STATE OF NEW HAMPSHIRE

BEFORE THE

PUBLIC UTILITIES COMMISSION

Petition of Pittsfield Aqueduct Company, Inc. for Waiver to Increase the Short-Term Debt Limit

DW 22-___

DIRECT PREFILED TESTIMONY OF GEORGE TORRES

November 3, 2022

Q. What is your name and what is your position with Pittsfield Aqueduct Company, Inc.?

A. My name is George Torres and I am the Chief Accounting Officer, Treasurer and Corporate Controller of Pittsfield Aqueduct Company, Inc. (the "Company" or "PAC"). I have been employed with the Company since February 2006, when I initially served as the Corporation's Accounting Manager. In 2015, I assumed the role of Director of Accounting and Corporate Controller, and was named and appointed as Treasurer in May 2020, in addition to those roles. I also serve as Chief Accounting Officer, Treasurer and Corporate Controller of the Company's parent, Pennichuck Corporation ("Pennichuck").

Q. Please describe your educational background.

A. I have a Bachelor of Science degree in Business Administration with a major in Accounting from Montclair State University in Montclair, New Jersey.

Q. Please describe your professional background.

A. Prior to joining the Company, I held Controller and Senior Accountant positions for several subsidiaries for the global human resource company Vedior North America, now known as Randstad USA from October 2002 to February 2006. My duties included all financial, accounting, and reporting functions for the subsidiaries as assigned. Prior to joining Vedior N.A., I held various senior accounting positions for several companies in the retail, energy services, and manufacturing sectors.

Q. What are your responsibilities as Chief Accounting Officer and Treasurer, and Corporate Controller of Pennichuck?

A. I am responsible for the overall management of the Company's treasury, accounting, financial reporting, compliance and budgeting functions. My responsibilities also include supporting the Chief Financial Officer in the issuance and repayment of debt, as well as quarterly and annual financial and regulatory reporting and compliance. The performance of these responsibilities is on the behalf of Pennichuck Corporation and all its subsidiaries.

Q. Please provide an explanation of the purpose of this written pre-filed testimony.

A. The purpose of this written pre-filed testimony is to explain the basis for the Company's request for approval of a permanent waiver of the 10% short term debt limit under N.H. Admin. Rule Puc 608.05. As a result of Order No. 25,292 (November 23, 2011) approving the acquisition of Pennichuck by the City of Nashua, the capital structure for the Companies was altered, to the benefit of ratepayers, by essentially eliminating the costs of equity financing. The resulting capital structure, however, alters the manner in which capital expenditures and working capital are funded, placing a greater emphasis on short-term debt financing. And since all capital investments for PAC will be financed by debt, its relatively small size limits its financing options to either SRF (State Revolving Fund) debt, DWGTF (Drinking Water and Groundwater Trust Fund) loans, or intercompany loans.

Q. What safeguards are in place to prevent abuses by the Company.

A. The Company will continue to include monthly levels of short-term debt with its Annual Reports. Also, monthly reporting of ratios are included in the financial reporting package submitted monthly to the Commission**.**

Q. Please describe the Company's recent short-term debt levels.

A. Since June 30, 2019, the Company has experienced short-term debt levels that have been at or below 10%, escalated to levels between 8.11% and 14.13% during 2022, leading up to a debt level reaching 21.3% in August 2022 due to a temporary one-time year-to-date true-up in the intercompany accounts for the Company's balance sheet (upon the completion of the accounting for that one-time true-up and the corresponding balance of the bookkeeping for that event, the level has contracted back to 11.98% as of September 2022). A previously granted waiver to the short-term debt limit in Puc 608.05 in Docket DW 15-288 (Order No. 25,820), provided a 18% limit until June 30, 2019, but also required the Company to send a notice to the Department of Energy (DOE) and Office of Consumer Advocate (OCA) in any month exceeding 15%. The Company did not seek an extension to the waiver granted, as of that termination date for the Order, because a refinancing of long-term and short-term intercompany debt reduced the Company's threshold below the statutory limit to 10% that closed on May 1, 2018. See Order No. 26,125 (April 20, 2018). However, due to current and anticipated levels of short-term debt, the Company requests a temporary short-term debt waiver and increase in the debt limit to 18% from the Commission until June 30, 2023, consistent with a waiver granted to Pennichuck East Utility, Inc. in Docket No. DW19-112 (Order No. 26,544).

Q. Please explain Exhibit GT-1, entitled "Historical Summary of Short-Term Debt Limits".

A. Schedule or Exhibit GT-1 presents the actual short-term debt limit levels for the Company for June 30, 2019 through September 30, 2022.

Q. How does the rate making structure of PAC differ from traditional rate making, and how do the CBFRR payments impact the short-term debt limit requirements?

A. The rate making structure of PAC differs from traditional rate making in a few key areas, affecting both total cash flow and the timing of cash flows. As a consequence of the acquisition of Pennichuck by the City of Nashua, the following key changes were made:

1. A pre-determined rate was derived for the PAC's Return on Equity (ROE). The ROE is set at 3% above the 13-month average yield for 30-year Treasury bonds, for the last approved test year. This equates to a pre-tax ROE of 5.90% for PAC for the 2012 test years approved in Dockets DW 13-126 and DW 13-128, and 2019 test year approved in DW 20-153. This ROE is substantially different from pre-tax ROE levels historically included in the rate structures of the Companies, which were approximately 16%. In addition, due to the nature of the Company's rate and ownership structure, including the funding of the CBFRR portion of allowed revenues as intercompany transfers of cash to Pennichuck Corporation, PAC generally has extremely limited or no equity for which an ROE is earned.

2. The City Bond Fixed Revenue Requirement ("CBFRR") portion of the revenue requirements for the Company was implemented as part of the acquisition. This fixed component of the revenue requirement for each company is that company's proportionate share of a fixed annual funding amount of the City's Acquisition Debt paid up to Pennichuck, which enables Pennichuck to repay the City of Nashua. The cash transferred from the CBFRR revenues, net of the income tax provision on pre-tax earnings, for each fiscal year is authorized and recorded as a both a dividend and return of capital to Pennichuck in the first quarter of the year (for the prior year's amount), in order to properly account for the payment of cash related to the CBFRR revenues. The annual dividend is recorded as an offset to the short-term debt accounts of each company, which has a material annual impact on the short-term debt limit requirements.

3. The capital structure of PAC, and its sister subsidiaries was altered to be nearly exclusively dependent on debt, versus the traditional debt/equity ratio that existed prior to the merger. For PAC, based upon the funding sources currently available to the Company for long-term capital investments, this requires using short-term debt to support long-term capital projects, until long-term financing is received from external lenders such as the New Hampshire Department of Environmental Services' SRF or DWGTS loan programs.

4. A Rate Stabilization Fund (RSF) was established at the time of the City's acquisition of PWW, and has since been allocated amongst the three regulated subsidiaries: PAC, Pennichuck Water Works, Inc. (PWW) and PEU. The RSF is available for use by the Companies when actual earned revenues are below allowed revenue requirement levels. Each of the Companies has the ability to borrow from these funds, to offset the deficit in revenues for the CBFRR, OERR and DSRR portion of the revenues, and to deposit excess revenues earned above allowed revenues into the RSF funds. This movement of cash to and from the RSF funds, would serve to potentially increase or decrease the Companies' short-term debt levels over time, absent the ability to replace these amounts with equity contributions (should a deficiency in revenues exist).

Q. **Was the Company's rate methodology amended to closely match the rates for PEU and PWW**?

A. Yes, on November 9, 2021, the Commission approved a settlement agreement and granted PAC's request to amend its ratemaking methodology. *See* Docket DW 20-153, Order No. 26,544 (November 9, 2021) at 8-9. The underlying capital structure composed primarily of debt, however, remains in place and is reinforced under the new methodology.

Q. **How will ratepayers benefit from a waiver of the 10% short term debt limit?**

A. A temporary waiver of the 10% short term debt limit will allow PAC to better manage cash flows throughout the year, finance working capital as intended within the current rate structure, and effectively invest in long-term capital replacement projects while obtaining annual reimbursement financing for these projects through various funding sources, including the SRF and DWGTF loans when available. If the waiver is not granted, the Company would be barred from accessing this available long-term debt financing for capital projects, which would be adverse to one of the Company's primary objectives for its customers; maintaining and properly upgrading its treatment and distribution facilities in order to fully comply with Safe Drinking Water Standards, on a consistent and reliable basis.

Q. **Will the waiver provide needed flexibility in the overall financing of the operations of the Company**?

A. Yes. The Company currently has an extremely limited number of external long-term debt funding sources. PAC only has funding available for certain long-term capital projects under the SRF or DWGTF, if in fact projects proposed are even eligible for funding in those programs, as it is of insufficient size and financial strength to qualify currently for term loans with commercial bank lenders. Accordingly, the balance of long-term capital project funding for PAC, over and above SRF and DWGTF funded amounts, comes from short-term working capital advances from Pennichuck, which can be converted into long term intercompany loans, pursuant to Commission approval.

It is important to note that, as a rule, funds spent on long-term capital projects, using short-term advances from Pennichuck or short-term working capital of PAC, are subject to refinance with intercompany loans approved in periodic financing proceedings before the Commission. Consequently, increasing the short-term debt limits for PAC will allow it to fund projects in a more predictable and orderly manner, reducing or foregoing the expense of long-term financings and rate cases.

Furthermore, the waiver accommodates funding of the CBFRR payments to Pennichuck throughout the year, workorder and management fee expenses which causes a build in the short-term debt levels to Pennichuck, pending the annual dividend (described above) related to these transfers of cash. PAC's short-term debt consists exclusively of intercompany loans with Pennichuck.

Q. **Is the purpose of Puc 608.05 satisfied by an 18% limit**?

A. Yes. The short-term debt rule, which implements RSA 369:7, appears intended to limit ratepayer exposure from utility funding of long-term projects with potentially higher cost short term cash flows or debt, which, at the same time, would not properly match the cash outflows for the depreciation associated with capital expenditures to the cash inflows from the funding source. The rule sets a generic short-term debt limit, above which a utility may not issue short-term debt without Commission approval. Under the existing rate structure and circumstances of PAC, however, the 10% debt limit is unnecessarily restrictive. Inasmuch as all capital investments for the Companies will be financed by debt, and their small size limits their financing options, increasing the short-term debt limit to 18% appropriately balances the policy goals of, on the one hand, limiting ratepayer exposure to increased financing costs without prior Commission approval and, on the other hand, decreasing financing and regulatory costs by providing financing flexibility to PAC.

Q. Do you believe that this proposal will be consistent with the public good?

A. Yes. A temporary waiver of the 10% short term debt limit and approval of an 18% short-term debt limit will serve the public interest because it will:

(1) Allow PAC to effectively reinvest in long-term capital projects and infrastructure at debt funding rates as opposed to debt/equity rates, thereby lowering the overall cost to ratepayers;

(2) Provide PAC the flexibility to effectively pursue long-term reimbursement financing in support of capital projects, which allows it to pursue favorable borrowing rates, such as those associated with the SRF or DWGTF loan programs; and,

(3) Stabilize revenue levels by allowing PAC to focus on annual revenue levels, without concern of running afoul of the overly restrictive 10% short-term debt limit requirement in portions of the fiscal year.

Q. Mr. Torres, does this conclude your testimony?

A. Yes, it does.