

**STATE OF NEW HAMPSHIRE
BEFORE THE
PUBLIC UTILITIES COMMISSION**

**Re: Pennichuck Water Works, Inc. –
American Recovery and Reinvestment Plan of 2009 SRF Financing
For Green Infrastructure
DW 09-**

DIRECT PREFILED TESTIMONY OF THOMAS C. LEONARD

June 9, 2009

1 **Q. What is your name and what is your position with Pennichuck Water Works, Inc.?**

2 **A.** My name is Thomas C. Leonard. I am the Chief Financial Officer of Pennichuck Water
3 Works, Inc. ("PWW" or the "Company"). I have been employed with the Company
4 since June 2008. I am a licensed professional engineer in New Hampshire,
5 Massachusetts, and Maine.

6 **Q. Please describe your educational background.**

7 **A.** I have a Bachelor's degree in Business Administration--Accounting from the University
8 of Wisconsin in Madison, Wisconsin.

9 **Q. Please describe your professional background.**

10 **A.** Prior to joining the Company, I was a Vice President with CRA International from June,
11 2006 to May 2008 and before that a Managing Director with Huron Consulting Group
12 from December 2002 to May 2006. My role at both organizations was to provide expert
13 accounting and financial analysis and testimony in connection with investigations and
14 disputes. Prior to joining Huron, I was the Head of the Audit Division in New England
15 for Arthur Andersen LLP and served as Audit Partner for a wide range of clients
16 including water, gas, and electric utilities.

17 **Q. What are your responsibilities as Chief Financial Office of the Company?**

18 **A.** As Chief Financial Officer of the Company I am responsible for the overall financial
19 management of the Company including financing, accounting and budgeting. My
20 responsibilities including issuance and repayment of debt, issuance of common or other
21 forms of equity as well as quarterly and annual financial reporting. I work with the
22 President of PWW to determine the lowest cost alternatives available to fund the annual
23 capital additions of PWW.

1 **Q. Please provide the Commission with an explanation of the purpose of the financing**
2 **proposed by the Company in its petition in this proceeding (the “Proposed**
3 **Financing”).**

4 **A.** The purpose of the Proposed Financing is to fund the cost of constructing a new booster
5 station in the south end of Nashua, hereinafter referred to as the Armory Booster Station.
6 The testimony of Donald Ware, included with the Company's filing in this case, will
7 provide additional detail regarding the scope and need for the proposed project

8 **Q. Please describe the overall financing plan for the capital improvements.**

9 **A.** The estimated cost of the constructing the Armory Booster Station is \$300,000.
10 Substantially all the funding is anticipated to be provided by the proceeds of the Proposed
11 Financing. In the event that the loan amount authorized by Department of Environmental
12 Services (“DES”) is not sufficient to fund completely the cost of constructing the Armory
13 Booster Station, the balance, if any, will be funded from a mix of PWW’s internal cash
14 flow from operations and/or advances to PWW from Pennichuck Corporation’s short-
15 term line of credit with Bank of America. The borrowing for which PWW is seeking
16 approval in this docket is for up to \$300,000 to be provided from the State of New
17 Hampshire Drinking Water State Revolving Loan Fund (“SRF”) through the American
18 Recovery and Reinvestment Act of 2009 (ARRA) for “Green” projects. The low-cost
19 funds from the SRF will lower the overall cost of the financing needed to complete the
20 construction of the Armory Booster Station. The State Department of Environmental
21 Services (“DES”), which is administering the ARRP funds through the SRF, has included
22 the Armory Booster Station project on the State’s 2009 ARRA Drinking Water State

1 Revolving Loan Priority List for Green Infrastructure projects, a copy of which is
2 attached as Schedule TCL-1.

3 **Q. What are the terms of the proposed ARRA SRF financing?**

4 **A.** As the Commission is aware, the SRF provides public and private water systems the
5 opportunity to borrow funds at below-market interest rates to fund the construction of
6 qualified projects. The terms of the ARRA SRF loans require repayment of 50% of the
7 loan principal over a twenty-year period, with the remaining 50% of the loan principal
8 being forgiven over the same twenty-year period. Interest at an expected rate not to
9 exceed 4.208% will be applied to 50% of the loan and 50% of the loan will carry a 0%
10 interest rate. Six months after the project is substantially complete, monthly payments
11 will consist of principal payments of approximately \$625 representing 50% of 1/240th of
12 the total amount borrowed, plus interest. Amounts advanced to PWW during
13 construction will accrue interest at a rate of 1%, and the total accrued interest will be due
14 upon substantial completion of the project. Copies of the loan documents will be
15 submitted to the Commission once they have been finalized and executed.

16 **Q. What are the estimated issuance costs for these loans?**

17 **A.** The anticipated issuance costs for these loans total \$7,500, and relate primarily to legal
18 costs which will be incurred to (i) review and revise the necessary loan documentation
19 prepared by the State and (ii) obtain Commission approval of the loans. The issuance
20 costs will be amortized over the twenty-year life of the SRF loans. The annual
21 amortization expense of approximately \$375 associated with the issuance costs has not
22 been considered in Schedules TLC-2 through 4 due to its immateriality with respect to
23 the overall analysis and impact of this proposed financing.

1 **Q. Please explain Schedule TCL-2, entitled “Actual and Pro Forma Balance Sheet at**
2 **December 31, 2008”.**

3 **A.** Schedule TCL-2 presents the actual financial position of PWW as of December 31, 2008
4 and the pro forma financial position reflecting certain adjustments pertaining to the
5 Proposed Financing.

6 **Q. Please explain the pro forma adjustments on Schedule TCL-2.**

7 **A.** Schedule TCL-2 contains two pro forma adjustments. The first adjustment for \$300,000
8 reflects the increase in PWW’s Plant in Service for the construction project and the
9 related funding sources. The second adjustment reflects the after-tax effect on retained
10 earnings for the annual interest expense accrued during the first year, with a
11 corresponding credit to accrued expenses payable.

12 **Q. Mr. Leonard, please explain Schedule TCL-3 entitled “Actual and Pro Forma**
13 **Income Statement for the Twelve Months Ended December 31, 2008”.**

14 **A.** Schedule TCL-3 presents the pro forma impact of this financing on PWW’s income
15 statement for the twelve month period ended December 31, 2008.

16 **Q. Please explain the pro forma adjustments on Schedule TCL-3.**

17 **A.** Schedule TCL-3 contains two adjustments. Adjustment one is to record the estimated
18 first year’s interest cost related to the new funding sources. The second adjustment is to
19 record the after-tax effect of the additional pro forma interest expense using an effective
20 combined federal and state income tax rate of 39.6%.

21 **Q. Please explain Schedule TCL-4 entitled “Actual and Pro Forma Statement of**
22 **Capitalization at December 31, 2008.”**

1 A. Schedule TCL-4 illustrates PWW's actual total capitalization, as of December 31, 2008,
2 which is comprised of common equity, funded debt and net inter-company advances.

3 **Q. Please explain the pro forma adjustments on Schedule TCL-4.**

4 A. Schedule TCL-4 contains two pro forma adjustments. The first pro forma adjustment
5 reflects the after-tax decrease to retained earnings for the additional pro forma interest
6 expense related to the new funding sources, while the second adjustment reflects the
7 funding sources for the project.

8 **Q. Mr. Leonard, are there any covenants or restrictions contained in PWW's other**
9 **bond and note agreements in which compliance would be impacted by the issuance**
10 **of debt under this proposed financing?**

11 A. Yes. PWW's existing agreements contain three covenants governing the issuance of new
12 PWW debt. These covenants specify minimum interest coverage ratios and maximum
13 amounts of debt in relation to net plant and to total capitalization. PWW's actual ratios,
14 pro formed for the SRF loans contemplated herein, are comfortably within these
15 covenants.

16 **Q. Has PWW's Board of Directors formally voted to authorize the Proposed**
17 **Financing?**

18 A. Yes. The Board of Directors has executed an action by consent approving the
19 borrowing, which is evidenced by the Secretary's Certificate provided to the Commission
20 with the filing of this testimony as Schedule TCL-5.

21 **Q. Do you believe that the Proposed Financing is in the public interest?**

22 A. Yes, I do. The project being financed will enable PWW to provide safe, adequate, and
23 reliable water service to PWW's customers while saving over \$15,000 in electrical costs

1 per year. For the reasons described in Mr. Ware's direct testimony, the Armory Booster
2 Station project will provide the most cost-effective solution to providing water service to
3 the south end of the DW Highway in Nashua. The terms of the financing through the
4 ARRA SRF are extremely favorable, and will result in lower financing costs than would
5 be available through all other current debt financing options including tax-exempt bonds
6 issued through the New Hampshire Business Finance Authority. Therefore, the
7 combination of reduced electrical expenses and low-cost financing will allow PWW to
8 provide the public with improved water service in a cost-efficient manner.

9 **Q. Is there anything else that you wish to add, Mr. Leonard?**

10 **A.** Yes. I respectfully ask the Commission to issue an Order in this docket as soon as
11 reasonably possible because the DES needs PWW to be authorized to enter into the loan
12 agreement associated with the ARRA SRF funds by the end of June 2009 in order to meet
13 the goals for the use of these funds as established by the federal legislation authorizing
14 these funds.

15 **Q. Mr. Leonard, does this conclude your testimony?**

16 **A.** Yes it does.
17
18

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[illegible]

Pennichuck Water Works, Inc.
Actual and Pro Forma Balance Sheet as of December 31, 2008
Unaudited
Reflecting the Issuance of \$300,000 ARRA Loan

	<u>Actual</u> <u>December 31, 2008</u>	<u>Pro Forma</u> <u>Adjustments</u>	<u>Pro Forma</u> <u>December 31, 2008</u>
Assets			
Plant in Service	\$ 143,364,838	\$ 300,000 ¹	\$ 143,664,838
Less: Accumulated Depreciation	(30,558,698)	-	(30,558,698)
Net Plant	112,806,140	300,000	113,106,140
CWIP	6,711,159	-	6,711,159
Total Net Utility Plant	119,517,299	300,000	119,817,299
Current Assets	16,084,180	-	16,084,180
Other Assets and Deferred Charges	11,196,394	-	11,196,394
Total Assets	<u>\$ 146,797,873</u>	<u>\$ 300,000</u>	<u>\$ 147,097,873</u>
Equity and Liabilities			
Common Equity	\$ 42,159,767	\$ -	\$ 42,159,767
Current Portion of Long Term Debt	660,478	-	660,478
Other Current Liabilities	3,307,016	-	3,307,016
Long-Term Debt	55,874,504	300,000 ¹	56,174,504
Other Liabilities and Deferred Credits	44,796,108	-	44,796,108
Total Equity and Liabilities	<u>\$ 146,797,873</u>	<u>\$ 300,000</u>	<u>\$ 147,097,873</u>

Notes:

1 - To record the issuance of a \$300,000 ARRA loan to fund the Armory St. booster station.

Pennichuck Water Works, Inc.
Actual and Pro Forma Income Statement for the Twelve Months Ended December 31, 2008
Unaudited
Reflecting the Issuance of \$300,000 ARRA Loan

	<u>Actual</u> <u>December 31, 2008</u>	<u>Pro Forma</u> <u>Adjustments</u>	<u>Pro Forma</u> <u>December 31, 2008</u>
Operating Revenues	\$ 22,097,323	\$ -	\$ 22,097,323
O&M Expenses	10,354,295	(15,000) ²	10,339,295
Depreciation & Amortization	3,372,205	11,200 ³	3,383,405
Taxes Other Than Income	2,408,484	6,570 ³	2,415,054
Income Taxes	1,386,011	3,597 ⁴	1,389,608
Total O&M Expenses	<u>17,520,995</u>	<u>6,367</u>	<u>17,527,362</u>
Net Operating Income	<u>4,576,328</u>	<u>(6,367)</u>	<u>4,569,961</u>
AFUDC	<u>417,986</u>	<u>-</u>	<u>417,986</u>
Other income (expense), net	<u>49,072</u>	<u>-</u>	<u>49,072</u>
Interest Income (Expense):			
Funded Debt	(3,219,256)	(6,312) ¹	(3,225,568)
Intercompany Debt	375,557	-	375,557
Total Interest Expense	<u>(2,843,699)</u>	<u>(6,312)</u>	<u>(2,850,011)</u>
Net income	<u>\$ 2,199,687</u>	<u>\$ (12,679)</u>	<u>\$ 2,187,008</u>

Notes:

1 - To record the annual interest (4.208%) on the 50% of the \$300,000 ARRA loan that bears interest (other 50% is interest free).

2 -To record estimated electricity savings from replacing equipment.

3- To record estimated depreciation and property taxes on new equipment.

4 - To record the tax effect (39.6%) resulting from additional interest, depreciation and property tax expenses and reduced electricity cost.

Pennichuck Water Works, Inc.
Actual and Pro Forma Statement of Capitalization as of December 31, 2008
Unaudited
Reflecting the Issuance of \$300,000 ARRA Loan

	Actual		Pro Forma		Pro Forma
	December 31, 2008		Adjustments		December 31, 2008
<u>Common Equity:</u>					
Common Stock	\$ 30,000		\$ -		\$ 30,000
Paid-in Capital	29,306,141		-		29,306,141
Retained Earnings	12,823,626		(12,679) ¹		12,810,947
Total Common Equity	42,159,767	42.7%	(12,679)		42,147,088
					42.6%
<u>Debt:</u>					
Current Portion of Long-Term Debt	660,478				660,478
Long-Term Debt	55,874,504		300,000 ²		56,174,504
Total Debt	56,534,982	57.3%	300,000		56,834,982
					57.4%
Total Capitalization	\$ 98,694,749	100.0%	\$ 287,321		\$ 98,982,070
					100.0%

Notes:

1 - To record the annual interest (4.208%) on the 50% of the \$300,000 ARRA loan that bears interest, and to record the income tax benefit (39.6%) resulting from the additional interest

2 - To record the issuance of a \$300,000 ARRA loan to fund the Armory St. booster project.

PENNICHUCK CORPORATION
PENNICHUCK WATER WORKS, INC.

SECRETARY'S CERTIFICATE

I, Roland E. Olivier, being duly elected Secretary of both PENNICHUCK CORPORATION ("PENNICHUCK") and PENNICHUCK WATER WORKS, INC. ("PWW"), each a corporation organized under the laws of the State of New Hampshire, do hereby certify that the following is a true and correct copy of resolutions duly adopted by the Board of Directors of both PENNICHUCK and PWW by means of an Action by Written Consent in Lieu of a Special Meeting of the Board of Directors effective as of May 28, 2009, and that such resolution is in conformity with the Articles of Incorporation and the By-laws of both PENNICHUCK and PWW (each as amended to date) and has not been rescinded or modified, and is in full force and effect, as of the date hereof:

VOTED: To authorize and approve an agreement between Pennichuck Water Works, Inc. ("PWW") and the State of New Hampshire under the State Revolving Loan Fund ("SRF"), pursuant to which PWW will borrow up to Three Hundred Thousand Dollars (\$300,000) at the current SRF rate of interest (currently less than 4.208%) with 50% of the borrowed principal being forgiven over the life of the loan for the purpose of funding the Armory Booster Station along the D.W. Highway in south Nashua, New Hampshire.

VOTED: That John J. Boisvert, Donald L. Ware and Thomas C. Leonard are, and each of them hereby is, authorized to act as Pennichuck Water Works, Inc.'s representative for purposes of executing and administering the above referenced loan agreement and/or executing any other related documents, certificates, and undertakings on behalf of PWW.

VOTED: To authorize and approve the guaranty by Pennichuck Corporation ("PENNICHUCK") of an agreement between Pennichuck Water Works, Inc. ("PWW") and the State of New Hampshire under the State Revolving Loan Fund ("SRF"), pursuant to which PWW will borrow up to Three Hundred Thousand Dollars (\$300,000) at the current SRF rate of interest (currently less than 4.208%) with 50% of the borrowed principal being forgiven over the life of the loan for the purpose of funding the Armory Booster Station along the D.W. Highway in south Nashua, New Hampshire.

VOTED: That Duane C. Montopoli and Thomas C. Leonard are, and each of them hereby is, authorized to act as Pennichuck Corporation's representative for purposes of executing and administering the above referenced loan guaranty and/or executing any other related documents, certificates, and undertakings on behalf of PENNICHUCK.

IN WITNESS WHEREOF, I have hereunto executed this certificate as of the date set forth below.



Roland Oliver, Secretary

Dated: June 9, 2009