STATE OF NEW HAMPSHIRE
BEFORE THE
PUBLIC UTILITIES COMMISSION

Pennichuck East Utility, Inc.

Petition for Authority to Issue Long Term Debt
CoBank and Intercompany Loans

DW 14-____

DIRECT PREFILED TESTIMONY OF LARRY D. GOODHUE

October 6, 2014

Q. What is your name and what is your position with Pennichuck East Utility, Inc.?

A. My name is Larry D. Goodhue. I am the Chief Financial Officer of Pennichuck East Utility, Inc. (the "Company"). I have been employed with the Company since December, 2006. I also serve as Chief Financial Officer, Treasurer and Controller of the Company's parent, Pennichuck Corporation ("Pennichuck"). I am a licensed Certified Public Accountant in New Hampshire; my license is currently in an inactive status.

Q. Please describe your educational background.

A. I have a Bachelor in Science degree in Business Administration with a major in Accounting from Merrimack College in North Andover, Massachusetts.

Q. Please describe your professional background.

A. Prior to joining the Company, I was the Vice President of Finance and Administration and previously the Controller with METRObility Optical Systems, Inc. from September, 2000 to June 2006. In my more recent role with METRObility, I was responsible for all financial, accounting, treasury and administration functions for a manufacturer of optical networking hardware and software. Prior to joining METRObility, I held various senior management and accounting positions in several companies.

Q. What are your responsibilities as Chief Financial Officer of the Company?

A. As Chief Financial Officer of the Company I am responsible for the overall financial management of the Company including financing, accounting, compliance and budgeting. My responsibilities include issuance and repayment of debt, as well as quarterly and annual financial and regulatory reporting and compliance. I work with the Chief Executive Officer and Chief Operating Officer of the Company to determine the lowest cost alternatives available to fund the capital requirements of the Company, which result from the Company's annual capital expenditures and its current debt maturities.

Q. What financings are proposed by the Company in its petition in this proceeding (the "Proposed Financings").

A. The Company is proposing two new long term debt financings: (1) a $625,000 loan from CoBank, ACB ("CoBank") to fund 2014 capital projects not funded by SRF loans and (2) a $1.0 million long term loan from Pennichuck to convert $1.0 million of short term intercompany debt into a long term note payable. The proceeds from the $625,000 CoBank loan will be utilized to fund capital projects for PEU for the 2014 fiscal year.

Q. Did you supervise the preparation of the Company's petition for authority to issue long term debt?

A. Yes.

Q. Does the Company have on file with the Commission a certification statement in its Annual Report with respect to its books, papers and records?

A. Yes.

Q. Please describe CoBank and its relationship with the Company.

A. CoBank is a federally chartered bank under the Farm Credit Act of 1971, as amended. Unlike commercial banks and other financial institutions, it is restricted to making loans and leases and providing financial solutions to eligible borrowers in the agribusiness and rural utility industries and certain related entities as defined under the Farm Credit Act of 1971. The characteristics of the Company's service territory are consistent with CoBank's charter and mission, and CoBank can therefore provide short, intermediate and long-term loans to the Company in connection with its capital requirements.

The Company entered into a Master Loan Agreement with CoBank effective February 9, 2010 (the "Master Loan Agreement"), which provides the framework for CoBank to make loans to the Company from time to time. The Master Loan Agreement was filed with the Commission in Docket DW 09-134 and can be found at:

http://www.puc.nh.gov/Regulatory/CASEFILE/2009/09-134/LETTERS,%20MEMOS/09-134%202010-03-31%20COBANK%20LOAN%20DOCS.PDF

In March 2010, the Company utilized CoBank to replace $4.5 million of maturing debt and to establish a $1.5 million revolving line of credit pursuant to Order 25,041 in DW 09-134. The $1.5 million revolving line of credit expired in March 2012. Additionally, in May 2013, the Company entered into two new loans with CoBank, in the amount of $925,000 and $1,723,150, for terms of 20 years and 10 years, respectively, pursuant to Order 25,480 in DW 13-017.

CoBank is a Government Sponsored Enterprise ("GSE") owned by its customers, who consist of agricultural cooperatives, rural energy, communications and water companies, and other businesses that serve rural America. As a GSE, CoBank issues its debt securities with the implicit full faith and credit of the US Government and uses these low cost funds to make loans to businesses like the Company that meet its charter requirements. As a result of the implicit backing of the US Government, CoBank's borrowing costs are less than commercial banks and financial institutions and the lower costs are passed on to its borrowers. In addition to the lower rates, CoBank loans generally have fewer covenants or restrictions as compared to loans from commercial banks and other financial institutions.

Q. **What are the basic terms of the proposed CoBank financing?**

A. While the final terms and interest rates are subject to change based on CoBank's due diligence (which is in progress) and market conditions, the Company expects to obtain a $625,000 term loan with a 25-year amortization, with level monthly principal and interest payments with an interest rate to be determined based on market conditions (currently estimated at 5.25% per annum). The proceeds from this new CoBank loan will be used to finance 2014 capital expenditures not funded by SRF loans. The new CoBank loan will provide permanent financing for the long-lived assets. The new CoBank loan will be secured by (i) a security interest in the Company's equity interest in CoBank (consisting of the Company's $58,870.23 equity investment in CoBank and the Company's right to receive patronage dividends) and (ii) the unconditional guarantee of the Company's obligations to CoBank by Pennichuck pursuant to the Guarantee of Payment , by Pennichuck in favor of CoBank dated as of February 9, 2010 (the "Guaranty"), a copy of which was also filed with the Commission in Docket DW 09-134. The Company's equity investment in CoBank consists of an initial $1,000 investment pursuant to the Master Loan Agreement cited earlier, as well as the accumulation of the equity portion of the annual patronage earned by the Company, associated with its existing debt obligations with CoBank.

Q. Are there any other important terms or benefits related to borrowing from CoBank?

A. Yes, as I mentioned earlier, CoBank is organized as a cooperative which means it is owned and controlled by its members who use its products or services (i.e. its borrowers). A key cooperative principle is the return to customers of a portion of net margins based upon their use of the bank. This is accomplished through the distribution of "patronage refunds"---the distribution to patronage customers of net margins remaining after payment of preferred stock dividends, deducting operating and interest expenses and amounts retained as core surplus. While not guaranteed, each year the Board of Directors of CoBank targets a distribution amount which is returned (in the subsequent year) to its borrower/members based on the annual average accruing loan volume. While these payments are not guaranteed and therefore are not included in the pro forma cost of capital on Exhibit LDG-3, the Company expects to reflect the patronage refunds in rates in future test years based on the receipt of the payments. The Company's experience with patronage refunds associated with the March 2010 $4.5 million refinancing, as well as the aggregate $2,648,150 financed in 2013, is as follows:

- 2010 earned patronage of $37,355,
- 2011 earned patronage of $43,108
- 2012 earned patronage of $41,482, and
- 2013 earned patronage of $57,351.

In general, CoBank's annual patronage has been 1% of the one-year average daily loan balance, paid to the Company in March of the following year (i.e., patronage earned in calendar year 2013 was paid to the Company in March 2014). The 1% is distributed as a mix of cash and equity stock in CoBank; for the years 2010 and 2011, the mix of cash and equity was 35% and 65%, whereas for the years 2012 and 2013 the mix of cash and equity was 75% and 25%. The distribution of patronage earned for 2014 will be a mix of cash at 75% and equity at 25%, per discussions with CoBank about the current allocation. The Company accounts for the cash portion as a reduction in interest expense when received in accordance with GAAP. The equity portion is accounted for as a deferred debit on the balance sheet.

Q. Please describe the new intercompany loan from Pennichuck.

A, The Company proposes to enter into a new long term loan from Pennichuck in the principal amount of $1,000,000 to replace $1,000,000 of short term debt payable to Pennichuck pursuant to the intercompany Money Pool Agreement dated as of January 1, 2006 (the "Money Pool Agreement"), a copy of which has been filed with the Commission pursuant to RSA 366:3. The proceeds of the short term debt was utilized to acquire used and useful property needed to provide water service to the public. The new loan from Pennichuck will be evidenced by an unsecured promissory note from the Company payable to Pennichuck in the principal amount of $1,000,000 providing for level monthly payments, an amortization period of ten years and an interest rate of 2.70% per annum. Under the terms of the Master Loan Agreement and the Guaranty, the Company's indebtedness to Pennichuck will be subordinate to the Company's indebtedness to CoBank. The Company's level of short term debt has been at or above ten percent (10%) of its net fixed capital since May 2014 and is forecasted to be at levels in excess of ten percent (10%) for the remainder of 2014. The Company filed for and was granted a temporary waiver of the 10% short term debt limit until October 31, 2014. See Order No. 25,716, issued in Docket No. DW 14-191 (September 12, 2014). Upon completion of the permanent financing for which approval is requested herein, the Company's level of short term debt is expected to remain below ten percent of net fixed capital for the remainder of 2014.

Q. Please describe the benefits of the proposed financing with Pennichuck.

A. The proposed financing would accomplish the following: (1) enable the Company to finance its 2014 Capital Projects with long term debt, rather than short term intercompany borrowings; (2) provide for debt carrying costs of 2.70% on the new long term intercompany note payable, creating a revenue neutral result from this portion of the financing, when compared to the current underlying cost of money for Pennichuck's borrowings from its Line of Credit, which is the ultimate source for short term moneys advanced to PEU, and (3) reduce the level of short term debt that is currently above the 10% limit of net fixed plant.

Q. What are the estimated issuance costs for the loans?

A. The anticipated issuance costs total approximately $20,000, and relate primarily to legal costs that will be incurred to (i) review and revise the necessary loan documentation prepared by CoBank, (ii) document the new loan from Pennichuck and (iii) obtain Commission approval of the loans. The issuance costs will be amortized over the respective lives of the CoBank loans. The annual amortization expense of less than $1,000 associated with the issuance costs has not been reflected in Schedules LDG-2 through 4 due to its immateriality with respect to the overall analysis and impact of this proposed financing. A summary of issuance costs will be filed once they are known and final.

Q. What other options has the Company considered other than the proposed CoBank financing?

A. The Company has explored options with several potential funding agencies over the past two years. The Company has determined that tax exempt debt bond financing through the Business Finance Authority of New Hampshire (BFA) lending is not available, as the overall borrowing levels for the Company do not meet the minimum bonding threshold amounts, even when aggregated over a three year needs analysis. The Company has been able to access some funding from the State Revolving Fund, for certain eligible and qualifying capital projects. However, not all of the Company's capital projects for 2014 were eligible for this financing. As a result, the options to finance the remainder of the 2014 capital projects was limited to taxable debt from banks or other financial institutions. For banks, the Company has determined over the past two years that there are a limited number of truly eligible lending candidates due to considerations including the financial structure of the Company with respect to normal debt-equity ratios, the overall capital borrowing needs, meeting normal financial covenants, or due to acceptable credit ratings. At the end of the process, CoBank has become the only viable option currently to finance these current needs.

Q. Please explain Schedule LDG-1, entitled "Actual and Pro Forma Balance Sheet at December 31, 2013".

A. Schedule LDG-1 presents the actual financial position of the Company as of December 31, 2013 and the pro forma financial position reflecting certain adjustments pertaining to the Proposed Financings.

Q. Please explain the pro forma adjustments on Schedule LDG-1.

A. Schedule LDG-1 reflects the pro forma adjustments related to the establishment of the $625,000 CoBank long term loan, and the assets acquired with those funds and the related depreciation adjustments from Cost of Removal. The schedule also reflects the conversion of $1.0 million of short term intercompany debt to a $1.0 million long term intercompany note payable.

Q. Please explain Schedule LDG-2, entitled "Actual and Pro Forma Income Statement for the Twelve Months Ended December 31, 2013".

A. As I indicated above, the costs associated with the refinancing are not expected to be significant and are not reflected in Schedule LDG-2. Schedule LDG-2 presents the pro forma impact of this financing on the Company's income statement for the twelve month period ended December 31, 2013.

Q. Please explain the pro forma adjustments on Schedule LDG-2.

A. Schedule LDG-2 contains three adjustments. Adjustment one records the estimated impact on interest expense related to additional debt raised. I have assumed an interest rate of 5.25% for the CoBank financing based on discussion with CoBank personnel; however, the actual interest rate will be based on market conditions at the time of closing. The second adjustment records the estimated impact on depreciation expense and property taxes, related to the assets placed in service from the financing. And, the third adjustment records the after-tax effect of the additional pro forma interest expense, depreciation expense, and property taxes, using an effective combined federal and state income tax rate of 39.6%.

Q. Please explain how the interest rate of 2.70% was derived for the long term intercompany note payable of $1.0 million in Schedule LDG-2.

A. The Company determined that a rate of 2.70% would be more appropriate in creating an income neutral result, when compared to the current underlying cost of money for Pennichuck's borrowings from its Line of Credit, which is the ultimate source for short term moneys advanced to PEU.

Q. Please explain Schedule LDG-3, entitled "Actual and Pro Forma Statement of Capitalization at December 31, 2013."

A. Schedule LDG-3 illustrates the Company's pro forma total capitalization as of December 31, 2013, which comprises common equity and long term debt including CoBank financing.

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

A. Schedule LDG-3 contains one set of adjustments. The column titled "Pro Forma Eliminations" reflects the elimination of debt related to Capital Recovery Surcharge Assets per Order 25,051 in DW 08-052 and the elimination of the Municipal Acquisition Regulatory Asset, ("MARA") and the related equity as of the date of the Nashua acquisition per Order 25,292 in DW 11-026.

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

A. Yes. Section 6(c) of the Loan Agreement between Pennichuck and TD Bank, N.A. prohibits Pennichuck or its subsidiaries from incurring additional indebtedness without the express prior written consent of the Bank. However, under Section 6(c)(v) the Company may incur new indebtedness up to $1.5 million per annum, on an unsecured basis, with CoBank, ACB or equivalent lender, provided that TD Bank, N.A. is provided at least 30 days prior written notice related to said indebtedness. The Company provided written notice to TD Bank, N.A. as of August 26, 2014. A copy of the notification is included as Attachment A.

Q. What is the status of corporate approvals for the Proposed Financings?

A. The CoBank financing has been approved by the Company's Board of Directors and is being submitted for approval by Pennichuck's sole shareholder, the City of Nashua. The Company will supplement its Petition with documentation showing such shareholder approval promptly upon receipt thereof. The conversion of the $1.0 million of short term debt into the new long term loan was approved by the board of directors of the Company and of Pennichuck on August 15, 2014; copies of said resolutions are included as Attachment B. No shareholder approval is required with respect to intercompany loans.

Q. Do you believe that the Proposed Financings are consistent with the public good?

A. Yes. CoBank, as a government sponsored entity whose mission is to assist vital industries across rural America, offers a source of low cost financing. In addition, the potential patronage refunds which I expect the Company to receive will further reduce the cost of this capital over the longer term. The additional Pennichuck borrowing will reduce the Company's short term debt and provide the Company with flexibility to finance capital improvements to continue to provide safe, adequate and reliable water service to the Company's customers. The use of CoBank as a lender will reduce the Company's reliance on its parent, Pennichuck, for financing for capital expenditures. The terms of the financing through CoBank are very favorable and lower than the alternative financing options available to the Company to refinance existing debt.

Q. Mr. Goodhue, does this conclude your testimony?

A. Yes it does.