STATE OF NEW HAMPSHIRE
BEFORE THE
NEW HAMPSHIRE PUBLIC UTILITIES COMMISSION
CITY OF NASHUA'S PETITION FOR VALUATION PURSUANT TO RSA 38:9
Docket No. DW04-048

DIRECT TESTIMONY OF PHILIP L. MUNCK

Q. What is your name and what is your association with the City of Nashua?

A. My name is Philip L. Munck. I am an associate of George E. Sansoucy, P.E., LLC, a consulting firm that has been engaged by the City of Nashua to assist it in this proceeding.

Q. Please describe your educational background.

A. I have a bachelor's degree from the University of Michigan and a Master of Business Administration degree from Plymouth State College.

Q. Please describe your professional background.

A. I have been an associate of George E. Sansoucy, P.E., LLC, since 1994 providing professional assistance in cases involving the valuation of special purpose properties and other engineering projects. Most notably, I was intimately involved in the process through which the Town of Hudson petitioned the PUC to take assets of Consumers New Hampshire Water Company and ultimately purchased the company. I was likewise involved in the acquisition of a water utility by the County of Ashtabula, Ohio. I have also been involved in several other water related cases of the firm.

Prior to joining George E. Sansoucy, P.E., LLC, I was employed for a total of 15 years by four communities in Michigan and New Hampshire as City Administrator, City Manager and Town Administrator. In the cities of Mt. Morris, Michigan, and Franklin and Somersworth, NH, the water departments reported directly to me. In Epping, NH, I provided significant administrative and managerial support to the Selectmen and the Water Commissioners for the daily operation of the Water Department.

In addition to the positions above I served for 10 years on active duty in the U.S. Navy and worked as a newspaper reporter and a manager of engineering administration for a defense contractor.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to describe the managerial and technical competency of the City of Nashua to own and operate a water utility and to discuss the financial advantages of public ownership of the water utility.

Q. Does the City of Nashua have the managerial capability to own and operate a water utility?

A. Yes, it does.

Ownership and operation of a water utility is a common municipal function. Local governments as large as New York City and Los Angeles and as small as Epping, New Hampshire, successfully own and operate water utilities. Nashua is the only city in New Hampshire that presently does not own its water utility.

As with all other municipal functions, there are levels of management responsibility. It falls to the elected leadership of the City to establish broad policy and to exert financial control by adopting budgets and setting rates. It exerts detailed control by engaging competent professional management to run the system according to City policy.

Nashua has determined that it will contract out the operation and maintenance and management oversight of the water system it acquires to skilled operating and management companies.

Q. Is the City's proposal to contract for operation of the water utility a reasonable approach?

A. The model in which a municipality owns a water (or other) utility and contracts for its operation has been successfully employed in a number of locations. The Pennichuck Water Service Company, another subsidiary of the Pennichuck

Corporation, operates the water utility of the Town of Hudson under just such an arrangement.

This public-private relationship is not the only way to operate a public water utility. Most of the municipal water systems in the United States are staffed and operated by dedicated public employees. Nashua's sewer collection and treatment utility is such an operation and Nashua, if it desired, could readily combine the sewer and water systems and operate them as one.

The City of Indianapolis has one of the largest public-private relationships in the United States with a firm that has expressed an interest providing contract services to a Nashua or regional water utility.

Q. What are some of the advantages of the public-private relationship?

A. Typically a municipality gains the services of an organization that is focused on the single narrow task of operating and maintaining a specialized plant. If an operator from a large organization is selected, the resources of that organization are available to deal with technical issues.

Because the municipality retains ownership, it also is able to direct the future of the utility in areas, such as conservation, in which a privately owned utility has no inherent interest.

Q. What are some of the disadvantages of the public-private relationship?

A. Because the relationship between public owner and private operator are defined by a contract, there is somewhat less flexibility in the ability of the owner to change directions quickly. There is also a reduced ability to share in some of the common capabilities of an integrated public works department.

The advantages and disadvantages balance fairly closely and either public operation or private operation can be successful making the choice a policy decision of the community.

Q. What steps has Nashua taken to develop a public-private relationship?

A. The City of Nashua has made a policy decision to contract for all aspects of the operation and maintenance of the water utility except for the treasury and cash management functions. Earlier this year, the City sought expressions of interest and qualifications from a number of potential contract operators and received positive expressions of interest from eleven companies including the Pennichuck Water Service Company.

The City is in the process of developing two requests for proposals. One is for the operation and maintenance of the system and a second is for management oversight of the operations and maintenance contractor. The two contract approach is being taken to minimize the additional in-house staff required by the City. Moreover, such an approach would, in the event there is an assumption of the operation of the system by the Merrimack Valley Regional Water District, permit that transfer of ownership to take place with the least disruption to ratepayers and the two entities.

Q. What should happen to the revenues required of ratepayers under public ownership as compared to private ownership?

A. All other things being equal, the cost to ratepayers for utility services has to be less under public ownership than under private ownership.

By other things being equal, I mean that the same amount of capital investment is made and that the same costs of operation such as staffing, power, chemicals and the like are made by each owner.

Those things being equal, there are costs that are lower for a municipality and costs that are avoided altogether.

The cost of capital, that is, the cost of the money needed to make investments in infrastructure, are about 5% for a municipality at the present time, which is the price of revenue bonds. Between the need to earn returns for investors and the higher rates of private debt, Pennichuck's cost of capital is over 8% at the present time. Exhibit PLM-1 is an analysis of the cost of capital reported by investor-

owned water utility companies that indicates the industry cost of capital for larger water utility holding companies is 7.5% and for smaller holding companies is 8.2%.

Water utilities are capital-intensive enterprises. The net book value of the three Pennichuck Corporation utilities was about $78 million at the end of 2003. The annual cost of that capital for the City would be $3.95 million and over $6 million for a private utility.

Municipal water utilities avoid altogether the payment of dividends to investors, state and federal taxes (other than payroll taxes), most of the compliance filings with the Securities and Exchange Commission and all of the regulatory costs of filings with the N.H. Public Utilities Commission. In 2003, the Pennichuck utilities paid $1.6 million in income taxes and declared dividends to stockholders of $1.9 million.

Q. Does this conclude your testimony?

Yes.

EXHIBIT PLM-1 - WATER UTILITY WEIGHTED AVERAGE COST OF CAPITAL

Company	Shares (000,000)	Book /Share	Equity (000,000)	ROE	Equity x ROE	Preferred (000,000)	Pref. Int. (000,000)	LT Debt (000,000)	LT Debt Int. (000,000)
American States Water	15.21	$13.97	$212.5	5.6%	11.899			$277.4	$16.5
California Water	16.93	$14.44	$244.5	7.9%	19.313	$3.5	$0.2	$272.0	$16.0
Aqua America	92.59	$7.12	$659.2	10.2%	67.243			$686.3	$45.0
Total			$1,116.2		98.455	$3.5	$0.2	$1,235.7	$77.5
As % Capital			47%			0%		52%	
Weighted Average				8.8%			4.29%		6.27%

Weighted Average Cost of Capital

		Weight	Rate	
	Equity	47%	8.82%	4.2%
	Preferred	0%	4.29%	0.0%
	Debt	52%	6.27%	3.3%
				7.5%

Source: Value Line Investment Survey, Issue 9, July 30, 2004 for 2003

Conn. Water Services	7.97	$10.46	$83.4	10.9%	9.087	$0.8	$0.0	$65.1	$4.6
Middlesex Water Co.	10.48	$7.60	$79.6	7.9%	6.292	$4.1	$0.3	$98.3	$5.2
SJW Corp.	9.14	$18.21	$166.4	10.0%	16.644			$143.9	$8.5
Southwest Water	14.67	$5.40	$79.2	9.0%	7.130	$0.5	$0.1	$55.0	$4.6
York Water	6.42	$6.08	$39.0	11.4%	4.450			$29.9	$2.5
Total			$447.7		43.602	$5.4	$0.4	$392.2	$25.4
As % Capital			53%			1%		46%	
Weighted Average				9.7%			7.59%		6.48%

Weighted Average Cost of Capital

		Weight	Rate	
	Equity	53%	9.74%	5.2%
Capital Distribution	Preferred	1%	7.59%	0.0%
	Debt	46%	6.48%	3.0%
				8.2%

Source: Value Line Investment Survey - Small and Mid-Cap Edition, Issue 9, July 30, 2004 for 2003 except LT Debt Int. from SEC 10-K for 2003