STATE OF NEW HAMPSHIRE
BEFORE THE
PUBLIC UTILITIES COMMISSION

AQUARION WATER COMPANY OF NEW HAMPSHIRE

DOCKET NO. DW 09-___

DIRECT TESTIMONY

OF

DONALD. J. SMIAROWSKI

October 8, 2009

Q. Please state your name and business address.

A. My name is Donald J. Smiarowski. My business address is 600 Lindley Street, Bridgeport, Connecticut.

Q. By whom are you employed and in what capacity?

A. I am Manager of Treasury and Risk at Aquarion Water Company of Connecticut ("AWCCT"), an affiliate of Aquarion Water Company of New Hampshire (the "Company"), responsible for treasury matters for each of Aquarion Water Company's three regulated water utility subsidiaries. I have held this position since January 2008 and have worked for AWCCT for 12 years.

Q. What is the purpose of your testimony?

A. The Company is seeking approval to issue an unsecured inter-company Promissory Note (the "Note") in an aggregate principal amount of up to $4,000,000. My testimony gives an overview of the proposed transaction and the reasons for it and explains why the Company believes the transaction is in the public interest.

Q. Please summarize the exhibits you are providing in connection with the Company's request for approval of the loan transaction you described.

A. I am including the following exhibits with my testimony, for the Commission's review.

Exhibit DJS-1	Estimated Issuance Costs
Exhibit DJS-2	Balance Sheet, Actual and Pro Forma to Reflect Issuance of Promissory Note

Exhibit DJS-3	Income Statement for The Twelve Months Ended June 30, 2009, Actual and Pro Forma to Reflect Issuance of Promissory Note
Exhibit DJS-4	Journal Entries to Reflect The Issuance of $4,000,000 Promissory Note
Exhibit DJS-5	Statement of Capitalization, Actual and Pro Forma to Reflect Issuance of Promissory Note
Exhibit DJS-6	Evaluation of Financing Proposals, Internal Rate of Return
Exhibit DJS-7	Promissory Note
Exhibit DJS-8	Consent by Board of Directors

Q. Please explain the purpose of this proposed transaction.

A. The Company presently has $4,300,000 in outstanding short-term debt, which is in excess of the 10% limit established under N.H. Code of Admin. Rules 608.05. The 10% limit would currently permit the Company to have approximately $2,550,000 of short-term debt. In its Order No. 24,959 issued April 22, 2009, the Commission authorized the Company to exceed the 10% limit on the condition that, by March 31, 2010,it refinance a sufficient portion of its short term debt to bring the outstanding balance below the 10% level. The financing being proposed in this will permit the Company to repay $4,000,000 of its short-term borrowings, reducing the level of short-term indebtedness from 16.85% of its net fixed plant to 1.18% of its net fixed plant (See Exhibit DJS-2).

Q. What is the purpose of the indebtedness being refinanced?

A. As explained above, the purpose of the new debt issuance for which the Company is seeking authority in this proceeding is to refinance existing short-term debt in accordance with Order No. 24,959. The proceeds of the existing short-term borrowing that is being refinanced were used primarily to fund capital improvements to the Company's system, including replacement of the Company's Mill Road standpipe. All of the improvements that were financed by the existing short term debt, including the Mill Road standpipe, are in service and, and as of the Company's most recent rate case, DW 08-098, are included in rate base.

Q. Would you please summarize the basic terms of the proposed financing?

A. The Company is proposing to issue a promissory note ("Note") in an aggregate principal amount of up to $4,000,000 to Aquarion Company, Inc. Aquarion Company, Inc. is the immediate parent company of Aquarion Water Company, Inc., and Aquarion Water Company, Inc. in turn is the immediate parent company of Aquarion Water Company of New Hampshire, Inc. The interest rate on the Note will be fixed at 4.62%. Final maturity will be five years. The Note will not amortize, and the entire principal amount will be payable at maturity, subject to the right of prepayment. Interest on the Note will be payable semi-annually in arrears. The Note will be unsecured.

Q. Please describe the circumstances in which the Note could be redeemed prior to maturity.

A. The Company may prepay the Note in whole or in part at any time without penalty or premium.

Q. Why did the Company choose to borrow from an affiliated entity, rather than from a conventional commercial lending institution?

A. In connection with the desired refinancing of the existing short-term debt, the Company determined that tax-exempt debt such as

State Revolving Fund (SRF) or Business Finance Authority of New Hampshire (BFA) lending was not available as the monies would not be used to finance new capital expenditures as required by the SRF and BFA lending programs, but rather to refinance existing indebtedness. Accordingly, the options available were limited to taxable debt from banks, insurance companies and other financial institutions or obtaining a loan from an affiliate. The Company solicited financing proposals from CoBank ACB ("CoBank"), and Bank of America in addition to exploring the terms on which it could borrow from an affiliate. Bank of America and CoBank both provided proposals for five-year loans on an unsecured basis, but were unwilling to quote a rate for unsecured financing beyond a five-year term. At the same time, Aquarion Company was willing to lend to its affiliate on an unsecured basis at a favorable interest rate. A comparison of the three proposals is reflected in Exhibit DJS-6. The internal financing option (i.e., the loan from Aquarion Company) was chosen based on a least cost analysis. The least cost analysis was performed by calculating the internal rate of return ("IRR")—i.e., the rate at which the future cash flows must be discounted back in order to equal the original principal amount and transaction costs associated with the loan. The IRR analysis resulted in an overall cost of debt of 4.63% for the loan from Aquarion Company versus a rate of 5.45% for CoBank and 6.37% for Bank of America.

Q. Why didn't the Company explore a secured financing to determine whether a longer term might be available?

A. Under a credit facility entered into between Aquarion Holdings, Inc. and Dresdner Bank, the Company is subject to a covenant that prohibits it from granting a security interest in its assets. Although the Company is not a party to the facility with Dresdner, it benefits from its existence because the credit facility provides a low cost source of short-term debt that the Company can access, which in turn benefits customers. If the Company were to grant a third party a security interest in its assets, Aquarion Holdings would be in default under the credit facility with Dresdner, and the Company would lose access to the funds that are available under that facility. As the Commission is aware, the low cost short-term debt in the Company's capital structure was included in the Company's weighted average cost of capital for purposes of establishing rates in DW 08-098. Loss of the credit facility would be harmful to both the Company and customers by, at a minimum, increasing the Company's cost of capital.

Q. Please explain Exhibit DJS-1, "Estimated Issuance Costs of the Promissory Note."

A. Exhibit DJS-1 sets forth in detail the amounts the Company anticipates having to pay for the various services and expenses involved in this financing. These financing costs – which are estimated amounts only – are expected to be amortized ratably over the 5-year term of the Note. They include the fees and expenses of the Company's counsel in documenting the transaction (including the fees and expenses associated with this proceeding.) The transaction costs associated with internal financing is substantially lower because there are no origination or similar fees involved, and the costs related to documenting the transaction are far lower because the transaction is far simpler (and therefore essentially consists of a promissory note).

Q. Do you believe the cost of the proposed loan, including the estimated fees and expenses associated with the proposed transaction, are reasonable?

A. Yes. Based on the foregoing, I do.

Q. Would you please discuss Exhibit DJS-2, "Balance Sheet at June 30, 2009 Actual and Pro Forma to Reflect Issuance of General Mortgage Note?"

A. Exhibit DJS-2 reflects the balance sheet of the Company as of June 30, 2009, adjusted to reflect the effect of the refinancing of the short-term indebtedness, the proposed issuance of the Note in an aggregate principal amount of $4,000,000 and the issuance costs of $2,500. That is, the exhibit shows what the effect would have been on the balance sheet on June 30, 2009 if the proposed transactions had been completed as of that date.

Q. Please explain the pro forma adjustments made in Exhibit DJS-2.

A. The adjustment columns in Exhibit DJS-2 show the reduction of short-term debt totaling $4,000,000, which is replaced by the issuance of $4,000,000 of long-term debt. The second adjustment is $2,500 of issuance expenses representing Company's attorney fees. The third adjustment is to record the net loss of $49,691 reflecting interest expense, amortization of issuance expenses and the related income tax adjustments. See Exhibit DJS-4 "Journal Entries to Reflect The Issuance of $4,000,000 Long-Term Debt" for the balance sheet journal entries associated with the issuance of the Note.

Q. Would you please discuss Exhibit DJS-3, "Income Statement for the Twelve Months Ended June 30, 2009 Actual and Pro Forma to Reflect Issuance of Promissory Note?"

A. This exhibit reflects the income statement of the Company as of June 30, 2009, adjusted to reflect the recent rate case decision and the pro forma impact on interest expense and its related income tax effect associated with the refinancing of the short-term debt and the amortization of the proposed issuance cost of the Note in the aggregate amount of $4,000,000 on the Company's income for the recent trailing twelve-month period ending on that date. See Items 3, 4, 5, 6 and 7 on Exhibit DJS-4 "Journal Entries to Reflect The Issuance of $4,000,000 Promissory Note" for the income statement journal entries associated with the refinancing of the Note.

Q. Would you please discuss Exhibit DJS-5, "Statement of Capitalization, Actual and Pro Forma to Reflect Issuance of Promissory Note?"

A. Exhibit DJS-5 shows a statement of capitalization ratios after giving effect to the proposed financing. At June 30, 2009, the total capital employed by the Company was $21,517,749. This is comprised of $8,314,949 of common equity, $2,800 of preferred stock, $8,900,000 of long-term debt and $4,300,000 of short-term indebtedness. Exhibit DJS-4 "Journal Entries to Reflect The Issuance Of $4,000,000 Promissory Note" records the reclassification of Short-Term Debt to Long-Term Debt, posts the new issuance costs, adjusts interest expense and reflects the income tax effect of the combined transactions resulting in a decrease to retained earnings of $49,691. As shown on Exhibit DJS-5, these adjustments result in a change in the percentage of total debt to total capitalization from 51.7% to 60.9% on a pro forma basis.

Q. Would you please discuss Exhibit DJS-7?
A. Exhibit DJS-7 is a preliminary draft of the Note. A final draft of the Note will not be available until shortly before closing, but the terms and conditions of the final document will be substantially similar to the terms and conditions set forth in Exhibit DJS-7.

Q. What is the deadline for closing this proposed transaction?
A. The Company is seeking an order of the Commission that is effective before year-end to ensure sufficient time to close the transaction prior to January 1, 2010.

Q. Has the Company's board of directors approved this proposed financing?
A. Yes. Exhibit DJS-8 is a copy of the consent of the Company's Board of Directors authorizing the proposed financing. This is a preliminary consent adopted by the Board, and the Company expects to request more specific authorization for the proposed financing from its Board of Directors prior to the closing of the transaction.

Q. Do you believe that the financing proposed by the Company is in the public interest?
A. Yes. For the reasons discussed in my testimony, I believe the financing is in the public interest.

Q. Mr. Smiarowski, does this conclude your testimony?
A. Yes it does.