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October 7, 2009

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

Re: DW 09-134, Pennichuck East Utility, Inc.  
Petition to Issue Long Term Debt



Dear Ms. Howland:

On July 28, 2009, Pennichuck East Utility, Inc. (PEU) filed a petition, pursuant to RSA 369, for authority to issue long term debt. PEU is a regulated water utility pursuant to RSA 362:2 and 362:4 and serves some 5,400 customers in various communities in southern New Hampshire. PEU intends to borrow \$6 million in notes with a 20 year term from CoBank, ACB (CoBank). Accompanying the petition is the direct testimony of Thomas C. Leonard, PEU's Chief Financial Officer. After review and discovery, Staff recommends approval of the petition through the issuance of an order *nisi*.

According to PEU's petition, PEU currently has a 10 year, \$4.5 million floating-rate secured note payable to Bank of America that matures on December 31, 2009. The company had purchased a derivative to hedge the variable rate on this note such that it has had an effective rate of interest of 6.0% in both 2007 and 2008. The proposed 20-year note with CoBank will have an interest rate not expected to exceed 6 to 6.5% according to the company's petition. PEU intends to use the proceeds of this borrowing to refinance the maturing Bank of America note and to use the remaining \$1.5 million to repay short-term intercompany borrowings incurred to fund ongoing capital improvements.

As described in PEU's petition, CoBank is a Government Sponsored Enterprise which is owned by its customers and issues debt with the implicit full faith and credit of the U.S. Government. It is a federally chartered bank under the Farm Credit Act of 1971, as amended, and is restricted to making loans and leases to eligible borrowers in the agribusiness and rural utility industries and certain related entities as defined in that Act.

The characteristics of PEU's service territory are consistent with CoBank's charter and mission and therefore PEU is eligible to borrow from it. On an annual basis, CoBank's Board of Directors targets a refund amount that is returned to borrowers based on the annual average loan volume. These refunds, known as "patronage payments", are not guaranteed, but are an expected additional benefit of financing with CoBank. Any such payments made to PEU in the future would be reflected in the company's cost of capital, serving to reduce the overall cost of the financing to PEU's customers. PEU has indicated that it sought other financing options from both Bank of America and Citizens Bank for this refinancing. According to PEU, neither bank was interested in lending on an unsecured basis for longer than 5-7 years, and PEU was seeking longer term financing which better matched the lives of the related utility assets.

According to PEU's petition and testimony, the \$1.5 million in financing available after retirement of the Bank of America note will be used for repayment of short term intercompany debt and for capital improvements. In discovery, Staff inquired as to the planned capital improvements (See Staff Data Request 1-4). PEU has indicated that the capital improvements planned or completed thus far in 2009 include \$516,000 for a radio read program, \$225,000 for 3 standby generators, and about \$80,000 for a booster station at the company's WESCO system in Hooksett. There are other capital projects on-going in amounts ranging from \$6,000 to \$50,000 in total cost.

PEU's proposed borrowing in this docket would add a net amount of \$1.5 million in new debt to its capital structure, and as illustrated on Exhibit TCL-3 attached to the testimony of Mr. Leonard, would result in a debt to equity ratio of 56/44. However, Staff sought to understand how the pending acquisition of the North Country assets contemplated in docket DW 08-052 would affect PEU's capital structure.<sup>1</sup> PEU's response to Staff Data Request 2-4 indicates that the acquisition of the assets and related transfer of equity to PEU would result in a debt to equity ratio of about 45/55. Although this creates a capital structure which would normally be considered too equity rich, it is Staff's opinion that this ratio is temporary. As indicated in PEU's supplemental response to Staff Data Request 2-4, dated September 24, 2009, PEU recently declared a dividend of \$700,000. This will serve to remove that amount of equity from the company's capital structure. As a result of this dividend, post-transfer the debt to equity ratio would now project to be about 48/52.

Staff believes this ratio is acceptable in this instance, given the need to address the rate implications resulting from capital improvements that have helped resolve the long time service issues at the North Country systems, partly by transferring them to PEU. The Commission has yet to issue its decision in DW 08-052, and as detailed above, the greatest impact to PEU's capital structure arises from that docket and not from the financing contemplated in the instant docket.

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<sup>1</sup> The settling parties in DW 08-052 presented a settlement proposal at the September 30, 2009 hearing which calls for Commission approval of the transfer of the North Country systems (Locke Lake in Barnstead, Birch Hill in Conway, and Sunrise Lake Estates in Middleton) from Pittsfield Aqueduct Company, Inc. (PAC) to PEU. That settlement agreement also provides for transfer of approximately \$1.6 million of equity from PAC to PEU.

As indicated earlier, Staff recommends approval of PEU's financing in this docket through the issuance of an order *nisi*. The terms of the financing are reasonable, and the proposed use of the funds has been reviewed and is considered reasonable. There will be no impact on customer rates resulting from this financing. Any potential rate impact will be determined at the time of PEU's next rate case, and in Staff's opinion, the impact of this financing will be negligible. Staff has attached to this letter a copy of the discovery requests that PEU responded to in the course of our review of this financing request.

If there are any questions regarding this, please let me know.

Sincerely,

A handwritten signature in blue ink that reads "Mark A. Naylor". The signature is fluid and cursive, with a large initial "M" and "N".

Mark A. Naylor  
Director, Gas & Water Division

Attachments  
cc: Service list