

STATE OF NEW HAMPSHIRE
BEFORE THE
NEW HAMPSHIRE PUBLIC UTILITIES COMMISSION

PENNICHUCK WATER WORKS, INC.

DOCKET NO. DW 13-130

NOTICE OF INTENT TO FILE RATE SCHEDULES

PRE-FILED DIRECT TESTIMONY

OF

JOHN L. PATERNAUDE

MAY 2013

1 **Introduction and Purpose of Testimony**

2 **Q. Please state your full name and business address.**

3 A. My name is John L. Patenaude. My business address is Pennichuck Corporation,
4 25 Manchester Street, Merrimack, New Hampshire 03054.

5 **Q. How are you currently employed?**

6 A. I am currently the Chief Executive Officer of Pennichuck Corporation (Pennichuck)
7 and the Chief Executive Officer and President of Pennichuck Water Works, Inc.
8 (Company). I have served in this capacity since January 27, 2012.

9 **Q. Please explain your work experience and educational background.**

10 A. From June 2010 to January 2012, I served as an advisor to the City of Nashua, New
11 Hampshire (City) as the Transaction Executive, with respect to the merger transaction
12 between the City of Nashua and Pennichuck Corporation. Prior to serving the City of
13 Nashua, I worked in several financial positions for various corporations. Until
14 September of 2009, I served as the Vice President-Finance, Chief Financial Officer and
15 Treasurer of Nashua Corporation. Prior to that position, other positions held at Nashua
16 Corporation included Assistant Treasurer and Director of Taxes. Prior to joining
17 Nashua Corporation in 1991, I worked in various financial capacities for various
18 companies. These companies included Coopers & Lybrand, Ausimont, N.V., Sanders
19 Associates Inc. and John Hancock Mutual Life Insurance Company.

20 I received a B.S. degree in Accounting from Boston College and a Masters in Taxation
21 from Bentley College.

22 **Q. What are your responsibilities as the Chief Executive Officer of Pennichuck?**

23 A. As the Chief Executive Officer, I am responsible for overall management of the
24 corporation and I report to the Board of Directors. I work with the Chief Operating

25 Officer, the Chief Financial Officer, the Director of Human Resources, and the Director
26 of Information Technology to implement short and long term strategies, insure funding
27 of debt and minimize water rate increases.

28 **Q. What is the purpose of your testimony?**

29 A. The purpose of my testimony is to provide information relative to the Pennichuck
30 Corporation merger, corporate governance after the transaction, the cost of the
31 transaction, the interest rate on the City Acquisition Bonds and, compliance with the
32 terms of the Settlement Agreement approved by the Public Utilities Commission in
33 Docket No. DW 11-026 (Settlement Agreement).

34 **Q. Would you please identify the other witnesses in this case?**

35 A. In addition to my testimony, the following witnesses will provide testimony. Donald
36 Ware, the Chief Operating Officer, will provide testimony as to operations. Larry
37 Goodhue, the Chief Financial Officer, Controller and Treasurer, will provide testimony
38 relative to finances. John Boisvert, the Chief Engineer, will provide information
39 regarding capital expenditures.

40 **The Merger Transaction**

41 **Q. When was the merger transaction completed?**

42 A. The merger transaction was completed on January 25, 2012, when the City of Nashua
43 acquired the shares of Pennichuck Corporation.

44 **Q. The Settlement Agreement estimated the "Acquisition Cost" to be \$152,099,885.**

45 **What was the actual acquisition cost?**

46 A. The actual acquisition cost was \$150,570,000. A comparison of the estimated cost
47 compared to the actual cost by category is attached as Exhibit JLP-1. Mr. Goodhue will
48 discuss the major differences in his testimony.

49 Q. **A condition of the merger approval was that the true interest cost of the City**
50 **Acquisition Bonds would not exceed 6.50 percent per annum. What is the true**
51 **interest cost?**

52 A. The true interest cost on the City Acquisition Bonds is 4.09 percent per annum as
53 shown in Exhibit JLP-4.

54 Q. **Can you provide an update as to the governance of Pennichuck after the merger?**

55 A. After the acquisition, the Pennichuck Board of Directors was reconstituted with 10 new
56 members appointed by the Sole Shareholder, the City of Nashua. There were six
57 members from Nashua, including the Mayor; one member from Londonderry; one
58 member from North Conway; one member from Windham; and, one member from
59 Amherst. These individuals also serve as members of the boards of directors of
60 Pennichuck's utility subsidiaries.

61 As agreed to in the Settlement Agreement, the By-Laws of Pennichuck Corporation
62 require that one member of the Pennichuck Corporation Board of Directors be
63 nominated by the Merrimack Valley Regional Water District. The District has
64 nominated a member who is currently being considered by the Board of Directors. If
65 approved, the Pennichuck Board of Directors will recommend the nominee to the Sole
66 Shareholder for approval.

67 While the Pennichuck Board members are from different locations, they have a
68 fiduciary responsibility to care for the finances and legal requirements of the

69 corporation. They must act in good faith and with a reasonable degree of care. The
70 interests of the corporation must take precedence over personal interests of individual
71 Board members.

72 **Q. Has the change in ownership as a result of the acquisition impacted customers and**
73 **operations?**

74 A. The change in ownership at the Pennichuck Corporation level has been transparent to
75 both customers and operations. Management changes at the senior executive level have
76 not affected customer services or operations. Mr. Ware will address this issue in more
77 detail.

78 **Rate Case**

79 **Q. Why is the Company filing a rate case at this time?**

80 A. The Settlement Agreement requires the regulated companies owned by Pennichuck
81 Corporation to file full rate cases simultaneously by no later than June 1, 2013.

82 **Q. Please discuss the ratemaking structure utilized in this filing.**

83 A. The rate making structure utilized in this filing is set forth in the Settlement Agreement.
84 There are two elements to the structure. The first element provides for recovery of the
85 City Bond Fixed Revenue Requirement ("CBFRR"). The second element is akin to
86 traditional ratemaking and provides for recovery of operating expenses and equity. Mr.
87 Goodhue and Mr. Ware will provide more detailed information relative to the structure.

88 **Q. How was the CBFRR amount determined?**

89 A. The CBFRR amount was determined in accordance with the Settlement Agreement.
90 Under the approved formula, the CBFRR amount is based on the pro-rata share of the
91 City's Acquisition Debt obligation, which is calculated based on the Company's

92 percentage share to the total share of the three regulated utilities. Mr. Goodhue will
93 provide more detail as to the computation of the CBFRR amount in his testimony.

94 **Q. How was the Company's allowable rate of return determined?**

95 A. The Company utilized the formula agreed to in the Settlement Agreement. The formula
96 applies a cost of equity based on the average of interest rates on 30-year Treasury bonds
97 for the most recent 12 months plus 3.0 percentage points. Mr. Goodhue will provide
98 more detail in his testimony.

99 **Q. In your testimony in DW 11-026, you testified that the savings related to the
100 acquisition of Pennichuck Corporation by the City of Nashua would result in
101 operational savings of \$1.7 million. Were the savings achieved?**

102 A. Yes. As described in Mr. Goodhue's testimony, the anticipated savings of \$1.7 million
103 were achieved by reducing public company costs in Pennichuck Corporation and
104 eliminating certain executive management positions in Pennichuck Water Works, Inc.

105 **Compliance with Settlement Agreement**

106 **Q. The Settlement Agreement provided for the establishment of a rate stabilization
107 fund by Pennichuck Water Works. Has the fund been established?**

108 A. Yes. The City Acquisition Debt included \$5 million for the establishment of a rate
109 stabilization fund by Pennichuck Water Works, Inc. The \$5 million was contributed by
110 Pennichuck Corporation to Pennichuck Water Works, Inc. upon completion of the
111 acquisition. The PWW Rate Stabilization fund has been maintained in accordance with
112 the procedures set forth in the Settlement Agreement in DW 11-026. Mr. Goodhue will
113 discuss the rate stabilization fund in more detail in his testimony.

114 **Q. Has the MARA been recorded on the Company books and how was the MARA**
115 **treated for ratemaking purposes?**

116 A. As agreed to in the Settlement Agreement, the MARA was computed and recorded on
117 the books at the time of the City's acquisition of Pennichuck. The MARA was
118 removed from the traditional ratemaking process because it is only recoverable as part
119 of the CBFRR.

120 **Q. Did the Company declare and provide dividends or distributions to its parent,**
121 **Pennichuck Corporation?**

122 A. Yes. The Commission approved the payment of dividend and distributions from paid in
123 capital to the parent corporation, Pennichuck Corporation, for the purpose of enabling
124 the City to satisfy the City's obligations for the City Acquisition Bonds. On February
125 28, 2013, Pennichuck Water Works, Inc. recorded the following to its parent
126 Pennichuck Corporation: (1) a dividend in the amount of \$3,246,477 (from retained
127 earnings) and (2) a distribution from paid in capital of \$3,587,567, which reflected the
128 Company's share of the funding of the City Acquisition Debt for 2012.

129 **Q. Did the Company make any payments to the City in 2012 for its Eminent Domain**
130 **costs?**

131 A. The Company did not make any payments to the City in 2012 pursuant to Paragraph
132 III. D. 4. of the Settlement Agreement. As part of the discovery process in the rate
133 cases, it may be advisable for the parties to discuss the mechanism by which the
134 Commission will audit the final Eminent Domain Amount.

135
136 **Temporary Rates**

137 **Q. Will the Company be seeking a temporary rate increase?**

138 A. Under the terms of the Settlement Agreement, the Company is required to seek
139 temporary rates in accordance with RSA 378:27. For PWW, the Company is requesting
140 that current rates be made temporary as pointed out in Mr. Ware's testimony.

141 **Communications**

142 Q. Please describe Pennichuck's efforts to communicate with the City of Nashua,
143 other affected communities, and customers relative to the rate filing?

144 A. We have been communicating with Nashua and other communities with customers
145 relative to rate information and the rate case process for some time. These constituents
146 have been notified of the filing of the Notices of Intent to File Rate Schedules and the
147 estimated rate increase. We will continue to keep them informed as the rate cases
148 proceed. We have indicated to the communities that our staff is available to meet with
149 each community as it desires. Customers will also be informed directly in accordance
150 with Puc 1203.02.

151 **Conclusion**

152 Q. How do the rates requested compare to the rates that would have been required
153 had Pennichuck Corporation remained a publicly traded company?

154 A. The requested increase in rates is 0.12% (less than 1%). Under the prior ownership
155 structure, the requested increase would have approximated 9.1% as shown in Exhibit
156 JLP-2. The higher rate increase assumes that the public company cost savings and the
157 savings associated with the management restructuring were not achieved. The higher
158 rate also assumes an overall rate of return of 7.86% on a capital structure with greater
159 equity. The annual impact on the average single family customer would have been
160 approximately \$53.00, instead of the approximately \$1.00 requested in the filing as

161 shown in Exhibit JLP-3. I believe these results demonstrate the sound judgment of the
162 City of Nashua in pursuing the acquisition of Pennichuck Corporation.

163 Q. Does this complete your testimony?

164 A. Yes.