is not $203 million with $248.4 million. Rather it is $243 million because the cost to Nashua of the $40 million mitigation fund must be included That leaves a relatively small 2% difference. Second, Mr. Guastella's analysis did not include Nashua operating costs from certain conditions imposed by the Commission, such as $311,000 annually for Veolia to perform all customer service functions (Noran, Tr. Day 4, pp. 99-103), $100,000 annually for participation in DigSafe (Noran, Tr. Day 4, pp. 181-85), at least $200,000 more annually in Veolia's base fee because of the passage of time since the contracts were first proposed (*id.*), and significant unanticipated amounts for Commission regulatory requirements (such as rate cases, financing approvals, and accounting). (*Id.*) Finally, Mr. Guastella's analysis

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[3] In fact, the Commission stated that Mr. Guastella testified that "Nashua's revenue requirement would be lower than PWW's" (Taking Order at 56), when in fact Mr. Guastella testified that even under Nashua's assumed operating costs at $248 million acquisition cost would result in rates that "would be *insignificantly* lower than Pennichuck's" Tr., 9/18/07 at 81 (emphasis added) and that "there would be *essentially no significant difference* in terms of revenue under continued ownership by PWW or acquisition by the City of Nashua." Exh. 3010 at 10 (emphasis added).

did not reflect all of the additional costs that Veolia will pass on to Nashua as supplemental charges outside of its fixed annual fee. Ex. 1005B (Draft Veolia Agreement, Appendices E, G, H, and Q). Veolia admitted that its contract seeks to shift pricing risks onto Nashua. Ashcroft, Tr. Day 4, pp. 35-37. Mr. Sansoucy even assumed that operating expenses for Nashua would be $10,410,000 in 2008 (Ex. 1002, Exhibit GES-4), a million dollars more than Mr. Guastella's earlier projection. (Ex. 3016X, Sch. C).

When all of these cost increases are factored in, ratepayers in all of PWW's service territories face **higher rates** under Nashua ownership. On an objective basis, this public interest factor must weigh in favor of continued PWW ownership.

M. The Mitigation Fund

In its order, at Nashua's urging, the Commission latched onto the concept of a mitigation fund, finding that "the public interest requires as a condition of our approval that Nashua establish an appropriate mitigation fund." (Taking Order, p. 96). The stated purpose of the fund was to mitigate the "$3.4 million in additional annual revenue requirements [that] would be needed by PEU and PAC if Nashua takes PWW." (Taking Order p. 95). The Commission established the fund at the low end of the range of damage to PEU and PAC discussed by Mr. Guastella, based on an assumed capitalization rate of 8.5%, (Taking Order, p. 96), but deferred "the specific method for implementing this result as a compliance matter in this proceeding after the City makes a ratifying vote and all rehearings and appeals are exhausted." *Id.* Pennichuck agrees with the Commission that PEU and PAC customers would suffer harm that requires compensation in the event of a taking, and that theoretically a fixed principal fund not held by Nashua, maintained in perpetuity, and totaling at least $40 million, is critically important and would serve as a remedy. But the Commission erred in assuming that it created a valid and

enforceable remedy for those customers and, in stating that, such a hypothetical remedy fixed yet another defect in Nashua's proposal.

In ordering that the mitigation fund be created, the Commission incorrectly stated that "Pennichuck proposes the creation of a mitigation fund to protect customers of PEU and PAC from lost economies or synergies resulting from the taking." (Taking Order, p. 94). PWW never proposed such a fund and, in fact, Mr. Guastella testified that he had not considered what problems might be encountered if the Commission attempted to require such a fund. (Guastella, Tr. Day 10, pp. 149-52). Mr. Guastella's testimony merely attempted to quantify in present value terms the magnitude of the harm that would be imposed on PEU and PAC customers if PWW's assets were taken by eminent domain. At no time did he testify that a mitigation fund would be possible to create, nor was such a fund otherwise proposed by Pennichuck. This erroneous understanding of the testimony is significant because the Commission failed to consider numerous critical issues regarding establishment of a mitigation fund and whether its purpose could be accomplished, particularly at the $40 million level.

The Commission simply assumed, without considering any evidence on the issue, that the annual revenue stream of $3.4 million it intended to create can in fact be generated by a fixed principal fund of $40 million, yet there was no testimony that this would reasonably be possible. Instead, the only testimony on the necessary size of such a fund was from Mr. Guastella, who testified only that *if* $40 million were contributed to a fund and *if* the fund earned 8.5% annually (i.e. on a *net* basis), it would yield an annual income stream of $3.4 million. The Commission then wrongly took this hypothetical proposition and effectively converted it into a finding that such a result was possible. In doing so, the Commission failed to take evidence on any of these

issues, and thus did not consider any of the following significant impediments, among others, that would undermine the result the Commission sought to achieve:

- taxation of the initial contribution of $40 million to the mitigation fund would reduce the net contribution to approximately $24 million after taxes[4], in which case the annual earnings on the fund would be only approximately $2 million annually (at 8.5% pretax), rather than $3.4 million;

- to the extent that the annual income stream from the fund is taxable, then the fund would have to generate substantially greater gross revenue to net 8.5%;

- a post-taxation 8.5% rate of return is highly unlikely to be achieved by any fund of investments appropriate for the Commission's stated purpose;

- Nashua may lack the legal authority to issue bonds for the purpose of creating a fund that earns a yield materially higher than the interest rate that the bonds themselves bear (sometimes referred to as arbitrage) or that will benefit customers of privately owned water systems that are located outside Nashua and that it does not serve.

N. The Commission Relied Upon Significant Information Outside of the Record

In the public interest and valuation portion of its order, the Commission used a number of documents outside of the record of this proceeding. It found that a water supply contract between Nashua and the Town of Milford filed with the Commission on February 22, 2008 "strengthened" Nashua's public interest case. (Taking Order, p. 61). In its asset approach analysis, it used adjustments for additions and retirements of assets and accumulated depreciation reserves for 2006, 2007 and 2008 based upon PWW's annual reports for 2006 and 2007. (Taking Order, p. 89).

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[4] As noted in Mr. Correll's prefiled testimony, Pennichuck's effective income tax rate is approximately 39%. (Ex. 3001 at 20).

While Pennichuck agrees that a valuation update is appropriate, the Commission's self help approach created more problems than it solved. Relying upon materials outside of the record of this proceeding creates easily avoidable error (such as the Commission's apparent failure to include certain readily ascertainable new assets in the update). It also is a due process violation of the most basic nature (see, *Appeal of Public Service Co. of N.H.* 122 N.H. at 1072-73,) and flies in the face of the Commission's own rules, which govern the use of materials from other proceedings. N.H. Code of Admin. Rules Puc 203.27(b) requires the Commission to give notice of its intent to use such materials, and Puc 203.27(c) affords parties the opportunity to contest their use. In fact, Nashua and Pennichuck considered submitting for administrative notice different materials from other proceedings, but the Commission refused to admit them into the record. (Secretarial Letter Order, September 17, 2007). It appears that the Commission ignored that order, reviewed material outside of the record, and used them to craft the Taking Order. That constitutes clear error.

O. The Commission Failed to Explain the Numbers in Its Valuation Order

While the Commission discussed its valuation methodology, it did not provide a roadmap to enable the parties to review how it applied its methodology to reach its conclusion. Absent a showing of the Commission's calculations whereby it reached its result, neither the parties nor a reviewing court can properly analyze the valuation portion of the Taking Order to determine if the Commission properly implemented the valuation methodology it purported to adopt. *Appeal of Newington*, *supra*; RSA 363:17-b.

P. The Commission Failed to Include a 2 Percent Growth Rate in Its Capitalization Rates

Both in its asset approach and income approach analysis of valuation, the Commission refused to apply a modest 2% long term growth factor to the applicable capitalization rate.

(Taking Order, pp. 88-89, 91-92). Mr. Reilly stated in his report and at the hearing that a growth factor is a regular component of the income approach capitalization rate (or its negative in the calculation of economic obsolescence under the asset approach). (Ex. 3007A, p. 35, 39; Reilly, Tr. Day 8, pp. 98-110). In fact, Mr. Reilly conservatively assumed no growth in customers or volume of water sold. He only assumed that, over time, PWW revenues and costs would each increase at a modest rate per annum such that the difference between them – income – would grow by a modest 2%. Nashua argued that there would be no growth in PWW's customers or sales over time, and Mr. Reilly did not dispute that in his testimony. But Nashua did not grasp the mathematical fact that, when revenues grow at a rate at least equal to the growth rate in expenses, income, by definition, also grows. As a regulated utility, PWW has a right to recover reasonable expense increases and, additionally, provided its average per annum capital spending exceeds its per annum depreciation expense, its rate base and the resulting net income generated from this increasing rate base will also increase over time. Especially in light of the fact that expense increases are recoverable dollar-for-dollar through rate case filings, an assumption that capital spending will exceed depreciation by an amount that will cause "income" to grow at an average rate of 2% is very reasonable and conservative. The Commission itself seemed to acknowledge the need to account for growth when it applied a 5% growth factor to update its income approach valuation from 2005 to 2008. (Taking Order, p. 93).

The consequence of not including the 2% long term growth factor in both the asset and income valuation calculations is significant. Pennichuck estimates the adverse effect on PWW's valuation as of December 31, 2005 to have been approximately $92.7 million. This amount should be added back to PWW's valuation as of that date.

Q. The Update of PWW's Value Is Based Upon Incomplete Information and Is Difficult to Evaluate

Apart from using information outside of the record in this proceeding, the information the Commission used to bring forward PWW's valuation from December 31, 2005 (the amended agreed date in the procedural schedule) to December 31, 2008 is incomplete and impossible to evaluate. (Taking Order, pp. 89, 92-93).

For instance, Pennichuck cannot determine whether the Commission provided an accurate mechanism to compensate PWW properly for capital additions made up until the date of taking. To compound matters, the Commission did not show what data it used to calculate its update, which makes it impossible for review by parties to this proceeding, let alone an appellate court. *See*, *Appeal of Newington*, *supra*. The Commission could have avoided these errors had it called for supplemental filings for the Commission to consider in its update of the initial order to the date of the taking. In summary, Pennichuck questions the methodologies employed and reserves its right to appeal the update amount and the methods by which they were determined.

R. Pennichuck is Entitled to a Jury Trial on Damages

As the Commission noted at Taking Order, p. 6, the superior court (Hillsborough South No. 04-E-0062) on August 31, 2004 ruled that it was not then ripe to determine whether Pennichuck is entitled to a jury trial on damages. That question would become ripe only after the Commission found public interest and made its award of damages.

Now that the superior court's ripeness criteria have been met, Pennichuck has been denied its equal protection constitutional right to a jury trial on damages. *See, e.g.*, N.H. CONST., pt. 1, arts. 2,12,14; *Gazzola v. Clements*, 120 N.H. 25, 29 (1980); *White Mountain Power Co. v. Maine Central RR*, 106 N.H. 443, 445 (1965). The owners of other public utility

assets facing eminent domain taking (RSA 371:10) and the owners of all other property subject to condemnation processes in New Hampshire (RSA 498-A:9) enjoy this right. The absence of this right makes the valuation process set forth in RSA 38 unconstitutional on equal protection grounds.

III. CONCLUSION

For the reasons set forth above, Pennichuck respectfully requests that the Commission rehear, including an oral argument, and reconsider the Taking Order as set forth above.

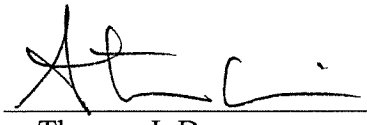
Respectfully submitted,

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: August 22, 2008

By: 

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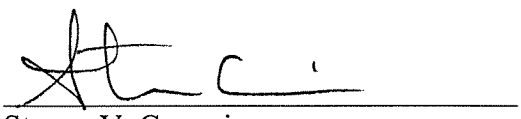
CERTIFICATE OF SERVICE

I hereby certify that on this 22nd day of August, 2008, a copy of the foregoing Motion For Reconsideration And/Or Rehearing Regarding Order No. 24,878 has been forwarded by electronic mail to the parties listed on the Commission's service list in this docket.



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