

# Memo

## Memorandum



One  
Financial  
Center  
Boston  
Massachusetts  
02111  
tel 617.856.8200  
fax 617.856.8201

DATE June 02, 2016  
TO File  
FROM BROWN RUDNICK LLP  
RE **CONFIDENTIAL ATTORNEY/CLIENT COMMUNICATION**  
Potential Acquisition of Milford Water Company

---

### I. Introduction

This Memorandum describes the (1) the judicial/regulatory process that the Town of Milford ("Milford") would likely need to adhere should it seek to purchase the Milford Water Company; (2) the evidence that the Department would likely evaluate to make its determination on the property available and the value of that property; and (3) the mechanism and standards that the Department would likely rely on to make its determination.

As detailed herein:

- the Town has a statutory right to purchase the Company subject to two thirds of the vote at town meeting to accept the determined purchase price;
- if the Company and the Town agree to the terms of the acquisition, no judicial/regulatory action is required;
- should the Town and the Company be unable to agree on the property to be purchased and/or the value for that property, the Town (or the Company) can petition the Supreme Judicial Court ("SJC") to resolve the issues;
- the Court will, in turn, refer this matter to the Department of Public Utilities ("Department"), which will make the requisite findings and determination;
- in evaluating what constitutes the property to be purchased, the Department will likely require the sale to include all of the Company's property and

**CONFIDENTIAL ATTORNEY/CLIENT COMMUNICATION**

franchise rights, including intangible assets, such as reports prepared for capital improvements that were not undertaken, customer records, water quality records, maintenance records, trained workforce and possibly outstanding debt;

- given the lack of specificity in Milford Water's charter, the Department could value the Company's property anywhere between the fair market value using Reproduction Cost New Less Depreciation (RCNLD) and the book value of the Company's property through Original Cost Less Depreciation ("OCLD"), based on the Department's most recent case involving the valuation of utility property for purchase by a municipality, *Stow Municipal Electric Department*, D.P.U. 94-176 (1996).
- per the charter, the Department's decision must be "accepted" by the SJC. The finding will be reported to the SJC to be "confirmed or approved" by a single justice or the full court.<sup>1</sup>

**II. The Town's Right to Purchase**

On March 9, 1881, the Massachusetts legislature voted to incorporate the Company "for the purpose of furnishing the inhabitants of Milford with pure water for the extinguishments of fires, and domestic and other purposes . . ."<sup>2</sup> The Milford Water Charter also gives the Company the right to set rates and collect revenues.<sup>3</sup> Per the legislation, and as detailed below, the Town has the right to purchase the Company.<sup>4</sup>

"The town of Milford shall have the right at any time during the continuance of the charter hereby granted, to purchase the corporate property and all the rights and privileges of said company at a price which may be mutually agreed upon between said corporation and the said town of Milford; and the said corporation is authorized to make sale of the same to said town."

---

<sup>1</sup> SJC Rule 2:13 provides that "The acts of any such special master and commissioner, when confirmed or approved, by a single justice or by the full court, as the case may be, shall have all the force and effect of a decision by a single justice or by the full court." There is no precedent for SJC review of the Department's findings pursuant a municipal water company's charter and/or G.L. c. 165, § 5.

<sup>2</sup> St. 1881, c. 77 ("Milford Water Charter").

<sup>3</sup> Milford Water Charter §4.

<sup>4</sup> *Id.* at §9.



## CONFIDENTIAL ATTORNEY/CLIENT COMMUNICATION

Accordingly, as long as the Company's Charter remains in existence, the Town has a right to purchase the Company's property.

### A. *The Town's Acceptance of the Purchase Price*

As originally enacted, the Milford Water Charter conditioned the Town's authority to purchase the Company upon "the approval by a two-thirds vote of the voters present at a meeting called for this purpose."<sup>5</sup> By such a vote, the Town was required to affirm its intention to purchase the Company and avail itself of its right to have the price fixed in the manner set forth in the charter. Under the original legislation, once the Town voted to purchase the Company, the Town was committed to do so.<sup>6</sup> Therefore, there was significant risk to the Town if the vote occurred before valuation and added incentive to negotiate a purchase price rather than seek a determination by the Department.

This risk and corresponding incentive for a negotiated purchase price was eliminated through a 2015 amendment to the Charter that conditioned the sale on the Town's acceptance of the purchase price as determined through agreement or by the Department.<sup>7</sup> The 2015 Amendment strikes the last sentence of Section 9 and inserts the following:

"The authority to purchase the franchise and property shall be granted upon the condition that the price for the purchase, either as agreed or determined as above, shall be accepted by the town by a 2/3 vote of the voters present and voting thereon at a meeting called for that purpose."

Under the 2015 Amendment, the Town can (i) agree to a price and present it for acceptance by vote of town meeting; (ii) have the price determined by the Department and SJC and present it for acceptance by vote of town meeting; (iii) have the price

---

<sup>5</sup> *Id.*

<sup>6</sup> *Cohasset Water Co. v. Town of Cohasset*, 321 Mass. 137, 142 (1947) ("*Cohasset*") (Like the Milford Water Charter, Cohasset's governing charter also conditioned the town's right to purchase on the two-third vote of the voters. In Cohasset, the court found that once the town had received authority through a properly held vote, the town had exercised its option to purchase the water company and could not rescind without the consent of the water company. The Court went on to hold that title did not pass by the town's vote, but that title passes only upon the execution of the proper conveyance and payment of price, to be ascertained in accordance with the governing charter); see also *Dedham Water Company v. Dedham*, 395 Mass 510 (1985) ("*Dedham*") (the town vote to acquire only certain portions of Dedham Water Company was held ineffective as it differed materially from the Company's offer to sell).

<sup>7</sup> St. 2015, c. 480.

**CONFIDENTIAL ATTORNEY/CLIENT COMMUNICATION**

determined by the Department and SJC and take no further action (assuming the price was excessive).

*B. The Town and the Company Agree on Property to be Purchased and the Price*

If the Town and the Company are able to agree on the property included and the price (either outright or through arbitration/mediation) and the purchase price is accepted by 2/3 vote at town meeting, no other judicial or administrative approval is necessary for the sale to be consummated.

*C. The Town and the Company Cannot Agree on the Property to be Purchased or the Price*

If the two entities are unable to agree on the property to be purchased or price, then the Milford Water Charter provides that

the compensation to be paid shall be determined by three commissioners to be appointed by the supreme judicial court upon application of either party with proper notice to the other, whose award, when accepted by said court, shall be binding upon the parties.<sup>8</sup>

Thus, in the event that the parties cannot agree on price, either party has the right to file an application before the SJC requesting that in accordance with G.L. c. 165, §5, which describes the current procedures for water companies with municipal water purchase rights within their charter, the matter be referred to the Department to determine the property to be purchased and the value of the property.

The Milford Water Charter states that the Department's decision is binding once it has been accepted by the SJC. The standard of review for the SJC to "accept" the Department's decision is not clear.

---

<sup>8</sup> Milford Water Charter §9. Massachusetts G.L. c. 165, §5 specifies that if a water company's legislative charter has a provision referring to the "Commission" to determine the price, the Department of Public Utilities is considered to be that Commission. See also *Cohasset, supra*.



## CONFIDENTIAL ATTORNEY/CLIENT COMMUNICATION

### III. Judicial/Regulatory Process

#### A. Application to Commence Proceeding

Should the Town (or the Company) decide to seek a judicial determination of the property to be purchased and its price, the moving party must petition the SJC and provide proper notice of its petition.<sup>9</sup>

In accordance with G.L. c. 165, §5, the SJC will refer the matter to the Department to determine the property to be purchased and the value of the property. The SJC has held that Department's decision must be determined using "wholly judicial methods," meaning that the Department will not conduct its own investigation, but will rely only on evidence presented to it by the parties.<sup>10</sup> Department procedures typically involve the submission of prepared written testimony followed by discovery and then evidentiary hearings. Written discovery would address issues such as the property to purchase and its value. The Department will then conduct a public hearing in Milford, discovery will be propounded (likely over two to three months), followed by evidentiary hearings (4-6 days over two weeks) and briefing.

There is no deadline by which the Department must issue a decision; it could be six months from SJC transfer to issuance of a decision. Please note that the Attorney General would likely seek to participate in the proceeding and could potentially seek funding for retaining her own expert analyses.<sup>11</sup>

#### B. Determination of Property Available for Purchase

The Milford Water Charter provides that the Town has the right to purchase "the corporate property and all the rights and privileges of said company."<sup>12</sup> Therefore, the Department would have to determine what property rights and privileges are to be

---

<sup>9</sup> The application to the SJC would consist of the filing of one original petition or application, together with the requisite filing fee of \$315.00. Although the Milford Water Charter does not define "proper notice", we can assume that service of the petition to the SJC would be deemed proper notice to the Company. All pleadings filed in the single justice session may be served by first class mail, hand delivery or, in the case of emergencies, via facsimile. We might also arrange for formal service.

<sup>10</sup> *Cohasset* at 148-149.

<sup>11</sup> It is unclear whether the Attorney General's statutory right to expert funding would apply to this matter. This cost is typically borne by the Company, but could ultimately need to be paid by the Town.

<sup>12</sup> Milford Water Charter §9.

**CONFIDENTIAL ATTORNEY/CLIENT COMMUNICATION**

included in the sale of the Company to the Town.<sup>13</sup> To make a finding as to what constitutes "property," the Department would likely be guided by how the Department and courts have interpreted other water company charters.<sup>14</sup>

In *Dedham Water Company v. Dedham*,<sup>15</sup> the Town of Dedham sought to purchase a portion of the Dedham Water Company pursuant to the rights granted to it under St. 1876, c. 138, §10 ("Dedham Water Charter"), which gave the Town of Dedham the "right at any time during the continuance of the charter . . . to purchase the corporate property and all the rights and privileges of said company at a price which may be mutually agreed upon between said corporation and the said town of Dedham." In this instance, the Town of Dedham sought to purchase only the parts of the Dedham Water Company that fell within the town limits and not the portions of the water company that lie within the Town of Westwood.

In interpreting the Dedham Water Charter, the court found that the plain language of the charter meant that Town of Dedham was compelled to purchase all of the company property regardless if it was within the town limits.<sup>16</sup> Consequently, as part of its due diligence into purchasing the Company, Milford should analyze the Company's property, both tangible and intangible, without regard to location.

In the *Town of Oxford v. Aquarion Water Company of Massachusetts, Inc.*,<sup>17</sup> the Charter allowed Oxford to purchase the franchise, property, rights and privileges of Aquarion -- all at actual cost. Thus, Aquarion argued that it should be entitled to "good husbandry expenses" and intangible assets. Included in these assets were fire hydrants,

---

<sup>13</sup> If the parties agree to what is included in the sale, it is likely that the Department will defer to that definition of "the corporate property and all the rights and privileges of said company." See *Petition of Stow Municipal Electric Department*, D.P.U. 94-176 at 3 (February 16, 1996) ("*Stow*").

<sup>14</sup> In *Stow*, the Department looked to the governing statute and rules of statutory construction, judicial interpretations in analogous context in finding that "property" can be broadly construed to encompass every type of property, including tangible and intangible property, such as contracts. The Department then went on to find that certain power sales agreements and stranded costs related to the cost of power supply should not be included in the valuation of the company. These findings were the subject of appeal and reversal by the SJC. See *Stow Municipal Electric Department v. Dept. of Pub. Utilities*, 426 Mass 341 (1997). These issues appear to be unique to the sale of electricity, but the Town should determine if the Company has any analogous contractual obligations that should be analyzed in a potential acquisition.

<sup>15</sup> *Dedham, supra*.

<sup>16</sup> *Id.* at 518.

<sup>17</sup> *Town of Oxford v. Aquarion Water Company of Massachusetts, Inc.*, No. 09000592 and No 09-01496 (Ma. Sup. Ct, November 4, 2013). ("*Oxford*") This matter first came before the court pursuant to motions for declaratory judgment as to the interpretation of the enabling statutes. The Oxford Charter did not provide for a referral by the SJC to the Department for price determination.



## CONFIDENTIAL ATTORNEY/CLIENT COMMUNICATION

customer records, water quality records, maintenance records, its trained workforce and reports and studies not leading to capital improvements, etc.<sup>18</sup>

The Superior Court ruled that Aquarion was entitled to be paid for intangible assets, such as for two studies and overhead expenses incurred on capital projects. Moreover, the Court found that Aquarion could recover reasonable overhead expenses incurred in maintaining the system so that the purchaser will acquire a going concern in full operation.<sup>19</sup>

Milford Water's recent rate case,<sup>20</sup> the Department noted that the Company has debt of approximately \$24 million. As the Department will likely consider the debt to be part of the Company's intangible assets, there could be a risk to the Town that it will be required to make the debt "whole". The Department will likely look at whether the conveyance of the Company's assets triggers default of the debt. The relevance of the Company's debt would likely only be an issue if the outstanding debt is higher than the relevant measure of either RCLND or book value, as discussed below.

Consequently, consistent with the *Dedham* and *Oxford* decisions, it is likely that the Department will consider all of the Company's property, both tangible and intangible (without regard to location) as part of "the corporate property and all the rights and privileges" of the Company to be included in the purchase price that the Town is compelled to purchase. Therefore, if after due diligence, the Town identifies certain Company assets that the Town does not want to acquire, we recommend that the Town attempt to exclude that property in the sale by agreement with the Company.

### C. Valuation of the Company's Property

The Milford statute is silent on how the Department should value the Company's assets. Unlike other water company statutes enacted at the time that Milford became

---

<sup>18</sup> *Id.* at 12.

<sup>19</sup> In *Oxford*, the court defined "good husbandry" to mean the obligation of the company to turn over the company's franchise and property as a going concern in full operation, noting that a necessary public service should not suffer during a period of transfer. *Oxford* at 14 citing *Cohasset* at 147.

<sup>20</sup> *Milford Water Company General Rate Increase*, D.P.U. 12-86 (August 30, 2013)

**CONFIDENTIAL ATTORNEY/CLIENT COMMUNICATION**

effective, there is no directive to value the assets based upon "actual costs"<sup>21</sup> or, in the case of other utilities, the "public interest".<sup>22</sup>

Given that there is no existing precedent for the Department's valuation of purchase by a municipality of its water company and no standard set forth in the Milford Water Charter, the Department likely will rely on utility-industry case law or judicial rulings as guidance to establish the Company's value.

The courts have issued declaratory rulings interpreting specific language in the enabling charters of two municipal water companies. The charters for the Southbridge Water Company and the Oxford Water Company were both established in the same time period as the Milford Water Charter. Unlike the Milford Water Charter, both charters used "actual cost" as a qualifier for price of the water company. In the recent *Oxford* case, the governing Charter provided the town to "take by purchase . . . the franchise, property, rights and privileges of the water company 'on payment of the actual cost thereof'" and five percent per annum net return on stockholder investment.<sup>23</sup> The *Oxford* Court defined "actual cost" to mean "original cost, the amount of money originally paid, as distinguished from any estimated cost, such as fair market value, or depreciated value."<sup>24</sup> Similarly, the Southbridge Water Company's charter gave the town the right to purchase "the corporate property and all rights and privileges of said company at the actual cost of same, or if mutually agreed upon . . . at a less price". In *Southbridge*, the court held "actual cost" to mean substantially the same terms as are employed regularly by the Department in determining rate base of the company and other regulated utilities . . . for rate setting purposes."<sup>25</sup> While the Department may consider these cases, the fact that the Milford Water Charter does not specify "actual cost" (or any other qualifier) as to the valuation of the Company provides the Department with discretion to look beyond the strict limitation of an "actual cost" or OCLD valuation.

---

<sup>21</sup> See *Town of Oxford v. Oxford Water Co.*, 391 Mass. 581, 586, 593 (1984).

<sup>22</sup> See *Stow*, *supra*.

<sup>23</sup> St. 1904, c. 193, §9.

<sup>24</sup> *Town of Oxford v. Oxford Water Co.*, 391 Mass. 581, 586(1984) (citations omitted).

<sup>25</sup> See *Southbridge v. Southbridge Water Supply Co.*, 371 Mass. 209 (1976) ("*Southbridge*").



**CONFIDENTIAL ATTORNEY/CLIENT COMMUNICATION**

In *Stow*, the Department determined the value of an electric utility pursuant to G.L. c. 164, §§ 42 and 43<sup>26</sup> which give the town the right to purchase the electric utility and the Department the right to determine the purchase price of the municipal utilities' property. Unlike the Milford Charter, Section 43 sets forth a "public interest" standard for the Department's determination and other directives regarding the calculation of price, including a "reasonable allowance for depreciation and obsolescence, and any other element which may enter into the determination of a fair value of the property."<sup>27</sup>

In *Stow* the parties advocated two distinct methods for the valuing the property: OCLD, which calculates the price based on historic numbers and RCNLD, which calculates the price based on the current cost to install these properties and then reduces the cost based on a realistic consideration of the condition of the properties.<sup>28</sup>

Essentially, OCLD is the net book value of the plant minus depreciation. To calculate OCLD, Stow Municipal Electric Department ("SMED") suggested that the Department establish a Company's original book value, its depreciation rate, and the year-end value of its distribution plant. SMED asserted that valuing a property for purchase is the same as valuing it for ratemaking purposes and argues that because utility rates in Massachusetts are based on the book value of the plant and that any amount that the purchaser paid over rate base would not earn a return. Therefore, SMED contended that a purchaser would not want to pay more for the plant than it could put into its rate base. SMED also argued that the plant had previously been paid for by the ratepayers and that any upward adjustment to the net book value of the system would result in ratepayers paying for the same plant more than once.<sup>29</sup>

Contrary to SMED's position, Hudson Light & Power Department ("HL&P") argued that SMED should pay the fair value of the properties and defined fair value as "the price to which a willing buyer and willing seller would agree, neither being under the compulsion to act, with full knowledge with all relevant facts and acting at arms' length".<sup>30</sup>

---

<sup>26</sup> Unlike Milford Water's Charter, Section 43 gives the town or the utility the right to directly petition the Department for a determination as to the property to be included and the price to be paid.

<sup>27</sup> See G. L. C. 164 § 43.

<sup>28</sup> The income approach is the other generally accepted approach for valuation of real estate. The income approach is calculated using the net operating income of the rent collected and dividing it by the capitalization rate (the investor's rate of return). This approach is similar to OCLD or book value.

<sup>29</sup> *Stow* at 51-52.

<sup>30</sup> *Id.* at 53.

**CONFIDENTIAL ATTORNEY/CLIENT COMMUNICATION**

HL&PD asserted that RCNLD is a more appropriate indicator of value than OCLD, because it considers the current cost to install the properties and then reduces this cost based upon a realistic consideration of the condition of the properties at sale.<sup>31</sup> HL&PD maintained that the OCLD is more appropriate to use in setting rates and determining allowed rates of return because OCLD provides the historic value of the investment as it is found in the rate base of a utility, but not a proper method of valuation for a sale of the utility at fair value.

In *Stow*, the Department determined that it was in the “public interest” to consider how municipal utilities are valued outside of the rate making process, including mergers and acquisitions, eminent domain and tax assessment cases, all of which include elements of RCNLD. Therefore, the Department found that RCNLD must be taken into account to reflect the fair value of the property and held the valuation of the utility in *Stow* to be based on 50 percent of SMED’s calculation of OCLD and 50 percent of HL&P’s calculation of RCNLD.<sup>32</sup> The Department’s rationale in *Stow* highlights the shift in the Department’s valuation of utilities from OCLD to RCNLD and acknowledges that the policy for valuing of utilities during a merger or acquisition has changed to allow for valuation well above book value.<sup>33</sup>

Finally, given that the language of the charter (*e.g.*, the compensation to be paid . . . whose award, when accepted by said court, shall be binding upon the parties), the acquisition could be viewed as analogous to a taking by eminent domain.<sup>34</sup> In eminent domain cases, the general measure of damages is the fair market value of the property at the time of the taking.<sup>35</sup> When the property to be taken is a “special property” (*e.g.*, utilities, which are not frequently bought or sold and are used for a special or unusual

---

<sup>31</sup> *Id.* at 53-54.

<sup>32</sup> *Id.* at 66.

<sup>33</sup> *Id.* at 64 citing DPU 93-167-A (Department allowed recovery of acquisition premiums for utilities).

<sup>34</sup> In *Cohasset*, the Court distinguished the Cohasset Water Charter (which is similar to the Milford Water Charter) from a traditional takings, noting that although analogous, the charter gives the town the right to vote to purchase rather than a taking. *See Cohasset* at 144-145.

<sup>35</sup> *Commonwealth v. Massachusetts Turnpike Authority*, 352 Mass. 143, 147 (1967).



**CONFIDENTIAL ATTORNEY/CLIENT COMMUNICATION**

purpose or property taken by eminent domain), the accepted way to determine fair value is RCLND.<sup>36</sup>

1. *How would the Department likely value the Milford Water Company?*

We suggest that the Department would first be guided by the underlying purpose of the legislation. Section 9 of the legislation allows the Town of Milford the "right at any time to purchase the corporate property and all the rights and privileges of said Company at a price which may be agreed upon between the corporation and the Town of Milford" and if the parties cannot agree "the compensation to be paid shall be determined" by the Department. As in *Stow*, the Department would likely view the underlying purpose of the statute to be facilitating the town purchase of the utility at a fair value.<sup>37</sup> The Department is likely to consider whether the legislature deliberately avoided mandating the Company's value based on "actual costs," especially given that the directive was included in charters enacted during the same time period as Milford Water Company's Charter.<sup>38</sup> On the other hand, because the Department usually seeks to preserve its broad discretion to interpret statutory authority, it is more likely that the Department will view the absence of a reference to "actual costs" as not determinative of the valuation method to be used in the Town's acquisition of the Company.

While the Department will also consider the court's reliance on book value as they did in *Southbridge*, *Oxford* and *Stow*, given the silence of the Milford Water Charter, the potential that the purchase could be viewed as analogous to a 'taking', treating the Company's property as 'special property' and with the more recent trends towards use of fair market value to value utilities in various contexts, there is a substantial likelihood that the Department would apply weight to the RCNLD method to account for fair market value. However, as in *Stow*, because the Department is unlikely to be able to provide a rationale for determining a precise mathematical weighting of RCNLD and OCLD, it is

---

<sup>36</sup> *Stow* at 62 citing *Commonwealth v. Massachusetts Turnpike Authority*, 352 Mass. 143, 147 (1967) and *Boston Edison Company v. Board of Assessors of Watertown*, 387 Mass. 298, 301 (1982) (finding public utility property to be considered special purpose property).

<sup>37</sup> *Id.* at 58.

<sup>38</sup> For example, in the *Oxford* decision, the court disallowed an adjustment to reflect the time value of money because it was not referenced in the Charter. The *Oxford* court found that "[t]he Legislature was presumably aware of how to include such language and chose not to. *Oxford* at 18.

**CONFIDENTIAL ATTORNEY/CLIENT COMMUNICATION**

likely that the Department will simply set the valuation at the midpoint of the two values as a just and reasonable value.<sup>39</sup>

---

<sup>39</sup> In Milford's case, given the Company's relatively new treatment facility, the difference between the RCLND (reproduction costs) and the OCLD (original costs) may not be as substantial as cases where the Company assets are substantially older.