

STATE OF NEW HAMPSHIRE
Before the
PUBLIC UTILITIES COMMISSION

DG 09-239

NORTHERN UTILITIES, INC.

PETITION FOR AUTHORITY TO ISSUE SECURITIES

SUPPLEMENTAL TESTIMONY

OF

DAVID L. CHONG

DECEMBER 21, 2009

1 **I. INTRODUCTION**

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

3 A. My name is David L. Chong. I am the Director of Finance for Unitil Service Corp.
4 (“Unitil Service”), which provides various professional and administrative services to
5 Northern Utilities, Inc. (“NU”, “Northern” or the “Company”), as well as to Unitil
6 Corporation’s (“Unitil”) other utility subsidiaries. My business address is 6 Liberty Lane
7 West, Hampton, New Hampshire, 03842.

8

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

10 A Yes, I did. On November 20, 2009, I submitted pre-filed direct testimony in support of
11 Northern’s petition for authorization to issue promissory notes evidencing unsecured
12 long-term debt in an aggregate principal amount not to exceed \$20,000,000 (hereinafter
13 referred to as the “Notes”). By letter dated On December 11, 2009, we notified the
14 Commission that: 1) due to favorable market conditions, the Company proposed to
15 increase the amount of the debt financing \$25,000,000, and 2) the amount of the equity
16 contribution to be made by Unitil, initially set at \$5,000,000, would be increased to
17 \$7,500,000 to improve the equity ratio in Northern’s capital structure.

18

19 **Q What is the purpose of your supplemental testimony?**

20 A. The purpose of my supplemental testimony is to update the Commission with regard to
21 the progress that has been made in placing the proposed issuance of \$25,000,000 in long-
22 term Notes and the terms of the proposed Notes. Additionally, I will address Northern’s
23 proposal with respect to short-term debt levels. Finally, I will respond to the issues raised

1 by the Office of Consumer Advocate (“OCA”) in its letter filed in this proceeding on
2 December 11, 2009.

3

4 **II. RESULT OF AUCTION OF PROMISSORY NOTES**

5 **Q What is the status of Northern’s efforts to secure a private placement of the Notes?**

6 A On December 18, 2009, Northern priced a private placement (see Schedule 1 for pricing
7 confirmation) of \$25,000,000 aggregate principal amount, 5.29% Senior Unsecured
8 Notes, due 2020. The coupon rate of 5.29 % reflects a spread of 190 basis points (“bps”)
9 over the interpolated 9-year treasury rate of 3.39 % at the time of circling. The marketing
10 of the Notes was done in an “auction” format where the Company’s existing investors as
11 well as other private placement investors were invited to participate in the process
12 creating a competitive solicitation process designed to result in the lowest cost for the
13 Notes. The auction was conducted by Banc of America Securities LLC and RBC Capital
14 Markets Corporation, the Company’s private placement agents for this transaction.

15

16 Northern and the placement agents were very pleased with the results of this private
17 placement, particularly given that Northern has been able to “lock-in” this attractive long-
18 term coupon rate. The final pricing of 190 bps is on the lower end of the anticipated
19 range initially provided in Schedule DLC-1 of my pre-filed testimony on November 20,
20 2009. Additionally, the placement agents have indicated that the final pricing of 190 bps
21 fits well within the range of recent comparable utility secondary mid-BBB rated market
22 transactions.

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SHORT-TERM DEBT

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Q. What is Northern’s proposed short-term debt limit for the twelve-month period commencing with the 2009 winter period cost of gas filing?

A. Northern proposes its short-term debt limits as specified in the following three components:

A) Consistent with the finding in the Commission’s Order 24,824 for Energy North, Northern proposes for fuel financing purposes that its short-term debt limit will be reestablished annually at a level equal to 30 percent of its total gas costs (*i.e.*, the total of its direct and indirect gas costs) projected for the winter period. The short-term borrowing limit for fuel financing purposes would be set as part of Northern’s winter period cost of gas filing each year, and would be in effect during the subsequent twelve-month period beginning November 1 and ending October 31. In Northern’s October 30, 2009 cost of gas filing in Docket 09-167, Forty-fourth Revised Page 38 (Calculation of Anticipated Cost of Gas), Northern calculated a total cost of gas of \$31.3 million. A 30 percent factor applied to this total cost of gas would result in a short-term debt limit for fuel financing purposes of \$9.4 million for the Period November 1, 2009 through October 30, 2010.

B) Northern proposes that a short-term debt limit for purposes other than fuel financing be set at a level equal to 10 percent of its net utility plant, which is consistent with Commission precedent. The short-term debt limit for such purposes would be established each month, based on Northern’s actual net

1 utility plant balances as recorded on its balance sheet at month's end. Based
2 on the projected net plant balance (excluding plant acquisition premium) of
3 \$184.1 million as of December 31, 2010 (*See* Response to Staff 1-3,
4 Attachment 1, page 2 of 2), the short debt level for purposes other than fuel
5 financing would be \$18.4 million. Combined with the short-term debt limit
6 for fuel financing purposes, Northern's total short debt limit at December 31,
7 2010 would be \$27.8 million.

8
9 C) Northern also proposes that the Commission not construe gas fuel
10 inventory financing as short-term debt and not set a limit on the amount of
11 fuel inventory to be financed through the Unitil Cash Pool, consistent with the
12 Commission's decision in Order 24,095 (DG 02-203, *In Re Northern Utilities,*
13 *Inc.*, issued December 13, 2002) which provided that gas fuel inventory
14 financing would not be construed as short-term debt.

15
16 **Q. Following the financing, do you anticipate that Northern's short-term borrowings**
17 **will reach the proposed cap?**

18 A. No. We do not expect that Northern's borrowings will be at this limit following the
19 financing. The purpose of the limit would be to set a cap that will apply over a longer-
20 term planning horizon. As I previously stated, construction expenditures are funded
21 initially with internally-generated cash flow and then supplemented with short-term debt
22 which is then redeemed and replaced with long-term financing. It is important to have an
23 established short-term debt limit in order to appropriately plan for future long-term

1 financings to adequately and timely match long-lived assets with long-term financings. In
2 addition, the exclusion of fuel financing from the calculation of short-term debt
3 essentially recognizes the volatility inherent in commodity prices and the need for a gas
4 utility to maintain some flexibility to finance its working capital requirements associated
5 with fuel separate from its capital construction needs and normal distribution utility
6 working capital requirements. Finally, fuel inventory is a specific financing need that is
7 separate and distinct from the general, ongoing operational purposes which are typically
8 funded by short-term debt.

9
10 **III. RESPONSE TO ISSUES RAISED BY THE OCA**

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

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

17
18 **Q. Please respond to the OCA's concern about the reasonableness of Northern's
19 proposal to issue the Notes at fixed annual interest rates not to exceed 7.8%.**

20 A. The OCA's objection to the reasonableness of the interest rate for the proposed notes
21 should now be resolved given the actual pricing information described above. The final
22 rate of 5.29% is significantly lower than the 7.8% maximum cap indicated in Northern's
23 Petition and objected to by the OCA. As previously stated, the coupon rate of 5.29%

1 reflects a spread of 190 bps over the interpolated 9-year treasury rate of 3.39%. The
2 pricing spread is in-line with secondary trading activity of comparable unsecured mid-
3 BBB rated utilities.

4 **Q. The OCA states that the costs of outside counsel “must be objectively reasonable**
5 **and consistent with the public good.” Please explain Northern’s reasons for**
6 **selecting outside legal counsel for the proposed financing.**

7

8 A. With respect to the estimated costs of the financing of \$410,000, \$200,000 represents the
9 private placement fee to be paid to the placement agents, \$50,000 is the estimate for
10 lender’s counsel’s legal services, and \$10,000 is for miscellaneous estimated costs. .
11 Dewey & LeBoeuf’s estimate of \$150,000 for legal fees, for the services of both
12 regulatory and corporate finance counsel, is a preliminary estimate, and will be updated
13 based upon actual bills. The majority of Dewey & LeBoeuf’s estimate is for corporate
14 finance counsel’s services for negotiating and preparing principal transaction documents
15 and the related ancillary documents. The transaction documents are similar to those used
16 in Northern’s 2008 note financing, with respect to which Dewey & LeBoeuf also served
17 as Unitil’s counsel. Additionally, the firm acted as corporate and regulatory counsel to
18 Northern after Northern was purchased by Bay State Gas Company in the 1970s until
19 approximately 2000. Unitil selected Dewey & LeBoeuf for this financing in order to
20 effectively and efficiently negotiate and prepare the Transaction Documents because
21 Dewey & LeBoeuf was well-acquainted with Unitil and Northern. Dewey & LeBoeuf
22 also have extensive experience with private placements under Section 4(2) of the
23 Securities Act of 1933 (the “1933 Act”) and Regulation D promulgated there under.

1 Dewey & LeBoeuf also helped prepare a Private Placement Memorandum relating to
2 Northern's note offering, which is the principal disclosure document for prospective
3 investors. Dewey & LeBoeuf's estimate also includes representation of Northern by
4 regulatory counsel in obtaining approval of the proposed note financing from the
5 Commission under R.S.A 369. In this regard Northern selected Dewey & LeBoeuf
6 because of its determination that the firm's significant experience with utility financings,
7 high quality of legal representation and its familiarity with Unitil and Northern would
8 provide the Company with efficient and cost effective representation on this matter.

9
10 **Q. Please comment of the OCA's suggestion that Northern be required to conduct an**
11 **RFP to select outside counsel for future financings.**

12 A. The financings for Northern, as well as UES, are significant events for the companies and
13 Unitil's management believes that it is in the best interest of our customers and
14 shareholders to obtain experienced and high quality counsel to advise the Company on
15 incurring a total of \$40 million in new issuances of debt. Rather than conduct an RFP for
16 solicitation of legal counsel and other advisors on this matter, Unitil relied upon its
17 professional judgment and knowledge of the market to select experienced advisors who
18 were most familiar with the anticipated issues, possessed the relevant experience and who
19 were familiar with the Company and its finance structure. We do not agree with the
20 OCA that an RFP should be required to select counsel for each financing. As discussed
21 above, a significant portion of the legal fees are associated with fees and expenses for
22 lender's counsel. These types of legal fees are not discretionary or under the Company's
23 direct control and would not be appropriate for an RFP. Nevertheless, the Company has

1 appropriate incentives to control these types of legal expenses as well as its legal
2 expenses associated with corporate and regulatory representation, because of the way
3 these costs are recovered through the rate making process. The expenses associated with
4 the financing, including outside legal expense, is not recoverable in rates until the
5 Company files a new base rate case. Additionally, such expenses are generally amortized
6 over the life of the issuance for recovery, in this case 10 years. As a result, the Company
7 pays the financing costs up-front, but only begins to recover these expenses once it has a
8 base rate case, and only then begins to recover the costs over an extended period of time.
9 Accordingly, the Company has a strong incentive to control all its financing costs,
10 including legal expenses.

11
12 **Q. Please respond to the OCA's criticism that Northern has provided insufficient**
13 **information as to how the existing short-term debt that is to be redeemed was**
14 **expended, or how the remaining funds from the proposed long-term financing will**
15 **be applied for "general corporate purposes" to meet its burden under R.S.A. 369:1**

16 A. The net proceeds of the \$25,000,000 million note offering in addition to the concurrent
17 \$7,500,000 million equity contribution will be used as specified in Supplemental
18 Attachment 1 in the letter dated December 11, 2009 amending the size of the offering
19 from \$20 million to \$25 million. The table shows approximately \$32.1 million of short-
20 term debt being repaid and the remainder of the proceeds applied to fees and expenses.

21
22 The capital necessary to finance capital expenditures is derived primarily from internally-
23 generated funds, which consist of cash flows from operating activities. As needed,

1 Northern supplements internally-generated funds through short-term borrowings.
2 Periodically, Northern replaces portions of its short-term debt with long-term financings
3 more closely matched to the long-term nature of its utility assets.

4
5 Unitil acquired Northern on December 1, 2008. Northern was initially capitalized with
6 \$80.0 million of long-term debt and \$65.7 million of equity. In addition, Northern had
7 \$8.4 million of short-term debt as of December 31, 2008. This short-term debt as of
8 December 31, 2008 is largely related to the utility assets and liabilities that were acquired
9 on the acquisition date.

10
11 Northern had incurred approximately \$77 million of capital expenditures under Nisource
12 since its last long-term financing (from the period July 1, 2003 to November 30, 2008).
13 Furthermore, since Northern was acquired by Unitil on December 1, 2008, Northern has
14 spent \$20.6 million of capital expenditures (December 2008 – November 2009) as was
15 provided in Staff 1-2 Attachment 1. Furthermore, Northern is supplying as Schedule 2 to
16 this testimony, a list and description of the major capital projects Northern has
17 undertaken from the period December 2008 through November 2009. In addition,
18 Northern forecasts a capital expenditure budget of approximately \$19.1 million in 2010
19 as was provided in Staff 1-4 Attachment 1.

20
21 In Supplemental Attachment 1 to the letter dated December 11, 2009, there is no “general
22 corporate purposes” as a use of proceeds because not all of the short-term debt will be
23 refinanced. As of September 30, 2009, the remaining amount of short-term debt would

1 be \$1.1 million as shown in Supplemental Attachment 5 in the letter dated December 11,
2 2009. As a result of the timing of the financing and when the cash proceeds will actually
3 be received by Northern (on or about March 1, 2010) the expectation is that the net
4 proceeds will be used to pay down a higher short-term debt balance than was reported at
5 September 30, 2009 due to ongoing capital expenditures by Northern in the approximate
6 six-month period from the balance sheet date (September 30, 2009) and the closing and
7 cash funding of the Notes.

8
9 Consistent with the Commission's findings in its recent Order Denying the OCA's
10 Petition for Rehearing in DE 09-033 (*Petition of Public Service Company of New*
11 *Hampshire for Issuance of Long-Term Debt*), Northern has requested approval of a long-
12 term financing for expenditures made in the normal course of utility operations.

13
14 **Q. The OCA is concerned that Northern's filing contains no information about the rate**
15 **impact of the proposed financing. Please comment.**

16 A. As shown in Schedule 3, the weighted average cost of capital for Northern will decrease
17 as a result of the proposed financing because the transaction will lower the Company's
18 overall cost of debt. There will be no immediate impact on Northern's rates as the effect
19 of the financing will not be reflected until Northern's next base rate case. However, by
20 lowering Northern's overall cost of capital, this financing will have the effect of lowering
21 Northern's rates over the long-term.

22

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

3 A. Northern respectfully submits that approval by order *nisi* is permitted under R.S.A.
4 §369:4, and is routinely employed by the Commission in utility financings. However, in
5 this instance, the OCA's concern that customers have not received sufficient notice of the
6 proposed financing is now moot because an evidentiary hearing has been scheduled for
7 January 5, 2009. Additionally, the Commission has scheduled a technical session prior to
8 the hearing. Accordingly, the impact of the proposed financing on customers and
9 Northern's proposed use of the funds will be fully explored by the Commission in
10 making its decision that the financing is consistent with the public good under R.S.A. §
11 369.1 *et seq.*

12
13 **Q. Does this conclude your testimony?**

14 A. Yes, it does.

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