STATE OF NEW HAMPSHIRE

BEFORE THE

PUBLIC UTILITIES COMMISSION

Petition of Pennichuck East Utility, Inc. for Approval of Financings From CoBank, ACB For New Term Loan to reimburse and refinance Fixed Asset Line Drawdowns for 2018 QCPAC Eligible Capital Expenditures

DW 19-___

DIRECT PREFILED TESTIMONY OF LARRY D. GOODHUE

May 29, 2019

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 Executive Officer Pennichuck East Utility, Inc. (the "Company" or "PEU"). 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. 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. What financings are proposed by the Company in its petition in this proceeding (the "Proposed Financings").

A. The Company is proposing the following financing: a term loan for $1,297,379 from CoBank, ACB ("CoBank") to fund the repayment and refinancing of amounts drawn under the Company's Fixed Asset Line of Credit ("FALOC") for 2018 QCPAC eligible capital projects not funded by NH State Revolving Fund loans ("SRF") or NH Drinking Water and Groundwater Trust Fund grants or loans ("DWGTF"), pursuant to the QCPAC process approved as a part of the modified rate structure included in the Company's rate case under DW 17-128. As approved in Financing Docket DW 17-157, and in conjunction with the QCPAC process, the Company procured a $3.0 million FALOC with CoBank during 2018. Even though the Company received Board and Shareholder approval to borrow up to $1.45 million under this new loan, the Company is only seeking approval in this petition filing to refinance the exact amount drawn on the FALOC for 2018 QCPAC eligible capital expenditures, as delineated in its QCPAC filing under docket DW 19-035, in the amount of $1,297,379. This loan will be issued for a term of 25 years, at an interest rate of approximately 4.5%. The actual interest rate may vary from this rate, as it is based upon a Weekly Quoted Variable Rate with

CoBank, tied to market fluctuations of the underlying base rates for the moneys available to fund the loan to the Company. The new loan will be a fully amortizing loan, with monthly principal and interest payments due throughout its 25-year term of repayment.

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 book, papers and records?

A. Yes.

Q. Please explain the purpose of the proposed CoBank term loan financing.

A. During 2018, approximately $1,297,379 of capital improvements have or will be made by PEU for a number of specific projects, routine maintenance capital projects, and other non-recurring capital expenditures that did not qualify for SRF or DWGTF funding. An overview of these projects is further described in the testimony of the Company's Chief Engineer, John Boisvert, included with the Company's filing, which provides the details regarding the scope and need for these completed and/or planned projects. The financing with CoBank is needed to reimburse and repay the PEU FALOC for moneys drawn under that facility to fund these projects which were completed in 2018, and used and useful as of December 31, 2018.

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 No. DW 09-134. 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 No. 25,041 in Docket No. 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 No. 25,480 in Docket No. DW 13-017. Also, the Company entered into a new loan with CoBank in March 2015, in the amount of $625,000, for a term of 25 years, pursuant to Order No. 25,746 in Docket No. DW 14-282, and another loan with CoBank for $2.2 million for a term of 25 years, pursuant to Order No. 25,890 in Docket No. DW 16-234. In 2017, the Company entered into a term loan with CoBank to fund its 2017 capital expenditures up to $500,000 (of which only $350,078 was actually borrowed), as well as opening the $3.0 million FALOC facility, both of which were authorized in Order No. 26,117, under Docket No. DW 17-157.

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 term loan financing?

A. While the final terms and interest rates are subject to change based on CoBank's completion of its due diligence (which is in progress) and market conditions, the Company expects to borrow $1,297,379 from the overall offered amount of $1,450,000, in the form of a 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 4.50% per annum). As addressed earlier in this testimony, the proceeds from this new CoBank loan will be used to reimburse and refinance amounts drawn on the CoBank FALOC for PEU, for 2018 capital expenditures not funded by SRF loans or DWGTF grants or loans. The new CoBank loan will provide permanent financing for these long-lived QCPAC eligible 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 $151,206.15 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 No. 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 "patronage" 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 all of its financings with CoBank, to date, is as follows:

- 2010 earned patronage of $37,355,
- 2011 earned patronage of $43,108,
- 2012 earned patronage of $41,482,
- 2013 earned patronage of $57,351,
- 2014 earned patronage of $63,638,
- 2015 earned patronage of $66,012,
- 2016 earned patronage of $ 71,432,
- 2017 earned patronage of $82,824, and
- 2018 earned patronage of $65,899.

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 2018 was just paid to the Company in late March 2019). 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 thru 2017 the mix of cash and equity was 75% and 25%, and for 2018 the mix of cash and equity was 60% and 40% 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. Are there any other benefits attributed to this term loan that will be beneficial to the Company or its customers?

A. Yes. In addition to securing a term sheet for this loan from CoBank, they have agreed to maintain the Debt Service Coverage ratio requirement at 1.1x, effective on all of the Company's outstanding loans with CoBank; this change was modified down from a 1.25x coverage requirement beginning with the new loans entered into in 2017. This brought that covenant in conformity with the DSRR 1.0 and DSRR 0.1 revenue components authorized in PEU's rate case filing, in Docket DW 17-128.

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

A. The Company has explored options with several potential funding agencies over the past several 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. As evidenced in this petition, as well as petitions filed and approved in previous years, the Company has been able to access some funding from the State Revolving Fund and the NH Drinking Water and Groundwater Trust Fund, for certain eligible and qualifying capital projects. However, not all of the Company's capital projects for 2018 were eligible for this financing or grant money. As a result, the options to finance the remainder of the 2018 capital projects was limited to the usage of funds available under the FALOC, with subsequent repayment and reimbursement with taxable debt from banks or other financial institutions. For banks, the Company has determined over the past several 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. What are the estimated issuance costs for these CoBank loans?

A. The anticipated issuance costs total approximately $10,000 and relate primarily to legal costs which will be incurred to (i) review and revise the necessary loan documentation prepared by CoBank, and (ii) obtain Commission approval of the loans. The issuance costs will and amortized over the life of the CoBank loans. The annual amortization expense of $500, associated with the issuance costs, has not been reflected in Schedules LDG-2 through 3, due to its immateriality with respect to the overall analysis and impact of this proposed financing.

Q. Please explain Schedule LDG-1, entitled "Balance Sheet for the Twelve Months Ended December 31, 2018".

A. Schedule LDG-1, pages 1 and 2, presents the actual financial position of the Company as of December 31, 2018 and the pro forma financial position reflecting certain adjustments pertaining to the proposed CoBank $1.297 million term loan refinancing.

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

A. Schedule LDG-1, page 1, reflects the pro forma adjustments to record the net assets related to the replacement and installation of the capital projects funded from the FALOC drawdowns which are being refinanced with this new debt obligation, in the amount of $1,297,379, and to record a full year of depreciation and the adjustments required to reflect the Cost of Removal, of $18,831. Schedule LDG-1, page 2 establishes the total CoBank loan of $1,297,379. This schedule also reflects the income impact on retained earnings related to costs associated with the financings, as reflected on Schedule LDG-2. Schedule LDG-1, page 2, also records the use of a small amount of intercompany funds to support some of the related expenses.

Q. Mr. Goodhue, please explain Schedule LDG-2 entitled "Operating Income Statement for the Twelve Months Ended December 31, 2018".

A. As indicated previously, the issuance costs associated with the financing are not expected to be significant and are not reflected in Schedule LDG-2, page 1. Schedule LDG-2, page 1, presents the pro forma impact of this financing on the Company's income statement for the twelve-month period ended December 31, 2018.

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

A. Schedule LDG-2, page 1, contains three adjustments. The first adjustment records the estimated increase in interest expense related to additional debt raised at interest rates of 4.50% per annum. The interest expense incurred in 2018 for the drawdowns on the FALOC have not been pro formed out of the expenses, as they will be recurring each year at relatively the same level as was incurred in 2018, as projects are funded each year under that facility, in conformity with the annual QCPAC process, and the annual refinance of those CWIP funded assets that go used and useful by each year-end, in the same manner as is being done with this financing. The second adjustment records the estimated depreciation and property taxes on the new assets. The third adjustment records the after-tax effect of the additional pro forma interest expense using an effective combined federal and state income tax rate of 27.08%.

Q. Please explain the omitted Schedule LDG-3 entitled "Pro Forma Capital Structure for Ratemaking Purposes for the Twelve Months Ended December 31, 2018."

A. Schedule LDG-3, in the past, has illustrated the Company's pro forma total capitalization as of December 31, 2018, which is comprised of common equity and long-term debt including the proposed CoBank financing. In light of the new rate structure approved for the Company under DW 17-128, this schedule is no longer applicable in support of financing dockets for the Company.

Q. Are you providing other data on Schedule LDG-3 in place of the traditional "Pro Forma Capital Structure for Ratemaking Purposes for the Twelve Months Ended December 31, 2018?"

A. Yes. On the attached replacement Schedule LDG-3 the Company is providing a pro-forma analysis of the projected rate impact on a single-family residential home as a result of this financing. The impact is based upon the last approved revenue requirement for the Company, under DW 17-128.

Q. Mr. Goodhue, are there any covenants or restrictions contained in the Company's other bond and debt 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, NA (the "Bank") prohibits Pennichuck or its subsidiaries from incurring additional indebtedness without the express prior written consent of the Bank, except for certain allowed exceptions. One of the listed exceptions, in 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 to written notice related to said indebtedness being closed upon. The Company has provided written notice to the Bank, as of February 27, 2019, which was acknowledged by TD Bank on March 1, 2019. Documentation in support of this is included in Exhibit D, as attached to this filing.

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

A. The CoBank financings have been approved by the Company's and Pennichuck's Boards of Directors, as well as Pennichuck's sole shareholder, the City of Nashua. The Company is providing documentation of these approvals as Exhibits A, B and C to this petition.

Q. Do you believe that the CoBank Financing will be consistent with the public good?

A. Yes. The new CoBank loan will enable PEU to continue to provide safe, adequate and reliable water service to PEU's customers. For the reasons described in Mr. Boisvert's direct testimony, the projects funded by the CoBank loan will provide the most cost-effective solutions in support of this overall benefit for PEU's customers. The terms of the financing through the CoBank loans are very favorable compared to other alternatives and will result in lower financing costs than would be available through all other current debt financing options.

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

A. Yes. I respectfully ask the Commission to issue an Order in this docket by the end of April 2019, if at all possible, such that the Order can be effective no later than the end of May 2019, but possibly sooner than that, for financing and covenant compliance reasons. This will allow the Company to repay the FALOC for the drawn amounts and align the entry into this new loan and its repayment, in conformity with the QCPAC filing in pendency with the Commission at this time, as referenced earlier in this testimony.

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

A. Yes, it does.