

STATE OF NEW HAMPSHIRE
BEFORE THE
PUBLIC UTILITIES COMMISSION

ORIGINAL	
N.H.P.U.C. Case No.	DW 14-130
Exhibit No.	# 4
Witness	Pana #
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DW 14-130

Petition of Pennichuck Water Works, Inc. for Approval of Financing Transactions

SETTLEMENT AGREEMENT

This Settlement Agreement is entered into this 19th day of September, 2014 (the "Agreement"), by and among the Pennichuck Water Works, Inc. ("PWW"), the Staff of the New Hampshire Public Utilities Commission ("Staff"), and the Office of the Consumer Advocate ("OCA") (PWW, Staff and OCA collectively are referred to as the "Settling Parties") with the intent of resolving issues in the above-captioned docket.

I. PROCEDURAL HISTORY

A. On May 16, 2014, PWW filed a Petition of Pennichuck Water Works, Inc. for Approval of Financing Transactions (the "Petition"), seeking approval and authority under RSA 369:1-4 to issue up to \$54,500,000 in aggregate principal amount of tax-exempt and taxable bonds and financing for the purpose of: (1) providing long-term financing for capital projects completed by PWW in 2013 that were funded through short-term borrowings in the amount of approximately \$5,100,000; (2) funding of capital projects to be completed in 2014, 2015 and 2016 in the amount of approximately \$19,500,000; (3) refinancing approximately \$23,375,000 of PWW's currently outstanding tax-exempt bonds; and (4) funding, if necessary and appropriate, a

debt service reserve fund or other credit enhancement measure as may be determined by PWW in response to prevailing market conditions, in the approximate amount of \$5,400,000, and costs of issuance in the approximate amount of \$1,125,000 (collectively, the “Integrated Capital Finance Plan”). PWW filed direct testimony of Larry D. Goodhue on May 16, 2014 with its Petition. The Commission established Docket No. DW 14-130 to consider the Petition.

- B. The Commission issued an Order of Notice dated May 27, 2014.
- C. A Prehearing Conference was held on June 11, 2014 pursuant to N.H. Code Admin. Rules Puc 203.15. The Settling Parties held a technical session following the Prehearing Conference.
- D. On June 13, 2014, the Commission issued a Procedural Schedule.
- E. OCA filed its first set of data requests on June 20, 2014.
- F. Staff filed its first set of data requests on June 24, 2014.
- G. PWW filed responses to the data requests of Staff and OCA on July 2, 2014.
- H. PWW filed Supplemental Testimony of Larry D. Goodhue on July 18, 2014.
- I. The Settling Parties held a technical session on July 25, 2014.
- J. OCA filed its second set of data requests on August 4, 2014.
- K. Staff filed its second set of data requests on August 4, 2014.
- L. PWW filed responses to the second set of data requests of Staff and OCA on August 15, 2014.
- M. The Settling Parties held a technical session and settlement conference on September 4, 2014.

II. BACKGROUND

A. Subject of this Agreement. The Settling Parties seek the Commission's approval of the proposed financings described in the Petition filed on May 16, 2014, subject to the terms and conditions of this Agreement.

The proposed financings are an important step in the restructuring of the capitalization of PWW to transition from ownership by a publicly traded, investor-owned corporation to ownership by the City of Nashua ("Nashua"). The acquisition of PWW's parent company, Pennichuck Corporation ("Pennichuck") by Nashua resulted in the elimination of traditional common equity from PWW's capital structure for ratemaking purposes (although PWW continues to have common equity for financial reporting purposes). While ultimately financing a utility entirely with debt is expected to lower PWW's revenue requirements and, hence, save customers money during normal economic and financial conditions, it has the potential to create additional risk for PWW and its customers during adverse economic conditions or other significant financial challenges.

PWW's current outstanding debt is less than optimal under PWW's new ownership structure. As explained more fully below, PWW's current outstanding debt contains covenants and balloon payments that were established when PWW was owned by an investor-owned parent corporation that had invested, and would continue to invest, common equity in PWW. With the removal of most common equity from PWW's capital structure for ratemaking purposes, and ultimate ownership by Nashua which does not intend to invest additional equity in PWW at this time, the Settling Parties agree that it is in the public interest to restructure PWW's debt financing and put in place debt covenants that reflect PWW's new ownership structure.

As PWW and Nashua continue their relationship, and as PWW continues to have a need to raise capital in the future, the Settling Parties expect that additional steps will be taken to better align PWW's financial plan with its new ownership structure. That is, the Settling Parties expect to continue their constructive dialogue over the coming years, as PWW continues to evaluate the risks and financing options that best meet the needs of the utility, its municipal owner and the public that it serves. While it is premature for the Settling Parties to evaluate future options for PWW's financial structure, they have agreed that the new and restructured debt PWW has proposed in this proceeding is a reasonable and important step in the process of financing PWW in a manner that is consistent with the interests of Nashua, PWW, PWW's customers, and the public at large.

B. Background on PWW's Unique Ownership Structure.

1. On January 25, 2012, the City of Nashua, New Hampshire (the "City") acquired all of the outstanding shares of Pennichuck Corporation ("Pennichuck") pursuant to a Merger Agreement. Upon completion of this acquisition, the City became the sole shareholder of Pennichuck, which continued to own all of the outstanding shares of Pennichuck's regulated water utilities PWW, Pennichuck East Utility, Inc. ("PEU") and Pittsfield Aqueduct Company, Inc. ("PAC"), as well as the other two subsidiaries owned by Pennichuck.

2. The City's acquisition of Pennichuck and, indirectly, Pennichuck's subsidiaries, including its public utilities PWW, PEU and PAC, occurred pursuant to approvals of the Commission issued in Order No. 25,292 in DW 11-026. This Order approved the acquisition and a Settlement Agreement of the parties to DW 11-026, dated October 18, 2011 (the "Acquisition Settlement Agreement"). Among other things, this Order and the Acquisition

Settlement Agreement required the approval of a special ratemaking structure (the “Ratemaking Structure”).

3. Order No. 25,292 and the Acquisition Settlement Agreement required PWW, PEU, and PAC each to file their first full rate case simultaneously no later than June 1, 2013. PWW, PEU and PAC each made their rate case filings with the Commission on May 31, 2013. On May 14, 2014, PWW, the Office of Consumer Advocate and the Staff of the Commission filed a Settlement Agreement with the Commission, providing for, among other things, a 0.0% change in PWW’s permanent rates and requesting approval of certain clarifications to the Ratemaking Structure. On July 15, 2014, the Commission issued Order No. 25,693, approving the Settlement Agreement and the permanent rates and clarifications described therein.

III. TERMS OF THIS SETTLEMENT AGREEMENT

The Settling Parties agree and recommend action by the Commission as follows:

A. Summary of PWW’s Financing Requests. Table I below summarizes the intended financings requested pursuant to PWW’s Petition in this matter. As described in the Petition and in the original and supplemental testimony of Mr. Goodhue in this case, pursuant to PWW’s Integrated Capital Finance Plan, PWW seeks to issue: (1) **up to \$5.1 million** in taxable indebtedness, issued either as taxable bonds or through a borrowing under a credit facility, for the purpose of providing long-term financing for capital projects undertaken by PWW during 2013 and January of 2014 that were funded with short-term borrowings (the “Taxable 2013 Financing”); (2) **up to \$19.5 million** in tax-exempt bonds for the purpose of financing PWW capital projects undertaken between February 2014 and December 2016 (the “Capital Project

Bonds"); (3) **up to \$23.375 million** in tax-exempt bonds for the purpose of refinancing currently outstanding PWW debt (the "Refinance Bonds"); (4) **up to \$5.4 million** in tax-exempt bonds for the purpose of financing the costs of possible credit enhancement options, including a debt service reserve fund and/or the cost of bond insurance if such credit enhancements are ultimately determined by PWW to be necessary to accomplish the proposed financings on a cost effective basis; and (5) **up to \$1.125 million** in taxable and tax-exempt borrowings for the purpose of financing the issuance costs required to accomplish the proposed financings.

As shown in Table I, the total borrowing authority requested by PWW in this proceeding is accordingly **up to \$54.5 million** in aggregate principal amount of taxable and tax-exempt borrowings. Table I also shows the tentative allocation of the borrowings related to the possible credit enhancements and the issuance costs among the three basic borrowing purposes (taxable borrowing related to 2013/2014 capital projects; tax-exempt bonds related to 2014, 2015 and 2016 capital projects; and tax-exempt bonds related to refinancing certain outstanding PWW debt). Importantly, as noted in more detail below, Table I also indicates PWW's current estimate of actual issuance costs. While the total of these issuance costs exceed the tentative amount of up to \$1.125 million, PWW will seek authority to borrow up to \$1.3 million to fund issuance costs, provided that the total principal amount of all financings shall not exceed \$54.5 million, which is the aggregate authority requested in PWW's Petition.

TABLE I: Summary of PWW Financings					
	2013 Reimbursement Taxable Bonds or Credit Facility (Taxable Debt)	2014, 2015, 2016 Capital Project Bonds (Tax-Exempt Bonds)	2014 Refinancing Bonds (Tax-Exempt Bonds)	Total	Requested Authority in Petition
Net Project Proceeds					
2014 Project Fund (Taxable Proceeds)	5,100,000			5,100,000	5,100,000
2014 Project Fund (Tax-Exempt Proceeds)		5,500,000		5,500,000	5,500,000
2015/2016 Project Fund (Tax-Exempt Proceeds)		14,000,000		14,000,000	14,000,000
Refinancing Bonds			23,375,000	23,375,000	23,375,000
Subtotal Net Project Proceeds	5,100,000	19,500,000	23,375,000	47,975,000	47,975,000
Issuance Costs					
Underwriter's Discount	326,800	249,474		576,274	
Cost of Issuance	175,526	120,574		296,100	
NH BFA Fees	219,000	150,188		369,188	
Subtotal Issuance Costs	721,326	520,236		1,241,562 *	1,125,000
Subtotal of All Financings, including Issuance Costs	5,821,326	20,020,236	23,375,000	49,216,562	49,100,000
Credit Enhancement Options					
Bond Insurance	475,340	328,427		803,767	
Debt Service Reserve Fund				4,479,671	
Subtotal Credit Enhancement Options	475,340	328,427		5,283,438 *	5,400,000
Total of All Financings, with Credit Enhancement Options	6,296,666	20,348,663	23,375,000	54,500,000 *	54,500,000
* See Settlement Agreement, Section III, E, 3, (e) in which Petitioner requests authority to issue up to \$1.3 million to finance issuance costs, provided that the total amount of all borrowings does not exceed \$54.5 million.					

B. Certain Financing Flexibility Requested by PWW. As indicated in Table I, and as described in the Petition and testimony of Mr. Goodhue in this case, PWW requests certain flexibility regarding the proposed financings.

1. Taxable Bonds vs. Taxable Credit Facility. PWW requests authority to accomplish the **\$5.1 million** Taxable 2013 Financing through either (a) the issuance of taxable bonds, or (b) the borrowing under a credit facility, the terms and conditions of each option as described more fully in Mr. Goodhue's testimony in this docket. PWW's decision will be consistent with the provision of safe and reliable service at the lowest-reasonable cost to customers.

2. One vs. Two Tranches for the Capital Project Bonds. PWW requests authority to accomplish the **up to \$19.5 million** Capital Project Bonds through either (a) the issuance of the entire amount of such bonds in a single "tranche" at the end of 2014, or (b) the issuance of such bonds in two tranches, one at the end of 2014 and the balance at the end of

2015, as may be determined by PWW based on market conditions prevailing at the end of 2014, as described more fully in Mr. Goodhue's testimony in this docket. PWW's decision will be consistent with the provision of safe and reliable service at the lowest-reasonable cost to customers.

3. Debt Service Reserve Fund and Bond Insurance. PWW requests authority to accomplish the entire proposed Integrated Capital Finance Plan with the ability to either (a) issue an additional **up to \$5.4 million** in bonds and indebtedness to fund a debt service reserve fund and/or the cost of bond insurance that would serve to enhance the creditworthiness of the proposed financing, or (b) to not issue such additional bonds and indebtedness, as may be determined by PWW based on market conditions prevailing at the end of 2014, as described more fully in Mr. Goodhue's testimony in this docket. PWW's decision will be consistent with the provision of safe and reliable service at the lowest-reasonable cost to customers.

4. Alternative Authority for Issuance Costs. The total amount of borrowing authority requested by PWW in this proceeding is **up to \$54.5 million**, taking into account all components of the proposed Integrated Capital Finance Plan, including possible debt service reserve fund, bond insurance costs and issuance costs. As part of its Petition, PWW requested authority to borrow **up to \$1.125 million** to fund anticipated issuance costs related to the proposed Integrated Capital Finance Plan. If PWW is not required to utilize all of the requested total borrowing authority (up to \$54.5 million) because it is able to accomplish the proposed financings without a debt service reserve fund and/or bond insurance as credit enhancements, then PWW requests authority to borrow **up to \$1.3 million** to fund issuance costs related to the

financings. PWW's issuance costs shall be subject to review and audit by the parties and Commission.

C. The Proposed Financings Mitigate Certain "Capital Structure" Risks. The Settling Parties, based on the Petition, Mr. Goodhue's testimony and discovery in this docket, agree that PWW's proposed Integrated Capital Finance Plan is a reasonable and important step in the process of restructuring PWW from an investor-owned utility to a utility owned by a municipality. The Settling Parties agree that this step is in the public interest because, among other reasons, it is designed to help mitigate the following risks of PWW's current capital structure:

1. Interest Rate Risk. By accomplishing the proposed financings at the end of 2014, PWW will reasonably reduce exposure to the possibility that interest rates generally will rise in the future so that, if PWW were to delay its financings, PWW and accordingly its customers would be exposed to paying higher costs. The Settling Parties note that there can be no assurances relating to future interest rates, but that the assumption that it would be appropriate to mitigate this interest rate risk is reasonable, given current market conditions and projections.

2. Refinance/Liquidity Risk. By accomplishing the proposed financings, PWW will reasonably reduce exposure to significant "bullet" or "balloon" repayment requirements under PWW's current indebtedness, thereby reducing the risk that PWW might not be able to satisfy such requirements in the future due to possible adverse market developments. The Settling Parties acknowledge that there can be no assurances relating to future market conditions, but that the assumption that refinancing such "bullet" or "balloon" payment debt at the end of 2014 in a deliberate manner well in advance of the current maturity dates is

reasonable, given current market conditions and projections. In particular, refinancing at this time eliminates future balloon payments of \$7.475 million in 2018, \$1.2 million in 2022, \$1.175 million in 2025, and \$12.125 million in 2035.

3. Covenant Compliance Risk. By accomplishing the proposed financings, PWW will reasonably begin the process of “migrating” the financial covenants of PWW’s capital structure from its current covenant profile, which was installed when PWW was part of a publicly-traded investor-owned utility system, to a profile that is more aligned with PWW’s status as a public utility now ultimately owned by the City of Nashua.

In particular, PWW’s existing debt covenants are based on a financial structure that assumes a significant amount of common equity. PWW’s new financing and ratemaking structure, which relies entirely on debt financing, is expected to benefit PWW’s customers through lower revenue requirements. That structure, however, also carries with it potential risks because it removes the cushion against an economic downturn (or other unexpected financial stress) that common equity provides. In other words, PWW’s financial structure is very different than it was when the existing debt instruments were entered into.

The Settling Parties agree that the financial covenants to be implemented under the proposed financings, as described in testimony in this docket, are better aligned with PWW’s current ownership status than the covenants under the Loan and Trust Agreement establishing the existing debt. The Settling Parties also recognize that while these covenants are reasonable at this time, they are designed to protect bondholders, not ratepayers, in the event of significant financial stress. Consequently, while Staff and OCA agree that PWW may enter into debt instruments containing such covenants, the Settling Parties expressly agree that this Settlement

Agreement (and the Commission's approval of that agreement, if it occurs) is without prejudice to the rights of any party to take any positions in future proceedings regarding PWW's financing plan, capital structure, or the ratemaking effect of the debt instruments and covenants. For clarity and the avoidance of doubt, the Settling Parties expressly agree that the "Rate Covenant" (Article V, Section 503 of the Loan and Trust Agreement submitted to the Commission in this proceeding) is subject to compliance by PWW with any federal or state law, including, New Hampshire laws governing public utilities, and accordingly does not in any way bind the OCA, the Staff or the Commission.

D. Common Impact on All Customers and Communities Served by PWW. The Settling Parties agree that the financings proposed by PWW are designed to impact all customers and communities served by PWW in the same manner, without discrimination in favor or against particular customers or communities.

E. Requested Findings and Approvals. The Settling Parties agree and recommend that the Commission adopt the following findings and order the following approvals:

1. The Commission should find that the issuance of the aggregate indebtedness and securities and other bank borrowings of PWW contemplated by the Petition (the "Indebtedness") is reasonable and that the Indebtedness and resulting capital structure are consistent with the process of restructuring PWW's capitalization as contemplated by the Commission's Order No. 25,292 (approving Nashua's acquisition of Pennichuck), and will enable PWW to continue supplying safe, reliable and affordable water service to PWW's customers.

2. The Commission should find that PWW is authorized to issue the Indebtedness described in this paragraph III.E. upon such terms as may be established by or on behalf of PWW at the time of issuing or effecting such Indebtedness.

(a) The issuance of **up to \$5,100,000** in principal amount of taxable indebtedness for the purpose of funding capital expenditures undertaken by PWW during 2013 and January of 2014, through either of the following two formats, the final format to be selected by PWW at the end of 2014 near the time of issuance, based on market conditions at that time and consistent with the provision of safe and reliable service at the lowest-reasonable cost to customers:

(i) the issuance of taxable revenue bonds by the New Hampshire Business Finance Authority (the "NHBFA") on behalf of PWW, the borrowing by PWW of the proceeds of such issuance, and the issuance by PWW of indebtedness to a trustee pursuant to a Loan and Trust Agreement in substantially the form submitted to the Commission (the "Loan and Trust Agreement"), are consistent with the public good, and the issuance of such taxable revenue bonds in one or more series, the execution of the Loan and Trust Agreement, the borrowing by PWW of the proceeds therefrom, and the issuance by PWW of indebtedness pursuant to the Loan and Trust Agreement, are hereby authorized; or

(ii) the borrowing by PWW from one or more banks under a credit facility, in accordance with terms described in testimony submitted to the Commission, is consistent with the public good, and PWW is authorized to effect such borrowing from such bank or banks pursuant to such credit facility.

(b) The issuance of **up to \$19,500,000** in principal amount of tax-exempt revenue bonds by the NHBFA on behalf of PWW, for the purpose of funding capital expenditures incurred and to be undertaken by PWW during February to December of 2014, and 2015 and 2016, the borrowing by PWW of the proceeds of such issuance, and the issuance by PWW of indebtedness to a trustee pursuant to the Loan and Trust Agreement, are consistent with the public good, and the issuance of such tax-exempt revenue bonds in one or more series, the execution of the Loan and Trust Agreement, the borrowing by PWW of the proceeds therefrom, and the issuance by PWW of indebtedness pursuant to the Loan and Trust Agreement, are hereby authorized;

(c) The issuance of **up to \$23,375,000** in principal amount of tax-exempt revenue bonds by the NHBFA on behalf of PWW, for the purpose of refinancing outstanding indebtedness of PWW, on behalf of PWW, the borrowing by PWW of the proceeds of such issuance, and the issuance by PWW of indebtedness to a trustee pursuant to the Loan and Trust Agreement, are consistent with the public good, and the issuance of such tax-exempt revenue bonds in one or more series, the execution of the Loan and Trust Agreement, the borrowing by PWW of the proceeds therefrom, and the issuance by PWW of indebtedness pursuant to the Loan and Trust Agreement, are hereby authorized;

(d) The issuance of **up to \$5,400,000** in principal amount of indebtedness by PWW, to be accomplished by PWW through a combination of taxable borrowing by PWW, and the issuance of taxable and tax-exempt revenue bonds by the NHBFA on behalf of PWW, for the purpose of funding the establishment of a debt service reserve fund and the payment of the costs of bond insurance as may be determined by PWW to be necessary

to support the financings, consistent with the provision of safe and reliable service at the lowest-reasonable cost to customers, as described above, is consistent with the public good, and the issuance of such indebtedness for such purposes, the allocation of such indebtedness by PWW among the various methods described above, and the execution of such documents required to evidence such borrowings, are hereby authorized;

(e) The issuance of **up to \$1,300,000** in principal amount of indebtedness by PWW, to be accomplished by PWW through a combination of taxable borrowing by PWW, and the issuance of taxable and tax-exempt revenue bonds by the NHBFA on behalf of PWW, for the purpose of funding the costs of issuing the Indebtedness, is consistent with the public good, and the issuance of such indebtedness for such purposes, the allocation of such indebtedness by PWW among the various methods described above, and the execution of such documents required to evidence such borrowings, are hereby authorized; provided, however, that PWW's issuance costs shall be subject to review and audit, as described above, and, provided further, that PWW shall only be authorized to borrow to fund issuance costs to the extent that the sum of the principal amount of such borrowing for issuance costs, plus the aggregate principal amount of other borrowings undertaken by PWW pursuant to the approvals issued in this docket does not exceed the total authority granted of **\$54.5 million**.

3. The Commission should further find that PWW is authorized to do all things, take all steps, and execute and deliver all documents necessary or desirable to consummate, implement and carry out the issuance of the proposed Indebtedness consistent with the above findings and approvals and the testimony submitted to the Commission.

4. The Commission should order PWW to file a report explaining the basis for PWW's final determination and resolution of the matters regarding financing flexibility set forth above in Paragraph III, B.1. (taxable bonds or credit facility), Paragraph III, B.2. (one or two tranches for Capital Project Bonds), and Paragraph III, B.3. (whether to implement a debt service reserve fund or bond insurance) within 10 days following the consummation of the proposed financings pursuant to the approvals described in Paragraph III, E. above. The filing of such reports shall not be a condition to the finality or effectiveness of the Commission's approvals of the proposed financings issued consistent with Paragraph III, E. above, and PWW shall be authorized to consummate such authorized financings regardless of the filing or contents of the report contemplated by this Paragraph III, E.5.

F. Request for Expedited Consideration and Order. The procedural schedule for this docket includes, in the case where parties reach settlement, a hearing on the settlement agreement on September 26, 2014. The Settling Parties agree that PWW should accomplish the proposed financings addressed in this Settlement Agreement by closing prior to December 31, 2014. Accordingly, to facilitate this intended closing, the Settling Parties respectfully request that the Commission consider the terms and matters of this Settlement Agreement expeditiously, and issue an order approving the Settlement Agreement in accordance with its terms prior to October 24, 2014.

IV. CONDITIONS

A. The Settling Parties expressly condition their support of this Agreement upon the Commission's acceptance of all its provisions, without change or condition. If the Commission does not accept the provisions in their entirety, without change or condition, any party hereto, at

its sole option exercised within 15 days of such Commission order, may withdraw from this Agreement, in which event it shall be deemed to be null and void and without effect and shall not be relied upon by any Settling Party to this proceeding or by the Commission for any purpose.

B. The Commission's approval of the recommendations in this Agreement shall not constitute a determination or precedent regarding any particular principle or issue in this proceeding, but rather shall constitute only a determination that the financings described in this Agreement are each reasonable and consistent with the public good based on the best information available at this time.

C. The discussions that produced this Agreement have been conducted on the explicit understanding that all offers of settlement relating thereto are and shall be confidential, shall be without prejudice to the position of any party or participant representing any such offer or participating in any such discussion, and are not to be used in connection with any future proceeding or otherwise.

D. This Agreement may be executed in counterparts.

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EXECUTION COPY

IN WITNESS WHEREOF, the Settling Parties have caused this Agreement to be duly executed in their respective names by their fully authorized agents.

PENNICHUCK WATER WORKS, INC.
By its attorneys
Rath, Young and Pignatelli, P.C.

Dated: September 19, 2014


By:


William F. J. Ardinger

STAFF OF THE NEW HAMPSHIRE PUBLIC
UTILITIES COMMISSION

Dated: September 19, 2014

By:


Alexander F. Speidel
Staff Attorney

OFFICE OF THE CONSUMER ADVOCATE

Dated: September 19, 2014

By:


Rorie E.P. Hollenberg
Assistant Consumer Advocate