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September 26, 2019

Debra A. Howland
Executive Director
New Hampshire Public Utilities Commission
21 South Fruit Street, Suite 10
Concord, NH 03301

Re: DW 19-112, Pennichuck East Utility, Inc.
Petition for Waiver of Short Term Debt Limit
Staff Recommendation for Approval

Dear Ms. Howland:

In this letter, Staff recommends the Commission approve continuation of the short-term debt limit previously authorized for Pennichuck East Utility, Inc., of 18 percent of its net fixed plant until June 30, 2023.

Background

On June 20, 2019, Pennichuck East Utility, Inc. (PEU or the Company), submitted a petition, pursuant to N.H. Code Admin. Rules Puc 201.05, requesting a permanent waiver of the short-term debt provisions established by RSA 369:7, and set at 10 percent of net fixed plant by Puc 608.05. The Company also filed a motion for an extension of the current temporary waiver approved in Order No. 25,820 (September 29, 2015) in Docket No. DW 15-288, set to expire on June 30, 2019. In support of the petition, the Company filed the testimony of Larry D. Goodhue, Chief Executive Officer of PEU. On July 3, 2019, the Commission issued a Secretarial Letter granting approval of the motion for a temporary extension of Order No. 25,820 until the conclusion of its investigation of PEU's petition of the instant docket.

Since the City of Nashua's acquisition of Pennichuck Corporation[1] (Pennichuck), Staff and the Company have met on numerous occasions, which have included discussions on PEU's short-term debt levels. As explained in Mr. Goodhue's testimony, the three Pennichuck utilities

[1] See, *Joint Petition of City of Nashua, Pennichuck Corporation et al*, Order No. 25,292 (November 23, 2011) in Docket No. DW 11-026 (Pennichuck Corporation is the parent company of PEU, Pennichuck Water Works, Inc. (PWW), and Pittsfield Aqueduct Company, Inc. (PAC)).

are financed almost entirely with debt capital. While debt capital is less costly than equity capital, providing a benefit to customers, the lack of access to equity markets conversely limits PEU's options for financing its capital expenditures. The decision only to finance capital expenditures through debt capital has also resulted in a greater reliance on the short-term debt of the Company. This has led to short-term debt levels that have exceeded the 10 percent of net fixed plant limit set by Puc 608.05. On several of those occasions, the Commission approved waivers of the statutory limit. These include Order No. 25,326 (February 1, 2012) in Docket No. DW 11-267 (15 percent); Order No. 25,482 in (March 28, 2013) in Docket No. DW 12-349 (12 percent); Order No. 25,716 (September 12, 2014) in Docket No. DW 14-191 (12 percent); and Order No. 25,820 (September 29, 2015) in Docket No. DW 15-288 (18 percent).

Mr. Goodhue's testimony stated that, consistent with Docket No. DW 15-288, the temporary short-term debt limit of 18 percent of net fixed plant has worked well to manage cash flows in an efficient manner, which have resulted in ratepayer savings with no negative impacts. Mr. Goodhue further stated that PEU's short-term debt level usually peaks during the first half of the year for two reasons. First, PEU must record a dividend payment to Pennichuck based on the City Bond Fixed Revenue Requirement, as incorporated into PEU's rates relative to the City of Nashua's purchase of Pennichuck. Second, PEU's accumulated short-term Fixed Asset Line of Credit borrowings for its previous years' capital projects are generally not converted to long-term debt until approximately May or June of the current year. This practice is part of the recently approved Qualified Capital Project Annual Adjustment Charge (QCPAC) mechanism.[2] For these reasons, Mr. Goodhue argued that the 18 percent threshold should continue to be PEU's short-term debt limit.

Mr. Goodhue further maintained that the short-term debt waiver should be permanent because it limits increases in the funding costs of short-term debt, ultimately borne by the ratepayer, by reducing the need for subsequent Commission approvals once the temporary status expires. That results in decreased regulatory costs, while also providing flexibility to the Company in its financing decisions. In addition, Mr. Goodhue stated that the proposed permanent waiver will allow PEU to better manage its cash flows and effectively finance its working capital needs. Further, PEU stated it will have the ability to effectively invest in long-term capital projects, while obtaining reimbursement for those projects through a variety of funding sources, such as the State Revolving Funds, the Drinking Water and Ground Water Trust Fund, and commercial lenders such as CoBank.

Analysis

In Order No. 25,820 (September 29, 2015) in Docket DW 15-288, the Commission acknowledged PEU's limited financing options resulting from its capital structure. Staff agrees with Mr. Goodhue that PEU's annual short-term debt levels will continuously increase until converted to long-term debt. Staff also notes, from its analysis of other PEU dockets at the Commission, the Company will be commencing various multi-year projects that will continue its reliance on its short-term debt financing.[3]

[2] Order No. 26,179 (October 4, 2018) in Docket No. DW 17-128.
[3] Order No. 26,285 (August 9, 2019) in Docket No. DW 18-101, and Order No. 26,189 (November 6, 2018) in Docket No. DW 18-132.

According to Puc 201.05(a), any request for a waiver of the Commission's Rules must serve the public interest and not disrupt the orderly and efficient resolution of matters before the Commission. Staff believes PEU's request for a waiver of Puc 608.05 meets that threshold, but on a limited basis. Historically, such waivers granted to PEU have not disrupted the Commission, and Staff believes this waiver request to be no different. Further, as explained by Mr. Goodhue, PEU is financed almost entirely with debt capital. While less expensive than equity capital, it does result in a greater reliance on short-term debt. The recently authorized QCPAC will, to some extent, also increase this reliance. Due to this capital structure, requiring PEU to maintain a short-term debt limit of 10 percent of net fixed plant is currently not practicable. Further, allowing a short-term debt limit of 18 percent of net fixed plant should result in greater financial flexibility and efficiency, which is in the public interest. Staff agrees that, given the facts presented at this time, a short-term debt level of 18 percent of net fixed plant is currently appropriate. Staff further recommends that PEU should be required to continue to provide written notification to Staff and the Office of the Consumer Advocate (OCA) in any month the short-term debt level exceeds 15 percent of net fixed plant. This notification can lead to discussions concerning the conditions upon which PEU requests waivers.

Regarding PEU's request for a permanent waiver of Puc 608.05, Staff disagrees and recommends the Commission deny the Company's request in this regard. Staff believes the impact of the QCPAC mechanism on PEU, approved only last year and currently petitioned for initial inclusion on customers' bills before the end of 2019, should first be analyzed over a sufficient period of time. Specifically with regard to its impact on the level of the Company's short-term debt. Staff believes that it would be unreasonable for a determination to be made regarding the permanency of the short-term debt waiver before a "real-time" evaluation is conducted. Therefore, Staff recommends a further four-year period of time, or until June 30, 2023, for this evaluation to occur. If it becomes apparent that the Company's short-term debt limit needs to be further extended or adjusted, PEU should make the appropriate filing with the Commission at the appropriate time. Staff notes again, that the Commission has historically supported the Company in its previous requests for waivers.

In summary, Staff recommends a temporary short-term debt limit of 18 percent of net fixed plant that, absent other Commission action, will expire four years from the expiration date of PEU's previous temporary waiver, or on June 30, 2023. Staff further recommends the Commission continue to require PEU to provide written notification to Staff and the OCA in any month the short-term debt level exceeds 15 percent of net fixed plant.

Please contact me if there are any questions regarding this Staff recommendation.

Sincerely,

Anthony J. Leone
Utility Analyst

Attachment
cc: Service list

Pennichuck East Utilities, Inc.
DW 19-112

Short Term Debt Limit Waiver
Responses to Staff Data Requests – Set 1

Date Request Received: 7/26/19	Date of Response: 8/8/19
Request No. Staff 1-1	Witness: Larry D. Goodhue

REQUEST: Neither Pennichuck Water Works nor Pittsfield Aqueduct Company are requesting short-term debt waivers at this time. Please explain further why PEU should continue to receive waivers when similarly structured companies no longer require them.

RESPONSE:

Pennichuck Water Works (PWW) provides all of the manpower/employees and vehicles in support of the other two Companies (PEU and PAC). As such, PWW is generally in a position where it has short-term receivables from the other entities, versus short-term payables/debt. As such and coupled with the fact that all capital projects are debt funded, PWW consistently has ST debt in total that is less than 5% of its utility capital assets. This percentage is related to the current portion of PWW long term debt.

Pittsfield Aqueduct Company (PAC) currently has a short-term debt ratio that is below 5% of its utility capital assets. This is primarily because it is currently earning its allowed rate of return, as it pertains to revenue coverage of its operating expenses, inclusive of the amounts it pays as intercompany payable transactions for the usage of PWW labor and vehicles.

PEU uses much more of the PWW resources in support of its operations, and as such, incurs short-term intercompany payables that raise its overall short-term debt ratio. Additionally, with the inception of its Fixed Asset Line of Credit mechanism, as approved in the Company's most recently completed rate case under DW 17-128, PEU will borrow each year up to $3 million of usage under that line of credit, pending its annual refinance of those borrowed funds with long-term loans, converting that short-term debt to long-term debt. As such, any borrowings on the FALOC for PEU in any given year, coupled with its short-term intercompany payables, cause its short-term debt ratio to elevate each year between annual refinancing events. Additionally, any regulatory lag or consumption pattern decreases due to weather or other factors cause PEU to have less than full coverage of those operating expenses, and as such, its short term intercompany payable balances are reflective of that dynamic and contribute to the elevated short-term debt ratios.

Pennichuck East Utilities, Inc.
DW 19-112

Short Term Debt Limit Waiver
Responses to Staff Data Requests – Set 1

Date Request Received: 7/26/19 | Date of Response: 8/8/19
Request No. Staff 1-2 | Witness: Larry D. Goodhue

REQUEST: **Ref. Attachment LDG-1**

a) Please explain further the increase in the Annual "Low" figure of the short-term debt from 4.47% in 2016 to a projected 14.48% in 2019.

RESPONSE:

The increase in this ratio over that timeframe is the result of two things.

First, since the end of 2016 thru the beginning of 2019, due to regulatory lag in getting full rate relief from its most recently filed rate case under DW 17-128, PEU incurred an increase in its short-term intercompany debt payable to Pennichuck Corporation, for which the Company is preparing a financing petition to convert to a long-term intercompany note payable, as described in the testimony filed in support of this docket. That financing petition will be seeking to convert $2.5 million of that short-term obligation, supported by investments in PEU's utility plant from work order activity over the past couple of years. This $2.5 million represents 4.75% of the 14.48%.

Second, during the year 2018, approximately $1.2 million of monies were borrowed under PEU's FALOC for projects that went used and useful by 12/31/2018, and for which a QCPAC filing is in pendency with the Commission under docket DW 19-035. The long-term debt obligation approved by the Commission as part of DW19-069 was closed on with CoBank in early July of 2019, which converted 2.4% of this short-term ratio to long-term.

Those two factors combined account for approximately 7.15% of the elevation in the ratio (which in total was 10.1%, as the change from 4.47% in December 2016 to 14.48% in January of 2019). The remainder of the elevation is the fact that PEU has amassed additional long-term debt in support of its utility plant, and with each new debt instrument, is the incidence of the current portion of any of those debt obligations (any amounts due for principal repayment within any succeeding 12-month period of time).

Pennichuck East Utilities, Inc.
DW 19-112

Short Term Debt Limit Waiver
Responses to Staff Data Requests – Set 1

Date Request Received: 7/26/19 Date of Response: 8/8/19
Request No. Staff 1-3 Witness: Larry D. Goodhue

REQUEST: **Ref. Attachment LDG-2**

a) Please indicate the APR(s) PEU's short-term debt facilities.
b) Please indicate the borrowing limits of PEU's short-term debt facilities.
c) Please explain why the short-term debt percentages indicated for month-ends March through September 2019 appear to be consistently running above the 16.0% level.
d) What was the actual short-term debt percentage calculated as of June 30, 2019.

RESPONSE:

a) PEU's short-term intercompany obligations incur interest at the Federal Discount Rate, adjusted each month. As of June 30, 2019, that rate was 3.0%. The balance of the APR rates is the coupon rate on all of PEU's outstanding long-term debt, for the current portion of those obligations, which range for a low of 1.96% to a high of 5.3%.
b) PEU short-term debt, as it relates to intercompany debt is not specifically limited. As it promulgates its rate cases and is able to earn a revenue return that fully funds its operating expenses, borrowings under this facility will not rise. However, to the extent it utilizes PWW manpower and assets in completing its capital projects, the Company intends to file annual financing petitions to convert the short-term payables related to these activities, to long-term intercompany notes, in support of these long-lived capital assets.
c) The ratio is consistently running above the 16% level for those months, as the annual refinancing of the FALOC monies await refinance to long-term debt. This dynamic will occur every year as a part of that annual refinance and QCPAC process. Going forward, this refinance should occur in April or May of each year. In 2019, it was delayed until the beginning of July due to time delays in getting the CoBank loan petition submitted and approved, due to a process of the annual credit review by the bank in light of the Company's new rate structure approved in DW 17-128, and due to associated modification of PEU's loan covenants with the bank resulting from this rate structure modification.
d) As of June 30, 2019, once calculated after the month-end closing was completed in mid-July, the ratio was computed to be 18.1%. The Commission has been notified of that in a

separate communication, as this docket is being pursued. The ratio for July 31, 2019 is anticipated to come back below the 18% level by nearly 2% as the refinance of the FALOC to the new CoBank term loan occurred in early July.

Pennichuck East Utilities, Inc.
DW 19-112

Short Term Debt Limit Waiver
Responses to Staff Data Requests – Set 1

Date Request Received: 7/26/19
Request No. Staff 1-4

Date of Response: 8/8/19
Witness: Larry D. Goodhue

REQUEST: **Pre-Filed Direct Testimony of Larry D. Goodhue, Bates 10, Line 5**
Please quantify the savings to PEU's ratepayers from the referenced waivers.

RESPONSE:

As demonstrated in docket DW 17-128, PEU funds all of its capital projects thru the issuance of long-term debt, with the exclusion of work order activity for PWW resources used in the completion of those capital projects. The cost of long-term debt for PEU averages approximately 4-5% versus a traditional 50/50 capital structure, with the ROE typically in the 16% pre-tax range. Additionally, using the FALOC to fund capital projects during each fiscal year, with borrowed monies under that facility adjusted monthly, but consistently in the 4-5% range, as well. As such, these waivers are needed to continue to allow PEU to fund its long-term utility assets using its existing approved rate structure, the FALOC and the QCPAC processes, as designed and intended (as it does not have access to additional equity investments, which would be more costly to ratepayers).

Pennichuck East Utilities, Inc.
DW 19-112

Short Term Debt Limit Waiver
Responses to Staff Data Requests – Set 1

Date Request Received: 7/26/19	Date of Response: 8/8/19
Request No. Staff 1-5	Witness: Larry D. Goodhue

REQUEST: **Pre-Filed Direct Testimony of Larry D. Goodhue, Bates 11, Lines 8 – 14**

a) Please provide further explanation regarding the reason for and the specific mechanics of the annual dual entries recorded, ie, dividend and return of capital, relative to the transfer of CBFRR revenues to Pennichuck.
b) Please provide further explanation regarding the statement that, "the annual dividend is recorded as an offset to the short-term debt accounts of each company", and why this, "has a material annual impact on the short-term debt limit requirements."
c) Please provide a cash flow schedule of the impact the CBFRR payment has on the short-term debt of the Company.

RESPONSE:

a) As a part of PEU's approved rate structure, originally established under DW 11-026, and further modified under DW 17-128, a component of PEU's allowed revenues relate to its CBFRR obligation to Pennichuck Corporation, and ultimately to the City of Nashua for the bonds it issued to buy Penn Corp in January 2012. This money flows up to Penn Corp from PEU on a monthly basis. An annual dividend is approved by our Board of Directors to properly account for this movement of cash up from PEU to its parent. Functionally, doing a dividend every month for this purpose is impractical, and as such it is an annual declared dividend.
b) It has an impact on the short-term debt accounts of each company because the transfer of cash results in an entry that credits cash at PEU and debits its intercompany account with the parent each month. Then, when the annual dividend is declared, it is recorded as an entry to APIC or Retained earnings, with the offsetting entry being to its intercompany account. As such, this amount builds throughout the year, and is declared as an annual entry for the second part of this process, when the annual dividend is declared and booked.
c) The monthly CBFRR obligation for PEU to Penn Corp, as approved in dockets DW 11-026 and DW 17-128 is $77,192.43, which results in the cumulative build up towards the annual dividend for these monies, which total $926,309.16 per annum.

Pennichuck East Utilities, Inc.
DW 19-112

Short Term Debt Limit Waiver
Responses to Staff Data Requests – Set 1

Date Request Received: 7/26/19 | Date of Response: 8/8/19
Request No. Staff 1-6 | Witness: Larry D. Goodhue

REQUEST: **Pre-Filed Direct Testimony of Larry D. Goodhue, Bates 13, Line 18 – Bates 14, Line 8**

a) Please describe the specific advantages of reinvesting in long-term capital projects and infrastructure at debt funding rates as opposed to debt/equity rates. Please explain the specific difference between these two rates.
b) Please provide further explanation regarding how the Company's permanent waiver request would provide it with the flexibility to pursue long-term reimbursement financing options at favorable borrowing rates.
c) Please provide further explanation regarding how the Company's permanent waiver request would specifically stabilize its revenue levels and allow it to focus on annual revenue levels.
d) Other than the cost associated with a filing for Commission review, please explain the other benefits of a permanent waiver of the short-term debt limit as compared to a term waiver, such as three to four years? Does the Company anticipate that if the permanent waiver is granted, the Company would not return seeking an adjustment to the short-term cap of 18 percent?

RESPONSE:

a) As has been demonstrated in the dockets for DW 11-026 and DW 17-128, long-term capital projects funded with debt at rates of 4-5% is much better for rate payers than the traditional rate structure (which existed for PEU prior to 1/25/2012) with 50% of its utility plant funded at those rates and 50% of its utility plant funded at ROE rates that range from 12-16% pre-tax (depending on the current federal and state income tax rates). This 50/50 capital structure based upon those rate ranges would be in the aggregate, between 8% and 10.5%.
b) PEU seeks a permanent waiver for this level of approved short-term debt ratio due to its rate structure and ownership structure. As it funds all of its capital with long-term debt, and has its FALOC and QCPAC processes in place, it will continue to have levels of short-term debt to utility plant that can and will exceed 10% during each year, as it funds its capital projects each year, awaiting annual refinancing events for repayment of the

borrowing FALOC funds. So, it's not needed to necessarily access those funds, but is needed to remain in compliance with this statutory requirement as it continues to fund its capital projects with long-term debt, as identified as an element of its approved rate structure for its most recent filed and approved permanent rate cases. Having this in place and being able to continue to utilize the facilities in place, with support of rates that allow for the repayment of the long-term debt obligations, gives PEU the ability to continue to work with its lenders in providing the funds for its capital projects.

c) Again, the waiver request does not necessarily accomplish those things, but having the waiver in place in support of the Company's approved rate structure does. The QCPAC element included in PEU's rate structure, along with the DSRR portion of its allowed revenues and the corresponding RSF fund backstopping those revenues, provides for a consistent and/or fixed portion of its revenues, ensuring the cash available to service its long-term debt payments. This is essential for the Company to be able to continue to access long-term debt for projects, as lenders are very focused on how debt can be repaid, especially in an ownership structure that does not have an ongoing equity component contributing to those investments.

d) The advantage of the permanent waiver is related to the cost and timing required to accomplish this every three to four years. But it also relates to the fact that the levels of short-term debt to utility plant for the Company will continue to meet or exceed the 10% statutory limit, due to the Company's structure and means of financing capital during each year. This process, as approved and tied to the Company's rate structure, is something that is intended to remain in place for the future. As such, it would make sense that the waiver needed in support of this, would be similarly termed. It is not anticipated that a waiver above the 18% level would be required or requested at any time in the future.

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