

STATE OF NEW HAMPSHIRE  
BEFORE THE  
PUBLIC UTILITIES COMMISSION

*City of Nashua: Petition for Valuation Pursuant to RSA 38:9*

Docket No.: DW 04-048

**MOTION FOR REHEARING AND CLARIFICATION**

**NOW COMES** the City of Nashua and moves for rehearing on issues related to valuation and clarification with respect to certain findings made concerning the public interest under RSA 541, and in support hereof states as follows:

**I. MOTION FOR REHEARING**

**A. THE COMMISSION ERRED BY ACCEPTING PENNICHUCK'S THEORY THAT MUNICIPAL BUYERS INFLUENCE VALUE WHICH WAS OVERWHELMINGLY CONTRADICTED BY THE EVIDENCE**

1. There can be little doubt that the Commission's Order of July 25, 2008; Order No. 24,878 is among the most comprehensive and thorough in the Commission's history. The City of Nashua, its citizens, and those of surrounding communities commend the Commission for both the scope and thoroughness of its analysis. The City therefore does not undertake lightly its decision to seek rehearing because it recognizes, as it must, the tremendous effort the Commission has undertaken in evaluating the issues and evidence presented to it.

2. However, the primary issue for which Nashua seeks rehearing or reconsideration, i.e. valuation, is one for which the Commission is itself divided. Therefore, rather than ask the Commission to simply weigh the evidence in its favor and accept the testimony of one expert in favor of another, Nashua asks this Commission to re-examine the errors identified by Commissioner Below's dissenting opinion and that lie

at the foundation of the majority's determination of the price to be paid by Nashua: that hypothetical not-for-profit municipal buyers fundamentally alter the market for Pennichuck Water Works' property that is the subject of this proceeding.

3. This motion therefore builds upon the four corners of the Commissioner Below's opinion, and draws the majority of Commission's attention to additional critical evidence that it overlooked that demonstrates that Pennichuck's municipal buyer theory is not supported by the evidence or the realities of the market for water utilities.

Specifically:

- i. The Commission erred by concluding that a competitive market of municipal or non-profit buyers exists or influences the market for Pennichuck Water Works, which was unsupported by the evidence.
- ii. The Commission erred by accepting a municipal buyer theory that is not legally permissible under New Hampshire Law.
- iii. The Commission erred because the municipal buyer theory is impracticable.
- iv. The Commission failed to consider that municipal buyers are not active participants in the marketplace because they have no authority to purchase stock of for-profit water companies.
- v. The Commission erred by concluding that the Reilly theory established the fair market value of the assets.

These points are addressed below.

**i. The Commission Erred By Concluding That A Competitive Market Of Non-Profit Purchasers Exists, Or Influences The Market for Pennichuck Water Works.**

4. The Commission accepted Pennichuck's theory of value put forth by its expert Robert Reilly, that multiple not-for-profit entities (municipalities) would compete in the pool of buyers and set the range of the purchase price because they could afford to

pay more than investor owned utilities.<sup>1</sup> There is, however, no evidence demonstrating that such a competitive market of municipal or not-for-profit buyers exists. The Commission's own decision, which spans 120 pages, fails to identify a single municipal or not for profit purchaser that would compete against Nashua.

5. Even Mr. Reilly acknowledged when asked in "how many situations have you seen where there have been multiple non -- not for profit or governmental bidders?"<sup>2</sup> that it only happens in "the minority of the cases".<sup>3</sup> He further indicated his belief that the situations in which more than one municipal buyer actually competed to "bid up" the value represented "very few cases -- where it may be back to back, literally next door municipalities, why should we -- you know, and the concern is often, I'll just be honest with you, if we're -- if I'm city A and I'm right next to city B and the water company is in the middle, [...]when city A and city B are both bidding, then the prices can get bid up."<sup>4</sup>

6. When asked if he could "recall the names of any of these situations" or examples where municipal buyers had "bid up" the market price for a water utility, however, *he was unable to recall even a single example to support his theory*. Mr. Reilly stated that "Oh, I can look--I can't think on the top of my head, but I can research that and get you that information".<sup>5</sup>

7. It may be that Mr. Reilly's failure to recall even a single example of when municipal or other not for profit purchasers competitively "bid up" the value of an investor owned utility is merely circumstantial evidence. However, "some circumstantial

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<sup>1</sup> Order No. 24,878 at p. 89.

<sup>2</sup> Transcript, September 12, 2007, Pages 210-211.

<sup>3</sup> Transcript, September 12, 2007, Page 211.

<sup>4</sup> Transcript, September 12, 2007, Pages 211-212.

<sup>5</sup> Transcript, September 12, 2007, Page 212.

evidence is very strong, as when you find a trout in the milk.”<sup>6</sup> Mr. Reilly’s comment that he thought that they existed, but simply could not recall an example, is particularly troubling because the difference between his value of \$248 million, and that of Mr. Walker of \$85 million is entirely dependent the existence of such a market for Pennichuck Water Works. There is no evidence that such a market exists, and his testimony that he thought one existed but could not recall any specific example is suspect. One would expect the milkman, confronted with the trout, to say no less.<sup>7</sup>

8. There was undisputed affirmative evidence, however, that such a competitive market of municipal buyers does not exist. Donald Ware, P.E., Chief Engineer and President of Pennichuck Water Works testified that, based on his 25 years of industry experience, municipalities as a general matter, have “no interest” in acquiring water systems and are “not regularly in the business” of doing so.<sup>8</sup> There is no rational basis for the Commission to accept Mr. Reilly’s vague but unconfirmed sense that municipal buyers might participate competitively in the market with Mr. Ware’s 25 years of *actual experience* indicating that they do not.

9. The Commission also heard from John Joyner, President of Infrastructure Management Group, Inc. (“IMG”) who testified on cross examination concerning his firm’s financial advisory practice made up of former investment bankers specializing in the privatizing and management of utilities, including water systems.<sup>9</sup> He prepared a report entitled *Tapping Public Assets*, with other members with considerable experience

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<sup>6</sup> *McIntosh v. Personnel Commission*, 117 N.H. 334, 339 (1977) quoting Henry David Thoreau, Journal, November 11, 1850.

<sup>7</sup> Nineteenth century American dairymen delivered their milk in cans and dispensed the amount each house required. If they forded a stream on the way to the market, there was always the temptation to top up the cans with water from the brook. This led Henry David Thoreau in his journal to observe that “some circumstantial evidence is strong, as when you find a trout in the milk.”

<sup>8</sup> Transcript, September 11, 2007, p. 63, 64.

<sup>9</sup> Transcript, September 18, 2007, Page 48.

in selling infrastructure assets and raising capital for new facilities.<sup>10</sup> That report advised that “[r]egulated utilities *usually sell for at or close to their “rate base”*; i.e., roughly, the original cost of the utility, less depreciation” and that “[s]ale prices for water utilities *usually range from \$1500 to \$3500 per customer connection*, with a \$2000 per connection median, but they can go higher if the opportunity for growth or operating cost savings is exceptional.”<sup>11</sup>

10. On cross examination, he applied his range of values for water utility assets to Pennichuck’s 25,000 customers, which resulted in a value range from \$37,500,000 to \$87,500,000. Thus, his own upper range of values, again based on his firm’s *actual experience*, bears a striking resemblance to the value of \$85,000,000 concluded by Nashua’s valuation expert Glenn Walker from his analysis of actual sales in actual markets.<sup>12</sup> The Commission’s Order and analysis overlooks this testimony which begs for an explanation.

11. Mr. Joyner’s testimony and report is also telling in what it does not say. At no point does Mr. Joyner or his team of municipal utility management experts suggest that there is any reason that other municipal buyers might step in and pay a substantial premium above what investor-owned utilities pay. Rather, his report confirms what Donald Ware candidly admitted on cross-examination: that there is no active market of municipal buyers that has any appreciable influence on the market.

12. This omission is particularly damaging to Pennichuck’s municipal buyer theory because, as discussed below,<sup>13</sup> a tax-exempt municipal seller would not be subject

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<sup>10</sup> Ibid at Page 49.

<sup>11</sup> Exhibit 1099, Page 6 (emphasis added).

<sup>12</sup> Exhibit 1007A, Page 65.

<sup>13</sup> See Section I (A)(iv).

to the capital gains tax that a for profit seller such as Pennichuck would face if it sold its assets to a municipality, due to the municipal purchasers inability to purchase stock without special legislative authorization.<sup>14</sup> As a result, a not-for-profit municipal buyer would have an even greater capacity to buy from another municipality because a municipal seller would not face the “substantial” capital gain tax liabilities amounting to “many tens of millions of dollars” just to make a financially equivalent offer to a for profit stock purchaser.<sup>15</sup> However, Mr. Joyner’s testimony and his report confirms what Pennichuck Water Works candidly admitted: that there simply are not municipal buyers actively competing in the marketplace.

13. It is also surprising to Nashua that the Commission would accept Reilly’s municipal buyer hypothesis because if in fact municipalities were active competitors influencing the market for Pennichuck Water Works, they would also be active in seeking approval from this Commission for the franchises they acquired. The Commission’s own jurisprudence, confirms that municipal acquisitions are in the nature of incremental expansions of existing infrastructure, not competitive acquisitions of the nature hypothesized by Mr. Reilly. The Commission’s decisions in *Tilton and Northfield Aqueduct Company Inc.*,<sup>16</sup> the *Manchester Water Works*,<sup>17</sup> *Portsmouth*,<sup>18</sup> and other cases confirm this.<sup>19</sup> Municipal buyers played little or no role in bidding or establishing the market price in the recent acquisitions of investor-owned utilities, including

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<sup>14</sup> Cf., Laws of 2007 Chapter 347; SB 206 (2007) (Nashua’s limited right to purchase stock).

<sup>15</sup> Exhibit 3001, Page 20.

<sup>16</sup> Order No. 24,562.

<sup>17</sup> See, e.g., *Manchester Water Works*, Order No. 18,628, Order No. 24,326 & Order No. 24,775.

<sup>18</sup> *City of Portsmouth*, Order No. 24,865 (sewer service).

<sup>19</sup> E.g. *City of Laconia*, Order No. 24,433; Order No. 24,841; *City of Dover*, Order No. 24,506; *North Conway Water Precinct*, Order No. 24,360.

Philadelphia's proposed acquisition of Pennichuck Water Works,<sup>20</sup> Aquarion,<sup>21</sup> Hampstead Water Company,<sup>22</sup> or PAC, Consolidated and Central Water Company, Inc., when they were acquired by Pennichuck.<sup>23</sup> Indeed, it was the testimony of the Commission's own Director of the Water Division, Mark A. Naylor,<sup>24</sup> and former PUC Commissioner, Douglas L. Patch,<sup>25</sup> that municipal water systems are not engaged in the *business* of acquiring other water systems.

14. Thus, the Commission erred by accepting Pennichuck's municipal buyer hypothesis, which was not only unsupported by the evidence, but contrary to the evidence before the Commission. However, Nashua does not suggest that the Commission need, as a matter of law, accept the appraisal of its own experts. Nashua requests that the majority reconsider its determination of value based on the lack of evidentiary support for the existence of a municipal buyers' market for Pennichuck Water Works and join Commissioner Below's opinion which tempered the municipal buyer theory in light of the paucity of evidence to support it. To do otherwise would force the citizens of Nashua and customers in surrounding communities to bear an unreasonable and unnecessary \$50 million in additional debt as a result of an unsupported theory of value that has made "the only real winners in this game ... the lawyers and expert witnesses, who collect their fees regardless of the outcome."<sup>26</sup>

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<sup>20</sup> See Order No. 24,020.

<sup>21</sup> *Aquarion Water Company of New Hampshire*, Order Nos. 24,651 & 24,691.

<sup>22</sup> *Hampstead Area Water Company*, Order No. 24,803.

<sup>23</sup> *Pennichuck Corporation*, Order No. 22,843; *Pittsfield Aqueduct Company, Inc.*, Order No. 24,606.

<sup>24</sup> Exhibit 5001, Page 52, 53, 56.

<sup>25</sup> Exhibit 5002, Page 18.

<sup>26</sup> *Southern New Hampshire Water Company v. Hudson*, 139 N.H. 139, 145 (1995).

**ii. The Commission Erred by Accepting a Municipal Buyer Theory That Is Not Legally Permissible Under New Hampshire Law.**

15. Municipalities in New Hampshire are subdivisions of the State and have only the powers granted to them by the Legislature.<sup>27</sup> In order for a city or town or district to acquire the assets of a utility, therefore, there must be a specific grant of authority from the legislature. Nashua has advocated that RSA 38 is the sole grant of that authority, not only for a taking but also a consensual sale. See RSA 38:2. As the Commission has already ruled in Order No. 24,425, herein, the only New Hampshire city or town or district which could lawfully acquire the assets of Pennichuck under RSA 38 is one in which the Company is engaged in distributing water for sale.

16. Even if Nashua and a municipality could legally acquire by agreement what it cannot accomplish under RSA 38, there must be some other grant of authority, which there is not. Under RSA 31:3, a municipality may only “purchase and hold real and personal estate for the public uses of [its] inhabitants”. Thus, a municipality cannot simply vote to raise and borrow funds to compete to acquire water utility property that serves customers in other municipalities under RSA 31:3 unless the acquisition was for “the public uses of [its] inhabitants.”

18. The similarity of RSA 31:3 to RSA 38:6 is noteworthy. In both RSA 31:3 and RSA 38:6, in order for a municipality to acquire water utility assets there must be a connection between those assets and the inhabitants of the municipality. Either their purchase serves the public use of the municipality’s inhabitants (RSA 31:3) or the assets must belong to a utility which serves its inhabitants (RSA 38:6). There is no grant of

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<sup>27</sup> *City of Manchester School Dist. v. City of Manchester*, 150 NH 664, 666 (2004); Order No. 24,425, Page 9.



authority in New Hampshire law for any municipality to acquire the assets of a water utility on a competitive basis regardless of where it is located.

19. Yet this is precisely the approach to value used by Pennichuck's expert and adopted by the Commission. He advocated in his report that the population of likely buyers included "*any incorporated New Hampshire city or town.*"<sup>28</sup> In his testimony before the Commission contrary to New Hampshire law, he argued that the "potential buyers did not actually have to either touch the city of Nashua *or touch Pennichuck Water Works.* [...] a buyer could be a municipality or a water district or a regional district *anyplace in New Hampshire; it doesn't have to be actually physically located within the Pennichuck service area.*"<sup>29</sup>

20. Mr. Reilly repeatedly referred to an alleged memorandum he had received from Pennichuk's attorneys which provided the legal authority for his hypothesis.<sup>30</sup> Yet, when asked to produce such a memorandum he was unable to do so.<sup>31</sup> Upon request by Nashua, the Commission required the memorandum to be produced by Pennichuk's attorneys. It became apparent that no memorandum existed and at best there had been a conversation with Mr. Reilly.<sup>32</sup> The substance of that conversation as set forth in the transcript provides no legal support for the Reilly hypothesis that the population of likely buyers could include any New Hampshire city or town. In fact, Mr. Reilly was told:

[T]hat the potential governmental buyers would be, obviously, Nashua. Any other town where Pennichuck Water Works provides service, any village district, similarly where Pennichuck Water Works provides service, all of those could, by consensually or exercise eminent domain under RSA 38.

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<sup>28</sup> Exhibit 3007A, Page 2.

<sup>29</sup> Transcript, September 12, 2007, Pages 47-48.

<sup>30</sup> Transcript, Sept. 12, 2007, page 58.

<sup>31</sup> Ibid at Pages 58-61.

<sup>32</sup> Ibid at Page 144.

In addition, the current regional water district, any new water district that was formed or any other intermunicipal special district formed pursuant to RSA 52A all can buy on a consensual basis.

The state of New Hampshire could acquire the utility, the United States Government could acquire the utility, or nay out of state or bi-state government body.<sup>33</sup>

It is clear that Reilly's hypothesis is in direct conflict with New Hampshire law. The alleged memorandum confirms that the pool of municipal buyers is limited to those cities and towns served by Pennichuck Water Works. The attempt to include water districts formed under RSA 52A goes nowhere. There is no RSA 52A! Assuming the reference should have been RSA 52, the boundaries of such a district are set by the selectmen in the towns in which they are located.<sup>34</sup> Nashua doubts that the law of New Hampshire is that a town not served by Pennichuck, such as Lancaster,<sup>35</sup> could establish a water district pursuant to RSA 52 that would be able to purchase the very assets the town could not purchase.<sup>36</sup> Likewise, if the reference was to RSA 53A, the same result is reached. Two towns not served by Pennichuck could not create a water district by intermunicipal agreement that could acquire what the towns were not permitted to buy. If Order No. 24,425 is good law, the Reilly hypothesis is vastly limited.

21. The Reilly theory is both factually and legally absurd, and not permitted under New Hampshire law. Relying on it, he was able to assign a value that would result from circumstances that do not and cannot exist as a matter of law. It is not fair market value, but a theoretical value in a hypothetical scenario that may have interest in

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<sup>33</sup> Ibid at p. 145.

<sup>34</sup> RSA 52:1.

<sup>35</sup> See discussion regarding Lancaster at Transcript Sept. 12, 2007, Page 51.

<sup>36</sup> See, e.g., RSA 52:8.

academic circles but does not exist in any market, and certainly not the market for Pennichuck Water Works.

**iii. In The Few Municipalities That Have The Legal Authority To Acquire Pennichuck Water Works, The Evidence Is Overwhelming That It Is Neither Practical Nor Reasonably Probable They Would Compete To Purchase Pennichuck Water Works.**

22. Even Mr. Reilly admits that if Nashua is the only practical legal not-for-profit buyer then “[t]hat hypothetical is the hardest question to answer [because] we've also seen cases where [bidding up] didn't happen”.<sup>37</sup> Such is the case with the market for Pennichuck Water Works, as there are no likely municipal buyers, other than Nashua, that could legally or practically acquire the system under RSA 38, or even RSA 31:3. As a result his hypothesis does not reflect generally accepted standards for valuing the fair market value of property at its legally permissible and reasonably probable highest and best use.<sup>38</sup>

23. There are no reasonably probable competitive municipal or not-for-profit buyers for Pennichuck Water Works. The record is undisputed that 87 percent of Pennichuck Water Works customers, or approximately 21,600 of 25,000, are located in Nashua.<sup>39</sup> The remaining customers are scattered in 10 other municipalities in southern New Hampshire. None of these municipalities have more than a fraction of the customers (RSA 38) or inhabitants (RSA 31) in Nashua.

24. Amherst, the largest in terms of the number of customers, has only 760 customers (3.8%) that use wells as their primary supply and are connected to the core system *as a backup*, and 181 customers in two community well systems not connected to

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<sup>37</sup> Transcript, September 12, 2007, Page 206.

<sup>38</sup> Exhibit 1097 / 3100; *The Appraisal of Real Estate*, Twelfth Edition, Chapter 12 (Highest and Best Use).

<sup>39</sup> Order No. 24,878 at p. 108; Exhibit 3001, Page 7.

the core.<sup>40</sup> The Nashua core system serves only a “small portion of the Towns of Merrimack and Hollis” with 222 (0.8%) and 67 (0.3%) customers, respectively.<sup>41</sup> Pennichuck Water Works’ customers in Bedford (812 in 5 systems for 3.2%), Derry (648 in 5 systems for 2.6%), Epping (78 for 0.3%), Newmarket (87 for 0.3%), Plaistow (194 in 3 systems for 0.8%) and Salem (72 for 0.3%) are served by satellite systems that are not hydraulically connected to the Nashua core.<sup>42</sup> Milford has 119 customers in three systems (0.5%), in addition to its wholesale supply contract for its own water department.

26. Under RSA 38, these are the only communities authorized to acquire Pennichuck Water Works. There are no other lawful purchasers. In contrast to Nashua with over 20,000 customers, each of these communities has only a tiny fraction of the customer base, though some, like Merrimack and Milford, have significant wholesale contracts or customers. It is plainly absurd to think that hypothetically, Amherst with 3.8% of the total number of customers would competitively bid against Nashua to acquire Pennichuck Water Works. Yet this is the foundation of the municipal buyer hypothesis adopted by the Commission.

27. The same result is true even if the Commission were to assume, for the purposes of argument, that municipalities have the power to acquire water utilities by agreement, outside the provisions of RSA 38. Under RSA 31:3, only Nashua of all of these municipalities can claim that the acquisition of the entire Pennichuck Water Works bears a rational relationship to the “public uses of [its] inhabitants”. To suggest that Amherst, would competitively bid in the market to establish or purchase its own water

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<sup>40</sup> Exhibit 3001, Page 7.

<sup>41</sup> Exhibit 3001, Page 6.

<sup>42</sup> Exhibit 3001, Page 7.

department by acquiring over 24,000 foreign customers in order to serve its own 941 customers is fundamentally unsupported by the evidence, setting aside common sense.

28. Even if these communities elected to competitively bid against Nashua, and managed to obtain financing and the votes and other necessary approvals for such an endeavor, the municipal buyer hypothesis still faces a fundamental practical problem. RSA 38:14 provides Nashua or any other municipality the ability to “opt out” of an acquisition by another municipality by conducting its own vote under RSA 38, *which is binding on the acquiring municipality*.

29. Thus, even assuming that one community, such as Bedford (3.2%),<sup>43</sup> bid competitively to acquire Pennichuck Water Works, under RSA 38:14, Nashua could simply not bid at all and conduct its own “vote to establish a municipal plant” and “all the provisions of this chapter shall be binding as to such determination.” Nashua would not need to compete and any other municipal buyer, because under RSA 38:14 any municipal buyer that did not cooperate with Nashua as Nashua has done with the Regional Water District, would potentially face the loss of 87% of its customers.

30. The simple reality is that only Nashua is in a position to overcome the financial, political, and legal obstacles that would face any municipality that sought to acquire Pennichuck Water Works. These obstacles make it a legal and practical impossibility for any other municipal or not-for-profit buyer to compete in the market place to acquire an investor owned utility like Pennichuck Water Works. If it were otherwise, it would be reflected in the record. However, the record in this proceeding reflects the fact such a market of competitive municipal buyers simply does not exist. Mr. Reilly’s theory is therefore not based on a hypothetical version of New Hampshire in

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<sup>43</sup> Bedford, of course, supports Nashua’s petition. See Exhibit 2003, Pages 4-5.

which municipalities free from legal, financial, political and tax<sup>44</sup> constraints compete in the open market to acquire the State's largest investor owned utility. His valuation does not reflect the reasonably probable highest and best use of property.

31. It is far more likely that, rather than compete in the market to acquire Pennichuck, municipal buyers would cooperate to ensure that they acquired the system at the lowest possible price. The Commission's own experience and the record in this case confirms this. For example:

- In this proceeding, Nashua is a founding member of the Merrimack Valley Regional Water District, which has consistently supported Nashua's petition. Nashua has committed to the principle of transferring ownership to the District,<sup>45</sup> and there is no evidence that even that process would be a competitive bid. Despite Nashua's pre-dominance in terms of the number of customers, Nashua has agreed to a charter for the District that allows in many, but not all, of the votes taken by the District Nashua only "gets one vote, just like any other community."<sup>46</sup>
- The Towns of Amherst and Bedford, the two largest communities by the number of customers outside of Nashua, supported Nashua's petition.<sup>47</sup>
- In the case of the Tilton-Northfield Water District's acquisition of the Tilton and Northfield Aqueduct Company, both municipalities involved cooperated to form a village district under RSA 52, which requires approval by both governing

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<sup>44</sup> See Section I (A)(iv), below.

<sup>45</sup> See *e.g.*, Transcript, January 10, 2007, Page 21; Exhibit 1014, generally, and at Pages 2, 15 & MBS Exhibit 3 (Response to Staff 4-93); Exhibit 1016, Pages 3-4.

<sup>46</sup> Transcript, January 11, 2007, Pages 43-44.

<sup>47</sup> Order No. 24,379, Page 8; Exhibit 2003, Pages 4, 5.

bodies.<sup>48</sup> They could have competed against each other up to their ability to pay but there is not evidence to suggest this occurred.<sup>49</sup> Nor did any other surrounding municipal or not-for-profit entity seek to acquire the system. The only municipalities in which the system was located collaborated to minimize their costs, as should be expected of not-for-profit governmental buyers.

- In the case of the proposed sale of Pennichuck to Philadelphia Suburban, as Commissioner Below recognized, Pennichuck's own investment banker SG Barr Devlin did not identify any municipal buyers as likely purchasers of the system.<sup>50</sup>

32. The evidence is clear that of all the potential municipal buyers with the legal authority to purchase Pennichuck Water Works, whether under RSA 38 or otherwise, only Nashua has the practical ability to do so. The record further demonstrates that the same limitations on municipal buyers in the market for Pennichuck Water Works exist throughout the entire water utility market. Were it otherwise, there would be evidence of sales of investor owned utilities similar to Pennichuck to municipalities. The record in this proceeding confirms that there are none that show any appreciable impact of the municipal buyer phenomenon as advocated by Mr. Reilly.

**iv. The Commission Failed To Consider That Municipal Buyers Are Not Active Participants In The Marketplace Because They Have No Authority To Purchase Stock Of For-Profit Water Companies And Are Therefore Unable To Compete In The Marketplace.**

33. During his cross-examination, when explaining why he believed SG Barr Devlin had not identified any municipal buyers in 2002, Reilly opined that municipalities cannot buy the stock of a for-profit water company. In doing so he demonstrated yet

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<sup>48</sup> See, e.g., RSA 52:1 ("the selectmen of the town or towns shall fix, by suitable boundaries, a district including such parts of the town or towns as may seem convenient").

<sup>49</sup> Order No. 24,562, *Tilton Northfield Aqueduct Company*, 90 NHPUC 599 (2005).

<sup>50</sup> Order No. 24,878, Page 109; Exhibit 1094, Page 33; Transcript, September 12, 2007, Page 71.

another reason why his theory that municipal buyers would set the purchase price for Pennichuck Water Works is fundamentally flawed.

34. Few, if any, asset sales occur in the market place for water utilities such as Pennichuck Water Works. Virtually all of the sales identified by both Reilly and Walker were stock sales. The reason for this is simple: asset sales cause a for-profit seller to recognize gain for federal and state income tax purposes equal to the excess of the aggregate value it receives for each asset less its adjusted tax basis in those assets.<sup>51</sup> The effective rate of such a tax is 39%.<sup>52</sup> By comparison, when the stock of the utility is sold to effectuate transfer, the only gain recognized is the gain in share price by the stock holder. As a result, stock sales avoid an effective 39% capital gain tax liability that sellers to municipalities would incur.<sup>53</sup>

35. New Hampshire municipalities do not have the authority to acquire and hold stock of for profit water utilities like Pennichuck under Part 2, Article 5 of the New Hampshire Constitution, absent a special grant of legislative authority and a public purpose.<sup>54</sup> Without authority to acquire and hold stock, municipalities are unable to compete with for-profit investor owned utilities in the market for water utilities. In a negotiated sale between a willing buyer and a willing seller, the sellers are not willing to incur an additional 39% tax liability without compensation.

36. In fact, Pennichuck's own testimony explains that it would never consider selling to a municipal purchaser. As Donald Correll explained "[b]ecause a large portion of PWW's assets are of a fairly old vintage, this differential would be substantial and *the*

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<sup>51</sup> Internal Revenue Code, Sec. 1211(a) ; Exhibit 3001, Page 20.

<sup>52</sup> Ibid.

<sup>53</sup> Exhibit 3001, Page 20.

<sup>54</sup> *Cf. Laws of 2007 Ch 347*; SB 206 (2007) (authorizing Nashua to purchase stock only by agreement).



*income tax burden would certainly run into the many tens of millions of dollars.”*<sup>55</sup>

Conveniently, Reilly’s municipal buyer theory ignores the “many tens of millions of dollars” costs that a municipal buyer of Pennichuck Water Works would need to overcome just to compete on an equal basis with a stock purchaser, if it were even allowed a seat at the negotiating table, as the SG Barr Devlin report shows it was not.<sup>56</sup>

37. By overlooking “the many tens of millions of dollars” in capital gains tax liability that a municipal buyer would need to overcome, the Commission failed to account for critical evidence demonstrating why municipal buyers do not and cannot appreciably influence the market for Pennichuck Water Works. This error allowed the majority of the Commission to assume a population of municipal buyers operating under financial circumstances that do not exist and arrive at a value far in excess of market value. The Commission should therefore reconsider its determination of price in light of this evidence and adopt the price as determined by Commissioner Below, whose valuation mitigated for the lack of data to support Pennichuck’s municipal buyer theory, which was not supported by the evidence.

**v. The Commission Erred By Concluding That The Reilly Theory Established The Fair Market Value Of The Assets.**

38. What the Commission has done by accepting Reilly’s hypothesis, as noted at length by Commissioner Below,<sup>57</sup> is not to establish the fair market value as required by RSA 38, but rather the price that Nashua, because of its many synergies,<sup>58</sup> is able to pay or, in other words, investment value to Nashua. It is not surprising then Reilly created his hypothesis concerning more than one municipal buyer. It allowed him to

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<sup>55</sup> Exhibit 3001, Page 20.

<sup>56</sup> See Order No. 24,878, Page 109 and the citations contained therein.

<sup>57</sup> Order No. 24,878, p. 104-108.

<sup>58</sup> Ibid at p. 92.

assume a lower cost of capital and rate of return and in so doing double the values he would have derived if he had used the cost of capital and rate of return of a typical buyer.<sup>59</sup>

39. However, what a buyer can afford to pay is not the same as fair market value. Investment value is specific to a particular investor or class of investors that has specific investment requirements,<sup>60</sup> while fair market value focuses on the *typical* investor with investment requirements *typical* of the market.<sup>61</sup> But, as Commissioner Below has noted, Reilly, himself, has admitted that the *typical* market for water utility assets consists of only one municipal buyer and that under such conditions the one municipal buyer will bid only \$1.00 more than what a *typical* for profit buyer would pay for the assets.<sup>62</sup> Because Reilly's market, by his own admission, is not *typical* and focuses on a particular class of investors rather than a typical investor, his hypothesis must fail.

40. Ultimately the best evidence of the market for PWW is the auction of its parent by SG Barr Devlin in 2002. SG Barr Devlin did not identify any potential municipal buyer and none submitted bids.<sup>63</sup> If municipal buyers could pay almost double what a for profit buyer could pay, notwithstanding any capital gains tax, it is likely SG. Barr Devlin would have invited their participation. Municipal buyers were not then, and are not now, the most likely population of hypothetical willing buyers. They do not have the motivations of a typical investor and they have different objectives. And, as Mr. Reilly admitted, the market does not typically consist of more than one.

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<sup>59</sup> Ibid at p. 104, 105; Exhibit 1015, GES Exhibits 16, 17.

<sup>60</sup> The Appraisal of Real Estate, 12<sup>th</sup> Ed., p. 26.

<sup>61</sup> Ibid.

<sup>62</sup> Order No. 24,878, p. 104, 105.

<sup>63</sup> Exhibit 1094, p. 33.

41. The only empirical evidence about the impact of municipal participation in the market suggests that they do not pay more than for-profit investors<sup>64</sup> confirming Commissioner Below's observation that it is unlikely a municipality would be willing to forego all its potential savings and synergies<sup>65</sup> and Reilly's admission that in a typical market with only one municipality, the price could be only \$1.00 more than what a for-profit buyer would pay.

**vi. Conclusion.**

42. The Commission should reconsider its reliance upon the Reilly hypothesis for the reasons set forth herein, in Nashua's November 16, 2007 Memorandum and in the dissenting opinion of Commissioner Below, which made reasonable adjustments in light of the lack of evidence in the record in this case to support his theory that municipal buyers would compete in the market to acquire Pennichuck Water Works. As noted herein, this theory does not reflect market value and is based on fundamental errors and assumptions.

**B. THE COMMISSION ERRED BY DENYING NASHUA'S PETITION TO ACQUIRE PAC & PEU AND REQUIRING THAT NASHUA MITIGATE HARM TO THEIR CUSTOMERS IN AMOUNT MORE THAN DOUBLE THEIR VALUE AND REVENUES**

**i. The Commission Improperly Denied Nashua The Opportunity To Acquire PEU and PAC.**

43. Nashua requests that the Commission reconsider its decision Order No. 24,425, strictly construing the notice provision in RSA 38:6 and prohibiting Nashua from acquiring Pennichuck East Utilities (PEU) and the Pittsfield Aqueduct Corporation

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<sup>64</sup> Exhibit 1007 (E); See also Transcript Sept. 10, 2007 (Afternoon) Page 85, 89.

<sup>65</sup> Order 24,878, Page 111.

(PAC). In so doing, the Commission defeated the plain meaning of the clear grant of authority to acquire those utilities consistent with the public interest.

44. In its March 22, 2004 *Petition for Valuation* and its October 21, 2004, *Memorandum of Law*, Nashua asserted that RSA 38:2, 6, 9 and 14 allow Nashua to seek to acquire all three of Pennichuck's regulated utilities, including PEU and PAC, and that it is the Commission's role to determine how much plant and property, including PEU and PAC, the public interest requires Nashua to purchase. Moreover, RSA 38:11 grants power to the Commission to set conditions and issue orders to satisfy the public interest, including the authority to require purchase of plant and property outside municipal boundaries it determines such acquisition is in the public interest.

45. At Pennichuck's urging, however, the Commission disregarded the "broad grant of authority" under the plain meaning of RSA 38:2 in favor "considering RSA 38:6 through the lens of strict construction".<sup>66</sup> In so doing, the Commission departed from express grant of authority established by the legislature and disregarded the New Hampshire Supreme Court's decision in the *Appeal of Ashland Electric*, 141 N.H. 336, 341 (1996) which clearly indicates that RSA 38 is to be construed according to "its plain and ordinary meaning," and that the Commission "must keep in mind the intent of the legislation, which is determined by examining the construction of the statute as a whole, and not simply by examining isolated words and phrases found therein."

46. By strictly construing RSA 38:6, a procedural provision of the statute entitled *Notice to Utility*, as limiting the substantive grant of authority in RSA 38:2, entitled *Establishment, Acquisition and Expansion of Plants*, Pennichuck and the Commission made a "fortress out of the dictionary" and defeated the "purpose or object

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<sup>66</sup> Order No. 24,425, Pages 10 & 12.

to accomplish” under RSA 38 of allowing the Commission to require that a municipality acquire such plant and property as necessary to protect the public interest.

47. Pennichuck’s use of the dictionary has been well played. In effect, strictly construing a procedural notice requirement of RSA 38:6, it has created the very harm that the statute seeks to prevent. As noted in Order No. 24,425, the legislative history of RSA 38 indicates that:

“a municipality may have to acquire some property outside of its boundaries. If there [are] some customers that would otherwise be stranded with a small distribution line that crosses a municipal boundary *the commission would have the power to order the utility that is selling its property or having its property acquired and also order the municipality to acquire that portion of a system that may be outside of their boundaries.*”<sup>67</sup>

48. Thus, Pennichuck has caused the Commission to impose a Mitigation Fund condition that will require Nashua to pay twice the value and revenues of the two utilities simply to maintain the status quo.<sup>68</sup> Pennichuck has essentially used this lens to prevent the very result that the plain meaning of RSA 38:2 & 11 are intended to prevent.

49. The evidence before the Commission supports acquisition of all three utilities by Nashua. The Commission found that “PWW, PAC and PEU are highly interdependent companies.”<sup>69</sup> In fact, PEU and PAC are simply shells created for rate purposes: they have no employees, no equipment or inventory, all of which are provided by PWW *using property located in Nashua*. Likewise PEU and PAC are operated out of PWW’s operations center in Nashua, using its communications and IT system, and its administration, accounting, billing and customer service. Their separation from PWW is

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<sup>67</sup> Order No. 24,425, Page 14 (emphasis added).

<sup>68</sup> Exhibit 3016, Pages 2-3.

<sup>69</sup> Order No. 24,878, Page 95.

a financial and regulatory exercise,<sup>70</sup> but from an operational perspective, the sale and distribution of water by PEU and PAC is controlled from and originates in Nashua using equipment and other property owned by PWW.

**ii. The Commission Erred By Requiring A Mitigation Fund Double The Combined Values And Revenues Of PAC And PEU.**

50. The Commission's decision suggests that Nashua employed a "litigation strategy" to avoid addressing the mitigation of harm to PEU and PAC customers. This is simply untrue.<sup>71</sup> Pennichuck first submitted testimony of John Guastella describing the harm in Reply Testimony on May 22, 2006, relying on company specific data responses that had not previously been produced.<sup>72</sup> As a result, Nashua never had the opportunity to submit responsive testimony. Even Staff acknowledges it had an inadequate opportunity to complete discovery on the company's testimony.<sup>73</sup>

51. The Commission has chosen to protect PEU and PAC customers from the harm that Pennichuck created by requiring that Nashua establish a \$40 million mitigation fund. The only evidence presented on the harm to PEU and PAC was based upon a continuation of the current corporate model. Such an approach, however, fails to consider several different opportunities to mitigate the harm by merging the operations into a larger utility.

52. For example, Donald Correll, former President of PWW and now the CEO of American Water, testified that his company would look at the purchase of PEU and PAC. Donald Ware, the current President of PWW said the sale of PEU and PAC to

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<sup>70</sup> See generally, Exhibit 1132.

<sup>71</sup> Order No. 24,878, Pages 94-95.

<sup>72</sup> See *e.g.*, Exhibit 3010, Page 10; Exhibit 3016, Page 2 (explaining his prior failure to calculate subsidies to PEU and PAC.)

<sup>73</sup> Transcript, September 26, 2007, Pages 129-130.

Nashua should be considered. For its part, Nashua urges the Commission to require that Nashua acquire all three regulated utilities, thereby eliminating the very harm that Pennichuck seeks to create in order to defeat the purposes of RSA 38. In any of these scenarios, PAC and PEU would continue to benefit from being part of a larger water system.

53. As Staff noted, Pennichuck's calculation of harm simply carried Pennichuck's existing overhead over to a much smaller utility without considering opportunities such as these to reduce or even completely eliminate any harm to customers of PEU and PAC.<sup>74</sup> There is every reason to believe that the harm to PEU and PAC has been overstated. The Commission should therefore reconsider its Order No. 24,425 and 24,878 and require that either Nashua acquire the assets of PEU and PAC to satisfy the public interest under RSA 38:11, or establish procedures whereby the mitigation fund may be reduced to a reasonable level in light of Pennichuck's ability to mitigate harm it created for its own customers.

**C. THE COMMISSION ERRED IN DETERMINING THE REBUTTABLE PRESUMPTION APPLIES ONLY TO ASSETS LOCATED IN NASHUA**

54. The Commission made a significant error by determining that the rebuttable presumption applies only to assets within a municipality's boundaries, which has no support under RSA 38. The error is harmless in this case because the Commission ultimately determined that it was in the public interest for Nashua to acquire all of the assets of Pennichuck Water Works. However, Nashua requests reconsideration of this determination in order to ask the New Hampshire Supreme Court to clarify the law in the event of an appeal by Pennichuck.

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<sup>74</sup> See, e.g., Transcript, September 26, 2007, Page 135.

55. The Commission stated that:

[T]he rebuttable presumption of public interest applies only to utility property within Nashua's municipal boundaries. Since it is the confirming vote that generates the presumption, *it follows that the Legislature's intent was to require us to accord a measure of deference to decisions arising out of the democratic process at the municipal level. Obviously, it would run counter to that principle if the democratic process in one municipality could have a potentially dispositive effect on the municipalization of property in one or more other municipalities.*<sup>75</sup>

56. Nashua has already explained in detail its position that the rebuttable presumption applies to all of the assets of Pennichuck Water Works and incorporates by reference its October 6, 2005 *Objection to Pennichuck Water Works, Inc.'s Motion for Summary Judgment*,<sup>76</sup> and its December 15, 2006 *Memorandum in Support of Petition for Valuation Pursuant to RSA 38:9*.<sup>77</sup>

57. It is apparent that the Commission erred by second guessing what the legislature might have enacted rather than applying the plain meaning of the terms it actually chose to enact. RSA 38 is clear that a favorable vote by Nashua's citizens creates a rebuttable presumption that acquisition of all of the utility's assets is in the public interest. There is no language in RSA 38 that suggests that the rebuttable presumption applies is limited to the voting municipality.

58. The Commission's concern that the will of one community's voters should apply to another is precisely the type of political question that is best left to the legislature, not for this Commission to resolve by re-writing the provisions of RSA 38. In fact, the legislature has already addressed this very concern: RSA 38:14 allows each municipality to conduct its own vote, which is binding on Nashua. The Town of

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<sup>75</sup> Order No. 24,878, Page 25 (emphasis added).

<sup>76</sup> See, e.g., Pages 8-10.

<sup>77</sup> See, e.g., Pages 11-15.



Bedford, a supporter of Nashua's petition and a member of the regional water district, has taken this precise step.

59. The Commission's error is harmless in this case because it determined under RSA 38:9 that acquisition of all of Pennichuck Water Works by Nashua is required by the public interest. Nashua merely requests reconsideration in order to preserve this issue in the event of an appeal by Pennichuck concerning the standard to be applied in this proceeding.

## **II. REQUESTS FOR CLARIFICATION CONCERNING THE MITIGATION FUND REQUIREMENT**

60. The Commission states that it has determined that "a mitigation fund of \$40 million is reasonably calculated to insulate PEU and PAC customers from the effects of the taking" and that it "will address the specific method for implementing this result as a compliance matter in this proceeding after the City makes a ratifying vote and all rehearings and appeals are exhausted."<sup>78</sup>

61. However, the amount of the mitigation fund, \$40,000,000 is substantial, and increases Nashua's cost to acquire Pennichuck Water Works by nearly 20%. According to Pennichuck's own experts, the amount of the fund is over twice the book value and revenues of utilities whose customers it is intended to benefit.<sup>79</sup> Nashua therefore requests the following clarifications so that its elected officials may evaluate its impact in their decision to ratify the Commission's decision pursuant to RSA 38:13.

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<sup>78</sup> Order No. 24,878

<sup>79</sup> Transcript, September 18, 2007, Pages 151-152.

**A. CLARIFICATION AS TO WHETHER NASHUA IS ENTITLED TO RECOVER THE MITIGATION FUND TO THE EXTENT THAT HARM TO PEU AND PAC CUSTOMERS IS ELIMINATED OR IS SHOWN TO BE LESS THAN ESTIMATED.**

62. The Commission's Order No. 24,878 states that the mitigation fund to be established "should be payable for the benefit of PEU and PAC customers pursuant to our ongoing authority over these utilities".<sup>80</sup> The Commission further ordered that it "will address the specific method for implementing this result as a compliance matter in this proceeding after the City makes a ratifying vote and all rehearings and appeals are exhausted."<sup>81</sup>

63. However, the Commission did not specify what happens to the mitigation fund in the event that the harm to customers to be mitigated ceases or is greatly reduced, for example, in the event that those utilities were: (a) acquired by the City of Nashua; (b) acquired by the municipalities in which they are located, as has already been proposed in Pittsfield; (c) acquired by another investor-owned utility such as Aquarion (Macquarrie); or (d) were found to be over-stated.

64. As a result, it is unclear to Nashua whether when ratifying the Commission's decision pursuant to RSA 38:13, it should consider the mitigation fund requirement as: (1) an additional \$40 million capital expenditure never to be returned to Nashua, even if the harm alleged ceases to exist; or (2) as an interim requirement that continues only so long as the Commission deems necessary.

65. This question is important because if the \$40 million mitigation fund is intended to be permanent, regardless of whether it is necessary, the combined cost to Nashua approaches the price at which the revenue requirement for a municipally owned

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<sup>80</sup> Order No. 24,878, Page 63.

<sup>81</sup> Order No. 24,878, Page 96.

water utility would be approach those of a for-profit, investor-owned utility. Thus, a permanent mitigation fund would reduce the financial benefits of Nashua's ownership.

66. The question is also important for the purposes of financing the acquisition. Nashua understands that under the provisions of the Internal Revenue Code, to the extent that Nashua retains any interest in the fund, including, any right to repayment of amounts in the fund, the bonds required to establish the fund will be taxable. However, without clarification, Order No. 24,878 leaves open a worst case scenario in which Nashua uses taxable bonds to establish the mitigation fund, only to discover at a later date that it is not entitled to receive the proceeds.

67. Nashua urges the Commission to clarify that Nashua will be in fact entitled to return of the mitigation fund upon a final determination by the Commission that it is no longer required. To do otherwise could: (1) substantially erode the financial benefits of municipal ownership; (2) act as a barrier to removal of inefficiencies that the fund is intended to mitigate by removing incentives for Pennichuck Corporation to sell to either the City of Nashua or a larger investor-owned utility in the region such as Aquarion or others or to reduce operating or other costs.

**B. CLARIFICATION CONCERNING THE DATE WHEN THE MITIGATION FUND IS TO BE ESTABLISHED.**

68. Order No. 24,878 is unclear whether the mitigation fund is to be established upon ratification under RSA 38:13 and RSA 33-B or at the time that the mechanics of the mitigation fund are determined by the Commission. Under the latter approach, for example, Nashua might consider treating the mitigation fund as an operating expense rather than as an initial capital expenditure, if it lowered cost to

customers. Nashua therefore requests that the Commission clarify its intent concerning the timing of the mitigation fund requirement.

**C. CLARIFICATION CONCERNING WHETHER THE MITIGATION FUND IS TO BE TREATED AS A CONDITION OF THE PUBLIC INTEREST OR AS SEVERANCE**

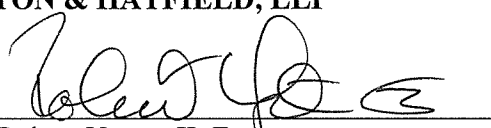
69. Order No. 24,878 states that the mitigation fund “should be payable for the benefit of PEU and PAC customers pursuant to our ongoing authority over these utilities”<sup>82</sup> as a condition imposed under RSA 38:11. However, the Commission also states that whether the mitigation fund “is more properly characterized as severance or a condition required as a matter of the public interest pursuant to RSA 38:11, the net effect is essentially the same.”<sup>83</sup>

70. There is one key distinction, however, insofar as an award of severance damages is payable to the condemnee. Nashua requests that the Commission clarify that the mitigation fund is not to be treated as severance damages payable to any of the Pennichuck entities.

Respectfully submitted,

**CITY OF NASHUA**  
By Its Attorneys  
**UPTON & HATFIELD, LLP**

Date: August 25, 2008

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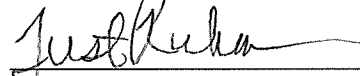
<sup>82</sup> Order No. 24,878, Page 63.

<sup>83</sup> Order No. 24,878, Page 95.

**CERTIFICATE OF SERVICE**

I hereby certify that a copy of the foregoing has been sent this day by e-mail and first class mail to all persons on the Commission's official service list in this proceeding.

Date: August 25, 2008

A handwritten signature in black ink, appearing to read "Justin C. Richardson", written over a horizontal line.

Justin C. Richardson, Esq.