

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

**Re: Pennichuck Water Works, Inc.**

**2010 SRF Financing of Drew Woods Interconnection to**

**the Town of Derry Water System**

**DW 10-\_\_\_\_\_**

**DIRECT PRE-FILED TESTIMONY OF THOMAS C. LEONARD**

**April 13, 2010**

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 Certified Public Accountant in Massachusetts.

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

6 **A.** I have a Bachelor in Business Administration in 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 include 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 PWW to determine the lowest cost alternatives available to fund the annual  
22 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 to interconnect the Company’s  
5 Drew Woods Water System with the Town of Derry water system, hereinafter referred to  
6 as the “Drew Woods Interconnection.” The testimony of Donald L. Ware, included with  
7 the Company's filing in this case, will provide additional detail regarding the scope and  
8 need for the proposed project.

9 **Q. Please describe the overall financing plan for the Drew Woods Interconnection.**

10 A. The Company’s estimated cost of constructing the Drew Woods Interconnection is  
11 \$1,218,000. Substantially all the funding is anticipated to be provided by the proceeds of  
12 loan funds issued by the New Hampshire Department of Environmental Services  
13 (“NHDES”) through the State Revolving Loan Fund (the “Proposed Financing”). PWW  
14 is seeking approval in this docket for borrowing up to \$1,600,000 from the State of New  
15 Hampshire Drinking Water State Revolving Loan Fund (“SRF”) in the event that the  
16 amount of the project exceeds \$1,218,000. The actual borrowing amount will be based  
17 on the actual costs of construction that the Company incurs. The use of the low cost  
18 funds from the SRF will lower the overall cost of the financing needed to complete the  
19 construction of the Drew Woods Interconnection. In the event that the loan amount  
20 authorized by NHDES is not sufficient to fund completely the cost of constructing the  
21 Drew Woods Interconnection, the balance, if any, will be funded from a mix of PWW’s  
22 internal cash flow from operations and/or advances to PWW from Pennichuck  
23 Corporation’s short term line of credit with the Bank of America.

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 2.95% 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.

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

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

20 **Q. Please explain Schedule TCL-1, entitled “Actual and Pro Forma Balance Sheet at**  
21 **December 31, 2009.”**

1 A. Schedule TCL-1 presents the actual financial position of PWW as of December 31, 2009  
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  
6 \$1,218,000 reflects the increase in PWW's Plant in Service for the construction project  
7 and the related funding sources. The second adjustment reflects the after-tax effect on  
8 retained earnings for the annual interest expense accrued during the first year, with a  
9 corresponding credit to accrued expenses payable. The third adjustment reflects the  
10 after-tax effect on retained earnings of the estimated additional cost of water from the  
11 Town of Derry.

12 **Q. Mr. Leonard, please explain Schedule TCL-2 entitled "Actual and Pro Forma**  
13 **Income Statement for the Twelve Months Ended December 31, 2009."**

14 A. Schedule TCL-2 presents the pro forma impact of this financing on PWW's income  
15 statement for the twelve month period ended December 31, 2009.

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

17 A. Schedule TCL-2 contains four 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 first year water cost from the Town of Derry. Adjustment three is to record  
20 the estimated depreciation and property taxes on the new assets. The fourth adjustment is  
21 to record the after-tax effect of the additional pro forma expenses (interest and O&M  
22 expense) resulting from the adjustments discussed above using an effective combined  
23 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, 2009.”**

3 A. Schedule TCL-3 illustrates PWW’s actual total capitalization as of December 31, 2009,  
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 two 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, while the second adjustment reflects the funding sources for the  
9 project.

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

13 A. Yes. PWW’s existing agreements contain three covenants governing the issuance of new  
14 PWW debt. These covenants specify minimum interest coverage ratios and maximum  
15 amounts of debt in relation to net plant and to total capitalization. PWW’s actual ratios,  
16 pro formed for the SRF loans contemplated herein, are comfortably within these  
17 covenants even with borrowing up to the proposed \$1.6 million.

18 **Q. Has PWW’s Board of Directors formally voted to authorize the Proposed**  
19 **Financing?**

20 A. Yes. A Resolution authorizing the subject financing has been circulated among the  
21 Board of Director’s for an authorization by consent. All the necessary signatures  
22 required from the Board of Director’s will be obtained by May 5, 2010. Evidence of the  
23 required resolution will be provided as soon as possible to the Commission.

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

2 A. Yes, I do. The project being financed will enable PWW to continue to provide safe,  
3 adequate and reliable water service to PWW's customers in the Drew Woods system.  
4 For the reasons described in Mr. Ware's direct testimony, the Drew Woods  
5 Interconnection project will provide the most cost effective solution to the need for  
6 additional source of supply to meet the average annual and summer time demands of the  
7 Drew Woods customers. The terms of the financing through the SRF are very favorable,  
8 and will result in lower financing costs than would be available through all other current  
9 debt financing options including tax-exempt bonds issued through the New Hampshire  
10 Business Finance Authority.

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

12 A. Yes. I respectfully ask the Commission to issue an Order Nisi in this docket as soon as  
13 reasonably possible since the NHDES needs PWW to be authorized to enter into the loan  
14 agreement associated with the SRF funds in June 2010 in order to meet the goal of  
15 completing this project during the 2010 construction season.

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

17 A. Yes it does.

**Pennichuck Water Works, Inc.**  
**Actual and Pro Forma Balance Sheet as of December 31, 2009**  
**Unaudited**  
**Reflecting the Issuance of \$1,218,000 SRF Loan**

	<u>Actual</u> <u>December 31, 2009</u>	<u>Pro Forma</u> <u>Adjustments</u>	<u>Pro Forma</u> <u>December 31, 2009</u>
<b>Assets</b>			
Plant in Service	\$ 153,584,779	\$ 1,218,000 <sup>1</sup>	\$ 154,802,779
Less: Accumulated Depreciation	<u>(32,044,968)</u>	<u>-</u>	<u>(32,044,968)</u>
Net Plant	121,539,811	1,218,000	122,757,811
CWIP	<u>439,540</u>	<u>-</u>	<u>439,540</u>
Total Net Utility Plant	121,979,351	1,218,000	123,197,351
Current Assets	4,600,921	-	4,600,921
Other Assets and Deferred Charges	<u>10,495,873</u>	<u>-</u>	<u>10,495,873</u>
<b>Total Assets</b>	<u>\$ 137,076,145</u>	<u>\$ 1,218,000</u>	<u>\$ 138,294,145</u>
<b>Equity and Liabilities</b>			
Common Equity	\$ 52,553,720	\$ -	\$ 52,553,720
Current Portion of Long Term Debt	5,733,402	-	5,733,402
Other Current Liabilities	5,435,367	-	5,435,367
Long-Term Debt	50,128,227	1,218,000 <sup>1</sup>	51,346,227
Other Liabilities and Deferred Credits	<u>23,225,429</u>	<u>-</u>	<u>23,225,429</u>
<b>Total Equity and Liabilities</b>	<u>\$ 137,076,145</u>	<u>\$ 1,218,000</u>	<u>\$ 138,294,145</u>

**Notes:**

1 - To record the issuance of a \$1,218,000 SRF loan to fund the Drew Woods Interconnection



**Pennichuck Water Works, Inc.**  
**Actual and Pro Forma Income Statement for the Twelve Months Ended December 31, 2009**  
**Unaudited**  
**Reflecting the Issuance of \$1,218,000 SRF Loan**

	<u>Actual</u> <u>December 31, 2009</u>	<u>Pro Forma</u> <u>Adjustments</u>	<u>Pro Forma</u> <u>December 31, 2009</u>
Operating Revenues	\$ 23,305,324	\$ -	\$ 23,305,324
O&M Expenses	10,424,551	55,750 <sup>2</sup>	10,480,301
Depreciation & Amortization	3,411,661	4,046 <sup>3</sup>	3,415,707
Taxes Other Than Income	2,967,467	4,656 <sup>3</sup>	2,972,123
Income Taxes	1,374,683	(39,771) <sup>4</sup>	1,334,912
Total O&M Expenses	<u>18,178,362</u>	<u>24,681</u>	<u>18,203,043</u>
Net Operating Income	<u>5,126,962</u>	<u>(24,681)</u>	<u>5,102,281</u>
AFUDC	<u>114,165</u>	<u>-</u>	<u>114,165</u>
Other income (expense), net	<u>96,611</u>	<u>-</u>	<u>96,611</u>
Interest Income (Expense):			
Funded Debt	(3,180,440)	(35,955) <sup>1</sup>	(3,216,395)
Intercompany Debt	<u>20,276</u>	<u>-</u>	<u>20,276</u>
Total Interest Expense	<u>(3,160,164)</u>	<u>(35,955)</u>	<u>(3,196,119)</u>
Net income	<u>\$ 2,177,574</u>	<u>\$ (60,636)</u>	<u>\$ 2,116,938</u>

**Notes:**

1 - To record the annual interest (2.952%) on the \$1,218,000 SRF loan.

2 -To record estimated water expense from Town of Derry.

3- To record estimated depreciation & property taxes on new equipment (excluding amount donated to Derry).

4 - To record the tax effect (39.6%) resulting from additional expenses.

**Pennichuck Water Works, Inc.**  
**Actual and Pro Forma Statement of Capitalization as of December 31, 2009**  
**Unaudited**  
**Reflecting the Issuance of \$1,218,000 SRF Loan**

	<u>Actual</u>		<u>Pro Forma</u>		<u>Pro Forma</u>	
	<u>December 31, 2009</u>		<u>Adjustments</u>		<u>December 31, 2009</u>	
<b><u>Common Equity:</u></b>						
Common Stock	\$ 30,000		\$ -		\$ 30,000	
Paid-in Capital	39,011,141		-		39,011,141	
Retained Earnings	13,512,579		(60,636) <sup>1</sup>		13,451,943	
Total Common Equity	<u>52,553,720</u>	48.5%	<u>(60,636)</u>		<u>52,493,084</u>	47.9%
<b><u>Debt:</u></b>						
Current Portion of Long-Term Debt	5,733,402				5,733,402	
Long-Term Debt	50,128,227		1,218,000 <sup>2</sup>		51,346,227	
Total Debt	<u>55,861,629</u>	51.5%	<u>1,218,000</u>		<u>57,079,629</u>	52.1%
Total Capitalization	<u>\$ 108,415,349</u>	<u>100.0%</u>	<u>\$ 1,157,364</u>		<u>\$ 109,572,713</u>	<u>100.0%</u>

**Notes:**

1 - To record the annual interest (2.952%) on the \$1,218,000 SRF loan plus additional water purchase, depreciation expense and property taxes, and to record the income tax benefit (39.6%) resulting from the additional expense.

2 - To record the issuance of a \$1,218,000 SRF loan to fund the Drew Woods Interconnection project.