STATE OF NEW HAMPSHIRE

BEFORE THE

PUBLIC UTILITIES COMMISSION

PENNICHUCK EAST UTILITY, INC.

DOCKET NO. DW 13-126

NOTICE OF INTENT TO FILE RATE SCHEDULES

PREFILED DIRECT TESTIMONY

OF

LARRY D. GOODHUE

May 2013

Background and Qualifications

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 East Utility, Inc. ("Company" or "PEU") 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"):

Financings

Pennichuck East Utility – 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.

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 $591,485, translating to a 9.97% increase over the existing revenue level.

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 $10.1 million, comprising long-term debt of $6.2 million, intercompany debt of $3.8 million and actual common equity of $0.1 million and yielding a capital structure that is 99% debt and 1% 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 34.0% 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. **Are there other factors the Company must consider related to its existing debt obligations?**

A. Yes. In addition to maintaining a debt level at or below 65% of total capitalization, on a GAAP basis, the Company must maintain a debt service coverage level of at least 1.25. At December 31, 2012, the debt service coverage level was 1.69. The debt service coverage level is calculated by dividing the Company's earnings before interest and depreciation/amortization for the trailing twelve months by the sum of all principal and interest payments on existing debt for the trailing twelve months. This ratio is a measure of the Company's inherent profitability versus the total debt leverage component of its capital structure. Maintaining an adequate debt service coverage level is not only important for the

Company's existing debt, as performance below the minimum required level of 1.25 would result in the Company being in default with the underlying covenants for its existing debt, but could also limit or prohibit the Company from procuring additional needed financing for its operations. Providing for an adequate overall rate of return for the Company is essential and insures that the Company can properly provide protections related to its inherent business and financial risks.

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 3.86%. The 3.86% weighted average cost of capital comprises three components: (1) 2.86% for the cost of long-term debt (4.64% cost of debt times 61.64% debt ratio), (2) 0.94% for the cost of intercompany debt (2.52% cost of intercompany debt times 37.31% intercompany debt ratio) and (3) 0.06% for the return on common equity (5.90% cost of equity times 1.05% equity ratio).

Q. Does the overall rate of return result in a requested increase in the proposed revenues for PEU, 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 $591,485 per year, an increase of 9.97% over the existing revenue levels. The issue of temporary rates was specifically addressed in DW 11-026, providing for the implementation of such rates. Accordingly, the Company is requesting that the Commission approve temporary rates in the amount of $415,437, or 7%, as discussed in the testimony of Mr. Ware.

Q. Is the Company requesting any other rate increases in addition to the proposed permanent and temporary rate increases cited above?

A. Yes. In addition to the rate increases being requested in the request for temporary and permanent rates, as discussed previously, the Company is seeking a Step Increase for investment in revenue producing assets being placed in service during 2013. Further discussion and support for this Step Adjustment is discussed in the testimonies of Mr. Ware and Mr. Boisvert.

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

A. The weighted average cost of long term debt calculation is represented on Schedule 5. Under this approach, the total Outstanding Balances for all long-term debt issues are summed together. 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 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 Effective Rate) is 4.64% based on all in annual cost of approximately $0.37 million divided into the outstanding balance of approximately $8.0 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 the entire water utility industry. The first factor is the Company's small size. Small size magnifies the impact of certain unavoidable fixed costs, such as: state and local property taxes; and, property & casualty insurance. 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 favorable credit 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 bond credit rating for its debt?

A. No. The Company does not currently have a bond credit rating designated for its debt, as a stand-alone company. However, the Company has recently completed a round of external financing with a banking institution, and as a part of that process, the banking institution did an evaluation of the credit worthiness of PEU. In discussions with them on this topic, they indicated that they do "risk rate" all of their customers on a stand-alone basis. In doing so, their customers must meet a minimum credit risk rating score. In completing their assessment of credit worthiness, they take a number of factors into consideration, and may impose certain requirements relating to lending to the entity, based upon these factors.

Q. What factors support the Company's creditworthiness?

A. In discussions with existing external bank creditors, the Company's creditworthiness 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, overall organization structure, and its funding from operations compared to its debt position.

Q. With respect to creditworthiness, what challenges face the Company?

A. The Company faces 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 needed to maintain an acceptable credit profile?

A. 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, and to maintain compliance with existing financial covenants (as discussed earlier in this testimony). 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 profile deteriorate?

A. Should the Company's credit profile deteriorate, its cost of capital could 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 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 $1-2 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 is 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, related to sources of funding necessary for capital expenditures. 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 portion of the overall capital needs for the Company in the time period being discussed. Discussions are ongoing with lending institutions, to provide funding for the 2013 through 2015 capital projects 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 the Company 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 the Company'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 PEU's percentage share of the total obligation for the three regulated subsidiaries of the Parent; namely, Pennichuck Water Works, Inc. ("PWW"), 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 PEU of $898,863 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 PEU's usage, versus the usage of the fund by the other two regulated utility companies (PWW 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 PEU, the total allowed revenue level was established in DW 07-032 as $4,926,950 per annum. If the actual revenues for PEU fall below this total allowed revenue level, PEU has the ability to access the reserve funds in the RSF via intercompany advances from PWW, as described by Mr. Patenaude in his testimony. The ability to repay these advances by PEU to PWW, as currently allowed for in the rate structure of PEU, is solely dependent upon PEU's ability to produce operating income in excess of allowed levels. As mentioned in Mr. Patenaude's testimony, a mechanism needs to be established for PEU, similar to the mechanism currently in place for PWW, so that revenues earned in excess of the CBFRR or below the CBFRR are subject to the establishment of a deferred credit (for excesses) or deferred debit (for deficits) to be collected or refunded in rates, amortized over a three-year period. This will provide the funding needed to insure repayment of intercompany advances with PWW for usage of the RSF, from PEU. The usage of funds from the RSF by PEU, or payment of funds into the RSF by PEU, is 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		
PEU CBFRR Amount	$ 898,863	$74,905.25
PEU Allowed Revenue Requirement	$4,926,950	
CBFRR Revenue Requirement % Note1	18.2438%	

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 18.2438% of actual revenues exceed $898,863 per annum, the excess revenues from this calculation are used to repay funds previously borrowed from the RSF, via intercompany advances from PWW. To the extent that 18.2438% of monthly actual revenues are below $898,863 per annum, the deficient amount is advanced to PEU via intercompany loans from PWW, as moneys transferred out of the RSF, in order to allow PEU to meet its portion of the obligation for funding of the monthly note payment to the City under the CBFRR.

For the year ended December 31, 2012, PEU had actual revenues in excess of CBFRR revenues, in the amount of $264,657. This conforms to the requirement that the Allowed Revenue Requirement and the calculated CBFRR Revenue Requirement percentage be based on the last rate order that determined the allowed revenue level for that company (in this case, DW 07-032, with a test year of 2006), which has caused the CBFRR Revenue Requirement percentage to be arbitrarily overstated. This is dissimilar to the usage of the RSF by the other two regulated utility subsidiaries of the Parent (PWW and PAC) where the basis for the current Allowed Revenue Requirement under the CBFRR, is based on a test year of 2009, which is consistent with the approach used in the Settlement Agreement for the establishment of the CBFRR calculation, and the calculated usage of the RSF.

As shown in the schedules supporting this rate filing, the current revenue requirement for PEU is well in excess of the last allowed revenue level, primarily due to the elongated period of time between filing for rate relief. If PEU had an Allowed Revenue Requirement equivalent to its actual revenues for calendar year 2012, which were $6,235,171, the CBFRR Revenue Requirement would have been 14.4160%. For the year ended December 31, 2012, the actual revenues in excess of the CBFRR would have only been $36,250. As discussed earlier, there is no mechanism currently in place to establish a deferred credit for this sum, enabling PEU to refund any monies determined to be due to ratepayers based upon this calculation, if any, and/or to allow PEU to provide for the moneys needed to repay future obligations to PWW out of PEU's currently allowed water rates, should access to the reserves under the RSF be needed to provide for deficits between actual annual water revenues, and the CBFRR revenue requirement.

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 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 PEU, 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 $7,398,364 (a 19.60% increase over current water rates), as opposed to our current request for required revenues of $6,826,656 (a 9.97% 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 PEU?

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 were allocated to PEU, 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.

<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 $1,199,216 denoted on Attachment A as the Water Sales Pro Forma, relates to the CBFRR revenues discussed in detail earlier in this testimony, as well as the elimination of the revenues associated with the Capital Recovery Surcharge pursuant to Order No. 25,051 (December 11, 2009) in DW 09-051. The pro forma for Insurance costs notated on Attachment C, page 1, 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. Similarly, 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. 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. Please discuss the nature and impact of certain adjustments notated on Schedule 3.

A. The adjustment of $6,410,053 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. 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.