UNITIL ENERGY SYSTEMS, INC.

DIRECT TESTIMONY

OF

ANDRE J. FRANCOEUR

AND

CHRISTOPHER J. GOULDING

PETITION TO INCREASE SHORT-TERM DEBT LIMIT

New Hampshire Public Utilities Commission

Docket No. DE 23 - ___

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SCHEDULES

I. INTRODUCTION

Q. Please state your name and business address.

A. My name is Andre J. Francoeur. My business address is 6 Liberty Lane West, Hampton, New Hampshire 03842.

My name is Christopher J. Goulding. My business address is the same as Mr. Francoeur's.

Q. Mr. Francoeur, what is your position and what are your responsibilities?

A. I am the Financial Planning and Analysis Manager for Unitil Service Corp., which provides services to UES. My responsibilities are primarily in the areas of strategic planning and budgeting, supporting investor relations, and assisting with various regulatory and treasury projects.

Q. Please describe your business and educational background.

A. I have approximately 7 years of professional experience within the finance and accounting areas. I began working for Unitil Service in 2017 as a Financial Analyst, was promoted to Senior Financial Analyst in 2020, and promoted to my current role in 2021. I graduated with honors from the State University of New York at Plattsburgh with a Bachelor of Science degree. I recently graduated from the University of New Hampshire with a Master of Business Administration graduate degree with a concentration in Finance.

Q. Do you hold any professional licenses?

A. Yes, I am a Certified Management Accountant.

Q. Mr. Goulding, what is your position and what are your responsibilities?

A. I am the Vice President of Finance and Regulatory for Unitil Service Corp. ("Unitil Service"), a subsidiary of Unitil Corporation ("Unitil Corp.") that provides managerial, financial, accounting, regulatory, engineering and information technology services to Unitil Corp.'s subsidiaries. My responsibilities include all rate and regulatory filings, financial planning and analyses, treasury operations, budget, and insurance and loss control programs.

Q. Please describe your business and educational background.

A. I have over 20 years of professional experience in the utility industry focused within the finance, accounting and regulatory areas. In 2000, I was hired by NSTAR Electric & Gas Company ("NSTAR," now Eversource Energy) and held various positions with increasing responsibilities in Accounting, Corporate Finance and Regulatory. I was hired by Unitil Service in early 2019 as the Director of Rates and Revenue Requirements. In 2023, I was promoted to my current position. I earned a Bachelor of Science degree in Business Administration from Northeastern University in 2000 and a Master's in Business Administration from Boston College in 2009.

Q. Were both this testimony and exhibits prepared by one of you or under your direct supervision?

A. Yes, they were.

II. SUMMARY AND OVERVIEW OF TESTIMONY

Q. What is the purpose of this testimony?

A. The purpose of this testimony is to support the Company's petition to change its current short-term debt limit formula pursuant to RSA 369:7 and N.H. Admin. Rule Puc 307.05. The testimony will first provide a description of how the Company uses short-term debt as part of its financing plan. Next the testimony provides a summary of the Company's current short-term debt limit and how the current limit formula has become increasingly restrictive. Lastly, we will describe the Company's proposed short-term debt limit formula and why it is in the public interest.

III. CURRENT DEBT LIMIT AND PURPOSE OF SHORT-TERM DEBT

Q. Please describe how the Company uses short-term debt and the financing cycle.

A. Short-term debt is used principally to fund seasonal working capital requirements and construction work in process ("CWIP"). The Company's funding is derived primarily from internally generated funds, which consist of net operating cash flows including depreciation, amortization and deferred income taxes. UES supplements internally generated funds through short-term borrowings under the Unitil Corp Cash Pool, which is supported by bank borrowings under Unitil Corp's credit facility. When UES' short-term balance builds to a sufficient level, it seeks long-term financing to reduce the short-term debt and appropriately match the long-term utility asset lives with long-term funding.

Q. What is the Company's current short-term borrowing limit?

A. The short-term borrowing limit currently in effect as of June 1, 2023 is $40.0 million pursuant to the short-term borrowing limit calculation approved in Docket DE 08-085.

Q. Please explain the current process for establishing the short-term borrowing limit.

A. The borrowing limit is based on a formula filed with the Commission by May 1 each year for effect June 1. The formula consists of 10% of Net Utility Plant reported on the most recent FERC Form 1 report plus a fixed amount of $10 million.

Q. Explain how the current short-term debt limit formula was established.

A. On June 12, 2008 UES filed a petition for authority to increase its short-term debt limit and to establish a short-term debt limit formula in Docket DE 08-085. On July 23, 2008, the Commission issued an Order authorizing the Company to increase its short-term debt limit from $16 million to $24 million but deferred a decision on the Company's request to establish a formula pending further examination (Order No. 24,875). On October 22, 2009, the Commission waived Puc Rule 307.05, which limits a utility's short-term indebtedness to 10% of net fixed plant, and approved a Settlement Agreement between Staff and the Company establishing a short-term debt limit formula equal to 10% of Net Utility Plant plus $10 million. Please refer to Schedule AFCG-1 for authorized borrowing limits since June 1, 2010.

Q. Why did the Company file a petition to increase its short-term borrowing limit in Docket DE 08-085?

A. The Company's prior petition to increase the short-term borrowing limit was largely predicated on higher working capital as a result of increasing purchased power and transmission expense, cash obligations for credit assurance as a participant in New England ISO, ongoing energy-related stranded cost obligations and increasing capital expenditures. The Company testified that reducing the frequency of long-term permanent financings created savings by reducing transaction costs and better optimized the offering size of the permanent financings.

IV. PROPOSED SHORT-TERM DEBT LIMIT FORMULA

Q. Is the Company requesting a waiver of Puc 307.05 to change the short-term borrowing limit formula in this docket?

A. Yes. The Company is requesting a waiver from the Commission of Puc 307.05 to change its existing short-term debt formula pursuant to Puc 201.05 regarding requests for waivers of Commission rules.

Q. Is a waiver of Puc 307.05 in the public interest?

A. Yes. As explained in more detail later in this testimony, the proposed formula change will serve the public's interest by allowing the Company more flexibility in the timing of permanent financings, lowering transaction costs and decreasing the amount of Company resources allocated to issuing permanent financing. The proposed formula change is justified in that it reflects the Company's current borrowing requirements, and is a reasonable alternative that will allow for the orderly and efficient determination of the Company's short-term debt authorization.

Q. What is the Company's proposed change to the currently authorized borrowing limit formula?

A. The Company is proposing to increase the Net Utility Plant percentage to 20% from 10% and remove the currently authorized fixed component of $10 million.

Q. When do you propose the new formula take effect?

A. The Company requests that the formula first take effect upon a final order in this docket and be updated effective June 1 for each year to follow, which is the same cadence that is currently approved.

Q. Are you proposing to change or add anything else to the existing process for establishing the Company's short-term borrowing limit?

A. No. The only proposed change is to the percentage applied to Net Utility Plant as reported on the most recently filed FERC Form 1 and removal of the $10 million fixed amount.

Q. Under the proposed borrowing limit formula, what would the new limit be based on Net Plant balance at the end of 2022?

A. Under the proposed borrowing limit formula, the Company's borrowing limit would be $59.9 million as illustrated on Exhibit AFCG-1.

Q. Please summarize the reasons why the Company is requesting to change the short-term debt limit formula.

A. As explained in greater detail below there are several factors driving the request to change the current short-term debt limit formula, which the Commission approved approximately fourteen years ago. First, the Company's long-term debt maturities put pressure on short-term borrowings; this was not yet an issue when Docket DE 08-085 was filed. Second, higher working capital requirements, specifically purchased power, have also pressured short-term debt levels. Lastly, the existing limit has become increasingly restrictive due to the Company's growth and is thereby limiting financing flexibility. Combined, these factors are contributing to the Company approaching the borrowing limit faster which in turn necessitates more frequent long-term debt or equity financings. Simply put, more frequent permanent financings result in less efficient issuance sizes and higher issuance costs which are ultimately borne by customers.

Q. Please explain the effect of debt retirements on short-term debt levels.

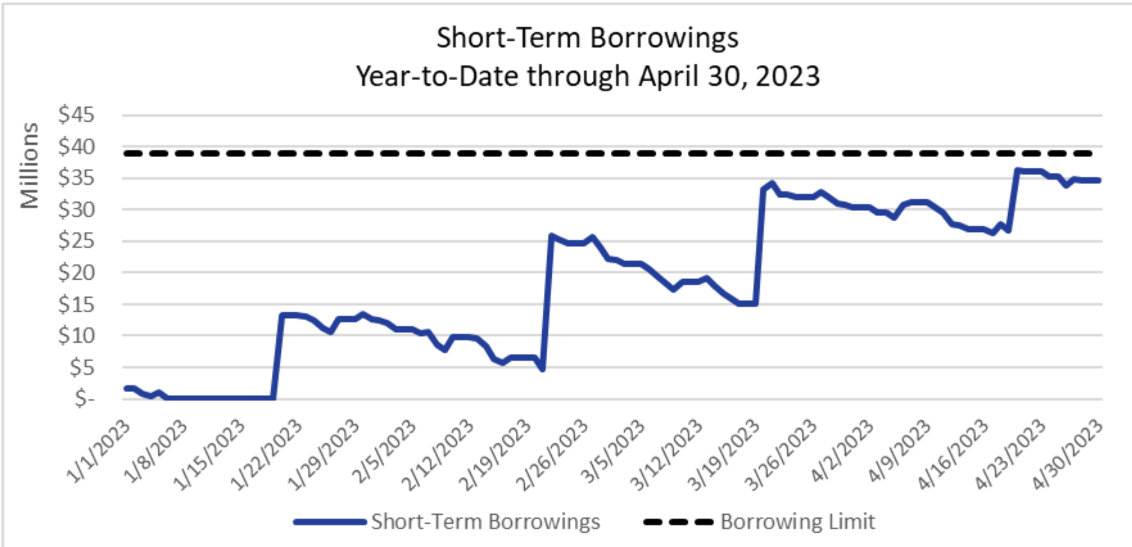
A. The Company has several Serial Bonds that have been maturing at regular intervals since 2015. As a result of this debt maturity schedule, short-term borrowings are increasing at a faster rate than they were previously. Unlike Term Bonds where the entirety of the principal matures on a single date, Serial Bonds mature at staggered dates and therefore provide additional flexibility to recapitalize the maturing debt at appropriate times and reduce refinance risk. The Company's various Serial Bonds have maturity dates spanning up to 10 years and the staggered debt retirements are often referred to as sinking fund payments. From 2018 to 2022, sinking fund payments at UES totaled $32 million, and over the next five years, payments will total $17.5 million. Please refer to Schedule AFCG-2, which illustrates both historical and projected sinking fund payments. When sinking fund payments are due, unless the Company has sufficient cash on hand, they are immediately funded with short-term debt. Sinking fund payment obligations put pressure on short-term borrowings and ultimately cause the Company to pursue long-term financings more frequently.

The proposed borrowing limit would allow the Company to reduce the frequency of long-term financings which benefits customers by spreading issuance costs over larger amounts of capital. Larger issuances of long-term debt can also result in a more competitive bidding process which can lead to lower debt rates. Exhibit AFCG-3 shows the Company's permanent financing activity over the last 5 years. The Company required two separate debt financings to recapitalize short-term debt in a span of less than three years. This illustrates the pressure sinking fund payments have placed on the Company's borrowings.

Q. Please explain the effect of working capital requirements on short-term debt levels.

A. Working capital requirements related to purchased power increased significantly in 2023 and a substantial portion of short-term debt capacity is being utilized for that purpose. Higher purchased power payments quickly increased short-term debt to levels that approached the current borrowing limit. As shown in Figure 1 below, the Company had zero short-term borrowings in early January, but as a result of energy supply payments borrowings quickly grew to a peak of $36 million in April 2023. The peak borrowing amount through April of 2023 was within $3.0 million of the existing borrowing limit.

Figure 1: YTD Short-Term Borrowings



Q. How does the current limit proportionally compare to the level that became effective June 1, 2010?

A. The debt limit at June 1, 2010, the year in which the formula of 10% Net Utility Plant plus $10 million first took effect, was $24.3 million. As shown on Exhibit AFCG-1, that limit as a percentage of Net Utility Plant was 17.0%, whereas the limit that took effect on June 1, 2023 is only 13.3% of Net Utility Plant. This decrease over time illustrates that the existing formula has become increasingly restrictive relative to the Company's asset growth and higher level of capital spending. This is further exacerbated by the aforementioned debt retirement payments and working capital requirements. The proposed formula will rebalance the limit as a percentage of Net Utility Plant, provide additional liquidity for working capital requirements, and allow for the limit to grow with the Company's needs over the coming years.

Q. Please explain how UES arrived at the proposed formula change.

A. The Company believes it is prudent to have a short-term borrowing limit that allows for permanent financings to be spaced up to three years apart. This long-term financing cycle allows transaction costs to be spread over larger amounts of capital and there is financing flexibility during times of capital market volatility. To achieve this, the Company needs a limit similar to the forecasted increase in short-term borrowings over a three-year period absent any additional permanent capital. Please refer to Schedule AFCG-4 which illustrates the Company's expected increase in short-term borrowings over a three-year period from 2023 to 2025. The forecasted short-term debt increase over the three-year period is approximately $62 million. This figure is similar to what the proposed borrowing formula would yield of $59.9 million.

Q. Please explain why it is beneficial to ratepayers to increase the short-term borrowing limit.

A. Increasing the short-term borrowing limit benefits ratepayers and is in the public interest because the result will be less frequent long-term debt offerings. By increasing the short-term debt limit the Company has flexibility to access capital markets during more favorable periods and increase the size of the financings. Without this increase the Company will likely have to access capital markets at a minimum interval of two years which affords considerably less flexibility. Larger debt offerings tend to be more efficient, can attract more investor interest in the private placement market and therefore can result in more competitive pricing. Less frequent financings also have the benefit of spreading issuance costs, such as legal fees, over larger amounts of capital and reducing the Company's resources used when organizing and executing long-term financings. Customers also benefit from short-term debt, typically the least expensive funding source, which the Company uses to fund CWIP. Customers benefit from funding CWIP with short-term debt by keeping the Allowance for Funds Used During Construction rate as low as possible.

V. CONCLUSION

Q. Does this conclude your testimony?

A. Yes, it does.