STATE OF NEW HAMPSHIRE

BEFORE THE

PUBLIC UTILITIES COMMISSION

PENNICHUCK WATER WORKS, INC.

DOCKET NO. DW 13-130

NOTICE OF INTENT TO FILE RATE SCHEDULES

PREFILED DIRECT TESTIMONY

OF

LARRY D. GOODHUE

May 2013

I. **<u>Background and Qualifications</u>**

Q. Please state your name and business address.

A. My name is Larry D. Goodhue. My business address is: Pennichuck Corporation, 25 Manchester Street, Merrimack, New Hampshire 03054.

Q. What is your position with the Company?

A. I am the Chief Financial Officer, Treasurer and Controller of Pennichuck Water Works, Inc. ("Company" or "PWW") and of its parent company, Pennichuck Corporation (the "Parent"). I joined the Company in December 2006, and served as the Controller and Chief Accounting Officer of the Company and the Parent from that time, until my promotion into my current role March 23, 2012. I am a licensed Certified Public Accountant in the State of New Hampshire; my license is currently in an inactive status.

Q. Have you previously testified before this or any other regulatory commission or governmental authority?

A. Yes. I have submitted written testimony in the following dockets before the New Hampshire Public Utilities Commission ("NHPUC" or "Commission"):

<u>Financings</u>

Pennichuck East Utility, Inc. – DW 13-017, DW 12-349 and DW 13-125

Q. Please summarize your educational background.

A. I have a Bachelor in Science degree in Business Administration with a major in Accounting from Merrimack College in North Andover, Massachusetts.

Q. Please summarize your professional background.

A. Prior to joining the Company, I was the Vice President of Finance and Administration and previously the Controller with METRObility Optical Systems, Inc. from September 2000 to June 2006. In my more recent role with METRObility, I was responsible for all financial, accounting, treasury and administration functions for a manufacturer of optical networking hardware and software. Prior to joining METRObility, I held various senior management and accounting positions in several companies.

Q. What are your responsibilities as Chief Financial Officer of the Company?

A. As Chief Financial Officer of the Company I am responsible for the overall financial management of the Company including financing, accounting, compliance, and budgeting. My responsibilities include issuance and repayment of debt, as well as quarterly and annual financial and regulatory reporting and compliance. I work with the Chief Executive Officer and Chief Operating Officer of the Company to determine the lowest cost alternatives available to fund the capital requirements of the Company, which result from the Company's annual capital expenditures and its current debt maturities.

II. Financial Overview

Q. What is the purpose of your testimony?

A. I will address the Company's determination of its capital structure including debt financing plans and the recent acquisition of the Company's Parent by the City of Nashua (the "City") on January 25, 2012 (the "merger transaction"), in accordance with DW 11-026, and the impact of that transaction upon the Company, which when all taken together, result in an overall rate of return of 5.94%. I will also address the critical importance to the Company of receiving adequate rate relief, in order to maintain its financial integrity and to ensure it an opportunity to continue to raise debt at reasonable costs and on acceptable terms, while continuing to properly support necessary operating costs, as addressed by Mr. Ware in his testimony, and support necessary capital expenditures, as addressed by Mr. Boisvert in his testimony.

Q. Please comment on the Company's need to file a rate request at this time.

A. The Company's current request for rate relief complies with the terms of the Settlement Agreement approved by the Public Utilities Commission in Docket No. DW 11-026 (the "Settlement Agreement"). The revenue deficiency indicated on Schedule A is $34,016, translating to a 0.12% increase over the existing revenue level. In normal circumstances, this would not be a basis for filing a request for rate relief, on its own.

Q. Please explain the Company's proposed capital structure.

A. As shown in Section 15, Schedule 2, the Company's total pro forma capitalization as of December 31, 2012, was $54.7 million, comprising long-term debt of $51.4 million and actual common equity of $3.3 million and yielding a capital structure that is 94% debt and 6% equity. The common equity reflects the remaining equity on the books of the Company prior to the merger transaction with the City, as it relates to the common stock of the Company owned by Pennichuck Corporation as of December 31, 2011, and the retained earnings generated post-merger transaction; giving consideration to the elimination of the City acquisition amounts allocable to the Company in accordance with the Commission's order in DW 11-026. DW 11-026 required the elimination of the Municipal Acquisition Regulatory Asset ("MARA") and the earned equity and paid in capital on the books of the company as of January 25, 2012 (the date of the merger transaction).

Q. What is the implication to the Company of a highly leveraged capital structure?

A. Should the Company's debt level exceed 65% or more of total capitalization, on a GAAP (Generally Accepted Accounting Principles) reporting basis, the Company would be in default of its current borrowing arrangements. As of December 31, 2012, the Company's debt level on a GAAP basis was 28.1% of total capitalization. Debt level on a GAAP basis includes MARA as a component of GAAP basis equity, as noted in the Settlement Agreement.

One potential risk facing the Company in financing its future operations is whether lenders will continue to consider MARA as a component of equity when assessing the minimum requirements related to the Company's debt/equity ratio, in qualifying the Company for debt needed to fund operations and capital improvements. Our current lenders have accepted the GAAP treatment of the MARA as equity.

As reflected in the information included in the filing for DW 11-026, the Company's debt leverage is going to increase over time. Such future change in the Company's leverage could require the Company's financing to be more akin to municipal financing, which may employ different metrics and possibly the need for different types of contingent bond or operating reserves. Such mechanisms could impact the rate of interest to be charged on debt.

Q. Would you please discuss the overall rate of return that the Company is requesting in this rate proceeding?

A. Yes. Section 15, Schedule 1 summarizes the Company's capital structure as well as the proposed component costs for long-term debt and common equity. The Company is requesting that the Commission authorize the Company to earn an overall rate of return on investment (ROI) of 5.94%. The 5.94% weighted average cost of capital comprises two components: (1) 5.59% for the cost of long-term debt (5.94% cost of debt times 93.99% debt ratio) and (2) 0.35% for the return on common equity (5.90% cost of equity times 6.01% equity ratio).

Q. Does the overall rate of return result in a requested increase in the proposed revenues for PWW, and if so, will temporary rates be sought as a part of this filing?

A. Yes, this rate of return does result in an increase in the proposed revenues in the amount of $34,016 per year, an increase of 0.12% over the existing revenue levels. The issue of temporary rates was specifically addressed in DW 11-026, providing for the implementation of such rates. However, as the rate increase being sought is of an immaterial amount, temporary rates are being requested at current rates.

Q. Please describe your methodology in determining the Company's embedded cost of long-term debt.

A. I have used the embedded actual cost methodology, which is represented on Schedule 5. Under this approach, the total Outstanding Balance for all long-term debt issues are summed together and then reduced by the respective aggregate Unamortized Debt Issuance Costs, to arrive at the Outstanding Debt Funded balance. The total All In Annual Cost of the long-term debt issues is computed by adding the actual Annual Interest expense for each debt issue to the Annual Amortization of related debt Issuance Costs. The sum total of the All In Annual Cost is then divided by the Outstanding Debt Funded balance. This produces a weighted average cost of long-term debt including both the interest expense and the amortization of the original debt issuance costs. Referring to Section 15, Schedule 5, the weighted average cost of long-term debt (or Funded Effective Rate) is 5.94% based on all in annual cost of approximately $2.9 million divided into the outstanding debt funded balance of approximately $48.2 million.

Q. What is the return on common equity that the Company is seeking in this rate proceeding?

A. The Company is seeking a return on common equity in accordance with the allowed return on common equity as defined in DW 11-026, which is specified to be the average rate of return on 30-year Treasury bonds for 2012, plus an incremental 3%. As of December 31, 2012, the average rate of return on 30-year Treasury bonds for 2012 was 2.90%, providing for an allowed return on common equity of 5.90%.

Q. Has the Company retained an outside expert witness for the return on (cost of) common equity?

A. No. The return on common equity formula, as discussed above, is computed in accordance with the agreed upon formula provided in DW 11-026.

Q. What is your opinion of the Company's specific business risk profile in comparison with the overall water utility industry?

A. There are a number of Company specific factors that need to be considered in evaluating its business risk profile relative to its peer group. The first factor is the Company's small size. In the Company's most recent Credit Analysis report from Moody's Investor Services ("Moody's"), dated December 27, 2012 (attached as Exhibit LDG-1), they cited that "PWW is extremely small compared to the peer group of regulated water utilities rated by Moody's." Small size magnifies the impact of certain unavoidable fixed costs, such as: state and local property taxes; and, property & casualty insurance. Also in the Company's most recent Credit Analysis report from Moody's they cited that "Offsetting the small size is the relative stability expected within the regulated framework. The NHPUC regulates PWW's rates..." Another factor magnifying the Company's business risk is its geographically small single state service territory. Water companies that operate in multiple states across larger geographic areas are generally considered to have less business risk as they are less reliant on a single regulator or on the weather in a specific geography.

Q. Please explain financial risk and why that is important to the Company in meeting its long-term obligations.

A. Financial risk reflects the assessment of the Company's corporate financing policies and practices including: liquidity (i.e., credit lines), and debt capitalization and the ability to raise sufficient debt to finance necessary capital expenditures, in relation to the Company's operating and capital spending plans. More specifically, financial risk considers and seeks to measure the Company's ability to finance its capital additions program while meeting its debt obligations on a timely and consistent basis. Ratings agencies such as Moody's Investor Service, Standard & Poors, and others have developed a number of key ratios (credit benchmarks) which quantify financial risk by business risk category. Other things being equal, the higher the business risk the higher the credit benchmarks necessary to achieve an overall bond rating. Certain aspects of the components of the Company's current rate structure, as defined under DW 11-026, helps to mitigate some of this financial risk, including the establishment of the CBFRR and the RSF, as defined later in this testimony.

Q. Does the Company have a credit rating for its debt?

A. Yes. In the fall of 2005 in connection with its $50 million tax-exempt bond issue, the Company sought and obtained a credit rating from Moody's. This rating has been periodically reassessed and re-affirmed, with the most recent update provided by Moody's in their December 27, 2012 Credit Analysis.

Q. What is the credit rating for the Company's debt?

A. Moody's assigned a credit rating of Baa3 to the Company's senior debt obligations. This rating is the lowest gradation in the category known as "investment grade" debt.

Q. What are the primary factors/determinants for Moody's assigned credit rating of Baa3?

A. According to Moody's, the Company's Baa3 credit rating is supported by a number of factors, including: stability & predictability of the regulatory environment, cost and investment recovery (ability and timeliness), revenue risk, operational efficiency, scale of capital program and asset condition, and its funding from operations compared to its debt position.

Q. Does the rating take into consideration particular challenges facing the Company?

A. Yes. The rating considers several challenges, including: the Company's capital additions program; the need to properly maintain a program of ongoing infrastructure replacement; the need for adequate rate relief to maintain financial ratios and service existing and new debt; and, the small size of the Company.

Q. What are the primary factors that could result in a downgrading?

A. In the Moody's report dated December 27, 2012, it cited that "given the recent acquisition by a higher rated entity, a downgrade is unlikely at this time." However, they also cited that "major operational disruptions" could result in a downgrade. Certain elements of the Company's current rate structure, as provided for in DW 11-026, are important in maintaining the current credit rating, and its ability to access necessary low cost debt funding, needed to maintain its operations without any major disruptions. These elements include the City Bond Fixed Revenue Requirement ("CBFRR"), the Rate Stabilization Fund ("RSF"), the inclusion of the MARA as an element of GAAP basis equity, the prescribed formulaic approach to the allowed return on common equity (as discussed above), and the current corporate governance structure as delineated by Mr. Patenaude in his testimony.

Q. What are the likely consequences should the Company's credit rating slip?

A. Should the Company's rating slip to "non-investment grade" status, its cost of capital would rise considerably and its access to capital at reasonable costs and terms could be severely curtailed.

Q. Can you discuss the Company's need for financing to support necessary capital expenditures for the years 2013 through 2015, and some of the implications and challenges that surround obtaining that financing?

A. Yes, as was disclosed in the testimony in DW 11-026 the Company has an ongoing need of between $6-8 million annually for the necessary replacement of aging infrastructure and other necessary capital expenditures. The Parent does have a $10 million line of credit, which is available to provide short-term capital funding to its subsidiaries through intercompany advances, however, sources of long-term capital funding are needed at the Company level, in order to repay these short-term borrowings and/or provide for long-term capital funding in lieu of using these short-term resources. The Company is pursuing various sources of potential funding for its capital expenditure needs for the years 2013 through 2015, which result in ongoing discussions with a number of different lending institutions and agencies. With respect to certain qualified capital projects, monies are potentially available through the State Revolving Fund as administered by the New Hampshire Department of Environmental Services ("SRF"), to finance certain qualifying projects at a low cost of money for a period of 20-years. However, as many projects would not qualify for the SRF money, this source of funding will only provide for the financing of a small portion of the overall capital needs for PWW in the time period being discussed. Discussions are ongoing with lending institutions, to provide funding for the 2013 through

2015 capital projects, and the possible refinancing of certain existing debt at lower interest rates. As a part of these discussions, included is the possibility of accessing tax-exempt bond funding through either one or more institutions, giving consideration to: financial covenants; the term for which the money can be borrowed; and, the rate for which the money is available. It is the intention of PWW to have access to low cost borrowed money to fund these necessary capital improvements over a term that nearly approximates the underlying lives of the financed assets, allowing for a proper matching of the cash flow generated by the depreciation expense from these assets with the repayment of the principal for the debt obligations.

Q. Can you explain what the CBFRR is and how the CBFRR for the Company was calculated?

A. As discussed in Mr. Patenaude's testimony, the rate making structure utilized in the filing that was agreed to in the Settlement Agreement, provided for two component elements of the Company's revenue requirement: (1) a fixed portion of the revenues which provides for PWW's pro rata share of the city's acquisition debt obligation (designated as the CBFRR); and (2) the portion of the revenues which is based upon traditional ratemaking principles and provides for coverage of operating expenses and an allowed rate of return on rate base (as shown on Schedule 3). The CBFRR for the Company was calculated based upon the prescribed formula, as defined in the Settlement Agreement. As noted in Mr. Patenaude's testimony, the CBFRR amount is based upon the pro-rata share of the city's acquisition debt obligation, which is based upon the PWW's percentage share of the total obligation for the three regulated subsidiaries of the Parent; namely, PWW, Pennichuck East Utility, Inc. ("PEU") and Pittsfield Aqueduct Company, Inc. ("PAC"). The basis for this calculation was the relative pro-rata equity balances for the three regulated subsidiaries as of December 31, 2011, attributing the equity balance of one non-regulated subsidiary of the Parent (the Southwood Corporation, hereinafter referred to as "Southwood") to the pro-rata share for PWW. As of that date, the relative pro-rata equity balances were as follows:

	Equity Balance at 12/31/11	Pro-rata Equity Share
PWW & Southwood Equity	$56,442,675	88.12%
PEU Equity	$ 6,540,063	10.21%
PAC Equity	$ 1,066,353	1.66%
Totals	$64,049,091	100.00%

The pro-rata equity shares are then applied to the total of the city's acquisition debt obligation of $150,570,000. This allocates the total debt obligation repayment between the three regulated utilities as follows:

	Pro-rata Equity Share	Pro-rata Share of CBFRR
PWW	88.12%	$ 132,688,434
PEU	10.21%	$ 15,374,727
PAC	1.66%	$ 2,506,839
Totals	100.00%	$ 150,570,000

The Settlement Agreement further provided for the establishment of the RSF, which will be discussed further below, as a component of the total acquisition debt, and therefore a component of the CBFRR calculation as a deduction from PWW's pro-rata share of the

CBFRR, prior to calculating the annual fixed revenue requirement in support of the CBFRR. As such, the pro-rata share of CBFRR allocated to PWW is further calculated as follows:

Pro-rata Share of CBFRR

PWW Share	$ 132,688,434
Less: RSF funding	$ (5,000,000)
Net Total PWW Share	$ 127,688,434

The annual fixed revenue requirement defined under the CBFRR is then calculated by calculating the annual payment based upon the Company's pro-rata share of the CBFRR, using the City's true bond interest rate of 4.09% (as noted in Mr. Patenaude's testimony) for the 30-year repayment term, which results in an annual payment amount for PWW of $7,465,139 per annum beginning as of January 25, 2012.

Q. **Please discuss the Rate Stabilization Fund, how it was established, how it is being used, and the features of the fund that pertain to PWW's usage, versus the usage of the fund by the other two regulated utility companies (PEU and PAC).**

A. The Settlement Agreement provided for a $5,000,000 rate stabilization fund. This sum was funded out of the money received from the City as a part of the merger transaction, and was used to establish a bank account for PWW. This account is maintained in compliance with the Settlement Agreement, and is treated as a restricted cash account. The fund was established as a mechanism to allow the three regulated utilities to have access to the reserve fund, which would be utilized to subsidize the pro-rata share of CBFRR revenues if those revenues fell below the CBFRR requirement, as shown below. As it pertains to PWW, the total allowed revenue level was established in DW 10-091 as $26,997,164 per annum. If the

CBFRR portion of actual revenues earned are in excess of the CBFRR portion of the allowed revenue level , that excess is required to be deposited into the RSF, as either a repayment of funds used previously, or as excess revenues subject to refund to the Company's ratepayers, in the next rate case. The usage of funds from the RSF by PWW, or payment of funds into the RSF by PWW, is transferred weekly from the operating cash account based upon cash collections within the month, and trued-up based on actual monthly revenues at the end of each month, based on 1/12 of the fixed percentage of annual revenues attributed to the CBFRR, as follows:

	Annual	**Monthly**
PWW CBFRR Amount	$ 7,465,139	$622,094.92
PWW Allowed Revenue Requirement	$26,997,164	
CBFRR Revenue Requirement % Note 1	27.6516%	

Note 1: This CBFRR Revenue Requirement % will be recalculated upon the issuance of a new Allowed Revenue Requirement pursuant to this rate filing. This newly calculated CBFRR Revenue Requirement % will be used for the calculation of excess/deficient actual revenues compared to the CBFRR Amount for years leading up to the next rate filing process for the Company.

To the extent that 27.6516% of monthly actual revenues exceed $622,094.92, the excess revenues from this calculation are contributed into the RSF. To the extent that 27.6516% of monthly actual revenues are below $622,094.92, the deficient amount is transferred out of the RSF and into the operating accounts of the Company, in order to allow PWW to meet its portion of the monthly obligation for funding of the monthly note payment to the City under the CBFRR. Additionally, in conformity with the settlement agreement sums in excess or below the $5,000,000 imprest balance of the RSF utilized by PWW, is subject to the establishment of a deferred credit (for excesses) or deferred debit (for deficits) to be collected or refunded in water rates, amortized over a three year period of time. Per the Settlement Agreement, usage of the RSF by either of the other two regulated utilities, PEU and PAC, allows for those companies to borrow money from the RSF as an intercompany loan payable to PWW.

Q. **Can you discuss how the actual acquisition cost of $150,570,000 differed from the estimated acquisition cost of $152,099,885, per the Settlement Agreement, and what the major differences were in those recognized lower costs?**

A. Yes, the major components of the estimated acquisition costs versus the actual acquisition costs realized are summarized as follows:

	Estimated Costs	Actual Costs
Merger consideration paid under the agreement	$137,793,398	$138,413,923
Bond issuance costs and fees	1,800,000	996,460
Transaction costs and fees	5,286,875	3,859,505
Severance costs	2,219,612	2,300,113
Establishment of the RSF	5,000,000	5,000,000
Total acquisition costs	$152,099,885	$150,570,000

Q. **Per the Settlement Agreement, there was anticipation that approximately $1.7 million in savings would be derived by taking the Parent Corporation from a publicly-traded company to a privately owned and closely-held corporation owned by the City. Were those savings actually realized?**

A. Yes, that level of savings was realized. In fact, the actual savings realized was approximately $1.87 million. These savings were realized at the Parent company level, and as such, a pro-rata share of those savings (pursuant to the 2006 Cost Allocation Agreement) were realized at PWW, with the balance of the savings being realized in the other subsidiary companies of the Parent. If the merger transaction had not been consummated, these savings would not have been realized and the result would be a request for required revenues of $30,209,550 (a 9.10% increase over current water rates), as opposed to our current request for required revenues of $27,723,230 (a 0.12% increase over current water rates).

Q. Why didn't the savings derived from the merger transaction discussed in the preceding section, result in a decrease in the proposed required revenues for PWW?

A. These savings were offset by increases in certain operating costs, between the 2009 pro forma test year (which was the basis of the cost savings analysis included in the settlement agreement) and the current pro forma test year of 2012. The table below illustrates the major items included in the increase of expenses between these two points in time, as well as the equivalent 2010 level of expenses for these major item (consistent with manner of Mr. Ware's testimony, and the overall expenses shown on the comparative operating income statements included on Schedule 1):

	2009	2012	Difference 2012 vs. 2009	2010
State and local property taxes				
PWW	$2,842,739	$3,425,687	$ 582,948	$2,775,635
PEU	543,505	842,830	299,325	652,297
PAC	80,397	99,882	19,485	60,787
Pension costs	948,133	1,559,184	611,051	894,529
Health insurance costs	1,122,036	1,441,356	319,320	1,187,966
Property and casualty insurance				
PWW	339,994	545,283	205,289	364,051
PEU	38,763	93,927	55,164	40,502
PAC	48,180	47,431	(749)	51,400
Total	$5,963,747	$8,055,580	$ 2,091,833	$6,027,167

The increase in state and local property taxes is the result of a number of factors, including: additions to net plant in service between 2009 and 2012; changes in the assessed values of the underlying property in the communities where the property resides; and, changes in the valuation methodology utilized by both the state and the local taxing authorities.

The increase in pension costs is primarily attributed to a decrease in the discount rate for the underlying benefit obligations, due to the depressed interest rates in the bond market since 2009.

The increase in health insurance costs is the result of premium increases experienced for those benefits, relative to the insured employee base.

The increase in property and casualty insurance premiums is the result of claims exposure and a general tightening in the reinsurance market, resulting in the current underlying premiums for the coverage's needed to properly protect the assets of the Company.

As shown above, some of these cost increases were realized at the corresponding subsidiary company level, while the remaining cost increases for pension and health insurance were allocable pursuant to the 2006 Cost Allocation Agreement, and thus, only a pro-rata share of these cost increases remain at PWW, with the balance of the increases being realized in the other subsidiary companies of the Parent.

Q. Would you please explain the term "test year"?

A. The test year (which is the calendar year 2012, for this rate case) is the period for which the Company's costs are examined to determine if they are reasonable and establish a level of water rates that will enable the Company to earn a reasonable return on its investment, and properly allow the Company to meets its obligations under the Settlement Agreement related to the CBFRR. Consistent with Commission practice, certain of the Company's financial documents have been adjusted or pro formed, to reflect annualization or normalization of known changes in conditions occurring during the test year and the twelve months thereafter.

III. <u>Pro-Forma Adjustments</u>

Q. Please explain the pro forma adjustments reflected on Schedule A.

A. Schedule A reflects the pro forma adjustments to consolidated rate base as notated on Schedule 3 and all of the associated attachment and exhibit schedules. It also includes the pro forma adjustments to adjusted operating net income as notated on Schedule 1, as it relates to the CBFRR revenue requirement discussed earlier in this testimony, and the notated adjustments to operating expenses as described in detail in the attachments to Schedule 1.

Certain elements of the notated adjustments included in Schedule 1 and Schedule 3 will be discussed further in this testimony, or in the testimony of Mr. Ware. As an exhibit to Mr. Patenaude's testimony he provides information which shows the impact on required revenues had the merger transaction with the City not occurred, and the savings related to the publicly-traded company discussed above, not been realized.

Q. Please discuss the nature and impact of certain adjustments notated on Schedule 1, please.

A. Yes. The adjustment of $7,465,139 denoted on Attachment A as the Water Sales Pro Forma, relates to the CBFRR revenues discussed in detail earlier in this testimony. The pro forma for Pension Expense notated on Attachment C, page 2, relates to the anticipated increase in this expense for the twelve-month period following the test year, based upon actuarially derived estimates, and impacted by the current discount rates discussed earlier in this testimony. Similarly, the pro forma for Insurance costs notated on Attachment C, page 2, reflects the estimated cost increase for this expense for the twelve month period following the test year based on the current level of premiums for the 2013 policy year. The pro forma for Property Taxes notated on Attachment D is an estimate of the increase in state and local property taxes for the twelve month period following the test year; the actual costs related to these taxes will be known and measurable in the November/December timeframe of 2013. The pro forma for the amortization of the MARA on Attachment F relates to the elimination of the amortization of that underlying asset over the 30-year life of the asset, in compliance with the Settlement Agreement; as the asset has been pro formed out of the rate base (as notated on Schedule 3), and therefore the associated amortization needs to be eliminated for rate making purposes. Attachment G pro forms the tax impact of all of the other pro forma adjustments notated on

Attachments A thru F, such that the net impact of the aggregated pro forma adjustments, on net operating income, is properly reflected on an after-tax basis. All other pro forma adjustments (as they pertain to Schedule 1) are not specifically discussed in this testimony, or that of Mr. Ware, as they are self-explanatory in their disclosure and description, as included on the Attachment schedules.

Q. Can you discuss the nature and impact of certain adjustments notated on Schedule 3, please?

A. Yes. The adjustment of $48,875,050 on Attachment A relates to the elimination of the equity related assets that pertain to the CBFRR revenues, in compliance with the Settlement Agreement. Accordingly, a fixed component of the revenues is allowed for in the allowed revenues, and as such, the rate base that is associated with that portion of the revenues needs to be eliminated before the revenue requirement can be calculated on the remainder of the rate base versus the adjusted net operating income, in determining the new revenue requirement. Also, in compliance with the Settlement Agreement, the MARA is eliminated from the deferred assets of the company, as notated on Attachment B, as the related equity has been eliminated on Schedule 2, and the CBFRR includes the revenue related to the funding of the MARA. Also on Attachment B, is the pro forma adjustment required under the RSF, discussed earlier in this testimony, related to the 13-month average balance in that fund, and the corresponding average deficit in that fund for the test year. Attachment F notates the impact of actual revenues versus allowed revenues, as it pertains to the RSF, and the corresponding establishment of a deferred credit for the reimbursement of over-earned amounts over a 3-year period, in compliance with the Settlement Agreement. All other pro forma adjustments (as they pertain to Schedule 3) are not specifically discussed in this testimony, or that of Mr. Ware, as they are self-explanatory in their disclosure and description, as included on the Attachment schedules.

Q. Does this complete your direct testimony?

A. Yes.