STATE OF NEW HAMPSHIRE

BEFORE THE

NEW HAMPSHIRE PUBLIC UTILITIES COMMISSION

Pennichuck East Utility, Inc.

Pittsfield Aqueduct Company, Inc.

Joint Petition to Increase Short Term Debt Limit

DW 15-_____

DIRECT TESTIMONY OF LARRY D. GOODHUE

July 23, 2015

Q. Please state your name, address and position with Pennichuck Corporation.

A. My name is Larry D. Goodhue. My business address is 25 Manchester Street, Merrimack, New Hampshire. I am currently the Chief Financial Officer, Treasurer and Controller of Pennichuck Corporation (Pennichuck). I also serve as Chief Financial Officer, Treasurer and Controller of Pennichuck East Utility, Inc. (PEU) and Pittsfield Aqueduct Company, Inc. (PAC) (together, the Companies), which are regulated subsidiaries of Pennichuck. Effective November 6, 2015, I will succeed John L. Patenaude as Chief Executive Officer of Pennichuck.

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. I am a licensed Certified Public Accountant in New Hampshire; my license is currently in an inactive status.

Q. Please describe your professional background.

A. Prior to joining Pennichuck, 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 Pennichuck?

A. I am responsible for the overall financial management of Pennichuck and its subsidiaries 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 Pennichuck to determine the lowest cost alternatives available to fund the capital requirements of Pennichuck and its subsidiaries, which result from their annual capital expenditures and current debt maturities.

Q. Have you previously testified before the New Hampshire Public Utilities Commission?

A. Yes. I submitted written testimony in the following dockets:

1. Financings for Pennichuck East Utility – DW 13-017, DW 12-349, DW 13-125, DW 14-020, DW 14-321, DW 14-282, DW 14-191, and DW 15-044;
2. Financings for Pennichuck Water Works, Inc. – DW 14-021, DW 14-130, DW 15-046; DW 15-196; and,
3. Rate Cases for Pennichuck Water Works, Inc. – DW 13-130, Pennichuck East Utility, Inc. – DW 13-126, and Pittsfield Aqueduct Company, Inc. – DW 13-128.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to explain the basis for the Companies' joint request for approval of a permanent waiver of the 10% short term debt limit under N.H. Admin. Rule Puc 608.05. As a result of Order No. 25,292 (November 23, 2011) approving the acquisition of Pennichuck by the City of Nashua, the capital structure for the Companies was altered, to the benefit of ratepayers, by essentially eliminating the costs of equity financing. The resulting capital structure, however, alters the manner in which capital expenditures and working capital are funded, placing a greater emphasis on short term debt financing

Q. Please describe the Companies' recent short term debt levels.

A. Since January 2012, the Companies have experienced short term debt levels that have reached as high as 15-18%, causing them to periodically request temporary short term debt waivers from the Commission, while long term financing petitions were completed and/or rate cases were pursued relating to increased revenue requirements.

Q. Please explain Schedule LDG-1, entitled "Historical Summary of Short Term Debt Limits".

A. Schedule LDG-1 presents the actual short term debt limit levels for the Companies for the years 2012 through 2014, including temporary short term debt limit increases previously allowed by the Commission.

Q. Please explain the forecast schedules on Schedule LDG-2, page 1 and 2.

A. Schedule LDG-2 contains a forecast of short term debt limit levels for the Companies for 2015 through 2016, including actual levels for January through May of 2015, and forecasted amounts for June 2015 through December 2016. The analysis includes anticipated best case and worst case scenarios of the monthly short term debt limit ratios throughout the period.

Q. How does the rate making structure of PEU and PAC differ from traditional rate making, and how do the CBFRR payments impact the short term debt limit requirements?

A. The rate making structure of PEU and PAC differs from traditional rate making in a few key areas, affecting both total cash flow and the timing of cash flows. As a consequence of the acquisition of Pennichuck by the City of Nashua, the following key changes were made:

- A predetermined rate was derived for the Companies' return on equity (ROE). The ROE is set at 3% above the 13-month average yield for 30-year Treasury bonds, for the last approved test year. This equates to a pre-tax ROE of 5.90% for both Companies for the 2012 test years approved in Dockets DW 13-126 and DW 13-128. This ROE is substantially different from pre-tax ROE levels historically included in the rate structures of the Companies, which were approximately 16%.
- The City Bond Fixed Revenue Requirement ("CBFRR") portion of the revenue requirements for the Companies was implemented as part of the acquisition. This fixed component of the revenue requirement for each company is that company's proportionate share of a fixed annual funding amount of the City's Acquisition Debt paid up to Pennichuck, which enables Pennichuck to repay the City of Nashua. The cash transferred from the CBFRR revenues, net of the income tax provision on pre-tax earnings, for each fiscal year is authorized and recorded as a both a dividend and return of capital to Pennichuck in the first quarter of the year (for the prior year's amount), in order to properly account for the payment of cash related to the CBFRR revenues. The annual dividend is recorded as an offset to the short term debt accounts of each company, which has a material annual impact on the short term debt limit requirements.
- The capital structure of the Companies was altered to be nearly exclusively dependent on debt, versus the traditional debt/equity ratio that existed prior to the merger. For PEU and PAC, and based upon the funding sources currently available to the Companies for long term capital investments, this requires using short term debt to support long term capital projects, until long term financing is received from external

lenders such as the New Hampshire Department of Environmental Services' State Revolving Fund (SRF) loan program.

- A Rate Stabilization Fund (RSF) was established at the sister subsidiary to the two companies, Pennichuck Water Works, Inc. (PWW). The RSF is available for use by the Companies when annual revenues are below revenue requirement levels, to the extent of the CBFRR portion of total revenues. Each of the Companies has the ability to borrow from these funds, to offset the deficit in revenues for the CBFRR portion of the revenues; however, there is currently no rate mechanism that permits the recovery and repayment of these amounts in future revenue requirements. As such, this would serve to potentially increase the Companies' short term debt levels over time, absent the ability to replace these amounts with equity contributions.

Q. How do ratepayers benefit from the new rate making structure?

A. The Companies' ratepayers have benefited in a number of ways. First, they benefit from a lower ROE due to the fact that the current rate structure produces reduced levels of equity upon which these returns are earned. Due to the annual dividend, the only equity that is allowed to be earned on in any given rate case year relates to the earnings accumulated from the date of the last recorded dividend through the end of the test year. Second, they benefit from the fact that the weighted cost of capital of the Companies is nearly all related to debt, and as such are at much lower pre-tax levels than a traditional debt/equity rate structure. Rather than having approximately 50% of the weighted cost of capital calculated on an after-tax rate of 9.75% (approximately 16.1% pre-tax), the weighted cost of capital for PEU and PAC for the last completed rate cases (DW 13-126 and DW 13-128) was approximately 2.33% after-tax (5.90% pre-tax), and was primarily driven by debt rates of 6.61% (PAC) and 4.64% (PEU).

As a result, the rate increases requested by the Companies were significantly lower than would have been requested under the traditional capital structure. In the case of PEU, a permanent rate increase of 9.97% was requested, whereas the request would have been 19.60% under the prior ownership and capital structure. Likewise, for PAC, a permanent rate increase of 9.34% was requested, as opposed to a rate increase of 21.73% that would have been requested under the old structure.

Q. How will ratepayers benefit from a waiver of the 10% short term debt limit?

A. A permanent waiver of the 10% short term debt limit will allow the Companies to better manage cash flows throughout the year, finance working capital as intended within the current rate structure, and effectively invest in long term capital replacement projects while obtaining annual reimbursement financing for these projects through various funding sources, including the SRF and commercial bank lenders.

Q. Will the waiver provide needed flexibility in the overall financing of the operations of the Companies?

A. Yes. The Companies currently have a limited number of external long term debt funding sources. PEU has access to funding for certain projects through the SRF, as well as commercial bank lenders in some instances. PAC, on the other hand, only has funding available for certain long term capital projects under the SRF, as it is of insufficient size and financial strength to qualify currently for term loans with commercial bank lenders. Accordingly, the balance of long term capital project funding for PAC, over and above SRF funded amounts, comes from short term working capital advances from Pennichuck, which must be converted into long term intercompany loans, pursuant to Commission approval.

It is important to note that, as a rule, funds spent on long term capital projects, using short term advances from Pennichuck or short term working capital of the Companies, are subject to reimbursement from loans approved in periodic financing proceedings before the Commission. Consequently, increasing the short term debt limits for the Companies will enable them to fund projects in a more predictable and orderly manner, reducing or foregoing the expense of long term financings and rate cases. Furthermore, it accommodates funding of the CBFRR payments to Pennichuck throughout the year, which causes a build in the short term debt levels to Pennichuck, pending the annual dividend related to these transfers of cash.

Q. Is the purpose of Puc 608.05 satisfied by an 18% limit?

A. Yes. The short term debt rule, which implements RSA 369:7, appears intended to limit ratepayer exposure from utility funding of long term projects with potentially higher cost short term cash flows or debt, which, at the same time, would not properly match the cash outflows for the depreciation associated with capital expenditures to the cash inflows from the funding source. The rule sets a generic short term debt limit, above which a utility may not issue short term debt without Commission approval. Under the particular rate structure and circumstances of PEU and PAC, however, the 10% debt limit is unnecessarily restrictive. Inasmuch as all capital investments for the Companies will be financed by debt, and their small size limits their financing options, increasing the short term debt limit to 18% appropriately balances the policy goals of, on the one hand, limiting ratepayer exposure to increased financing costs without prior Commission approval and, on the other hand, decreasing financing and regulatory costs by providing financing flexibility to the Companies.

Q. Does the waiver serve the public interest?

A. Yes. A permanent waiver of the 10% short term debt limit and approval of an 18% short term debt limit will serve the public interest because it will:

(1) Allow the Companies to effectively reinvest in long term capital projects and infrastructure at debt funding rates as opposed to debt/equity rates, thereby lowering the overall cost to ratepayers;

(2) Provide the Companies the flexibility to effectively pursue long term reimbursement financing in support of capital projects, which allows them to pursue favorable borrowing rates associated with the SRF loan program and other commercial loan products; and,

(3) Stabilize revenue levels by allowing the Companies to focus on annual revenue levels, without concern of running afoul of the overly restrictive 10% short term debt limit requirement in portions of the fiscal year.

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

A. Yes, it does.