

STATE OF NEW HAMPSHIRE
PUBLIC UTILITIES COMMISSION

DW 04-048

In the Matter of:
City of Nashua
Petition for Valuation
Pursuant to RSA 38:9

Reply Testimony

Of

Steven Paul, Esq.

May 22, 2006

STATE OF NEW HAMPSHIRE
BEFORE THE
NEW HAMPSHIRE PUBLIC UTILITIES COMMISSION

City Of Nashua: Petition For Valuation Pursuant To RSA 38:9

Docket No. DW04-048

REPLY TESTIMONY OF STEVEN PAUL, ESQ.

1 **Q. Please state your name, business address and position.**

2 A. Steven L. Paul. I am a partner of Edwards Angell Palmer & Dodge LLP, 111
3 Huntington Avenue, Boston, Massachusetts 02199.

4 **Q. Have you previously submitted testimony in this proceeding?**

5 A. Yes. On or about November 22, 2004, I provided testimony in this proceeding
6 that Nashua's acquisition of the water utility assets under RSA 38 need not result
7 in the imposition of capital gains tax on Pennichuck shareholders. Since that
8 testimony, on November 1, 2005, Palmer & Dodge LLP merged with Edwards &
9 Angell LLP to form Edwards Angell Palmer & Dodge LLP.

10 **Q. What is the purpose of your testimony today?**

11 A. On April 13, 2006, Mark Naylor of the PUC staff provided testimony that he had
12 reviewed my "arguments [*sic*] that Pennichuck can reinvest the sale
13 proceeds...within two years in order to avoid capital gains taxes." He further
14 testified that, following a sale by Pennichuck of the assets in question to the City
15 of Nashua, there can be no reasonable expectation that Pennichuck would either
16 search for other water systems to purchase or redeploy the proceeds of the taking
17 in other non-utility assets "just to avoid capital gains taxes, given that
18 Pennichuck's expertise is and has been water." See Pages 65-66. I have therefore

1 prepared this rebuttal testimony in order to respond to Mr. Naylor's speculations
2 concerning what actions the management and shareholders of Pennichuck would
3 or would not take in response to a condemnation.

4 **Q. Did Mr. Naylor dispute your testimony that Pennichuck would have the right**
5 **to avoid capital gains taxes by reinvesting the proceeds of the condemnation?**

6 A. He did not. His testimony was simply that Pennichuck would choose not to
7 exercise that right.

8 **Q. Is there any evidence that, contrary to Mr. Naylor's testimony, Pennichuck**
9 **would consider, or is considering, reinvesting some or all the proceeds of a**
10 **taking in order to avoid capital gains taxes?**

11 A. The 2005 Form 10-K for Pennichuck Corporation, filed with the Securities
12 Exchange Commission on or about March 31, 2006, contains the following
13 statement (see page 12):

14 It may be possible for Pennichuck Water to defer the
15 recognition of gain for tax purposes on the deemed sale of the
16 assets if within a certain time period it reinvests the amount
17 received from the sale in property that is similar or related in
18 service or use to the property acquired by the City of Nashua.
19 The rules for replacing real property under these circumstances
20 are less stringent than the rules for replacing personal
21 property. To the extent that some of the assets subject to sale
22 are determined under state and local law to be personal property
23 and not real property, Pennichuck Water will be more limited in
24 its options for locating suitable replacement property for these
25 assets and, thus, less likely to defer any potential tax at the
26 corporate level. There can be no assurance that Pennichuck Water
27 would be successful in deferring recognition of all or any of the
28 taxable gain by reinvesting the proceeds in replacement property.
29

30 **Q. Did Mr. Naylor offer any basis for his testimony that Pennichuck would not**
31 **reinvest?**

32 A. He claimed that he was relying on January 12, 2006 testimony of Donald Correll.

1 **Q. Did Mr. Correll testify that Pennichuck would not or could not exercise its**
2 **right to avoid taxes by reinvesting proceeds of a taking?**

3 A. In my opinion he did not. He testified that that the idea that Pennichuck could
4 reinvest the proceeds of the taking in other New Hampshire water systems is
5 unrealistic. See page 18. He then testified as follows: “Certainly, what PNNW
6 does with the proceeds of an eminent domain taking is the matter that the board of
7 directors would have a fiduciary duty to address. At that point any use of the
8 proceeds would have to be in the best interests of the company’s shareholders.”

9
10 The obligation of the board to act in the best interest of the company’s
11 shareholders is at the crux of the matter. If there are reasonable opportunities to
12 invest the proceeds of a taking in a manner that will permit the avoidance of
13 taxable gains, the board would be bound to consider them and, if necessary or
14 appropriate, submit them to the shareholders. As I have previously testified, such
15 reinvestments are not limited to utility assets; they could also include controlling
16 stock interests in utility companies and, to the extent Pennichuck’s assets are real
17 property under New Hampshire law, investments in a broad array of real estate
18 assets. Moreover, it would be possible for Pennichuck to “mix and match” by
19 investing some proceeds in assets to be used to serve existing customers who
20 would continue to be served by Pennichuck following the taking, investing other
21 proceeds in the purchase of other water systems (or controlling interests in
22 companies owning such systems) either in New Hampshire or elsewhere and
23 investing some or all of any remaining proceeds in real estate assets.

1 Thus, the inability of Pennichuck to reinvest all the proceeds in other New
2 Hampshire water systems, if true, would not be dispositive of the question
3 whether Pennichuck could reinvest the proceeds of a taking so as to avoid or
4 minimize the recognition of taxable gain.

5 **Q. As described above, Mr. Naylor testified that the expertise of the company is**
6 **and has been water. Do you agree?**

7 A. It is not my place to determine where the expertise of the company resides. I
8 note, however, that the company has a real estate subsidiary, Southwood
9 Corporation. The website for Pennichuck Corporation describes Southwood as a
10 developer of commercial and residential real estate and states that Southwood's
11 holdings include over 500 acres of developable land located in southern New
12 Hampshire, as well as a portfolio of multi-tenant office buildings. According to
13 the website Southwood's activities include land planning, land development and
14 sales, as well as developmental joint ventures, acquisitions of income properties,
15 and asset management.

16 It does not seem unrealistic to expect that that the board of directors would
17 consider whether investing some or all the proceeds of a taking in the activities of
18 Southwood would be in the best interests of the shareholders, particularly if such
19 investment so would substantially reduce or even eliminate the taxes payable by
20 the company by reason of the taking. Mr. Naylor's testimony and, for that matter,
21 Mr. Correll's testimony fail to address this strategy.

22 **Q. Does that conclude your reply testimony?**

23 A. Yes.