STATE OF NEW HAMPSHIRE

BEFORE THE

PUBLIC UTILITIES COMMISSION

Pennichuck Water Works, Inc., Pennichuck East Utility, Inc., and Pittsfield Aqueduct Company, Inc. 2018 CIAC Tariff Amendments

DW 18-189

DIRECT PREFILED TESTIMONY OF LARRY D. GOODHUE

January 31, 2019

Q. **What is your name and what is your position with Pennichuck Water Works, Inc.?**

A. My name is Larry D. Goodhue. I am the Chief Executive Officer of Pennichuck Water Works, Inc. (the "Company" or "PWW"). I have been employed with the Company since December 2006. I also serve as Chief Executive Officer, Chief Financial Officer, and Treasurer 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 of 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 Executive Officer of the Company, and Chief Executive Officer, Chief Financial Officer and Treasurer of Pennichuck?**

A. In my roles, including my primary responsibilities as Chief Executive Officer, with ultimate responsibility for all aspects 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 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. Please provide an explanation of the purpose of this written pre-filed testimony.

A. The purpose of this written pre-filed testimony is to provide support to the Commission for the defined and absolute need to provide for a change in the Company's existing tariffs, with regards to amounts that can be collected from developers and prospective customers with regards to CIAC (Contributions in Aid of Construction). These tariff changes have become necessary at this time, due to the enaction of the Tax Cut and Jobs Act ("TCJA") by the Federal government, with respect to certain aspects of that act that have come to light that have a negative impact on water utilities across the country. And most importantly, this testimony is being provided to give support to the Commission that the Current Effective Rate to be used in the "gross-up" calculations must be the statutory tax rate, as opposed to any other effective rates at the time of the CIAC contribution.

Q. What is the purpose of the requested change in the tariffs for CIAC?

A. The purpose for the changes in the tariffs for CIAC is to provide the necessary cash contribution from developers and other CIAC contributors, to fully and adequately fund the tax liability associated with the CIAC property and/or monies being contributed to the Company. Absent the ability to provide for this in the tariffs, the Company's current ratepayers will bear the burden for those tax payments, even though the value of the CIAC being provided has no association with them and brings no financial benefit to them going forward.

Q. Please describe the basis for the "gross up" calculation.

A. Currently the statutory rate for the Company is 27.24%. This is comprised of the current 21% Federal Corporate Income Tax Rate, plus the net State BPT Rate of 6.24% (7.9% NH BPT rate, net of the Federal Tax Deduction Benefit for State Income Taxes). In the following formula, the statutory rate is calculated as follows, and is the rate used as the Current Effective Rate for CIAC "gross up" calculations:

Current Effective Tax Rate = Current BPT Rate + (Current Federal Tax Rate * (1 – Current BPT Rate))

Based upon this calculation, under current statutory Federal and State Income Tax rates, the Current Effective Tax Rate is as follows:

Current Effective Tax Rate: **27.24%** = .079 + (.21*(1-.079)

The calculation of the "gross up" cost and rate factors the Company is requesting, under current effective rates, is as follows:

<u>For plant and equipment contributed:</u>

Tax Cost = ((CIAC - [CIAC*(1/Tax Life)*.5]) / (1-Current Effective Tax Rate)) – CIAC

This calculation allows for the "gross-up" of the value of the CIAC at the statutory rates, and gives credit for ½ year of tax depreciation, in conformity with the ½ year 25-year life convention rules applicable for federal tax filings for depreciable property of water utilities. Under those rules, ½ year of depreciation is taken in the first year of a depreciable asset's life and is a direct offset in the year for which CIAC is includable in taxable income of the water utility. This is in conformity with the rate structure of the

Company and its rates methodology, all being based upon cash flow coverage requirements. Credit is not given for depreciation after year one, as the ownership of the asset resides with the utility, and the depreciation in those subsequent years is the generator of cash flows to pay for the ongoing obligations related to the CIAC assets, including but not limited to: state and local property taxes, repairs and maintenance, and eventual replacement of the asset, all of which become the responsibility of the Company and its ratepayers after the property is contributed in that first year.

<u>For land or cash contributed:</u>

Tax Cost = ((CIAC)/(1-Current Effective Tax Rate)) – CIAC

<u>The "Gross Up" rate derived from either calculation is calculated as follows:</u>

CIAC "Gross Up" Rate = Tax Cost/CIAC

Under these formulas, the Tax Cost and CIAC "Gross Up" Rate for <u>contributed plant and equipment</u> would be (based upon a pro-forma property value of $1,000):

Tax Cost: **$346.90** = ($1,000-[$1,000*(1/25)*.5]/(1-.2724) – $1,000

CIAC "Gross Up" Rate: **34.69%** = $346.90/$1,000

And under these formulas, the Tax Cost and CIAC "Gross Up" Rate for <u>contributed land or cash</u>, would be (based upon a pro-forma value of $1,000):

Tax Cost: **$374.38** = ($1,000/(1-.2724)) – $1,000

CIAC "Gross Up" Rate: **37.44%** = $374.38/$1,000

Q. **Why is it essential that the "gross up" is based upon the statutory rates, as opposed to any effective rates?**

A. First, any deviation from the statutory combined rate, to an effective rate is due to:

- Temporary differences between book and tax accounting (for example, depreciable lives for assets on a tax basis is 25 years for water utility property, whereas the weighted average life for book basis calculations is 40+ years). The difference in the depreciable lives for utility plant is the primary driver for any temporary differences for the Company. Any other temporary differences are the result of variations between the tax rules and the book accounting rules for normal business activities, exclusive of CIAC.
- Permanent differences between book and tax accounting (for example, the non-deductibility of meals and entertainment for tax purposes, or the inclusion of CIAC as income for tax purposes, both of which are handled the exact opposite way for book purposes). Under the TCJA, there is also an Interest Expense Deduction Limitation. If or when this limitation applies to the Company's tax reporting, any excess interest expense deductions above the IRS limitation, would be a permanent difference, elevating the effective rate above the statutory rate. But, this elevation in the rate would be applicable to non-CIAC tax liabilities, as the interest expense deduction is not associated with the CIAC in any manner. Currently, under recent IRS interpretation and code section 163j, water utilities are not subject to this interest expense deduction limitation, either partially or fully.

- All of the temporary or permanent differences, exclusive of CIAC, result from activities paid for by either the rate payers of the Company or the shareholder of the Company. The Company has the Municipal Acquistion Regulatory Asset (MARA), as approved under DW 11-026, which is a deduction for book purposes, but is not deductible for tax purposes, and as such, is a permanent difference for tax calculations.
- As such, none of the difference between statutory and effective tax rates will be the result of the CIAC contributed to the Company, and as such, all CIAC should be grossed up at the statutory rate, giving credit for the first ½ year of deprecation on contributed plant.

Second, CIAC assets do not have an impact on the book or tax basis income for assets, with the exception of CIAC assets placed in service after the TCJA was enacted. All of the other depreciable assets for both tax and book purposes were funded by ratepayers and have an equivalent initial basis for tax and books, with differences over time that are temporary in nature, due to the difference in depreciable lives for tax and book accounting purposes. CIAC assets are includable in the valuation for both the Statewide Utility Tax and local property taxes. And, as of 2018, CIAC assets are now taxable for federal and state income tax purposes in the year for which they are received as cash contributions or as plant placed in service as used and useful. As such, beginning in 2018, there is a tax liability due for the value of CIAC in a given year, based upon the value of CIAC contributed. The tax liability may generate a cash payment due on the CIAC assets in the current year, or will result in the consumption of Net Operating Loss

Carry forwards or Deferred Tax Liabilities, all of which were generated by temporary or permanent differences paid for by the rate payers and/or the shareholder, and as such, are not the entitlement of the CIAC contributor or developer.

Thirdly, under the TCJA, companies can only shelter 80% of their current year's tax liability with NOL carryforwards from previous year (or carrybacks, as it might apply), for any NOL's generated <u>after</u> 2017. For any NOL carryforwards generated <u>thru</u> 2017, these can be utilized 100% to offset current year tax liability. However, any and all of these NOL's were funded by ratepayers or the shareholder, based upon the temporary differences described earlier in this testimony. As such, the usage of any NOL carryforwards to offset tax liabilities from CIAC, to lower the value below the statutory rates is not acceptable. If that were to be the case, the contributors of CIAC would be benefiting from tax benefits that they are not entitled to and would cause the ratepayers to be prohibited from using these benefits to their full extent in current and future tax years.

For all of these reasons, the Company absolutely feels that the CIAC "gross up" calculation must be done at statutory rates in effect for any given tax year. And that the payment must be received in the tax year for which land or cash is received, and/or when property is transferred to the Company, or when a main extension agreement is bound. This provides the cash to the Company in the year in which the tax liability is incurred.

Q. Are there other factors you wish the Commission to consider with respect to the tariff change being requested at this time?

A. Yes. This matter is highly time sensitive. The Company regularly receives CIAC, and any delays in the requested tariff change does not allow the Company to collect the cash for the contributed CIAC, and its associated tax liability. Delays of the tariff change only erode the Company's available NOL's and Deferred Tax Liabilities, to the detriment of ratepayers. Further, the Company has been proactively responding to PFOA contamination issues at the invitation of the NHDES and is going to be entering into another major project funded by an external source, for the extension of water to affected customers, resulting in a large value of CIAC being placed in service during 2019. Absent the requested tariff changes, the Company cannot enter into the agreements with this external entity to oversee the installation of this project, as it does not currently have the tariffed right to include the CIAC "gross up" calculation for that project. Delays in getting this tariff change in place, would endanger the timeline for the remediation of water to these affected residents in southern NH, due to these circumstances.

Q. Is there anything else that you wish to add?

A. Yes. I respectfully ask the Commission to issue an Order in this docket as soon as reasonably possible, as well as its overlay on the open docket under DW 18-101, as it relates to the Woodmont Commons project.

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

A. Yes, it does.