THE STATE OF NEW HAMPSHIRE
SUPREME COURT

Appeal of City of Nashua, et al.

Case No. 2009-0274

TOWN OF PITTSFIELD'S MEMORANDUM OF LAW REGARDING ESTABLISHMENT OF MITIGATION FUND

NOW COMES the Town of Pittsfield, by and through its attorneys, Mitchell Municipal Group, and submits this memorandum of law regarding the mitigation fund established as part of the Public Utilities Commission's Order approving the acquisition of Pennichuck Water Works, Inc. by the City of Nashua.

I. INTRODUCTION AND FACTS

By Order dated June 25, 2009 ("Order"), the New Hampshire Public Utilities Commission ("PUC") approved a petition by the City of Nashua to acquire the assets of Pennichuck Water Works, Inc. ("PWW"). That approval was subject to several conditions, one of which is the establishment of a $40 million so called mitigation fund to protect customers of Pittsfield Aqueduct Company ("PAC") and Pennichuck East Utilities ("PEU") from the lost economies of scale or synergies resulting from that acquisition. The City of Nashua, which proposed the creation of this fund if it were not to be permitted to acquire PAC and PEU, now claims that the amount of the fund is too large, being in excess of the combined rate base of the two entities. PWW suggests that the size of the mitigation fund may be too small, and is not guaranteed to generate the $3.4 million required each year to offset the effects of the taking on the customers of PAC and PEU.

The Town of Pittsfield submits this memorandum in support of the PUC's establishment of the mitigation fund.

II. ANALYSIS

A. Standard of Review

RSA 541:13 sets forth the standard of review that this Court employs when reviewing a decision of the PUC.

> [T]he burden of proof shall be upon the party seeking to set aside any order or decision of the commission to show that the same is clearly unreasonable or unlawful, and all findings of the commission upon all questions of fact properly before it shall be deemed to be prima facie lawful and reasonable; and the order or decision appealed from shall not be set aside or vacated except for errors of law, unless the court is satisfied, by a clear preponderance of the evidence before it, that such order is unjust or unreasonable.

See also Appeal of Stonyfield Farm, Inc., 2008-897 (N.H. 8-5-2009). This Court will not substitute its policy preferences for those made by the PUC. See Appeal of Verizon of New England, 153 N.H. 50, 56 (2005).

B. The Establishment of a Mitigation Fund to Offset Potential Harm to Pittsfield Aqueduct Company From the City of Nashua's Taking of Pennichuck Water Works, Inc. Was Legal And Reasonable And Should Be Affirmed By This Court

The PUC found:

> The record demonstrates that PWW, PAC, and PEU are highly interdependent companies sharing resources through Commission-approved affiliate agreements. PWW supplies the majority of the shared resources that PAC and PEU rely on to provide water service to customers. PAC and PEU will lose the efficiencies inherent in sharing resources, and replacing those resources will cause PAC and PEU to incur greater expense. This greater expense would be passed along to customers in the form of rate increases.

Order at 95. It therefore found "that the public interest requires as a condition of our approval that Nashua establish an appropriate mitigation fund" of $40 million that would generate $3.4 million each year, and concluded that it would "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." Order at 96. These factual findings and legal conclusions were legal and reasonable and should be affirmed by this Court.

In reaching its conclusion that the mitigation fund was required by the public interest, the PUC evaluated the positions of both parties. It held that it was within the scope of the proceeding to address the effects of the taking of PWW on PEU and PAC, and noted that both parties had the opportunity to present testimony and evidence on the topic. It noted that PWW did present such testimony, but that Nashua had chosen not to do so. The PUC then went on to discuss in detail the testimony provided by PWW on the mitigation fund. See Order at 95-96.

As the PUC accurately summarized from the relevant portions of the testimony (which is found in the Certified Record at 4638-55 and 9351-53 and 9408-11 and in the Appendix to this memorandum at 1-14), PWW retained John F. Guastella, who concluded that PEU and PAC would need $3.4 million in additional annual revenue requirements if the taking were approved. Mr. Guastella reached this conclusion after reviewing expense projections and 2005 operations summaries. Mr. Guastella adjusted for items such as changes in vendor charges due to reduced volume, changes in the number of employees, and changes in salaries, and included a return and depreciation expense on assets PEU and PAC would need to acquire to replace the common assets lost with the taking of PWW.

After performing his analysis, Mr. Guastella concluded that PAC would need a revenue increase of $409,873,09, which is an approximate 66 percent rate increase *in addition* to rate increases PAC would normally obtain in a rate case.[1] Mr. Guastella performed a similar analysis for PEU and concluded that the combined shortfall in annual revenue requirement for both PAC and PEU would be $3.4 million. Mr. Guastella went on to testify that assuming a capitalization rate in the range of 6.5 percent to 8.5 percent, a fund of approximately $40 to $50 million would be required to generate annual earnings of $3.4 million. The PUC noted that Staff contended that the customer impact is on the low end asserted by PWW, a contention with which the PUC agreed, and therefore the PUC required the establishment of a mitigation fund of $40 million. See Order at 95-96.

Although it proposed the establishment of the mitigation fund if it were not permitted to take the assets of PEU and PAC, Nashua presented no testimony regarding the degree of harm that would be suffered by PEU and PAC or the appropriate amount of the mitigation fund if the taking were approved.[2] Instead, it merely disputed that there would be any harm at all. Nashua's valuation witness,

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[1]As this Court may not be aware, PAC is in the process of obtaining a 44% rate increase before the PUC at this time. A final hearing on that petition is scheduled for September 30, 2009.

[2]Nashua claims in its brief that it did not have the opportunity to submit testimony responsive to Mr. Guastella's testimony. While the procedural schedule may not have permitted such additional testimony, Nashua had over a year between the time Mr. Guastella's testimony was filed (May 22, 2006) and the date on which he actually testified before the PUC (September 9, 2007), to formulate an effective cross examination to challenge his methodology.

George Sansoucy, testified, using PEU as an example, that there would actually be no harm to PEU as a result of the taking, because it owned no equipment and employed no personnel before the taking (and instead obtained those resources from PWW); and would be in the same position if the taking were approved (although it would be required to utilize a different vendor).. See Certified Record at 6858-6860, Appendix at 15-17. Mr. Sansoucy also criticized the manner in which Mr. Guastella reached his conclusions, see Certified Record at 6871 and 6952-6954, Appendix at 18-21; but presented no mitigation fund valuation conclusions of his own. In fact, the only analysis Mr. Sansoucy performed regarding this issue concluded that "PWW, if separated, at the purchase price [Nashua is] proposing *may not* harm PEU or PAC." Certified Record at 6956, Appendix at 22 (emphasis added).

The PUC weighed the testimony of Mr. Guastella and Mr. Sansoucy, including the cross examinations of the two witnesses, and determined that Mr. Guastella's testimony and conclusions were more credible. This conclusion, and all factual findings of the PUC, are entitled to deference. See, e.g., Appeal of McKenney, 120 N.H. 77 (1980)("Once testimony is admitted, it is the PUC's duty to resolve issues of fact and conflicts of opinion. This Court does not sit as a trier of fact when reviewing orders of the commission."). Therefore, this Court should affirm the PUC's conclusions regarding the mitigation fund.

III. CONCLUSION

The PUC's acceptance of Nashua's proposal of a mitigation fund to offset the harm to PEU and PAC as a result of the taking of PWW was lawful and reasonable and should be affirmed by this Court. The PUC's finding that a $40 million fund was required to offset that harm is a factual conclusion reached by the PUC after it heard and weighed the evidence submitted by the parties. That factual conclusion is entitled to deference by this Court unless it can be shown that the decision is unjust or unreasonable. No such showing has been made, and therefore this Court should affirm the PUC's establishment of a $40 million mitigation fund.

Respectfully submitted,

TOWN OF PITTSFIELD

By Its Attorneys
MITCHELL MUNICIPAL GROUP, P.A.

Date: September 25, 2009 By: Laura Spector

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing has been sent via first class mail, postage prepaid, to the attached service list.

Date: September 25, 2009

Laura Spector
Laura A. Spector

Service List 8/21/09
THE STATE OF NEW HAMPSHIRE
SUPREME COURT
NO. 2009-0274
Appeal of City of Nashua et al.

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Impact of Nashua Taking on PEU, PAC and PWSC

Q. What are the results of your analysis of the impact on the rates of PEU and PAC if the City of Nashua were to acquire PWW?

A. On the basis of my analysis of 2005 operations of these companies, I found that if the City of Nashua acquired PWW, PEU would have needed a rate increase of approximately 64% above the revenue requirement PEU would have had without the acquisition; and PAC would have needed a rate increase of about 66% above the revenue requirement it would have had without the acquisition.

Q. What would be the impact on PWSC if the City of Nashua had acquired PWW?

A. Also on the basis of an analysis of 2005 operations, PWSC's net income would have decreased from a profit of about $151,000 to a loss of about $265,000.

Q. What would be the impact of that magnitude of a loss in PWSC's earnings?

A. On the basis of discussions with Company personnel, it is likely that compensatory increases in PWSC's charges would raise them beyond a competitive level and, therefore, result in a loss of the entire business. In addition to the present value of the loss of that future cash flow, the loss of PWSC as a viable business would further impact PEU's and PAC's rates because they would have to absorb yet a larger portion of common costs.

Q. Is there any mechanism whereby the Public Utilities Commission could insulate PEU's and PAC's customers from the rate increases that would be required to compensate for the taking of PWW?

A. Despite 44 years of experience in utility regulation and rate setting, I am not aware of any precedent or regulatory rate setting mechanism that exists for such a circumstance. The combined additional revenue requirement for PEU and PAC, beyond their "normal"

App. 1

revenue requirement, is about $3.4 million, not considering the further impact of the economies of scale related to the potential loss of PWSC as a viable business. This shortfall in revenue requirement is more than double the required return on their combined rate base, which is about $1.64 million on a combined rate base of about $18 million. If some type of fund were established to generate some $3.4 million in the revenue requirement shortfall, and assuming a capitalization rate in the range of 6.5% and 8.5%, it would be in the approximate range of $40 to $50 million. Thus, if PEU's and PAC's customers were to be insulated from the rate increases related to an acquisition, in addition to establishing the acquisition price at market value, a $40 to $50 million payment into such a fund would also be necessary.

Q. Is it your recommendation that such a mechanism be established?

A. At this point in time, I am simply identifying and attempting to quantify a major issue that the PUC must consider in evaluating whether, under these unusual circumstances, this acquisition would be in the best interests of all of the customers.

Q. Were schedules prepared by you or under your direction and supervision that summarize the results of your analysis?

A. Yes. Attachment JFG-2, which is my response to Nashua 3-11 provided to the parties to this case in March, contains three schedules. The first two schedules contain similar statements of operations for PEU and PAC and the last schedule contains a profit and loss statement for PWSC.

Q. Would you describe the first two schedules attached to the supplemental response to Nashua 3-11?

A. These schedules contain the actual operating results for 2005 in the "2005 Per Book" column, which shows that in 2005 PEU's rate of return was 3.74% and that PAC's rate of return was 3.28%. The column entitled "2005 With Appropriate Revenue Levels" reflects the revenues needed to produce an 8.35% rate of return for PEU and an 8.67% rate of return for PAC, before an assumed acquisition by the City of Nashua. The last column entitled "2005 Without PWW Affiliation" contains the changes in operating expenses, rate base, rate of return and resulting revenue requirement, under an assumed acquisition of PWW. This reflects that PEU and PAC both needed rate increases (about 22.4% and 32.8%, respectively) on the basis of 2005 operating results, before consideration of an acquisition. The acquisition of PWW by the City of Nashua would have required a further increase of 64% for PEU, or a total increase of 101% over 2005 revenues and a further increase of 66% for PAC, or a total increase of 120% over 2005 revenues.

Q. **Would you briefly describe the analysis that you performed in order to determine the rate impact on PEU and PAC under the assumption that the City of Nashua acquired PWW, as summarized in Attachment JFG-2?**

A. Yes. Under the current structure, PWW owns all "common use" assets and employs all utility personnel in the operation of all affiliated companies, and allocates the related cost to each. To determine what the costs would be if PWW were no longer sharing the capital and operating functions with PEU and PAC, we met with various Company personnel to compile information and analyze the operations. Each component of the operations of PWW, PEU and PAC, as well as PWSC was examined to determine the labor, materials, and other costs that would no longer be needed, and those that would be necessary for the remaining operations, and to determine the new level of costs. In effect, while the total costs to be borne by the companies on a combined basis would be less because the largest of the systems would be taken, each of the remaining companies would ultimately bear a higher level of costs because of the loss in economies of scale.

Q. **Have you previously provided in response to data requests detailed explanations with respect to your analysis, along with schedules showing the various calculations that support the summary schedules contained in Attachment JFG-2?**

A. Yes. I am including Attachment JFG-3 with this testimony, which contains a copy of my response to a supplemental NH PUC Staff data request, Staff 4-22. My response answers each of Staff's inquiries and provides a narrative and detailed schedules that explain the analysis and calculations that support the results summarized in Attachment JFG-2.

Revisions to Original Revenue Requirement Analysis

Q. **Have you prepared revised schedules that reflect the corrections you have made to your original Attachment JFG- 1?**

A. Yes. I am including with this testimony "Attachment JFG-1 REVISED" which contains the results of the corrections to my original Schedules A, B, and C. Although no revisions were necessary with respect to Schedule D of the original Attachment JFG-1, I have included that schedule as well in order to have a complete set of schedules in this revised attachment.

Q. **Would you please explain the corrections that are reflected in Attachment JFG-1 REVISED?**

A. Yes. The financial projections originally provided to me by the Company did not include the cost of utility plant related to its projection for contributions in aid of construction. I also found that a cell reference with respect to deferred tax credits contained a positive

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

DW 04-048

Pennichuck Water Works, Inc. and Pennichuck Corporation's Supplemental
Responses to the City of Nashua's Third Set of Data Requests

Date of Request: January 27, 2006
Data Request No.: Nashua 3-11

Date of Supplemental Response: March 31, 2006
Witness: John Guastella/Donald Correll

REQUEST: Please provide any document prepared by or on behalf of Pennichuck or any of its subsidiaries or agents that support your conclusion that if PWW's assets were taken by eminent domain significant economies of scale would be lost.

SUPPLEMENTAL RESPONSE: The impact of the lost economies of scale are reflected in the attached analysis, which shows that, in the absence of PWW, the following would occur:

a. PAC's revenue requirement absent its relationship with PWW would be approximately 66% above its 2005 revenue requirement and approximately 120% above its 2005 actual revenues.

b. PEU's revenue requirement absent its relationship with PWW would be approximately 64% above its 2005 revenue requirement and approximately 101% above its 2005 actual revenues.

c. PWSC's annual net income, based on its current contracts in place, would change from an annual profit of approximately $151,000 to an annual loss of approximately $265,000.

Under the current corporate structure, PWW owns and maintains all common use assets and employs all personnel (other than two employees of The Southwood Corporation) and allocates facility and personnel costs to its affiliated companies. In order to project the cost of service of PEU, PAC and PWSC in the absence of PWW, analyses were made to measure the impacts of the revised personnel levels, the impacts on the purchasing discounts due to reduced volume ordering of materials and supplies, the impacts of the revised levels of customers, the impacts of the investment and depreciation of the required plant asset replacements, and the impacts on capital costs of the restructured corporate entity. To develop comparative cost results, the projected common use utility asset costs and utility personnel costs were allocated to PEU, PAC, PWSC and Southwood in a manner consistent with the cost allocation methodology of PWW on file with the PUC. The revised cost of service results provided hypothetical revenue requirements for each company, and the rate increases that would be necessary without PWW as part of the combined operation.

Based on the foregoing, the substantial adverse economic impacts shown on the attached schedules reflect the projected cost to each entity and/or its customers of having to acquire replacement assets or conduct their businesses on a less efficient basis. In the case of PWSC, assuming it could continue its operations while experiencing substantial economic losses until expiration of its existing operating contracts, its future existence would be dependent on whether the market in which it operates would allow it to impose significant cost increases on its customers when those contracts were renewed. Given the highly competitive nature of that market, PWSC's ability to increase its revenues sufficiently to continue to operate successfully is highly doubtful.

Pittsfield Aqueduct Company
Statement of Operations - At Projected Revenue Requirement

	2005 Per Book	2005 with Appropriate Revenue Levels	2005 Without PWW Affiliation
Operating Revenues	$ 489,439.24	$ 622,083.29	$ 1,031,956.38
O&M Expense:			
Water Supply-Production Expenses	68,539.00	68,539.00	97,554.16
Distribution-T&D Expenses	60,105.46	60,105.46	85,621.63
Engineering Expenses	7,800.00	7,800.00	21,641.02
Acct'g & Collect'g w/o Meter Reads	9,581.80	9,581.80	18,709.05
Admin & General Expenses	126,928.91	126,928.91	275,808.89
Corp.-Div Mgmt Fees (A&G)	27,000.00	27,000.00	59,992.18
Total O&M Expense	299,955.17	299,955.17	559,326.94
Depreciation Expense	85,463.31	85,463.31	125,461.44
Amortization of CIAC	(23,888.24)	(23,888.24)	(23,888.24)
Amortization Expense	17,827.50	17,827.50	17,827.50
Leasehold Amortization Exp.	1,000.00	1,000.00	4,165.31
Misc. Operating Gains	-	-	-
Taxes, Other than Income Tax	28,500.63	28,500.63	29,600.05
Income Tax	2,075.00	58,504.58	100,585.63
Total Operating Expenses	$ 410,933.37	$ 467,362.95	$ 813,078.64
Net Operating Income	$ 58,505.87	$ 154,720.34	$ 218,877.74
Rate Base	$ 1,783,677.74	$ 1,783,677.74	$ 2,341,568.16
Rate of Return	3.28%	8.67%	9.35%
Revenue Increase Required		$ 152,644.05	$ 409,873.09
Revenue Percentage Increase		32.52%	65.89%
Percentage over Booked Revenue			119.83%

on that?

A. Yes. That's not at all what my analysis was. You know, I've performed many cost allocation studies for water utilities. And, there are essentially two kinds. One is what's known as a "customer class allocation study", where you take the Company's total revenue requirement and you allocate the costs among the various customer classes, such as residential, commercial, industrial, fire protection, and so on. The other type of allocation study would be if you have multiple systems and you're performing an allocation of costs that are common to multiple systems. That's not at all what was done in my study. And, I believe Mr. Sansoucy mischaracterized my study as being a "cost allocation study". We did not merely allocate total costs among PEU and PAC. We actually performed a very detailed analysis and study, which included interviews with various Company people, including the heads of each of their departments, and officers of the Company. We analyzed every department to determine what staffing levels would be needed if Pennichuck Water Works itself were acquired by Nashua, and all that would be left would be PEU, PAC, and PWSC, the service company. And, we eliminated a large number of employees. I believe we went from -- I believe we went down to about 30 employees, from an original number of about 46 -- 76 employees. We also reviewed each of the employees during the course of this analysis as to how much time was spent for regular time, overtime, what the various pay rates would be for the employees remaining. We also reallocated duties of the employees to make sure that there would be (1) no duplication, or, when we made adjustments for employees, and we were left with, for example, three and a half employees, whether we could use one employee and change the duties, so that the employees would share duties. For example, we eliminated the president of the Company's position entirely. We eliminated other officers' positions entirely. And, we spread those duties to remaining officers that would left, if the PEU and PAC operation, as well as the PWSC operation, remained. We undertook an effort or I undertook an effort to direct the Company to contact all of the 17 vendors of major supplies to determine whether the purchasing of material, supplies, chemicals, would change if their purchasers were of a lower volume. So, they obtained specific estimates from their vendors, so that we could establish what would be the remaining costs, if they were no longer purchasing on a larger scale basis, would they lose the economies of scale? We had them call the insurance companies that provide insurance to determine what the insurance levels would be. So, we undertook a very detailed examination of costs. And, rather than just allocate costs, and, for example, the Company had, on a companywide basis, including Pennichuck Water Works, had O&M expenses of something in the magnitude of $19.9 million. We reduced that total 19.9 million down to approximately 8.8 million. That's not a cost allocation study. We made a very detailed effort to examine what would be remaining under -- if the operation of Pennichuck Water Works was taken. We analyzed all of the utility plant in service of each of the individual companies. And, we determined what additional equipment would have to be purchased by PEU, PAC, and PWSC, in order to continue its operations, which equipment is now with PWW. So, we went through a long list of assets that had to be acquired. And, we eliminated a number of assets. We eliminated vehicles. So, we performed much more than just a cost allocation study. We actually performed a very detailed study to determine what would be left.

Q. Was it your goal to --

wrong cell. But the impact of doing that is simply correct it, and I would assume he would not be offended by using the correct number so it paints the correct picture, and doesn't distort the impact of what his schedules are intended to show.

Q. Now, --

A. I would appreciate being correct if I made a mistake. Just correct it and live with it.

Q. I would say, in this -- in this case, you would be unique in that regard. And, that's a compliment, sir.

A. That's not a question, I'm assuming, but --

Q. You've testified that "if PWW is acquired by Nashua, PEU and PAC will require rate increases in excess of 60 percent", right?

A. Yes.

Q. And, you described for Mr. Boutin the analysis that you went through. And, I'm not going to ask you to repeat that. But that was the analysis that you performed this morning and described for Mr. Boutin?

A. That was the analysis I performed, and then described, in sum, to Mr. Boutin, yes.

Q. Okay. Now, one thing you didn't do, though, was you didn't test any of your conclusions by looking at the operations of similarly sized water companies, did you?

A. I don't do impossible tasks. There are no similarly sized water systems. I know just about every water utility that's of any size, and there's none like Pennichuck Water Works, that serve 100 -- between PEU, PAC, and PWSC, there's 100 separate systems. There's nothing like that out there in any part of the country.

Q. Did you test to see if your conclusions about the level of compensation for officers and administrative and general expense were supported by other companies in a new configuration?

A. In order to do those comparisons, you have to have comparable utilities. And, there are no comparable utilities. I mean, the closest thing I know of are American -- Aqua Utilities in Florida that has 80 systems. But that's not comparable, because they're spread more. And, certainly, their costs and salary levels are greater than what I'm looking at for the remaining PEU, PAC and PWSC. And, I might point out, in my analysis I eliminated the entire officer's salary for the president of the company and another officer. So, I've made adjustments, significant adjustments for officers' salaries and personnel staff in order to do the analysis.

Q. Did you look at how PAC was operated before it was

acquired by Pennichuck?
A. No, of course not.
Q. Wouldn't that have given you some idea of how it could operate as a stand-alone?
A. Not at all. I wouldn't even know how to go about that kind of a task.
Q. Did you consider getting bids from contract operators to test your conclusions about how much it would cost to operate those systems?
A. I mean, respectfully, hardly worth the effort. There's -- I don't know of any investor-owned utility that would be run more efficiently or effectively by outside sourcing its operations. You're not going to find people who are as qualified, who are as under control. And, I've never seen it happen, of all the utilities that I'm aware of, which is thousands of them around the country, you just don't see that happening.
Q. Well, this isn't a normal operation of a utility. This is a utility that, as you say, has had, you know, the major source of its property and employees taken away from it. Wouldn't it be -- Wouldn't you want to know whether somebody else, with economies of scale, could come in and operate that system at a lower cost? And, wouldn't a prudent owner consider doing just that?

A. Absolutely not. Because the analysis that I did was to create the most efficient operation with PWW gone. We analyzed all of the employees that would stay, all the employees that should leave. We adjusted all of the costs. We went through every single operation that the remaining operation would have, down to individual assets that would be needed, new assets. If an outside -- If a request for proposal were submitted for bidding from outside contractors, they could not come up with a more accurate estimate than what we came up with. And, because there would have to be profit margins added to their contract, I can't imagine, in all my experience, that they would come even close to being as efficient or as less costly.
Q. But you didn't test them?
A. I don't head down fruitless roads.
Q. If PEU had it's own employees and equipment, it wouldn't be affected by what happens to PWW, would it?
A. I just demonstrated that PEU is going to be affected by what happens to PWW. That's what my whole study does. Unless I'm not understanding your question.
Q. I understand that. What I'm asking you is, if it had its own individual employees and its own equipment, and operated as a stand-alone company, it wouldn't be

Nashua, that PEU, PAC, and Pennichuck Water Service Corp. will need to replace those assets that are taken?

A (McCarthy) It depends. If the assets that are taken are the assets that are used to maintain the systems that are taken, no.

Q For whoever can answer this question. Does Nashua understand that the sale proceeds are a return of capital?

A (Sansoucy) Marcia, Nashua believes that the sale proceeds from the proposed purchase constitutes both a return of debt, return of capital, and a acquisition premium or profit above and beyond both.

Q Mr. Sansoucy, I'll direct my next question to you. In the event of a taking, if Pennichuck Corporation funds the replacement of these assets, are you aware of whether the shareholders will still get a return on those replaced -- replacement assets at the rate of return the Commission has authorized for each of those customers [companies?]?

A (Sansoucy) That question cannot be answered that way, because Pennichuck -- what you're asking is, the trucks and the tools and everything that's owned by Pennichuck Water Works is used in the operation of

Pennichuck East and Pittsfield Aqueduct and Pennichuck Services Company. And, if this taking takes all those trucks, tools, machinery, then there's nothing left for Pennichuck East. Pennichuck East, as an example, has never owned any of those tools. It has relied on a contract with Pennichuck Water Works to service those systems. Pennichuck East is free to go out and solicit contracts, first and foremost, from others, including the City of Nashua, to continue to operate the Pennichuck East systems with those various tools, rolling stock and equipment that is the ownership of Pennichuck Water Works.

Pennichuck East would have many other options for other vendors, such as Aquarion, in the Hampton area, could certainly be requested to provide a contract to operate the systems on the Seacoast. Lakes Region Water could be suggested to operate the systems in the northern part of the state that Pennichuck is now purchasing. There is no -- Pennichuck East doesn't get hurt, because it never owned anything, it had a contract with Pennichuck Water Works. It doesn't have to replace anything it doesn't have. It will have to go out and re-contract. The obvious, the obvious staring us, staring everyone in the face is that they're welcome to solicit a contract from Veolia Environmental, who will be a new vendor in the State of New Hampshire to provide that very service that they could -- that they could consider.

So, no, we don't believe that they have to recap -- recapitalize the equipment. They're free to if they wish to recapitalize the equipment. And, if they were to recapitalize it, then, in a rate case, this Commission may or may not or would consider whether or not that was capitalized and whether or not a return on investment and other investment would be considered at that time. They may capitalize it out of the acquisition premium paid by Nashua to Pennichuck Water Works, such that it doesn't impact the rate bases for Pennichuck East or for Pittsfield Aqueduct Company. So, I think there are many options available to the subsidiaries in the instance of your question.

Q I'm going to move onto Exhibit 1001, which is Mr. McCarthy's testimony dated November 22nd, 2004. And, in particular, Page 8.

MR. DONOVAN: What exhibit?

That says, "Without an opportunity for discovery on these figures, Staff is unable to render an opinion on them." So, do you still hold, Mr. Sansoucy, that Mr. Naylor accepted Nashua's figures in 3-11 uncritically, if this is what was stated in his testimony?

A (Sansoucy) Yes, I do, because Mr. Naylor has stated two very critical things. First, he has stated that he doesn't believe this taking is in the public interest, is one thing. One of the reasons he continues to recite is the impact on the -- on the satellites. And, secondly, in the balance of that, on Lines 3, 4 and 5, he says "Nonetheless, I believe it is quite clear that there would be negative financial impacts to both PEU and PAC if the assets of PWW were taken."

The only document submitted to him at that time were the Guastella documents, which he referenced in the previous sentence before that. And, those were nothing more than an allocation of Pennichuck Water Works's costs to Pennichuck East and Pennichuck -- and PAC, without any restructuring of the company. And, they appear to have been accepted to formulate this opinion, even though it's qualified

I said is, there are economies of scale which can be -- the assertion that is implicit in your question is that that requires ownership of the assets by the consumer. The argument that Mr. Sansoucy gave this morning was that those are acquirable through those, and with those same economies of scale, through contracted services.

Q Let's look at, actually, Exhibit 1015, Page 27. And, this is from your testimony, Mr. Sansoucy, on May 22nd. And, here you're talking about different options that PAC and PEU would have after a separation. Why don't we highlight the first three paragraphs. You're saying that they will need fewer engineering services, right?

A (Sansoucy) Yes, in general, that's true.

Q Right. And, then, you're saying they'll need less travel time, because they're going to move north and east, is that right?

A (Sansoucy) Yes. The Company has discussed moving a hub northeast from Nashua, and their stated goal is to better serve their far-flung units.

Q Right. And, then, the next paragraph saying there are emergency efficiencies, because they're going to be smaller, they're going to need fewer employees and

less equipment, right?
A (Sansoucy) That's true.
Q Right. So, you're saying here, aren't you, arguing here that, in fact, it's going to be cheaper for PEU and PAC, because they're going to be smaller. Small is beautiful. Isn't that right?
A (Sansoucy) Could be. It could very well be.
Q But you don't know, because you've never done a study, have you, Mr. Sansoucy?
A (Sansoucy) We have looked at Pennichuck East and PAC. And, there are ways to operate those systems that could -- could be much more cost-effective than they're currently being operated.
Q But that's not in this case, is it?
A (Sansoucy) No, it is not.
Q Right. The only study that has been done in this case of "what would the effect be on PEU and PAC?" is the study done by Mr. Guastella, right?
A (Sansoucy) No, that's not true.
Q Who else did the study?
A (Sansoucy) That is not a study. It's an allocation of costs. It's not a cost of service study.
Q Well, he created a model.
A (Sansoucy) No, he did not.

Q He did not create a model?

A (Sansoucy) No, he did not. He allocated costs. He moved all the trucks over and all the overhead over and all the people over, and then spread the costs out. He allocated costs only.

Q Let's take a look at Exhibit 10 -- 3016. That's Mr. Guastella's testimony, Page 2. And, his -- let's go onto the next page. Next page, please. Let's hold that. Actually, that's your testimony. You've maintained that there is subsidization, is that right?

WITNESS SANSOUCY: Mr. Chairman, could he blow it up? We can't read this.

MR. DONOVAN: Yes, the top paragraph you can blow up.

WITNESS SANSOUCY: I'm sorry. Yes, I can't read it --

MR. DONOVAN: Yes, I can't, I can't either.

BY MR. DONOVAN:

Q What Mr. Guastella concluded is that you'd have to create a fund of 40 to $50 million in order to reduce rate base, in order to have the rates stay the same for those companies, isn't that right?

needed? He went out to -- He determined what it would cost in the Derry/Londonderry area to acquire a garage spot. Didn't he do all of those things to create his cost analysis, Mr. Sansoucy?

A (Sansoucy) He did a number of items, speculated on a number of items like that.

Q So, you're saying "he speculated". Well, at least he did an analysis. You didn't do an analysis, correct?

A (Sansoucy) I think we have done substantial analysis to indicate that PWW, if separated, at the purchase price we're proposing, --

Q Okay.

A (Sansoucy) -- may not harm PEU or PAC.

Q Right. I'm scrolling through some pages of his. This is his speculation, is that right?

A (Sansoucy) These are all allocations.

Q Based upon an analysis that he did of the post -- the post taking remnants that would face PEU and PAC, isn't that right?

A (Sansoucy) I can't agree, because that's --

Q That's in Exhibit 3 -- excuse me, Exhibit 1076.

A (Sansoucy) We can't agree.

CHAIRMAN GETZ: Mr. Donovan, you're going to have to let Mr. Sansoucy answer.