TAB 9

Testimony of Larry Goodhue

STATE OF NEW HAMPSHIRE

BEFORE THE

PUBLIC UTILITIES COMMISSION

Docket No. DW 20-156

Pennichuck East Utility, Inc.
Permanent Rate Proceeding

DIRECT TESTIMONY OF LARRY D. GOODHUE

November 23, 2020

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I. INTRODUCTION

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

A. My name is Larry D. Goodhue. My business address is 25 Walnut Street, Nashua, New Hampshire. I am the Chief Executive Officer of Pennichuck East Utility, Inc. ("PEU" or "Company"). I am also the Chief Executive Officer of Pennichuck Corporation ("Penn Corp"), which is the corporate parent of PEU. 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 PEU. In addition to holding the CEO title for both PEU and Penn Corp, I have retained the title of CFO for both entities, 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 PEU 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 PEU, and I report to the Board of Directors. I work with the Chief Operating Officer, the Corporate Controller, Treasurer, Assistant Treasurer, Director Water Supply, Chief Engineer, Distribution Manager, 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 PEU – DW 12-349, DW 13-017, DW 13-125, DW 14-020, DW 14-191, DW 14-282, DW 14-321, DW 15-044, DW 16-234, DW 17-055, DW 17-157, DW 18-132, DW 19-069 and DW 20-081;
- Financings for Pittsfield Aqueduct Company ("PAC") – DW 15-045 and DW 16-235;
- Financings for Pennichuck Water Works, Inc. ("PWW") – DW 14-021, DW 14-130, DW 15-046, DW 15-196, DW 16-236, DW 17-183, DW 19-026, DW 20-055, DW 20-064 and DW 20-157.

- Permanent and Temporary Rate Increase Proceedings for: PWW – DW 13-130, DW 16-806 and DW 19-084; PEU – DW 13-126 and DW 17-128; and PAC – DW 13-128 and DW 20-153.
- Numerous other special dockets for Pennichuck Water Works, Inc., Pennichuck East Utility, Inc., and Pittsfield Aqueduct Company, Inc, since 2012.

II. PURPOSE OF THIS TESTIMONY

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to provide information supporting PEU'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 Docket No. DW 19-084 (Order No. 26,383); and (4) information supporting the rate relief requested by PEU and the specific further modifications to PEU'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 PEU 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.

III. 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 PEU and how that history supports PEU's requests?

A. Yes. Currently, PEU, 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 PEU operates as a utility?

A. Yes. As vetted in prior case testimonies, the change in the ultimate ownership of PEU'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 PEU.[1]

One of the most important consequences is that PEU, 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, PEU expected to finance its on-going capital needs entirely through the issuance of debt.[2]

Q. Does reliance solely on debt to finance PEU's operations have impacts on PEU'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 PEU's capital structure is significantly lower than it was prior to the City's acquisition. This lower cost of capital

[1] See, PWW's 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. See also PEU's rate case, Docket No. DW 17-128, Pre-filed Direct Testimony of Larry D. Goodhue (October 18, 2007).

[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 for PWW through the New Hampshire Business Finance Authority. These financings support PEU's access to low-cost debt either as an intercompany loan or by demonstrating the credit worthiness of PEU via its affiliate PWW because PEU has no employees and uses PWW's employees.

has had, and will continue to have, direct benefits for PEU's customers. The lower cost of capital is a direct result of PEU'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, at then existing tax rates, or approximately 12% pre-tax at current corporate tax rates), 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 PEU's operations have negative consequences for PEU'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 PEU's (and Penn Corp's other subsidiary utilities') ratemaking methods and procedures to accommodate PEU'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 PEU 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 PEU to generate extra cash to cover the repayment of debt obligations, provide adequate coverage of operating expenses and regulatory lag, 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, PEU 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, first implemented for PEU in Docket No. DW 13-126, recognized that for PEU, in its post-acquisition periods, it is much more important to set rates at levels that assure PEU's lenders that PEU 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, some of which are borne at the Pennichuck Corporation level at it pertains to the Working Capital Line of Credit ("W/C LoC") available for usage by all subsidiaries, as well as specific covenants that underly PEU's debt obligations with CoBank.[3] In light of lender credit risk concerns

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

as well as overall lender requirements, the Company has worked with its lenders to put covenants in place on its issued bonded debt for PWW, and covenants which allows the Company to continue to access the W/C LoC it has as a resource through its parent (Penn Corp Corporation). These new covenants are aligned with PEU's new capital and rate structures and recognizes PEU's cash-flow based model, as well as PEU'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 City Bond Fixed Revenue Requirement ("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, Docket No. DW 11-026.

IV. OVERVIEW OF REQUEST FOR RATE RELIEF AND PROPOSED MODIFICATIONS TO PEU'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, PEU is requesting a rate increase of 21.05% (see Tab 7 of PEU's Rate Filing), bringing its allowed revenues to a level of $10,715,419, as shown at Tab 14, (Puc 1604.08 "Schedule 9") and as detailed at Tab 13 (Puc 1604.06 "Schedule A"). This rate increase is dampened somewhat by the fact that some of the increase will or is already being collected via PEU's Qualified Capital Project Adjustment Charge ("QCPAC") of 2.98% approved in NHPUC Order 26,313 for QCP's placed in service during 2018 and the 1.97% QCPAC for QCP's placed into service during 2019 for which the approval process is currently in pendency in docket DW 20-019. Although, if the Commission approves

PEU's temporary rate request, then PEU suggests that the QCPAC be reflected as an element of the temporary rate increase, so as to reduce the number of times customer rates change, and be less confusing to customers.

The second component of PEU's requested relief is set forth in its Petition for Further Modifications in Ratemaking Structure. PEU seeks the Commission's approval of further modifications to the ratemaking structure that was approved in DW 17-128 to include modifications approved for PWW in DW 19-084. My testimony focuses mostly on the latter component.

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

A. PEU is requesting the Commission to approve further modifications to PEU's ratemaking structure that would continue to allow PEU and its lenders to have reasonable expectations of future rates to support PEU'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, or other prudent 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 PEU's lenders. PEU's requested further modifications acknowledge that PEU'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 PEU'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 PEU, PWW, and 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 PEU 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, exclusive of certain key events which have occurred since that time, for which no possibility of predicting such events could have been know at that time. These key events include: (1) the material expansion of the distribution systems in certain key communities that the Company was obligated to accept in their approved franchise territories due to PFOA contamination issues, (2) the increase in property taxes due to increases at or above inflationary levels in several communities, as well as an expansion of the taxable property base from the PFOA activities, and (3) the assumption of more management fee expenses by the Company due to increased prorata revenues and prorata customers, as elemental components in the fixed methodology calculations from the approved and promulgated management fee allocation between the subsidiaries of Penn Corp, and with Penn Corp itself..

The increase being sought in this proceeding is consistent with the City's assumptions, excluding the identified key events, as the rate of increase of base operating expenses for the Company since 2012 have regularly been in the 2-3% rate per annum. If PEU had experienced annual 2.9% rate increases over this entire period, the resulting rates would be near the level PEU is seeking in this proceeding, excluding the inclusion of the impact of the exceptional key events. 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 PEU's petition are consistent with the anticipated capital structure of PEU?

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 No. 16-806, as well as the further modification approved in Docket No. DW 19-084, both of which PEU seeks, are absolutely consistent with the Company having a municipal-like capital structure. The requested further modified ratemaking methodology for PEU, as it is for PWW, is required to properly, adequately, and timely provide PEU with the necessary cash flows to fund all operating and debt service obligations and to allow PEU to access lending markets in the future to meet its needs at reasonable costs.

Q. What are the primary benefits of the DW 19-084 Settlement Agreement for PWW, and how do they apply to PEU?

A. The primary benefits of the rate structure modifications included in the DW 19-084 Settlement Agreement as shown immediately below, and how they apply to PEU are all intended to: (1) increase PEU's required access to necessary debt funding, (2) provide adequate cash flows to repay their debts, (3) give them the ability to meet lender covenant requirements, and (4) will provide lenders with the confidence in PEU's ability to repay their debt obligations in spite of the process to get new permanent rates approved and the regulatory lag that occurs in that overall process, all of which are fundamental for PEU to be able to continue to access needed debt for infrastructure replacement and operations.

The key structural elements being requested as a modification to the existing rate structure approved for PEU in Docket No. DW 17-128, are:

(1) a Material Operating Expense Factor ("MOEF") to provide for ongoing cashflow support for PEU's Material Operating Expense Revenue Requirement ("MOERR") and associated Rate Stablization Fund ("RSF");

(2) for atypical years in the 5-year average of water consumption, that the Company be allowed to substitute the data from the next most recent preceding typical operating year's data. Also, that an "atypical" year be defined as one in which that year's water consumption either exceeds or falls short of the calculated trailing 5-year average of water consumption by more than 15%. Further, for purposes of determining whether an "atypical" year exists, that calculation shall be based on the trailing 5-year average of the test year as well as the four immediately preceeding years. Therefore, the underlying trailing 5-year average data used in that determination shall be inclusive of the data pertaining to the potential "atypical" year;

(3) the inclusion of actual NH Business Enterprise Tax cash payments in the revenue requirement;

(4) prioritization of usage of available Debt Service Revenue Requirement-0.1 (“DSRR-0.1”) funds;

(5) recovery of State Revolvoing Loan Fund (“SRF”) and Drinking Water Groundwater Trust Fund (“DWGTF”) debt issuance costs; and

(6) re-establishment of imprest levels of Rate Stabilization Fund accounts retention of a previously approved reconciliation mechanism.

Q. Did the Parties to the DW 19-084 Settlement Agreement anticipate that the modified rate structure would also apply to PEU in this case?

A. There was no formal or written inclusion of such action for PEU in that Settlement Agreement, but our discussions during the prosecution of that docket with the parties to the case and the Agreement made parties aware that PEU would be seeking a similar treatment in this rate proceeding, when filed.

Q. Is PEU now seeking to implement the same ratemaking structure described in the DW 19-084 Settlement Agreement?

A. Yes. This is the ideal time for the new ratemaking structure to apply to PEU as this further modified structure is needed to: (1) insure ongoing adequate EBITDA coverage for PEU, as it relates to covenant requirements, (2) provide adequate cash flows from revenues to pay debt service, CBFRR and operating expenses, and (3) provide adequate support funds in the form of maintaining and supporting the RSF accounts, to provide for cash funding during times of revenue shortfalls and expense growth above inflationary levels between rate case filings, and minimizing the impact of regulatory lag between rate cases, as described in further detail in the testimony of Mr. Ware for this docket.

Q. What is PWW's bond credit rating and has it changed since the implementation of the modified rate structures in DW 16-806 and DW 19-084, and what does that imply for PEU, as result of the modifications approved in DW 17-128 and requested in this permanent rate filing?

A. PWW's credit rating is a Standard and Poors ("S&P") "A" rating, with a negative outlook. The Company was downgraded slightly for its April 2020 bond issuance from a rating 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. And, they cited that the impact of the timing of rate cases, as well as the degradation in cash balances that occurred from regulatory lag, were the main contributing factors. Since that April bond issuance, PWW has obtained an order approved the further modifications to its rate structure being included in this case, but final permanent rates have not yet been issued and approved in that docket. As such, when PWW completed a debt restructuring bond issuance in September 2020, the "A" rating with a negative outlook was affirmed. S&P indicated at that time that an increase in the credit rating could not be granted at that time due to two factors: (1) permanent rates from the case and modified structure were not yet in place and approved, and (2) the impact of COVID-19 had caused a shift in the paradigm of assessing overall debt risk in the market. S&P indicated on the call reviewing the issued rating in September, that absent the rate structure modifications approved in DW 19-084, and sought in this case, a credit downgrade would have actually occurred. As such, indications are that PWW's credit rating will be either maintained or enhanced upon the receipt and order of final permanent rates from the docket, and when the full impact of COVID-19 is fully understood in the market. How this applies to PEU is simply that the paradigms that an entity such as S&P uses to assign a credit rating, are nearly synonymous with the factors that commercial bank lenders use in approving and issuing debt for an entity such as PEU. Additionally, even though a favorable credit rating for PWW does not have a direct impact on PEU, as PEU uses the workforce and equipment assets of PWW for its overall operational activities, PWW's ability to access and finance its capital assets at a favorable credit rating has an overall long-term tangential benefit to PEU.

Q. Will the proposed further modifications address this negative outlook for PWW, and what does that mean for PEU?

A. Yes. Again, in discussions with the rating agency at the time of PWW's September 2020 bond issuance it became clear to PWW that primarily the inclusion of the MOEF, and secondarily the other enhancements, are and looked upon favorably in the credit rating process, which directly impacts the reduction of cash liquidity risk going forward. Therefore, the modifications to rate structure being requested in this docket are very important in re-establishing a "positive outlook" for PEU and its commercial lenders, like it will for PWW in its bond credit rating outlook.

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 from the test year, to get full rate relief in a permanent rate filing, and in that interim, inflation or other operating expense factors will have increased currently occurring operating expenses well over and above "test year" operating. As such, the Company has used its rate stabilization fund coverage, as allowed in Dockets DW 11-026 and DW 17-128, 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 discussions conducted annually by the Company's primarily commercial lender, as it pertains to current financial status, liquidity levels, and rate modification and rate setting opportunities, has also influenced PEU's request for further requisite modifications to its ratemaking methodology .

Q. Mr. Goodhue, why is PEU requesting these further modifications at this time, when it could have requested them in the original acquisition docket or in Docket DW 17-128?

A. In short, just as was the case for the process pursued for PWW, 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, PEU had not yet acquired direct experience on how the capital markets and commerical lenders would react to PEU's unique ownership structure.

Second, PWW has now acquired experience and information from its significant bond financings that has allowed that Company to obtain direct input and insights into how capital markets have and will continue to respond to its ownership structure; which indirectly and directly impacts PEU, both in its ability to utilize PWW personnel and assets for its operational activities, as well as PEU's ability to continue to access debt funding for its commercial lending partners, both is availability of those funds, and in the cost of those funds.

Third, PEU has acquired actual experience with respect to the operation of the current ratemaking method, and its modifications approved in Docket DW 17-128, and has been able to observe and test its benefits, and its deficiencies.

Fourth, PEU 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 between permanent rate filings, but on a more timely or pre-emptive 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 as an element of the Operating Expense Revenue Requirement ("OERR") portion of allowed revenues, as approved in DW 17-128).

V. SUMMARY OF PROPOSED RATE RELIEF

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

A. Yes. As described in the testimony of Donald L. Ware, PEU is requesting the Commission to approve a rate increase of 21.05%, bringing its allowed revenues to a projected level of $10,715,419 as delineated in PEU's rate case filing at Tab 14 (Puc 1604.08 "Schedule 9") and at Tab 13 (Puc 1604.06"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 PEU's current operating expenses, maintain adequate and supported RSF for adequate liquidity and risk containment, and to meet the demonstrated costs of servicing PEU's direct debt obligations plus its share of the CBFRR. PEU has prepared its ratemaking schedules to demonstrate this fundamental basis.

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

A. PEU is filing a rate case at this time to get a reset in its 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 17-128. Operating expenses of the Company have increased due to inflation and other factors as delineated earlier in this testimony, 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 PEU upon which the requested rate relief is based.

A. PEU's requested rate relief is based on the modified ratemaking as approved in Docket Nos. DW 11-026, DW 13-126, DW 16-806, and DW 19-084. 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 factor 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, (2) Debt Service Revenue Requirement and the (3) Operating Expense Revenue Requirement. The required schedules under Puc 1604.06 (Schedule A and Schedule 1) and Puc 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 PEU'S RATEMAKING STRUCTURE

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

1. Create a Material Operating Expense Factor (MOEF) which would become an embedded element of the allowed revenues included in the OERR portion of those revenues.

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 17-128). 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 the testimony of Mr. Ware in this docket. In order to accomplish that, absent the inclusion of an MOEF, 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 MOEF would simplify this and reduce the overall cost to ratepayers for the adequate coverage of operating expenses, as the additional dollars needed to reinforce the MOERR RSF between rate cases would be funded with dollars earned ratably, without need to cover an incremental cost of debt service for those funds. 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 has only received a dollar-for-dollar coverage in the permanent rates. This is being done to minimize the impact of adequately funding and maintaining the MOERR RSF fund, as a component of the Company's permanent rate request, to adequately maintain necessary cash balances to operate the Company and fund its ongoing operating costs between rate cases. In the alternative, if the Commission does not approve the MOEF, 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 17-128) and their respective rate orders, and as more fully described in the testimony of Mr. Ware in this docket.

2. Include the actual cash basis of incurred NH Business Enterprise 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 the NH Business Enterprise Tax be 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. The Company will request the inclusion of Federal Corporate Income Taxes and NH BPT, in a future rate case, when NOLs are exhausted to the point where either 20% of taxable income is subject to cash payment, or eventually 100% of taxable income is subject to cash payment requirements.

This is the same arrangement that was agreed to for PWW in the Settlement Agreement for DW 19-084.

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, or (2) operating expenses were at levels well above approved levels, due to the fact that allowed revenues were based on test year expenses with some adjustment for proformas for 12-months after the test year, but continued to grow with compound inflation, or due to other factors, in the years following the completion of a rate case. 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 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 17-128.

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

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 but are prudent ongoing annual operating expenses. The priority order will also enhance the Company's overall ability to cash flow and/or debt-fund operations. This would be positive for ratepayers because an enhanced ability to continue to access debt funding at favorable terms translates directly to reduced cost of interest on debt incurred for Capital improvements.

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

A. In Docket No. DW 17-128, the Commission approved the Company's request to establish the imprest levels of these RSF funds. In Docket No. DW 17-128, the Commission approved allocation of this $1.080 million aggregate imprest sum: CBFRR RSF - $31,000; MOERR RSF - $898,000; and 1.0 DSRR RSF $51,000. In Mr. Ware's testimony to this docket, he outlines the actual calculations and needs relating to the RSF funds, as well as the Company's current request on reallocating, funding and addressing these funds.

5. 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: term loans from a commercial lender (Cobank), SRF loans, and DWGTF loans. Unlike PWW, where the cost of issuance is included in the overall amount issued in the annual bond issuances, the cost of issuance for these debt instruments are not included in the borrowed sums. 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 Cobank, 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, 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 unamortized Deferred Debt expense currently on its books.

Q. Will PEU be seeking a temporary rate increase?

A. Yes. PEU will be seeking a temporary rate increase in this filing. Direct testimony and a petition for temporary rates has been prepared and filed as a part of this case.

VII. <u>NOTIFICATION OF RATE CASE</u>

Q. Please describe PEU's efforts to communicate with the affected communities and customers relative to this filing.

A. Concurrent with the filing of this case with the Commission, PEU is notifying, in writing, officials of all communities served by PEU. PEU is specifically mailing letters to representatives of each of the nineteen municipalities served by PEU, including State Senators, and State Representatives within PEU's service territory. The overall potential impact of the requested rate relief and proposed modifications have already been presented to PEU'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 of the permanent and temporary rates sought, including all general metered customers and customers served under special contracts.

VIII. JUST AND REASONABLE FINDING AND CONCLUSION

Q. Mr. Goodhue, do you believe that PEU's proposed rate relief and modifications to its ratemaking structure as established in DW 11-026, and modified in DW 16-806 and DW 19-084 for PWW but also applied to PEU, will result in just and reasonable rates for PEU's customers?

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 PEU'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%, excluding unique and special events such as the PFOA-related expansion of PEU's service area. . While the rate increase sought in this proceeding is significant when the cumulative increase is examined as an average annual increase, it is, however, generally consistent with the original assumptions of the acquisition docket, excepting the unique and necessary events.

Second, the requested rates continue to be materially lower than the levels which would otherwise have occurred under the private investor ownership which would have had a 50/50 debt/equity capital structure as well as a return on equity value that would be well in excess of PEU's current cost of debt. This lower cost of capital has and continues to benefit ratepayers and was one of the principal benefits the Commission found when approving the City's acquisition. Since the acquisition, PEU has, like its affiliates, migrated to a utility model that finances all of its capital needs via the issuance of debt. 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 PEU'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 PEU's current ratemaking structure are the result of further experience the Company has obtained in the period of time since its last permanent rate increase. Since the Company's last approved permanent rate increase, funds in theMOERR RSF have been utilized at a significant level to "backstop" the inflationary increases in operating expenses(as further described in the testimony of Mr. Ware to this docket). The impact of this is significant, PEU drew the $898,000 imprest 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 also was brought up as a matter of concern by the Company's commercial lender in their annual credit review of the Company, and the continuing ability to access necessary debt funding. This experience caused PEU to propose the specific additional modifications to its ratemaking methodology so that going forward, PEU will have confidence that these modifications will continue to enhance it'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 PEU continues to be able to provide safe and high-quality water service to its customers?

A. Yes. PEU'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 as they are incurred between rate cases. 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 compliance with all rules and regulations as a public water provider, inclusive of requirements as established by the Environmental Protection Agency and the NH Department of Environmental Services. 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. In order to do this, 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 these modifications 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, on a periodic and recurring basis. 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.