

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

Re: Pennichuck East Utility, Inc.

2011 SRF Financing of Community Water Booster Station and Water Storage Tank

Replacement in the Liberty Tree Water System

DW 11-

DIRECT PRE-FILED TESTIMONY OF THOMAS C. LEONARD

May 18, 2011

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 East
3 Utility, Inc. (“PEU” or the “Company”). I have been employed with the Company since
4 July 2008. I am a licensed Certified Public Accountant in Massachusetts.

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

6 A. I have a Bachelor in Business Administration--Accounting from the University of
7 Wisconsin in Madison, Wisconsin.

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

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

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

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

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 a the cost to replace the existing
5 atmospheric tanks, treatment system and pump house for the Liberty Tree community
6 water system and the installation of an emergency generator, hereinafter referred to as the
7 “Liberty Tree Upgrades”. The testimony of Donald L. Ware, included with the
8 Company's filing in this case provides the detail regarding the scope and need for the
9 proposed project.

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

11 A. The estimated cost to replace the existing atmospheric tank, pump house and treatment
12 system in addition to the installation of an emergency generator is \$602,650. Of that
13 amount, \$400,000 of the required funding for this project is anticipated to be provided by
14 the proceeds of loan funds issued by the New Hampshire Department of Environmental
15 Services (“NHDES”) through the State Revolving Loan Fund (the “Proposed
16 Financing”). The remainder of the project cost will be funded from a mix of PEU’s
17 internal cash flow from operations and/or advances to PEU from Pennichuck
18 Corporation’s short term line of credit with the Bank of America. PEU is seeking
19 approval in this docket is for borrowing up to \$400,000 from the State of New
20 Hampshire Drinking Water State Revolving Loan Fund (“SRF”). The actual borrowing
21 amount will be based on the actual costs of construction that the Company incurs. The
22 use of the low cost funds from the SRF will lower the overall cost of the financing
23 needed to complete the construction of the Liberty Tree Upgrades.

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

2 A. As the Commission is aware, the SRF provides public and private water systems the
3 opportunity to borrow funds at below-market interest rates to fund the construction of
4 qualified projects. Amounts advanced to PWW during construction will accrue interest
5 at a rate of 1%, and the total accrued interest will be due upon substantial completion of
6 the project. The terms of the SRF loans require repayment of the loan principal plus
7 interest over a twenty-year period commencing six months after the project is
8 substantially complete. The current interest rate on SRF borrowings is 2.864% although
9 the actual rate will be based on the current rates available at the time the loan is actually
10 closed. Copies of the loan documents will be submitted to the Commission once they
11 have been finalized and executed. The loan is projected to come with 35% principal
12 forgiveness based on the current water rates and Median Family Income for the Liberty
13 Tree Water System.

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

15 A. The anticipated issuance costs total \$7,500, and relate primarily to legal costs which will
16 be incurred to (i) review and revise the necessary loan documentation prepared by the
17 State and (ii) obtain Commission approval of the loans. The issuance costs will be
18 amortized over the twenty-year life of the SRF loans. The annual amortization expense
19 of approximately \$375 associated with the issuance costs has not been considered in
20 Schedules TLC-1 through 3 due to its immateriality with respect to the overall analysis
21 and impact of this proposed financing.

22 **Q. Please explain Schedule TCL-1, entitled “Actual and Pro Forma Balance Sheet at**
23 **December 31, 2010”.**

1 A. Schedule TCL-1 presents the actual financial position of PEU as of December 31, 2010
2 and the pro forma financial position reflecting certain adjustments pertaining to the
3 Proposed Financing.

4 **Q. Please explain the pro forma adjustments on Schedule TCL-1.**

5 A. Schedule TCL-1 contains three pro forma adjustments. The first adjustment for \$602,650
6 reflects the increase in PEU's Plant in Service for the construction project and the related
7 funding sources. The second adjustment reflects the increase in accumulated
8 depreciation associated with the depreciation expense on the Liberty Tree Upgrades
9 during the first year. The third adjustment reflects the after-tax effect on retained
10 earnings for the annual interest and property tax expense accrued during the first year, net
11 of income tax expense, with a corresponding credit to accrued expenses payable.

12 **Q. Mr. Leonard, please explain Schedule TCL-2 entitled "Actual and Pro Forma**
13 **Income Statement for the Twelve Months Ended December 31, 2010".**

14 A. Schedule TCL-2 presents the pro forma impact of this financing on PWV's income
15 statement for the twelve month period ended December 31, 2010.

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

17 A. Schedule TCL-2 contains three adjustments. Adjustment one is to record the estimated
18 first year's interest cost related to the new funding sources. Adjustment two is to record
19 the estimated depreciation & property taxes on the new assets. The third adjustment is to
20 record the after-tax effect of the additional pro forma expenses (interest, property tax and
21 depreciation expense) resulting from the adjustments discussed above using an effective
22 combined federal and state income tax rate of 39.6%.

1 **Q. Please explain Schedule TCL-3 entitled “Actual and Pro Forma Statement of**
2 **Capitalization at December 31, 2010.”**

3 A. Schedule TCL-3 illustrates PEU’s actual total capitalization, as of December 31, 2010,
4 which is comprised of common equity, funded debt and net inter-company advances.

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

6 A. Schedule TCL-3 contains three adjustments. The first pro forma adjustment reflects the
7 after-tax decrease to retained earnings for the additional pro forma expenses related to the
8 new funding sources. The second and third adjustments reflect the funding sources (SRF
9 and internal) for the project.

10 **Q. Mr. Leonard, are there any covenants or restrictions contained in PEU’s other bond**
11 **and note agreements which would be impacted by the issuance of debt under this**
12 **proposed financing?**

13 A. Yes. PEU’s existing agreement with CoBank contains two covenants governing the
14 issuance of new PEU debt. These covenants specify minimum interest coverage ratio and
15 maximum amounts of debt in relation to total capitalization. PEU’s actual ratios, pro
16 formed for the SRF loans contemplated herein, are comfortably within these covenants.

17 **Q. Has PEU’s Board of Directors formally voted to authorize the Proposed Financing?**

18 A. Yes. A Resolution authorizing the subject financing has been circulated among the
19 Board of Directors for an authorization by consent. Once obtained, evidence of the
20 required resolution will be provided as soon as possible for the NHPUC’s records.

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 PEU to continue to provide safe,
23 adequate and reliable water service to PEU’s customers. For the reasons described in Mr.

1 Ware's direct testimony the Liberty Tree Upgrades project will provide the most cost
2 effective solution toward correcting the aging infrastructure of the Liberty Tree system
3 along with the addition of emergency back up power. The terms of the financing through
4 SRF are very favorable, and will result in lower financing costs than would be available
5 through all other current debt financing options including tax-exempt bonds issued
6 through the New Hampshire Business Finance Authority.

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

8 A. Yes. I respectfully ask the Commission to issue an Order in this docket as soon as
9 reasonably possible since the NHDES needs PEU to be authorized to enter into the loan
10 agreement associated with the SRF funds by the end of July 2011 in order to meet the
11 NHDES goal of disbursing the majority of its 2010 DWSRF funds by the end of 2011.

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

13 A. Yes it does.
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