Docket No. DW 19-084
Pennichuck Water Works, Inc.
Rate Proceeding

TAB 7

Testimony of Larry D. Goodhue

STATE OF NEW HAMPSHIRE

BEFORE THE

PUBLIC UTILITIES COMMISSION

Docket No. DW 19-084

Pennichuck Water Works, Inc.
Rate Proceeding

DIRECT TESTIMONY OF LARRY D. GOODHUE

June 27, 2019

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I. INTRODUCTION

Q. Would you please state your name, address and position with Pennichuck Water Works, Inc., as well as its corporate Parent, Pennichuck Corporation?

A. My name is Larry D. Goodhue. My business address is 25 Manchester Street, Merrimack, New Hampshire. I am the Chief Executive Officer of Pennichuck Water Works, Inc. ("PWW" or "Company"). I am also the Chief Executive Officer of Pennichuck Corporation ("Penn Corp"), which is the corporate parent of PWW. I have been employed in the CEO capacity since November 6, 2015. Prior to serving as CEO, I served as Chief Financial Officer of Penn Corp and PWW. In addition to holding the CEO title for both PWW and Penn Corp, I have retained the title of CFO for both entities, as well as Treasurer for the two companies, as well as the other subsidiaries of Penn Corp.

Q. Please describe your educational background.

A. I have a Bachelor's in Science degree in Business Administration with a major in Accounting from Merrimack College in North Andover, Massachusetts. I am a licensed Certified Public Accountant in New Hampshire; my license is currently in an inactive status.

Q. Please describe your professional background.

A. Prior to joining PWW and Penn Corp, 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 with several private and publicly-traded companies.

Q. What are your responsibilities as Chief Executive Officer of Penn Corp?

A. As Chief Executive Officer, I am responsible for the overall management of Penn Corp and its subsidiaries, including PWW, and I report to the Board of Directors. I work with the Chief Operating Officer, the Corporate Controller, Assistant Treasurer, the Director of Human Resources and the Director of Information Technology to: (1) implement short and long-term financial and operating strategies, (2) insure the adequate funding of debt and expenses, and (3) enable Penn Corp's utility subsidiaries to provide high quality water service at affordable rates, on a consistent basis.

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 (the "Commission"):

- Financings for Pennichuck East Utility – DW 13-017, DW 12-349, DW 13-125, DW 14-020, DW 14-321, DW 14-282, DW 14-191, DW 15-044, DW 16-234, DW 17-055, DW 17-157, DW 18-132 and DW 19-069;
- Financings for Pittsfield Aqueduct Company – DW 15-045, DW 16-235 and DW 18-033;
- Financings for Pennichuck Water Works, Inc. – DW 14-021, DW 14-130, DW 15-046, DW 15-196, DW 16-236, DW 17-183, DW 18-133, and DW 19-026.

- Permanent and Temporary Rate Increase Proceedings for: Pennichuck Water Works, Inc. – DW 13-130 and DW 16-806; Pennichuck East Utility, Inc. – DW 13-126 and DW 17-128; and Pittsfield Aqueduct Company, Inc. – DW 13-128.
- Numerous other special dockets for Pennichuck Water Works, Inc., Pennichuck East Utility, Inc., and Pittsfield Aqueduct Company, Inc, since 2012.

I. PURPOSE OF THIS TESTIMONY

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to provide information supporting PWW's request for permanent rate relief, including: (1) relevant historical information regarding the City of Nashua's ("City") acquisition of Penn Corp in early 2012; (2) subsequent developments with respect to transformative changes in the capitalization of PWW as was presented to this Commission in more detail in three recent financing dockets, DW 14-130, DW 15-196 and DW 17-183; (3) information concerning how the ratemaking structure set forth in the Settlement Agreement approved by this Commission in Order No. 25,292 in Docket No. DW 11-026 has been operating since the 2012 acquisition and within the context of subsequent PWW financing efforts, as well as modifications to that structure approved in Docket No. DW 16-806 (Order No. 26-070); and (4) information supporting the rate relief requested by PWW and the specific further modifications to PWW's current ratemaking structure included therein, and information demonstrating that such requests are just, reasonable and in the public interest.

Q. Would you please identify the other witnesses in this case?

A. The other witness in this case, who is providing written testimony in this proceeding, is Chief Operating Officer Donald Ware. He holds this role for both PWW and Penn Corp, as well as the other subsidiaries of Penn Corp. His testimony will describe his qualifications, history and previous instances of testimony before the Commission.

II. HISTORY OF THE CITY OF NASHUA ACQUISITION

Q. Mr. Goodhue, before explaining the details of the rate case, would you please provide some history regarding the ownership of PWW and how that history supports PWW's requests?

A. Yes. Currently, PWW, as a corporate entity, is wholly-owned by Penn Corp, which is, in turn, a corporation that is wholly-owned by the City of Nashua, New Hampshire. The City of Nashua acquired its ownership of Penn Corp on January 25, 2012, pursuant to this Commission's Order No. 25,292 (November 23, 2011) (Approving Acquisition and Settlement Agreement). Prior to this acquisition by the City of Nashua, Penn Corp's shares were traded on the NASDAQ public stock exchange. For purposes of my testimony, I refer to the period prior to the City's acquisition as "pre-acquisition" and the period after as "post-acquisition".

Q. Did the City's acquisition affect the way in which PWW operates as a utility?

A. Yes. As vetted in prior case testimonies, the change in the ultimate ownership of PWW's parent, Penn Corp, from a publicly-traded investor-owned utility ("IOU") to ownership by the City has had important consequences for the operation of PWW.[1]

One of the most important consequences is that PWW, after the City's acquisition of Penn Corp, no longer has access to private equity markets as a method of financing its capital needs. As such, and as contemplated during the Commission's proceeding to approve the City's acquisition of Penn Corp in DW 11-026, after the acquisition, PWW expected to finance its on-going capital needs entirely through the issuance of debt.[2]

Q. Does reliance solely on debt to finance PWW's operations have impacts on PWW's customers?

A. Yes. As testified to in prior dockets, debt is important as it relates to the ongoing capital structure of the Company and its ability to finance its operations and capital investments.

Q. Please Explain.

A. As was contemplated during the acquisition proceedings, one very positive result of this anticipated debt component is that the weighted average cost of PWW's capital structure is significantly lower than it was prior to the City's acquisition. This lower cost of capital has had, and will continue to have, direct benefits for PWW's customers. The lower cost

[1] See, PWW's most recent rate case, Docket No. DW 16-806, Pre-filed Direct Testimony of Larry D. Goodhue (9/26/16) and Hearing Transcript of July 25, 2017.
[2] See, Order No. 25,734 (Nov. 7, 2014) in Docket No. DW 14-130 approving PWW's Integrated Capital Finance Plan totaling $54.5M. See also Order No. 25,808 (Sept. 2, 2015) in Docket No. DW 15-196 approving $25.5M in tax-exempt bonds through the New Hampshire Business Finance Authority.

of capital is a direct result of PWW's transition from a traditional investor-owned utility debt/equity capital structure to the new, municipal-like capital structure which is solely debt-financed. Instead of financing approximately 50% of the Company's capital structure with a return on equity, which the Company was earning prior to 2012 at a post-tax rate of 9.75% (or approximately 16% pre-tax), the Company now funds 100% of its capital structure with debt, at rates in the range of 2.5-4.5%. The lower overall rates translate directly into reduced customer rates, both currently and on a going forward and long-term basis.

Q. Does reliance solely on debt to finance PWW's operations have negative consequences for PWW's rate setting methods and procedures?

A. Yes. It exacerbates regulatory lag and negatively affects traditional bank/lender coverage ratios. As also contemplated in the acquisition Docket DW 11-026, the City's acquisition of Penn Corp and the resulting need to finance utility operations with debt has required modifications to PWW's (and Penn Corp's other subsidiary utilities') ratemaking methods and procedures to accommodate PWW's municipal-like debt only financing structure. Even though this low-cost municipal debt model is better in its overall cost of capital, it however, makes PWW much more dependent on the direct relationship of cash flow generated from rates, as it relates to the ongoing repayment of debt in support of ongoing capital investments. Under the previous IOU structure, the allowed return on equity, allowed PWW to generate extra cash to cover the repayment of debt obligations, provide adequate coverage of operating expenses, and allowed Penn Corp. to satisfy dividend obligations to public-company shareholders. That IOU structure also allowed the Company to seek debt for infrastructure replacements that could have interest only repayment structures, with balloon maturities, that could either be refinanced at maturity or repaid by issuing more equity into the marketplace. Post-acquisition, PWW has lost this buffer to cash flows, and regulatory lag, because it has lost the ability to raise additional equity to repay balloon maturity obligations.

Q. Was this shift to debt and the resulting cash flow consequences discussed in prior dockets?

A. Yes. This shift has been discussed extensively in prior dockets. The Commission's order approving the settlement agreement in the acquisition docket DW 11-026 expressly acknowledged this shift, as the Commission approved a "modified ratemaking structure" that had important differences from the traditional "equity-based" ratemaking method. This modified ratemaking structure recognized that for PWW, in its post-acquisition periods, it is much more important to set rates at levels that assure PWW's lenders that PWW will earn revenues sufficient to provide cash flow coverage for repayment of its debt obligations, and to satisfy on a continuing basis all associated debt covenant obligations associated with the debt used for infrastructure replacement and short-term working capital needs.[3] In light of lender credit risk concerns as well as overall lender requirements, the Company has worked with its lenders to put covenants in place on its issued bonded debt and covenants which allows the Company to continue to access the working capital line of credit it has as a resource through its parent (Penn Corp Corporation). These new covenants are aligned with PWW's new capital and rate

[3] See footnote 2 and financing dockets listed on page 2 of this testimony.

structures and recognizes PWW's cash-flow based model, as well as PWW's need to seek recovery of: 1) cash outflows for necessary operating expenses and debt service on the Company's external debt for capital projects; and 2) the CBFRR obligation for the bonds issued to purchase the parent company, as a necessary and requisite ongoing rate structure element, as approved in the acquisition docket, DW 11-026.

III. OVERVIEW OF REQUEST FOR RATE RELIEF AND PROPOSED MODIFICATIONS TO PWW'S RATEMAKING STRUCTURE

Q. Mr. Goodhue, please provide an overview of the nature of the Company's requests?

A. The proposed relief consists of two principal components. First, as set forth in our full rate filing materials, which are described in more detail by Mr. Ware in his testimony, PWW is requesting a rate increase of 11.91%, bringing its allowed revenues to a level of $35,510,803, as shown at Tab 12, ("Schedule 9") and as detailed at Tab 13 ("Schedule A"). This rate increase is dampened somewhat by the fact that some of the increase will or is already being collected via PWW's 2018 approved 1.69% Qualified Capital Project Adjustment Charge ("QCPAC") per NHPUC Order 26,183 and the 2.39% QCPAC for which the approval process is currently in pendency in docket DW 19-029.

The second component of PWW's requested relief is its request, set forth in its Petition for Further Modifications in Ratemaking Structure, is to seek the Commission's approval of further modifications to the ratemaking structure most recently approved in DW 16-806. My testimony focuses mostly on the latter component.

Q. Please explain in more detail the reasons behind needing the second component.

A. PWW is requesting the Commission to approve further modifications to PWW's ratemaking structure that would continue to allow PWW and its lenders to have reasonable expectations of future rates to support PWW's long-term, post-acquisition capital requirements (i.e., debt). Additionally, and more importantly, the further modifications are being requested to minimize the adverse impact of "regulatory lag" in the recovery of dollar-for-dollar coverage of necessary and prudent operating expenses, without the need to borrow debt funds to refill or sufficiently fund rate stabilization/reserve cash funds.

To illustrate this problem further, in its prior ownership structure, and like other IOUs, the return on equity allowed for incremental profits to be earned between permanent rate filings. These incremental profits were used to fund shareholder dividends, but more importantly, provided coverage for inflationary increases in operating expenses between rate cases, for which the regulatory lag in rate recovery never fully funded. This coverage issue is a very important concern to PWW's lenders. PWW's requested further modifications acknowledge that PWW's reliance on debt financing requires a ratemaking method that is based on a fixed multiple of the annual debt service on existing debt, with the balance of the allowed revenue requirement tied to coverage of prudent, normal and ongoing operating expenses, but in a more-timely manner. The benefit of this to ratepayers is smaller incremental rate increases, versus larger periodic rate changes, as well as cash coverage of actual operating expenses versus rate coverage to fund the cost of debt service on moneys borrowed to provide for adequate cash reserve funds, required to access debt funding for ongoing necessary capital improvements of the water distribution and treatment infrastructure of the Company.

Q. Do you believe that the requested increase in PWW's rates is consistent with the projected rate increase trajectory anticipated when the City of Nashua acquired Penn Corp?

A. Yes. The increase being requested is consistent with the history of the City's acquisition of Penn Corp. The City's acquisition was premised on the assumption that the City's ownership of PWW, Pennichuck East Utility, Inc. ("PEU"), and Pittsfield Aqueduct Company, Inc. ("PAC") would produce consistently lower rates for ratepayers, as compared to the previous investor-owned utility structure. In the forecasts underlying the settlement agreement and order approving the acquisition, it was assumed that PWW would realize rate increases over time of approximately 2.9% per year in order to fund projected increases in operating costs and debt repayment and procurement obligations. The increase being sought in this proceeding is consistent with these assumptions. If PWW had experienced annual 2.9% rate increases over this period, the resulting rates would be near the level PWW is seeking in this proceeding. And as demonstrated in my testimony and the testimony of Mr. Ware, this rate request takes into account the fact that certain operating expenses, specifically property taxes, have risen at a rate in excess of the average annual 3% increase assumed in the acquisition docket.

Q. Do you believe that the further modifications requested in PWW's petition are consistent with the anticipated capital structure of PWW?

A. Yes. The premise of lower customer rates was based primarily on two factors: 1) a reduction in operating expenses attributable to the fact that Penn Corp would no longer be required to carry the significant costs associated with the SEC requirements, as well as management and administrative infrastructure required of publicly-traded companies; and 2) PAC, PEU, and PWW would be transitioned from a traditional IOU debt/equity capital structure (subject to the traditional cost-of-service ratemaking model) to a debt capital structure that is more aligned with the ratemaking model typically applied to municipally-owned utilities. For example, the modified ratemaking structure approved in DW 11-026 included a special requirement to allow the utilities to collect revenues sufficient to cover the City's obligations on the bonds it issued to accomplish the acquisition (the "CBFRR") and dispensed with the traditional idea that the City should be allowed to collect an "equity-based" rate of return on its investment in the utilities. Because the City only sought revenues sufficient to assure itself, its lenders, and its rating agencies that it would meet its debt obligations and enable the utilities to continue to provide excellent and safe water service at affordable prices, the resulting rates were projected to be lower than if the City had sought a "profit" on its investment.

The modifications approved for PWW in Docket DW 16-806, as well as the further modification requested in this docket are absolutely consistent with PWW having a municipal-like capital structure. The requested further modified ratemaking methodology is required to properly, adequately, and timely provide PWW with the necessary cash flows to fund all operating and debt service obligations and to allow PWW to access lending markets in the future to meet its needs at reasonable costs.

Q. Are the requests for permanent rate relief and rate-making methodology modifications consistent with the 2014, 2015 and 2018/2019 financing proceedings?

A. Yes. The 2014 and 2015 capital financings were expressly constructed with the purpose of transitioning PWW's capital structure from a pre-acquisition "debt-equity" mix to one that is aligned with PWW's ownership by the City.[4] The bonds issued for PWW in 2018 and 2019, as approved in Docket DW 17-183, were issued under the same terms and conditions as the 2014 and 2015 capital financings. All of these approved financings, now successfully completed and issued, have allowed PWW to: (1) issue debt with covenants that are better aligned with PWW's post-acquisition capital structure; (2) replace bonds that were subject to "balloon" payments at maturity with bonds that are fully amortizing with terms that are consistent with the long-term nature of PWW's asset base; and (3) take advantage of lower debt interest rates, as opposed to higher return on equity rates.

Q. What is PWW's bond credit rating and has it changed since the last permanent rate filing?

A. The Company's credit rating has increased from a pre-acquistion Moody's rating of Baa2 (Standard and Poors equivalent of BBB), to its current rating of "A+" with a negative outlook. The Company was downgraded slightly for its 2019 bond issuance from a rating

[4] See, e.g., Order No. 25,734 (Nov. 7, 2014) in Docket No. DW 14-130 approving PWW's Integrated Capital Finance Plan totaling $54.5M.

of "A+" with a stable outlook, to the current rating with a negative outlook, for one primary reason: Standard and Poors indicated that the change and reduction in the outlook was the result of the Company's overall cash balance position at the time of the current rating issuance.

Q. Will the proposed further modifications address this negative outlook?

A. Yes. In discussions with the rating agencies on how to address this negative outlook, it became clear to PWW that further modifications to the ratemaking formula would be necessary, and looked upon favorably in the credit rating process, which directly impacts debt service costs going forward. Therefore, the modifications to rate structure being requested in this docket are very important in re-establishing a "positive outlook" and perhaps even will allow for an increase in the Company's overall credit rating.

Q. Please explain the relationship between rate relief and the Company's cash position.

A. The Company's current cash position is the direct result of the Company's inability to have its rates provide cash coverage for inflationary increases between rate cases as well as the permanent rate lag due to the timing for recovery of operating expenses from a permanent rate case filing process. It currently takes the Company the better part of two years to get full rate relief in a permanent rate filing, and in that interim, inflation has increased operating expenses for "test year" operating expenses to their current levels. As such, the Company has used its rate stabilization fund coverage, as allowed in Dockets DW 11-026 and DW 16-806, when revenues did not exceed allowed levels which would have fully refunded or overfunded those rate stabilization funds. This experience with the existing ratemaking modifications (and the associated ratings reviews by Standard and Poors) has also influenced PWW's request for further requisite modifications to its ratemaking methodology .

Q. Mr. Goodhue, why is PWW requesting these further modifications at this time, when it could have requested them in the original acquisition docket or in Docket DW 16-806?

A. In short, gradualism and experience. First, as the Commission is aware, the settlement agreement approved in DW 11-026 provided that PWW, PEU, and PAC would file their first full rate cases simultaneously not later than June 1, 2013. The purpose of that filing requirement was to allow the utilities to develop experience and operating history under the new ownership structure. PWW, PEU, and PAC filed their first post-acquisition rate cases consistent with this requirement. However, at that relatively early time, PWW had not yet acquired direct experience on how the capital markets and rating agencies would react to PWW's unique ownership structure.

Second, PWW has now acquired experience and information from its significant bond financings that has allowed PWW to obtain direct input and insights into how capital markets have and will continue to respond to its ownership structure.

Third, PWW has acquired actual experience with respect to the operation of the current ratemaking method, and its modifications approved in Docket DW 16-806, and has been able to observe and test its benefits, and its deficiencies.

Fourth, PWW felt it was necessary to implement the various needed modifications to rate structure in a "stepped" approach, giving consideration to requested rate increases and their impact on customers, but to also analyze the various methods that might be employed to accomplish this. The further modifications being requested in this case are designed to only provide adequate cash coverage of operating expenses, but on a more timely basis, and without the need to borrow debt funds to provide for adequate cash reserves, for which rates would be needed to provide debt service coverage for those borrowed funds (instead of providing solely for the funds required).

V. INVESTMENT ADVISOR ASSISTANCE WITH RATEMAKING MODIFICATIONS

Q. Mr. Goodhue, has PWW sought the assistance of any investment advisor in connection with the development of the proposed rate relief and ratemaking methodology modifications?

A. Yes. PWW has continued to consult with representatives of TD Securities (USA) LLC in assessing the current and long-term benefits of the proposed modified rate-making structure. TD Securities (USA) LLC served as the underwriter in connection with the issuance of tax-exempt bonds through the New Hampshire Business Finance Authority for the bond issuances in 2014-2019. In discussions with TD Securities (USA) LLC, PWW has received favorable indications of the benefits of the modifications to PWW's ratemaking method as approved in Docket DW 16-806, as well as the further modifications being requested in this docket, with respect to PWW's projected capability to access low cost, long term, financing for ongoing capital improvements and infrastructure replacement.

VI. SUMMARY OF PROPOSED RATE RELIEF

Q. Mr. Goodhue, would you please briefly describe the rate relief requested in this proceeding by PWW?

A. Yes. As described in the testimony of Donald L. Ware, PWW is requesting the Commission to approve a rate increase of 11.91%, bringing its allowed revenues to a projected level of $35,510,803 as delineated in PWW's rate case filing at Tab 12 ("Schedule 9") and at Tab 13 ("Schedule A").

Q. Would you briefly describe the basis for this requested rate relief?

A. The fundamental basis for this request is that it represents the revenues required to cover PWW's current operating expenses and to meet the demonstrated costs of servicing PWW's direct debt obligations plus its share of the CBFRR. PWW has prepared its ratemaking schedules to demonstrate this fundamental basis.

Q. Why is PWW filing a rate case at this time?

A. PWW is filing a rate case at this time to get a reset in their permanent rates sufficient to cover necessary and prudent operating expenses, which have grown in magnitude and overall dollar value since its last permanent rate filing in Docket No. DW 16-806. Operating expenses of the Company have increased due to inflation since the last filed permanent rate filing, and in some cases, at rates above inflationary levels. This has caused the Company to nearly fully extinguish its funds in the MOERR RSF, as it has been used in accordance with the currently approved rate structure, to backstop the increased expenses since the last permanent rate case. Absent the ability to file this case at this time, the Company would have neither: (1) sufficient overall revenues to cover its prudent and necessary operating expenses, or (2) sufficient funds remaining in the MOERR RSF fund to provide support to its necessary cash operating requirements.

Q. Please discuss the format of the ratemaking schedules filed by PWW upon which the requested rate relief is based.

A. PWW's requested rate relief is based on the modified ratemaking as approved in Dockets No. DW 11-026 and DW 16-806. The rate increase is also based on the modified methods reflected in the ratemaking schedules, to the extent they have an impact on the current rate request, versus the implementation of forward-looking rate and surcharge elements. As further described in the testimony of Mr. Ware, these rate schedules embody financial information and resulting rates attributable to the approved rate structures resulting from those dockets and include the three primary "buckets" of allowed revenues: (1) City Bond Fixed Revenue Requirement (CBFRR), (2) Debt Service Revenue Requirement (DSRR) and the (3) Operating Expense Revenue Requirement (OERR). The required schedule under 1604.06 (schedule 1) and 1604.08 (schedule 5) address the approved revenue requirements being sought in this case, inclusive of the rate structure, pro forma operating expenses, and underlying debt service obligations for the Company's used and useful Capital Improvements.

VI. SUMMARY OF PROPOSED MODIFICATIONS TO PWW'S RATEMAKING STRUCTURE

Q. Please identify the specific additional modifications PWW is requesting be made to its current ratemaking structure.

1. Create a Material Operating Expense Surcharge (MOES) that the Company would file with the NHPUC on an annual basis, seeking a surcharge between rate cases for inflationary increases in its material operating expenses.

A. Currently, due to the Company's capital structure being supported solely by its last approved rates and debt between rate cases for capital improvements, inflationary increases in operating expenses are not covered by allowed revenues and are "backstopped" by the usage of cash funds reserved in the MOERR RSF (as approved in Docket No. DW 16-806). However, the adequacy of these funds is not sufficient in their total imprest value to cover these increases in costs between rate cases. In order to fully "backstop" these expenses with the MOERR RSF, this fund would have to be funded at a much higher value, as delineated in DLW Exhibit 2 and in order to accomplish that, all of those funds would have to be funded thru a debt issuance. In doing this, ratepayers would then have included in their rates the cost of these funds, as well as the debt service on those funds, in order to hold cash balances in reserve to support these increasing operating expenses. Implementing the MOES would simplify this and reduce the overall cost to ratepayers for the adequate coverage of operating expenses. The advantages to this approach are lower overall costs to ratepayers and the reduction or near elimination of non-recoverable regulatory lag for necessary operating expenses, for which the Company gets only a dollar-for-dollar coverage in the permanent rates. Additionally, ratepayers would see smaller incremental annual rate increases versus larger periodic rate increases. As a component of this request, the Company has included only 50% of the amount needed to refill the deficiency in the RSF accounts per 1604.06 Sch 1, Attach I, as allowable for the three years following the reset of permanent rates. This is being done to minimize the impact of replenishing those RSF funds, as a component of the Company's permanent rate request, while the implementation and benefit derived from the new MOES comes online. In the alternative, if the Commission does not approve the MOES, the Company requests that the allowable refill of the RSF funds over the succeeding three years be maintained at 100% efficacy, as allowed in those prior Dockets (DW 11-026 and DW 16-806) and their respective rate orders.

2. Include the actual cash basis of incurred Federal and State Corporate Income Taxes in the operating expenses of the Company OERR allowed revenues.

A. With recent changes in the Federal Tax laws, the Company will soon be in a position where its Net Operating Loss Carryforwards (NOL's) will either be fully exhausted, or under the Tax Cuts and Jobs Act (TCJA) that only 80% of its taxable income can be offset with the usage of NOL's. As such, there is a high likelihood that the Company will be subject to actual cash costs related to Federal Income taxes before its next fully promulgated rate case. Additionally, in the State of NH, corporations are subject to both the Business Profits Tax (BPT) and Business Enterprise Tax (BET), which has a cash payment requirement associated with one or both of them, regardless of current NOL position. Under the Company's current allowed revenue rate structure, the cash coverage of corporate taxes is not included in any of its revenue components. The Company is requesting in this filing that the actual cash cost of these taxes be included in the MOES each year, as well as included in the OERR component of allowed revenues in this and future permanent rate cases, so it has the actual cash to pay these obligations. To this end, the Company will be filing its Corporate tax returns in the first quarter of each year, such that these amounts will be known and measurable to be inclusive in its annual filings with the Commission.

3. Re-prioritization of the usage of the 0.1 DSRR funds collected each year.

A. Currently, these funds are to be used to fund capital improvements each year without the incurrence of debt, however, the Company now has experience with the collection and usage of these funds since the approval and establishment of this fund since its last permanent rate case. It seems illogical that these funds would be first used to fund these capital improvements, when the RSF funds have been reduced in their overall value due to: (1) revenue performance below allowed levels due to weather impacts in 2018, or (2) operating expenses incurred in 2018 were at levels well above approved levels, due to the fact that allowed revenues were based on 2015 test year expenses with some adjustment for 2016 proformas, but continued to grow with compound inflation for 2017 and 2018. As such, the Company is requesting in this filing that the 0.1 DSRR funds be used in the following priority order: 1) fund the cost of deferred assets (i.e. studies, engineering design work completed in advance of construction bids and construction[5], and other intangible assets) that do not qualify for QCPAC and debt financing; 2) pay for the interest cost on Fixed Asset Line of Credit borrowings (FALOC), if these costs are not allowed to be included in the Company's QCPAC surcharges; 3) refill RSF fund balances to their imprest values; and 4) pay for capital improvements, as previously authorized in DW 16-806.

Q. Would this priority order benefit ratepayers? If so, how?

[5] On numerous occasions, engineering design work has to be completed and paid for in a fiscal year preceding the year in which the project is actually constructed. As such, cash has to be spent which does not currently qualify for QCPAC surcharge funding contemporanaeous with the year for which the dollars are expended. Being that these design costs are not "used and useful" in the year for which they are incurred, as currently constituted and allowed they cannot be included in the QCPAC filing for the year, and there is currently no other mechanism in the rate structure that covers this cash need.

A. The overall impact of this would be positive for ratepayers as it would lessen the burden on rates to ensure that the RSF funds are retained at adequate levels to properly support the allowed revenues and expenses of the Company, and fully fund necessary activities that are engaged for, which are neither depreciable capital or routine and prudent ongoing annual operating expenses. The priority order will also enhance the Company's overall ability to cash flow and/or debt-fund operations. As noted earlier, Standard and Poors in support of bonds issued by the Company on April 4, 2019, changed PWW's credit rating from "A+ with a stable outlook" to "A+ with a negative outlook." The Company was told during the credit review teleconference and due diligence call, that the reason that the outlook changed on the rating was due to the Company's reduced balances in the RSF funds and the fact that there was no mechanism currently in place that allowed for a cure of this between permanent rate filings. Standard and Poors also indicated that if the MOES (as described to them by the Company as an element we would seek in this next filed rate case, on the due diligence call) were to be approved along with the change in the usage of the 0.1 DSRR funds, it was highly likely that the Company's rating outlook would be enhanced, and possibly its overall credit rating. This would be positive for ratepayers because a better credit rating and outlook translates directly to reduced cost of interest on debt incurred for Capital improvements. Conversely, if the two elements were not to be improved, it was indicated that there is a strong possibility that the negative outlook could translate to a reduction in the Company's credit rating, which would cause an increase in the cost of debt funding going forward.

4. Reallocate the imprest value of PWW's aggregate RSF funds.

A. The initial aggregate imprest funding level for the RSF accounts for PWW was $5 million, per DW 11-026. In Docket No. DW 16-806, the Commission approved the Company's request to lower the value of this fund, available in the aggregate for PWW, to an amount of $3.92 million, with the balance transferred to or held for PEU and PAC. In Docket No. DW 16-806, the Commission approved allocation of this $3.92 million aggregate sum: CBFRR RSF - $680,000; MOERR RSF - $2,850,000; and DSRR RSF $390,000. The Company is seeking to reallocate this imprest aggregate value further, to the individual funds, as per the attached DLW Exhibit 2, in order to achieve an estimated 2 years of coverage provided by the imprest value of the individual funds. This will give protection for regulatory lag that needs to be covered by them, in conjunction with the annual impact of the QCPAC and MOES surcharges. Even though the QCPAC and the proposed MOES provides for an annual surcharge to supplement rates for increases in overall debt service from incremental borrowings, and inflationary increases in operating expenses, the timing of these still incurs some regulatory lag as to full cash coverage of these underlying costs, simply due to the time it takes to process them thru the Commission, and the erosion effect of inflation and/or the fact that there is always a modicum of customer turnover before orders are issued, for which recoupment is unavailable (as customers have left our service territory before recoupment can be billed to them). The balance of the funds adding up to the $3.92 million total will remain in the CBFRR RSF fund, as that was the initial imprest provided into the fund from the monies that were borrowed for, by the City, and invested into PWW.

5. Allow the current QCPAC process, and the proposed MOES process, increases to be implemented annually and at the same time.

A. PWW also requests approval to show the QCPAC and MOES increases as a single, consolidated rate change on the customer bills, similar to electric and gas bills in the State, which aggregate two surcharges together on the bill, as one line item. The Company is sensitive to the potential "pancaking" effect of rate increases to its customers. The single effective date would be less confusing to customers and would allow customers to budget more easily.

6. Treatment of Debt Issuance costs for long-term debt, other than tax-exempt and taxable bond issuances.

A. The Company funds its operations with debt from three general sources: tax-exempt or taxable bonds, SRF loans, and DWGTF loans. In the case of bond issuances, the cost of issuance is included in the overall amount issued in the annual bond issuances. As such, the cost of issuance, as included in Deferred Debt Expense on the Company's books, has coverage in the allowed revenues of the Company in its 1.0 DSRR revenues, plus the over-cover in its 0.1 DSRR revenues. However, because the amortization of Deferred Debt expense is not included in the covered expenses under the OERR revenues and those *de minimis* cost of issuance costs are not included in the amounts borrowed from the SRF or DWGTF, there is no cash coverage for those costs included in the Company's currently allowed rate structure. As these costs are generally de minimis in nature, as it relates to the debt issued, the Company proposes that they be allowed to carry these costs in Outside Services going forward, as an includable expense in the NOERR portion of the overall allowed revenues of the Company. This would allow the Company to recover the actual cash outflows for these cost of issuance expenses at a dollar-for-dollar coverage level, as absent that ability, the cost of these necessary and prudent expenses have no cash coverage in the Company's rate structure. And, as the Company has an overall rate structure designed to cover actual cash expenses, without any excess coverage, the inclusion of these costs is essential, without causing unnecessary or further impairment of the RSF funds between rate cases. This would be altered going forward for all debt of this type, but the Company would not seek to go backwards and include the amortization of the remaining Deferred Debt expense for non-bonded debt on its books.

Q. Will PWW be seeking a temporary rate increase?

A. No. PWW will not be seeking a temporary rate increase in this filing. The Company currently has its annual QCPAC filing in process with the Commission, under Docket DW 19-029, and has proformed changes in its operating expenses, included certain proformas for 2019 into the filing schedules for this rate case. The Company would be prepared to file its first annual MOES (for 2019 expenses) with the Commission in early 2020, to the extent needed, while this case is still in pendency. The results of that MOES filing would be requested, with an expectation that any basis for that would be approved sometime soon after permanent rates would be approved under this case.

VII. NOTIFICATION OF RATE CASE

Q. Please describe PWW's efforts to communicate with the City of Nashua, and other affected communities and customers relative to this filing.

A. Upon filing the NOI for this case with the Commission, PWW communicated in writing with officials of all communities served by PWW. These communications included representatives of the City of Nashua government, officials of the other ten communities served by PWW, and State Senators and State Representatives who represent any of the eleven communities served by PWW. The requested rate relief and proposed modifications have already been presented to PWW's and Penn Corp's Board of Directors. Upon filing of this petition with the Commission, as referenced in the testimony of Mr. Ware, all of the Company's customers will be served notice in accordance with the tariffed requirements, including all general metered customers, as well as customers under special contracts.

VIII. IMPLEMENTATION OF THE PROPOSED MODIFICATIONS

Q. Mr. Goodhue, how would you recommend that the MOES be implemented and filed annually?

A. We would request that this be an annual filing with the Commission on or about May 1st of each year. The requested MOES would be based upon a comparison of the filed actual expenses by the Company with its required Annual Report Filing to the NHPUC versus the allowed operating expenses approved in the Company's last approved permanent rate case. The MOES would calculate the percentage increase for the surcharge based upon this comparison as either an increase or decrease in its allowed revenues, for the overall revenue coverage inclusive of the MOES calculated. Similar to the QCPAC the MOES granted in years between rate cases would become part of the permanent rate granted as part of the next complete rate filing. Mr. Ware's testimony includes further discussion and an exhibit to show the impact that an MOES would have had in 2017 and 2018 on PWW's revenues had this concept been in effect. See, DLW Exh. 2.

IX. JUST AND REASONABLE FINDING AND CONCLUSION

Q. Mr. Goodhue, do you believe that PWW's proposed rate relief and modifications to the ratemaking structure established in DW 11-026, and modified in DW 16-806, will result in just and reasonable rates?

A. Yes. I believe the requested rates and the proposed modifications are just and reasonable for several reasons.

First, the requested rates, including the effects of the proposed modifications to PWW's ratemaking structure are generally consistent with the long-term projections presented in the City's acquisition of Penn Corp, in Docket No. DW 11-026, which assumed an average annual increase in rates of approximately 3%. While the rate increase requested in this proceeding is significant, when the cumulative increase is examined as an average annual increase, it is generally consistent with the original assumptions of the acquisition docket.

Second, the requested rates continue to be materially lower than the levels which would have been reasonably projected to result from continued private investor ownership under the pre-acquisition structure, with a 50/50 debt/equity capital structure and a return on equity value well in excess of the Company's current cost of debt. This lower cost of capital benefits ratepayers and was one of the principal reasons for the approval of the City's acquisition. PWW has migrated to a utility that finances all of its capital needs via the issuance of debt and this results in a materially lower weighted cost of capital than a private, IOU with a more traditional debt and equity capitalization.

Third, the requested rates are necessary to maintain PWW's ability to continue to provide safe and high-quality water service by financing continued reasonable and prudent operations and by having access to borrowed funds necessary to finance required capital assets and infrastructure.

Fourth, the requested additional modifications to PWW's current ratemaking structure are the result of experience the Company has obtained in the period of time since its last permanent rate increase. During 2018, when the Company experienced an extremely wet August, approximately $1 million in revenues were lost for the year, which exacerbated the reduction in the MOERR RSF, which had already been utilized to "backstop" the inflationary increases in operating expenses since the last rate case. The impact of this was significant, in that it drew the $2.85 million impress fund down to values that approached zero. Not only did this bring this required fund to a level where it could not fully serve its designated purpose, it was also the reason that S&P changed the outlook on the Company's credit rating. This experience has allowed PWW to develop the specific additional modifications proposed in this petition and further to have confidence that these modifications will continue to enhance PWW's ability to access debt markets in the future at affordable interest rates and at reasonable covenants.

Q. Mr. Goodhue, do you believe that the requested rate relief and adoption of the proposed modifications are required to ensure that PWW continues to be able to provide safe and high-quality water service to its customers?

A. Yes. PWW's current rate structure is based upon a cash flow model for the dollar-for-dollar coverage of its obligations under the CBFRR and DSRR, as well as coverage of its necessary operating expenses. It is not designed to create excess operating profits. It is imperative that the Company have a rate structure that enables it to provide 100% of the cash needed to pay for its obligations, in compliancy with all rules and regulations as a public water provider, and as such, an element in the overall public health system in the State, inclusive of requirements as established by the Environmental Protection Agency and the NH Department of Environmental Services ("NHDES"), as well as the Department of Health and Human Services ("DHHS"). This is especially important in an environment in which the standards for public water have come under increased scrutiny, and public pressure as well as peer-review science, is impacting the standards for many existing and newly emerging contaminants. Some of these emerging water quality standards will have an impact on the Company in both annual operating expenses, as well as capital project investments, which could be significant or material on a going forward or initial investment basis. And, as a regulated public water supplier, the Company is obligated to comply with all Federal and State water quality standards, to the health and benefit of its customers, without unnecessary delays and in conformity with promulgated dates of implementation. As an example, almost simultaneous with our submission of this petition for modifications to our ratemaking structure, the NHDES along with DHHS is releasing their recommended State Maximum Contaminant Level for per- and polyfluoroalkyl substances ("PFAS") on June 28, at levels that will require certain material investment in treatment costs, capital investments and/or overall operating costs that must be borne in compliancy with this new public water and health based standard, which is set to have an effective date beginning as of October 1, 2019. As such, as a Company that does not have a return on equity component that allows for any over-earning on allowed revenues (that are not subject to refund to our customers), any form of material regulatory lag is problematic. Regulatory lag makes it more difficult to timely comply with these regulations and in response to the overall purpose of the Company, to provide water in compliance with health-based water quality standards. In order to continue to meet our compliance obligations with current and emerging water quality standards, the Company needs to have a mechanism in place to reduce or eliminate regulatory lag for the coverage of its operating expenses, in addition to the coverage of monies to pay its obligations for CBFRR and access necessary external debt service to fund capital structure replacement and improvements, as well as fund capital and operating expense costs as a result of current and changing water quality standards. Without this mechanism in place, the Company will not be able to meet these obligations going forward without the need to borrow monies to properly fully fund its RSF accounts with borrowed monies. In doing so, it would further burden rate payers for debt service for monies held in reserve to back stop operating expenses, which would be analogous to an individual taking out a mortgage on their home to pay their monthly home operating costs.

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

A. Yes, it does.