

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

Re: Pennichuck East Utility, Inc.

SRF Financing of Water Main Replacement in the Locke Lake Water System

DW 10-

DIRECT PRE-FILED TESTIMONY OF THOMAS C. LEONARD

December 16, 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 East
3 Utility, Inc. ("PEU" or the "Company"). I have been employed with the Company since
4 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--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 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 the cost to replace about 3,000 LF of
5 water main the Lock Lake Water System, hereinafter referred to as the “Locke Lake
6 water main replacement”. The testimony of Donald Ware, included with the Company's
7 filing in this case, provides the detail regarding the scope and need for the proposed
8 project

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

10 A. The estimated cost of the replacing about 3,000 LF of water main in the Locke Lake
11 Water System is \$300,000. Substantially all the funding for this replacement is
12 anticipated to be provided by the proceeds of loan funds issued by the New Hampshire
13 Department of Environmental Services (“NHDES”) through the State Revolving Loan
14 Fund (the “Proposed Financing”). In the event that the loan amount authorized by
15 NHDES is not sufficient to fund completely the cost of Locke Lake water main
16 replacement, the balance, if any, will be funded from a mix of PEU’s internal cash flow
17 from operations and/or advances to PEU from Pennichuck Corporation’s short term line
18 of credit with the Bank of America. PEU is seeking approval in this docket for
19 borrowing up to \$300,000 from the State of New Hampshire Drinking Water State
20 Revolving Loan Fund (“SRF”). The actual borrowing amount will be based on the actual
21 costs of construction that the Company incurs. The use of the low cost funds from the
22 SRF will lower the overall cost of the financing needed to complete the construction of
23 the Locke Lake water main replacement.

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 PEU during construction will accrue interest at
5 a rate of 1%, and the total accrued interest will be due upon substantial completion of the
6 project. The terms of the SRF loans require repayment of the loan principal plus interest
7 over a twenty-year period commencing six months after the project is substantially
8 complete. The current interest rate on SRF borrowings is 2.864% although the actual rate
9 will be based on the current rates available at the time the loan is closed. Copies of the
10 loan documents will be submitted to the Commission once they have been finalized and
11 executed. The loan is projected to come with 40% principal forgiveness based on the
12 current water rates and Median Family Income for the Locke Lake Water System.

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

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

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

1 A. Schedule TCL-1 presents the actual financial position of PEU 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 two pro forma adjustments. The first adjustment for \$300,000
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 after-tax effect on retained earnings
8 for the annual interest expense accrued during the first year, with a corresponding credit
9 to accrued expenses payable. .

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

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

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

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

21 **Q. Please explain Schedule TCL-3 entitled "Actual and Pro Forma Statement of**
22 **Capitalization at December 31, 2009."**

1 A. Schedule TCL-3 illustrates PEU's actual total capitalization, as of December 31, 2009,
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-3.**

4 A. Schedule TCL-3 contains two adjustments. The first pro forma adjustment reflects the
5 after-tax decrease to retained earnings for the additional pro forma expenses related to the
6 new funding sources, while the second adjustment reflects the funding sources for the
7 project.

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

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

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

16 A. Yes. A Resolution authorizing the subject financing has been circulated among the
17 Board of Directors for an authorization by consent. All the necessary signatures required
18 from the Board of Directors should be collected by the end of December 2010. Evidence
19 of the required resolution will be provided as soon as possible for the Commission's
20 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 Locke Lake Water Main replacement project will provide
2 the most cost effective solution toward beginning to correct the leakage problem
3 associated with a water distribution system constructed with materials that were not
4 designed for use in purveying water. The terms of the financing through SRF are very
5 favorable, and will result in lower financing costs than would be available through all
6 other current debt financing options including tax-exempt bonds issued through the New
7 Hampshire Business Finance Authority.

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

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

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

14 A. Yes it does.
15
16

Pennichuck East Utility, Inc.
Actual and Pro Forma Balance Sheet as of September 30, 2010
Unaudited
Reflecting the \$0.3 million Water Main Replacement and related SRF Loan

Exhibit TCL-1

	<u>Actual</u> <u>September 30, 2010</u>	<u>Pro Forma</u> <u>Adjustments</u>	<u>Pro Forma</u> <u>September 30, 2010</u>
Assets			
Plant in Service	\$ 37,331,919	\$ 300,000	¹ \$ 37,631,919
Less: Accumulated Depreciation	(7,891,373)	(4,272)	² (7,895,645)
Net Plant	<u>29,440,545</u>	<u>295,728</u>	<u>29,736,274</u>
CWIP	<u>76,969</u>	-	<u>76,969</u>
Total Net Utility Plant	29,517,515	295,728	29,813,243
Current Assets	1,279,501	-	1,279,501
Other Assets and Deferred Charges	<u>780,121</u>	-	<u>780,121</u>
Total Assets	<u>\$ 31,577,137</u>	<u>\$ 295,728</u>	<u>\$ 31,872,866</u>
Equity and Liabilities			
Common Equity	\$ 6,928,750	\$ (12,398)	³ \$ 6,916,352
Current Portion of Long-Term Debt	322,396		\$ 322,396
Other Current Liabilities	848,740		\$ 848,740
Advances from Associated Companies	3,263,526	8,126	³ \$ 3,271,652
Long-Term Bonds	5,264,293	-	5,264,293
LTD--SRF Loans	3,177,586	300,000	¹ \$ 3,477,586
Deferred Income Taxes	3,727,639	-	\$ 3,727,639
Contributions in Aid of Construction, Net	7,889,352	-	\$ 7,889,352
Other Liabilities and Deferred Credits	<u>154,855</u>	-	<u>154,855</u>
Total Equity and Liabilities	<u>\$ 31,577,137</u>	<u>\$ 295,729</u>	<u>\$ 31,872,866</u>

Notes:

1 - To record the \$0.3 million of Water Main Replacement and related SRF Loan.

2 - To record the impact of full year depreciation. See Proforma P&L.

3 - To record the impact of additional expenses on equity (retained earnings) and intercompany account. See Proforma P&L.

Pennichuck East Utility, Inc.
Actual and Pro Forma Income Statement for the Twelve Months Ended September 30, 2010
Unaudited
Reflecting the \$0.3 million Water Main Replacement and related SRF Loan

Exhibit TCL-2

	Actual	Pro Forma	Pro Forma
	September 30, 2010	Adjustments	September 30, 2010
Operating Revenues	\$ 5,070,700	\$ -	\$ 5,070,700
O&M Expenses	3,073,281	-	3,073,281
Depreciation & Amortization	506,898	4,272 ²	511,169
Taxes Other Than Income	389,017	7,663 ²	396,680
Income Taxes	269,217	(8,128) ³	261,088
Total O&M Expenses	<u>4,238,413</u>	<u>3,806</u>	<u>4,242,219</u>
Net Operating Income	<u>832,287</u>	<u>(3,806)</u>	<u>828,481</u>
AFUDC	<u>-</u>	<u>-</u>	<u>-</u>
Other income (expense), net	<u>-</u>	<u>-</u>	<u>-</u>
Interest Income (Expense):			
Funded Debt	(285,002)	(8,592) ¹	(293,594)
Intercompany Debt	(136,833)	-	(136,833)
Total Interest Expense	<u>(421,835)</u>	<u>(8,592)</u>	<u>(430,427)</u>
Net income	<u>\$ 410,452</u>	<u>\$ (12,398)</u>	<u>\$ 398,054</u>

Notes:

- 1 - To record the change in interest expense associated with refinancing.
2 - To record the impact of new and replaced water mains on depreciation and property taxes.
3 - To record the tax benefit (39.6%) resulting from additional expenses.

Supporting Calculations:

Interest Expense:

New SRF debt	\$ 300,000
Interest Rate	2.864%
Annual Interest	<u>\$ 8,592</u>

Depreciation Expense:

New Water Mains	\$ 300,000
Replaced Water Mains (Estimated)	<u>\$ (9,418)</u>
	\$ 290,582
Depreciation Rate	1.47%
Annual Depreciation	<u>\$ 4,272</u>

Property Taxes:

New Water Mains	\$ 300,000
Replaced Water Mains (<u>\$ (9,418)</u>
	\$ 290,582
Tax Rate Per \$1,000	
Barnstead	\$ 19.77
State	<u>\$ 6.60</u>
	\$ 26.37
Annual Property Taxes	<u>\$ 7,663</u>

Pennichuck East Utility, Inc.
Actual and Pro Forma Statement of Capitalization as of September 30, 2010
Unaudited
Reflecting the \$0.3 million Water Main Replacement and related SRF Loan

Exhibit TCL-3

	Actual		Pro Forma		Pro Forma	
	September 30, 2010		Adjustments		September 30, 2010	
Common Equity:						
Common Stock	\$ 100		\$ -		\$ 100	
Paid-in Capital	6,000,000		-		6,000,000	
Other Comprehensive Income	(385,564)		-		(385,564)	
Retained Earnings	1,314,214		(12,398) ¹		1,301,817	
Total Common Equity	<u>6,928,750</u>	36.6%	<u>(12,398)</u>		<u>6,916,352</u>	35.9%
Debt:						
Current Portion of Long-Term Debt	322,396				322,396	
Advances from Associated Companies	3,263,526				3,263,526	
Long-Term Bonds	5,264,293		300,000 ²		5,564,293	
LTD--SRF Loans	3,177,586				3,177,586	
Total Debt	<u>12,027,801</u>	63.4%	<u>300,000</u>		<u>12,327,801</u>	64.1%
Total Capitalization	<u>\$ 18,956,551</u>	100.0%	<u>\$ 287,602</u>		<u>\$ 19,244,153</u>	100.0%

Notes:

- 1 - To record the impact of interest, depreciation, property taxes and income tax benefit on retained earnings.
2 - To record the issuance of the \$0.3 million SRF loan.