STATE OF NEW HAMPSHIRE
Before the
PUBLIC UTILITIES COMMISSION

DE 09-236

UNITIL ENERGY SYSTEMS, INC.

PETITION FOR AUTHORITY TO ISSUE SECURITIES

SUPPLEMENTAL TESTIMONY

OF

DAVID L. CHONG

DECEMBER 21, 2009

I. INTRODUCTION

Q. Please state your name, title and business address.

A. My name is David L. Chong. I am the Director of Finance for Unitil Service Corp. ("Unitil Service"), which provides various professional and administrative services to Unitil Energy Systems, Inc. ("UES" or the "Company"), as well as to Unitil Corporation's ("Unitil") other utility subsidiaries. My business address is 6 Liberty Lane West, Hampton, New Hampshire, 03842.

Q Have you previously submitted pre-filed testimony in this proceeding?

A Yes, I did. On November 20, 2009, I submitted pre-filed direct testimony in support of UES' petition for authorization to issue First Mortgage Bonds evidencing unsecured long-term debt in an aggregate principal amount not to exceed $15,000,000 (hereinafter referred to as the "Bonds").

Q What is the purpose of your supplemental testimony?

A. The purpose of my supplemental testimony is to update the Commission with regard to the progress that has been made in placing the proposed issuance of $15,000,000 in long-term Bonds and the terms of the proposed Bonds. I will also address the concerns raised by the Office of Consumer Advocate ("OCA") in its letter filed in this proceeding on December 11, 2009.

II. RESULT OF AUCTION OF FIRST MORTGAGE BONDS

Q What is the status of UES' efforts to secure a private placement of the Bonds?

A On December 18, 2009, UES priced a private placement (see Schedule 1 for pricing confirmation) of $15,000,000 aggregate principal amount, Series P, 5.24% First Mortgage Bonds, due 2020. The coupon rate of 5.24 % reflects a spread of 185 basis points ("bps") over the interpolated 9-year treasury rate of 3.39% at the time of circling. The marketing of the Bonds was done in an "auction" format where the Company's existing investors as well as other private placement investors were invited to participate in the process creating a competitive solicitation process designed to result in the lowest cost for the Bonds. The auction was conducted by Banc of America Securities LLC, the Company's private placement agent for this transaction.

UES and Banc of America were very pleased with the results of this private placement, particularly given that UES has been able to "lock-in" this attractive long-term coupon rate. The final pricing of 185 bps is on the lower end of the anticipated range initially provided in Schedule DLC-1 of my pre-filed testimony on November 20, 2009. Additionally, the placement agent indicated the final pricing of 185 bps fits well within the range of comparable utility secondary mid-BBB rated market transactions.

III. RESPONSE TO ISSUES RAISED BY THE OCA

Q. Please summarize the issues raised by the OCA in its December 11, 2009 letter.

A. The OCA's concerns relate to the proposed interest rate in UES' initial petition, the proposed costs of the financing, the sufficiency of the evidence regarding UES' proposed use of the funds, the impact on UES' customers, and the type of approval process requested in UES' Petition for approval of its long-term debt financing under R.S.A. 369.1 et seq. I will address each of these concerns.

Q. Please respond to the OCA's concern about the reasonableness of UES' proposal to issue the Bonds at fixed annual interest rates not to exceed 7.8%.

A. The OCA's objection to the reasonableness of the interest rate for the proposed bonds should now be resolved given the actual pricing information described above. The final rate of 5.24 % is significantly lower than the 7.8% maximum cap indicated in UES' Petition and objected to by the OCA. As previously stated, the coupon rate of 5.24 % reflects a spread of 185 bps over the interpolated 9-year treasury rate of 3.39%. The pricing spread compares in-line with secondary trading activity of comparable secured mid-BBB utilities.

Q. The OCA states that the costs of outside counsel "must be objectively reasonable and consistent with the public good." Please explain UES' reasons for selecting outside legal counsel for the proposed financing.

A. With respect to the estimated costs of the financing of $615,000, $135,000 represents the private placement fee to be paid to the placement agent, $100,000 is the estimate for lender's counsel's legal services, $65,000 represents the waiver fee to be paid to UES' existing bondholders, $55,000 is the estimated amount to be paid to the trustee, trustee's counsel and for title examination costs, and $10,000 is for miscellaneous estimated costs. Dewey & LeBoeuf's estimate of $250,000 for legal fees, for the services of both regulatory and corporate finance counsel, is a preliminary estimate, and will be updated based upon actual bills. The majority of Dewey & LeBoeuf's estimate is for corporate finance counsel's services for negotiating and preparing the following principal transaction documents and the related ancillary documents (collectively, the "Transaction Documents"); (1) the Waiver Agreement; (2) the Bond Purchase Agreement; (3) the Fourteenth Supplemental Indenture; and (4) the Series P Bonds. The Transaction Documents are similar to those used in UES' 2006 bond financing, with respect to which Dewey & LeBoeuf also served as Unitil's corporate finance counsel. Unitil selected the same law firm for this financing in order to effectively and efficiently negotiate and prepare the Transaction Documents because Dewey & LeBoeuf was well-acquainted with the documents used in UES' 2006 bond financing. Dewey & LeBoeuf also have extensive experience with private placements under Section 4(2) of the Securities Act of 1933 (the "1933 Act") and Regulation D promulgated there under. Dewey & LeBoeuf also helped prepare a Private Placement Memorandum relating to UES' bond offering, which is the principal disclosure document for prospective investors. Dewey & LeBoeuf's estimate also includes representation of UES by regulatory counsel in obtaining approval of the proposed bond financing from the Commission under R.S.A 369. In this regard, UES selected Dewey & LeBoeuf because of its determination that the firm's significant experience with utility financings, high quality of legal representation and its familiarity with UES would provide the Company with efficient and cost effective representation on this matter.

Q. Please comment of the OCA's suggestion that UES' be required to conduct an RFP to select outside counsel for future financings.

A. The financings for UES, as well as Northern, are significant events for the companies and Unitil's management believes that it is in the best interest of our customers and shareholders to obtain experienced and high quality counsel to advise the Company on incurring a total of $40 million in new issuances of debt. Rather than conduct an RFP for solicitation of legal counsel and other advisors on this matter, Unitil relied upon its professional judgment and knowledge of the market to select experienced advisors who were most familiar with the anticipated issues, possessed the relevant experience and who were familiar with the Company and its finance structure. We do not agree with the OCA that an RFP should be required to select counsel for each financing. As discussed above, the significant portion of the legal fees are associated with fees and expenses for lender's counsel and trustees counsel. These types of legal fees are not discretionary or under the Company's direct control and would not be appropriate for an RFP. The Company has appropriate incentives to control these types of legal expenses and well as its legal expense associated with corporate and regulatory representation because of the way these costs are recovered through the rate making process. The expenses associated with the financing, including outside legal expense, is not recoverable in rates until the Company files a new base rate case. Additionally, such expenses are generally amortized over the life of the issuance for recovery, in this case 10 years. As a result, the Company pays the financing costs up-front, but only begins to recover these expenses once it has a base rate case, and only then begins to recover the costs over an extended period of time . Accordingly, the Company has a strong incentive to control all its financing costs, including legal expenses.

Q. Please respond to the OCA's criticism that UES has provided insufficient information as to how the existing short-term debt that is to be redeemed was expended, or how the remaining funds from the proposed long-term financing will be applied for "general corporate purposes" to meet its burden under R.S.A. 369:1

A. UES has provided such an explanation in its response to Staff Request #1-2. As set forth therein, the net proceeds of the $15 million Bond offering in addition to the concurrent $5 million equity contribution will be used as specified in the Sources and Uses table in Exhibit UES-2. The table shows approximately $16.7 million of short-term debt balance as of September 30, 2009 being repaid and the remainder of the net proceeds applied to "general corporate purposes". Internal cash flow from operating activities is first used to finance capital expenditures, and any shortfall in internally generated funds is supplemented with short-term debt. The current level of $16.7 million of short-term debt was incurred to supplement internally generated funds which were used to finance all of the capital expenditures since UES' last debt financing in 2006. The bondable additions shown in Schedule DLC-6 attached to my initial testimony reflect approximately $43.6 million of net bondable additions placed in service after UES' 2006 bond issuance. In supplemental response to Staff 1-2 a), UES provided attachments for the monthly capital additions from September 1, 2006 through September 30, 2009 for both Unitil Energy System divisions summarized by account number. Subsequently, Staff further requested a list describing the major capital projects from September 1, 2006 through September 30, 3009. UES is currently preparing this list, but because of the several years of capital projects involved, and the work required to compile and format all this information, UES expects this list to be ready by the technical session on December 31, 2009.

In Exhibit UES-4, page 1, the "general corporate purposes" adjustment is to cash as described in footnote A. Thus, "general corporate purposes" in this sense represents cash which may be used for a variety of lawful corporate purposes, including additional distribution utility capital expenditures and working capital. For example, UES is projecting to spend approximately $20.8 million of capital expenditures in the next 15 months. (See Staff 1-2 Attachment 1.) In this regard, as a result of the timing of the financing and when that cash proceeds will actually be received by UES (on or about March 1, 2010) the expectation is that the net proceeds will be used to pay down a higher short-term debt balance than was reported at September 30, 2009 due to ongoing capital expenditures by UES in the approximate six-month period from the balance sheet date (September 30, 2009) and the closing and cash funding of the Bonds.

Consistent with the Commission's findings in its recent Order Denying the OCA's Petition for Rehearing in DE 09-033 (*Petition of Public Service Company of New Hampshire for Issuance of Long-Term Debt*), UES has requested approval of a long-term financing for expenditures made in the normal course of utility operations.

Q. **The OCA is concerned that UES' filing contains no information about the rate impact of the proposed financing. Please comment.**

A. As shown in Schedule 2, the weighted average cost of capital for UES will decrease as a result of the proposed financing because the transaction will lower the Company's overall cost of debt. There will be not immediate impact on UES' rates as the effect of the financing will not be reflected until UES next base rate case. However, by lowering

UES' overall cost of capital this financing will have the effect of lowering UES' rates over the long-term.

Q. **Please respond to the OCA's concern that the Order *Nisi* process would not provide adequate notice to UES' customers of the proposed financing.**

A. UES respectfully submits that approval by order *nisi* is permitted under R.S.A. §369:4, and is routinely employed by the Commission in utility financings. However, in this instance, the OCA's concern that customers have not received sufficient notice of the proposed financing is now moot because an evidentiary hearing has been scheduled for January 5, 2009. Additionally, the Commission has scheduled a technical session prior to the hearing. Accordingly, the impact of the proposed financing on customers and UES' proposed use of the funds will be fully explored by the Commission in making its decision that the financing is consistent with the public good under R.S.A. § 369.1 *et seq.*

Q **Does this conclude your testimony?**

A. Yes, it does.

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