STATE OF NEW HAMPSHIRE
BEFORE THE
PUBLIC UTILITIES COMMISSION

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

Docket No. DW 04-48

PENNICHUCK'S OBJECTION TO NASHUA'S MOTION FOR REHEARING AND CLARIFICATION 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") object to the late-filed Motion for Rehearing and Clarification filed by the City of Nashua ("Nashua") with respect to the Commission's Order No. 24,878 (the "Taking Order"). The Commission has already considered and rejected the issues that Nashua raises, and Nashua has presented no good reason that the Commission should now alter its prior determination on those matters. Pennichuck addresses the lateness of Nashua's Motion in a separate Motion to Strike. By way of further explanation for this Objection, Pennichuck states as follows:

A. IN VALUING PWW'S ASSETS, THE COMMISSION PROPERLY CONSIDERED THE COST OF CAPITAL AND CASH FLOWS FOR NOT-FOR-PROFIT PURCHASERS OF PWW ASSETS

The Commission properly considered the operating cost and cost of capital advantages enjoyed by not-for-profit entities, including municipalities, in its calculation of the income approach component in valuing PWW's assets. (Taking Order, pp. 89-91). That cost of capital percentage is also used in calculating economic obsolescence in determining the value of PWW's assets under the asset approach. (Taking Order, p. 88).

The Commission had no choice but to consider not-for-profit buyers in determining cost of capital for the asset and income approach, and cash flows for the income approach, since the supreme court has determined that it would be error not to do so. *Southern N.H. Water Co. v. Hudson*, 139 N.H. 139, 142 (1994). Despite the clear direction of *Southern N.H. Water*, Nashua took the incredible position that the Commission should limit itself only to considering the cost of capital and cash flows of for-profit entities. In fact, with no authority, Mr. Walker's and Mr. Sansoucy's income approach assumed that the hypothetical purchaser would simply inherit PWW's same income, expenses and cost of capital. (Ex.1007A, pp. 62-64).[1]

Nashua apparently has learned well from Mr. Sansoucy, and has reversed itself with respect to the propriety of considering not-for-profit buyers in the calculation of PWW's asset value. Nashua will now settle for half a loaf--latching on to Commissioner Below's dissent, with its 50-50 weighting of for-profit and not-for-profit buyers. (Taking Order Dissent, pp. 103-110). The problem with Nashua's fawning praise of the dissent's analysis, and with the dissent itself, is its obsession with the likelihood of specific purchase deals, instead of the simple requirement that certain types of deals are hypothetically possible. See, Taking Order, p. 91, n. 14. Contrary to Nashua's argument, the Commission's job is not to confine itself to the one municipal purchaser – Nashua – that is attempting to take PWW assets by eminent domain, but rather to consider all potential purchasers that could buy the assets if offered for sale on a consensual basis. That is precisely what the majority did.

The Commission found Pennichuck's valuation expert, Mr. Reilly, to present a "persuasive" analysis using a *hypothetical* buyer's cost of capital and cash flows, not that of a particular *likely* buyer. (Taking Order, pp. 89-90). And not all of those buyers need be not-for-

[1] Not surprisingly, Mr. Sansoucy took the opposite approach in prior valuations of PWW ("the income analysis presented from the view of the hypothetical municipal utility presents a sound indicator of value", Ex. 3212, p. 9)(see also, Ex. 3200, pp. 4-7).

profit buyers, with their attendant synergies. As Mr. Reilly stated in his report, a single not-for-profit potential buyer among for-profit buyers "impacts the fair market value of the system". (Ex. 3007, pp. 14-19). See, Tr. Day 8, pp. 75-76, 186. As Mr. Reilly said: "we don't need a hundred municipal buyers, we don't even need ten, but we need *one* or two" to have it influence the hypothetical bidding. Tr. Day 8, pp. 186. The mechanics of this hypothetical mixed not-for-profit and for-profit bidding environment are simple:

> each buyer looks around and says if I want to win, I've got to outbid everyone at this table. And if one or two or three people at the table are municipal buyers, then I've got to bid at least what they're going to bid. Now the ultimate winner may well be an investor owned utility. All I'm saying is that investor owned utility is going to have to pay what he thinks the municipal buyer is going to pay, otherwise he'll never be the winner in the bidding process.

Tr. Day 8, pp. 188-89.

The problem with Nashua's motion, and with the dissent, is its transformation of the appraisal concept of *typical* buyers into a subjective review of the motivation of specific not-for-profit entities. For Nashua to identify and then psychoanalyze a subset of specific potential buyers within the pool of typical buyers inserts a level of detail and subjective analysis simply not relevant to an appraiser's determination of typical hypothetical buyers. This added subjectivity is improper because it is impossible to know who *actually* would participate in a consensual bidding process for the assets if they were actually offered up for sale. All that can be known is who *may* participate. As the Commission quoted from Mr. Reilly's testimony:

> What any particular public entity has or has not indicated about its interest in the PWW system is not relevant to a fair market valuation... Appraisal literature and appraisal courses never insert the subjectivity of asking what any particular person's interest is in property subject to a fair market valuation.

Taking Order, p. 90, quoting Ex. 3007, p. 22 [sic, should be 14].

Mr. Reilly's full testimony on this point is as follows:

> What any particular public entity has or has not indicated about its interest in the PWW System is not relevant to a fair market valuation. If I inserted what a particular town was saying about its current interest in the PWW System, it would be the same as inserting what my brother-in-law's motivations and thoughts were about the woodsy cottage in my example above—it has no place in the analysis. Appraisal literature and appraisal courses never insert the subjectivity of asking what any particular person's interest is in property subject to a fair market valuation. If an appraiser had to identify every specific purchaser of a particular piece of property before concluding a fair market valuation, he would never finish his assignment. Moreover, as to the current population of not-for profit public entities, things change and what a particular municipal buyer may or may not do is driven by the current political environment. That environment could change tomorrow. Finally, an appraiser must include in the population of hypothetical buyers entities that may be formed in the future (yet-to-be-formed public entities) that would have the authority to acquire the PWW System. It would not be feasible to ask these yet to-be-formed entities what their subjective current interest is in the PWW System—because they do not exist. In short, the subjective interest of any particular buyer is never a question in a fair market evaluation.

Ex. 3007, pp. 14-15.

The appraisal literature that Mr. Reilly referred to includes, of course, The Appraisal Institute, *The Appraisal of Real Estate*, (12th ed. 2001), which the Commission cited extensively. The Commission rightly found PWW's assets to be special purpose property (Taking Order, p. 84), limiting the market of buyers and requiring an appraiser to use considerable "personal judgment". *The Appraisal of Real Estate*, pp. 25-26. Still, an appraiser must consider whatever market exists, and must be "objective, impersonal and detached" from any one buyer. Id., p. 476. Considering the needs of a "particular investor" means the appraisal is no longer of "market value" but instead of "investment value", using "subjective, personal parameters". Id[2]. Mr. Reilly thus was careful to identify the (albeit small) class of not-for-profits as typical buyers, without getting sucked into a subjective analysis of the specific situation of Nashua or another specific municipality.

[2] The dissent (Taking Order, p. 105) misapplies the concept of investment value, assuming that the class of not-for-profit buyers that Mr. Reilly identified in his determination of market value is the same as a "particular investor" for whom an appraiser would determine investment value.

The Commission is right to find Mr. Reilly's report and testimony, backed up by appraisal literature, to be persuasive. He is a pre-eminent valuation scholar, with six professional designations and certifications, and authorship of six authoritative books in the field. (Ex. 3007, pp. 2-5; Ex 3007A, pp. 96-98). Nashua's only "experts" lacked any meaningful credentials and totally ignored municipal buyers. Ex. 1007, pp. 62-64.

Nashua in its motion points to scattered evidence for the obvious proposition that there is not a large market for water companies the size of PWW. Motion, ¶ ¶ 4-7. That is inconsistent with Nashua's earlier valuation claim, which relied heavily upon the presence of 28 alleged comparable sales, and argued for a fifty percent weighting for that approach. (Taking Order, p. 66). Of course the Commission did not give any weight to the sales approach, finding a "paucity of comparable sales" (Taking Order, p. 84). But the lack of sales that are *comparable* is not indicative of the size of the market and, more important, simply is irrelevant to the income approach and its reliance upon *hypothetical* buyers.

Nashua also misunderstands Mr. Reilly's testimony. There need not be two specific municipal buyers hypothetically competing to acquire PWW assets. See, Motion, ¶ ¶ 13, 22-32. There could be one municipal buyer and one for-profit buyer, and the for-profit buyer may well offer as much as the capitalized cash flow of the municipal buyer.[3] (Tr. Day 8, pp. 188-89). Thus Nashua's discussion as to what two or three not-for-profit buyers would or would not do is subjective and hence irrelevant to an appraiser's work.

[3] Not-for-profit buyers and for-profit buyers may analyze matters differently, but the for-profit buyer must address the synergies that not-for-profits enjoy in cost of capital and expenses, which carries over into the 2% inflation factor that Mr. Reilly applied and which is, in part, the subject of Pennichuck's Motion for Rehearing, sec. P. If the successful buyer is a not-for-profit, its ratemaking need not be based upon rate base, and its revenue would likely rise by no less than inflation over time. If the successful buyer is a regulated for-profit utility, long term income still will go up at least 2% annually, assuming typical rises in recoverable expenses, and ongoing capital expenditures somewhat exceeding depreciation.

While more than one hypothetical not-for-profit buyer is not required, Nashua's motion by itself admits that other hypothetical not-for-profit buyers exist. Nashua admits that Amherst, Merrimack, Bedford, Milford and other communities could acquire PWW assets pursuant to RSA 38. Motion, ¶ 26. The choices those towns made in the current case — such as the choices of Merrimack and Milford not to pursue an acquisition -- are plainly irrelevant to an analysis of fair market value. Of course, Nashua conveniently ignored the evidence that one town, Bedford, actually voted to condemn PWW assets, and would be interested in a consensual purchase as well, either through the Regional Water District or directly. Scanlon Test., Tr. Day 10, pp. 142-150.

Nashua's motion seems to admit, as it must, that the Merrimack Valley Regional Water District, or some other water district, could acquire PWW assets pursuant to RSA 38:2-a. Motion, ¶ ¶ 21,31. The State of New Hampshire and Manchester Water Works, with a franchise in Bedford, could do so as well. See, Tr. Day 10, pp. 145-47. Nashua's own motion (¶ ¶ 43-49), includes mention of Nashua's desire to acquire PEU and PAC assets. Pittsfield has also expressed an interest in buying PAC assets.

As Mr. Reilly testified and the Commission found, there is more than one legally permissible potential not-for-profit buyer for PWW assets. (Taking Order, p. 90). It does not matter that some of the potential municipal buyers identified might face practical or political challenges in pursuing an authorized purchase (just as Nashua has encountered in its efforts to purchase PWW), because that would introduce a level of subjectivity into the appraiser's work. Ex. 3007, p. 14. Whether designing a proposal that is determined to meet the public interest or public use requirements of RSA 38 and 31:3 (Motion, ¶ 18) or the need to form a water district under RSA 52-A and 38:2-a (Motion, ¶ 20), such logistical considerations are irrelevant, if they

exist at all. Nashua claims that its size gives it veto power over any other entity wishing to acquire PWW assets (Motion, ¶ 29, 30). While such threatening statements confirm the fears of surrounding towns about Nashua's intentions, the City's characterization of how negotiations take place in the real world are not true, in addition to being impermissibly subjective. Nashua assumes that a hypothetical negotiation occurs only after non-profit buyers have taken the formal votes needed to close on a consensual transaction with Pennichuck. The more likely scenario is an informal negotiation, including for-profit buyers, at which an agreed upon price is arrived at well before the negotiated price is presented for formal votes.

Nashua then makes the argument that there is no market for municipal buyers of privately owned water companies in New Hampshire because municipalities and other not-for-profits allegedly can only conduct asset purchase transactions, which water companies avoid for tax reasons. Motion, ¶ ¶ 33-37. That is not true: municipalities and other not-for-profits can purchase stock.[4] In fact, the Commission approved a private water company stock sale in *Tilton Northfield Aqueduct Company*, 90 NHPUC 599 (2005). And Nashua itself obtained clarifying legislation to confirm that it can both buy *and hold* Pennichuck shares. Laws 2007, Ch. 347:5.

Contrary to Nashua's specific statements (Motion ¶ 4-7) about the lack of a municipal buyers ' market, Pennichuck offered additional evidence involving competing not-for-profit buyers. The Commission at the hearing specifically requested Pennichuck to locate other completed transactions in which more than one potential municipal buyer expressed interest.

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[4] A recent consensual Connecticut water district purchase of the stock of a water company illustrates this fact and further supports the valuation found in this case. If the Commission were to order a rehearing, Pennichuck would introduce evidence showing that South Central Connecticut Regional Water Authority, even though it was the only bidder for the entire business enterprise of BIW Limited, purchased all of the shares of BIW for $23.75 per share, or 3.55 times book value. See, SEC 8-K filing dated January 14, 2008, found at http://www.sec.gov/Archives/edgar/data/1169237/000107261308000101/0001072613-08-000101-index.htm. If this same multiple were applied to Pennichuck's stock, it would value Pennichuck at approximately $40 per share as of June 30, 2008.

Pennichuck complied, and supplied a list of four such transactions, Ex. 3258. After a post-hearing conference with the Commission chairman, at which Nashua objected to the admission of that exhibit, the Commission by letter order dated October 17, 2007, refused to admit it. A copy of Ex. 3258 is attached to this objection, and the discussion on the record at that hearing provides additional facts about those four transactions (Tr. 10/12/07, pp. 22-28). In light of Nashua's false characterization of Mr. Reilly's testimony on this issue, if the Commission were to grant a rehearing, Pennichuck would again seek admission of Ex. 3258 into evidence, including any necessary supporting material to demonstrate that these transactions respond directly to the questions asked by Commissioner Below during the hearing on the merits.

Nashua also claims that the 39% federal income tax consequence from an asset transaction means that Pennichuck would never agree to an asset sale. Motion, ¶ 34. First of all, whether a purely voluntary transaction takes the form of a stock or asset sale does not define or limit that hypothetical market. Beyond that, of course Pennichuck has steadfastly objected to a forced taking of its assets because, among other things, of the substantial corporate level tax burden it would place on its shareholders. The Commission should have considered this and other shareholder interests in its public interest analysis. See, Pennichuck's Motion for Rehearing, section F. In its motion (¶ 34), Nashua finally seems to concede this harm to Pennichuck's shareholders. If anything, a for-profit company's resistance to sell because of income tax consequences would drive the necessary purchase price *higher* in a true consensual transaction. Yet Nashua just as quickly forgets that Pennichuck shareholders exist, complaining that the Taking Order "would force the citizens of Nashua... to bear ... $50 million in additional debt... that has made 'the only real winners in this game ... the lawyers and expert witnesses...' (citation omitted)." Motion, ¶ 14. Nashua is not being forced to do anything. Instead, it seeks to

use raw governmental power to force Pennichuck and its shareholders to hand over private property. This is the nub of Pennichuck's public interest case.

Finally, like the dissent, Nashua incorrectly seizes upon the 2002 work of SG Barr Devlin for Pennichuck. But since SG Barr Devlin's assignment was the sale of the entirety of the publicly traded holding company, not just the regulated utility assets, it is not surprising that municipalities were not considered among the likely purchasers. Mr. Reilly distinguished SG Barr Devlin's work, and the Commission rightly was not concerned with it in its Taking Order. (Ex. 3017A, pp. 17-18)(Tr. Day 8, pp. 227-232).

B. THE COMMISSION CANNOT NOW REVISIT ITS 2005 REMOVAL OF PAC AND PEU ASSETS FROM THIS CASE

Nashua asks the Commission to revisit its Order No. 24,425, dated January 21, 2005, which, among other matters, ruled that Nashua's petition could not include PEU or PAC assets. PWW timely sought rehearing from another portion of that order, dealing with the municipal vote and PWW satellite system assets. Nashua objected to PWW's motion, but never moved for rehearing on the ruling removing PEU and PAC assets from the case. That is, until now.

Nashua's attempt to seek a rehearing on Order No. 24,425 fails because it was not filed within thirty days of the order, as required by RSA 541:3. That requirement is particularly applicable in this case, since the case has proceeded over the past three and one half years, through extensive discovery, valuation testimony and a merits hearing, without the inclusion of the PEU and PAC assets. Mr. Reilly did not value those assets. The Taking Order did not make any public interest analysis or valuation with respect to those assets. In fact, the parties presented no evidence whatsoever regarding the taking of those assets, other than the harm to the customers of PEU and PAC if the assets of PWW are taken. For the Commission to grant a rehearing on this point would lead to revisiting public interest and valuation issues for all of the

Pennichuck entities, requiring additional discovery, expert testimony and a new merits hearing. It is simply too late.

Moreover, the Commission properly stated the law in Order No. 24,425 that eminent domain statutes must be read strictly, that RSA 38 does not afford an interpretation to permit Nashua to take assets of entities with no connection to the City. Order No. 24,425, pp. 9-16. See, *Maine-New Hampshire Interstate Bridge Authority v. Ham*, 91 N.H. 179, 181 (1940); RSA 38:6 ("utility [must be] engaged...in...distributing...water for sale in the municipality").

Nashua' s new-found problem with Order No. 24,425 is the fact that the Taking Order requires Nashua, as a condition of taking PWW assets, to establish a $40 million mitigation fund to offset rate increases that PEU and PAC customers will suffer as a result of the taking of PWW assets. Taking Order, pp. 94-96. That requirement reflects the harm to the interests of those customers, as documented by Mr. Guastella's testimony. Nashua now complains that it did not have the chance to counter that evidence, first quantified in Mr. Guastella's May 22, 2006 testimony. Motion, ¶ 50. Yet, in addition to cross-examination of Mr. Guastella at a deposition and at trial, Nashua had more than enough opportunity to conduct discovery on and address this argument. It chose not to. Nashua even agreed to forego a round of capstone testimony as late as September, 2006. Commission Letter Order, September 14, 2006. Nashua has not articulated a reason for a new hearing on the harm suffered by PEU and PAC, other than an attempt to retry the issue.

C. NASHUA WAIVED ANY CLAIM THAT THE REBUTTABLE PRESUMPTION DOES NOT APPLY TO ASSETS OUTSIDE OF NASHUA

The Commission ruled in Order No. 24,567 (December 22, 2005) that the rebuttable presumption contained in RSA 38:2 only applies to PWW assets located within Nashua. It reaffirmed that ruling in the Taking Order, p. 25. Nashua never filed a timely motion for

rehearing of Order No. 24,567, as required by RSA 541:3, and so has waived raising this issue at this point.

The Commission properly interpreted the rebuttable presumption provision of RSA 38:2 not to apply to assets of PWW located in communities outside of Nashua, many of which opposed the taking. To do otherwise would extend beyond the town line the effect of Nashua's already deficient municipal vote. See, Pennichuck Motion for Rehearing, sec. D. Nashua voters cannot presume to speak for Merrimack residents, and vice versa. The Commission made the only logical interpretation possible of the statute.

D. MITIGATION FUND CLARIFICATION

In seeking clarification of the Commission's order, Nashua seeks to gut the $40 million mitigation fund that is required to be established as a condition of Nashua's approval in order to offset the harm to customers of PEU and PAC. Nashua's attempt to eviscerate the mitigation fund before it is even established proves Pennichuck's concern that, after PWW's assets are taken, Nashua will invoke every avenue to reduce or remove the many conditions that underpin the Commission's finding of public interest for this taking. See, Pennichuck Motion for Rehearing, sec. J.

For instance, Nashua seems to hope that it can get a refund of the fund, or that it need continue only so long as the Commission will order it. (Motion, ¶ 64). Nashua seems to hope that it can avoid actually fronting any money for the fund (Motion, ¶ 68), making it an annual operating expense, and thereby placing PEU and PAC at the mercy of Nashua for payment each and every year. Nashua also wants to retain financial control over the fund (Motion ¶ 66), which would harm the customers of PEU and PAC and would defeat the purpose of its establishment in the first place.

The real reason for Nashua's request for clarification concerning the mitigation fund is its desire not to have to pay for it. It admits that: "the combined cost to Nashua approaches the price at which the revenue requirement for a municipally owned water utility would be approach [sic] those of a for-profit, investor owned utility. Thus, a permanent mitigation fund would reduce the financial benefits of Nashua's ownership." Motion, ¶ 65. That proves the point of Pennichuck's Motion for Rehearing, sec. L, that there is no public interest benefit coming from Nashua's ownership of PWW assets, because, among other things, there are no savings to PWW customers under municipal ownership.

E. CONCLUSION

For the reasons set forth herein, Pennichuck requests that the Commission deny Nashua's Motion for Rehearing and Clarification.

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,
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Date: August 29, 2008

By: _____

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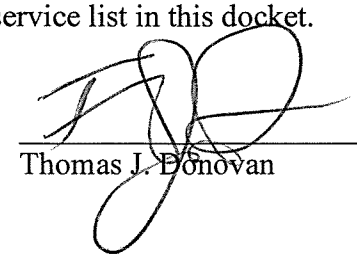
CERTIFICATE OF SERVICE

I hereby certify that on this 29th day of August, 2008, a copy of the foregoing Objection to Motion for Rehearing and Clarification has been forwarded by electronic mail to the parties listed on the Commission's service list in this docket.



Thomas J. Donovan

ATTACHMENT 1

DW 04-048
Exhibit 3258

STATE OF NEW HAMPSHIRE
BEFORE THE
PUBLIC UTILITIES COMMISSION

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

DW 04-048

Response to Commission Record Request

Date of Request:	September 12, 2007	Date of Response:	September 26, 2007
Exhibit No.:	Exhibit 3258	Witness:	Robert Reilly

REQUEST: Are you aware of any situations in which there has been more than one not-for-profit or governmental entity bidder for the purchase of an investor owned utility?

RESPONSE: Some examples of situations in which multiple not-for-profit or governmental entities have sought to purchase an investor owned water utility include the following:

Sale by Duke Power of its water utility in Anderson County, South Carolina, in which the Anderson County Water Association and the City of Anderson both sought to purchase the system.

Sale of New Haven Water Company in New Haven, Connecticut, in which both the City of New Haven and the South Central Connecticut Regional Water Authority sought to purchase the system.

Sale of Utilities Inc. of Maryland, in which both the Washington Sanitary Commission and Maryland Environmental Services expressed an interest in buying the water and wastewater utility.

Sale of General Development Utilities, Inc. (the Port St. Lucie, Florida division) in which Port St. Lucie County first acquired the utility, but shortly thereafter agreed to sell it to the City of St. Lucie.