Narrative and Discussion of the Revenue Requirements and Rate Stabilization Funds as well as associated Fixed Revenue Restricted Cash accounts

Pennichuck East Utility, Inc.'s (PEU) overall revenue requirement consists of the following three components:

1. City Bond Fixed Revenue Requirement (CBFRR) and associated RSF.

2. Operating Expense Revenue Requirement (OERR) which is further composed of the following:

    a) Material Operating Expense Revenue Requirement (MOERR) and associated RSF
    b) Non-Material Operating Expense Revenue Requirement (NOERR).

3. Debt Service Revenue Requirement (DSRR) which is further composed of the following:

    a) Debt Service Revenue Requirement - 1.0 (DSRR-1.0) and associated RSF.
    b) Debt Service Revenue Requirement - 0.1 (DSRR-0.1)

In this instant rate case, PEU also seeks to add a Material Operating Expense Factor (MOEF), which would be included as a part of the second component of PEU's overall revenue requirement, coupled together with the MOERR.

Flowcharts attached to this narrative describe the requirements of each component and how funds flow to and from each account created for each component.

The revenue requirement components are further described as follows:

1. City Bond Fixed Revenue Requirement and Rate Stabilization Fund

The purpose of the CBFRR RSF is to provide a cash reserve to be accessed or replenished based upon the amount in the CBFRR Checking Account. The CBFRR RSF may only be accessed if necessary to supplement the amount recorded in the CBFRR Checking Account for PEU to meet its portion of the monthly note payment obligation to the City and/or its quarterly standard dividend payment to the City, both as approved under DW 11-026 (i.e. if the monthly amount accrued to the CBFRR Checking Account is less than PEUPEU's approved monthly CBFRR amount to the City). The cash amount is only used for the payment of the CBFRR and is reconciled monthly. Conversely, PEU deposits additional funds in the CBFRR RSF Account when it accumulates cash in the CBFRR Checking Account in excess of the amount needed to meet its monthly and quarterly obligations to the City. At the time of each rate case, the CBFRR RSF Account is subject to replenishment or reduction to an amount equal to the original balance of $13,000. The replenishment or reduction amount will be reflected in PEUPEU rates through a deferred debit or credit amortized over a three- year period.

In DW 16-806, Pennichuck Water Works (PWW) proposed that the $5,000,000 CBFRR Rate Stabilization Fund (RSF) maintained by PWW, (which was established under the Original Rate Structure approved in the acquisition docket DW 11-026), should be re-allocated amongst the three Pennichuck Corporation Utilities: PWW, PEU, and Pittsfield Aqueduct Company, Inc. (PAC) such that PWW's allocated share of the CBFRR RSF would be $3,920,000, PEU's allocated share of the CBFRR RSF would be $980,000, with the remaining balance of $100,000 of the CBFRR RSF being allocated to PAC. This allocation of the $5,000,000 CBFRR RSF was based on the revenue requirements established in Dockets DW13-126 for PEU, DW13-128 for PAC, and 13-130 for PWW, divided by the total revenue requirement of all three utilities as established in those dockets.

2. Material Operating Expense Revenue Requirement Rate Stabilization Fund (MOERR RSF)

This account is used to fund cash flow needs related to allowable expenses (as defined above) which amount to costs of approximately 99.9% of the operating expenses of the Company, excluding interest expense. To facilitate accountability related to the MOERR RSF, a separate restricted cash bank account has been established and is maintained, known as the MOERR Checking Account. This fund operates as an impress fund from which funds could be drawn upon or deposited into on a monthly basis, based upon anomalies in the specified and covered operating expenses, as well as revenue fluctuations above or below levels. It serves to provide rate stabilization and cash flow coverage for operating expenses between permanent rate filings. At the time of each rate case, the MOERR RSF is subject to replenishment or reduction to an amount equal to the original balance of $898,000.

3. Debt Service Revenue Requirement 1.0 Rate Stabilization Fund (DSRR-1.0 RSF)

The DSRR-1.0 RSF is used to ensure that, even in adverse revenue conditions such as wet weather, there will be a sufficient cash reserve available to enable to pay the debt service obligations on its long-term debt. To facilitate accountability related to the DSRR-1.0 RSF, establishes and maintain a separate restricted cash bank account, known as the DSRR-1.0 RSF Account. This fund operates as an impress fund from which funds could be drawn upon if needed based upon the cash flow requirements to meet principal and interest payment obligations on outstanding debt and in meeting its debt covenant requirements. It serves to provide adequate cash flow coverage for debt servicing between permanent rate filings. At the time of each rate case, the DSRR-1.0 RSF is subject to replenishment or reduction to an amount equal to the established original balance of $51,000.

4. CBFRR, DSRR-1.0, DSRR-0.1 and MOERR Bank Accounts

These accounts have funds transferred into them from the main operating cash account on a weekly basis, based upon weekly cash collections for billed water revenues, for their pro-rata shares of the overall allowed revenue requirement. This is a consistent methodology to the accepted methodology established for the CBFRR account in DW 11-026.

5. Material Operating Expense Factor

This is a component being added into the calculation of the allowed revenue requirement as a part of the OERR allowed revenues. It is designed to minimize the impact of regulatory lag coming out of a rate case, as necessary and prudent operating expenses which vary and increase leading up to the next full rate case. As such, it is not only a component of the OERR portion of allowed revenues, but works in concert with the MOERR expenses in the usage of, and refilling of, the MOERR RSF account (as described above).

6. Funding of Stabilization Funds Based Upon Allocation of Revenue Requirement

In conformity with the manner in which the RSF fund established under DW 11-026 is funded or utilized, each of the Rate Stabilization Fund Restricted Cash accounts noted above (CBFRR RSF, DSRR-1.0 RSF, MOERR RSF) have money transferred into them, or withdrawn from them on a monthly basis based upon the actual monthly revenue performance, compared to 1/12 of the annual allowed revenue from the most recent rate case for the Company. If in any month, the actual revenues earned are less than 1/12 of the annual allowed revenue requirement, the pro-rata share of the deficit applicable to each of the RSF accounts will be extracted from each of the RSF accounts and transferred to the Company's main operating accounting. Conversely, if in any month, the actual revenues earned are in excess of 1/12 of the annual allowed revenue requirement, the pro-rata share of the excess applicable to each of the RSF accounts will be deposited into each of the RSF accounts from the Company's main operating account.

7. Weekly Deposits into the Revenue Requirement Restricted Checking Accounts (CBFRR, DSRR-1.0, and DSRR-0.1, MOERR)

In conformity with the manner in which the CBFRR account methodology was established under DW 11-026, on a weekly basis, the pro-rata share of cash collections on total revenues for each of these revenue accounts is transferred from the Company's main operating cash account, into each of the respective restricted checking accounts.

8. Usage of Funds in the Revenue Requirement Restricted Checking Accounts (CBFRR, DSRR-1.0, DSRR-0.1, MOERR)

A. As payments are due to the City of Nashua for the monthly note payment and/or the quarterly required dividend in support of the full CBFRR requirement, these payments will be made out of the CBFRR Checking Account, as established under DW 11-026. To the extent there are insufficient funds in the CBFRR Checking Account to make these payments; funds are transferred into the CBFRR Checking Account from the Company's main operating account to fund these payments. To the extent that funds in the CBFRR Checking Account are in excess of the monthly payment need (and/or quarterly dividend need, in the month paid), the excess funds is transferred back into the main operating account.

B. On a monthly basis, the actual Material Operating Expenses for that month is compared to the monthly revenue requirement provided from the

MOERR/MOEF portion of the last allowed revenue requirement, from the most recent rate case. To the extent that the identified expenses under the MOERR, for the month, are in excess of the pro-rata revenue allowance for these expenses, money is transferred out of the MOERR Checking Account to the main operating account. To the extent that the identified expenses under the MOERR, for the month, are less than the pro-rata revenue allowance for these expenses, money will be transferred to the MOERR Checking Account from the main operating account.

C. As payments are due to all other external debt holders of the Company on a monthly, quarterly, or semi-annual basis, these payments will be made out of the DSRR-1.0 Checking Account, consistent with the methodology for the CBFRR account under DW 11-026. To the extent there are insufficient funds in the DSRR-1.0 Checking Account to make these payments; funds is transferred into the DSRR-1.0 Checking Account from the main operating account. And, to the extent that there are excess funds in the DSRR Checking Account, the excess funds is transferred back to the Company's main operating account.

i. The monthly payment funding obligation will be based upon, and equal to the following:

a. The sum of all monthly debt service payment obligations in the aggregate;

b. 1/3 of the sum of all quarterly debt service payment obligations in the aggregate for the quarter; and

c. And 1/12 of the sum of all semi-annual debt service obligations in the aggregate for the fiscal year.

D. The funds that accumulate in the DSRR-0.1 Checking Account is considered on an annual basis, at the end of each fiscal year. The accumulated funds in this account as of the close of each year-end will be utilized as the funding source for capital expenditure needed in the first months of the succeeding year, leading up to an annual bonding or financing event in support of capital expenditures for that succeeding year.

9. Accounting for the CBFRR, DSRR-1.0 and MOERR Allocation Amounts

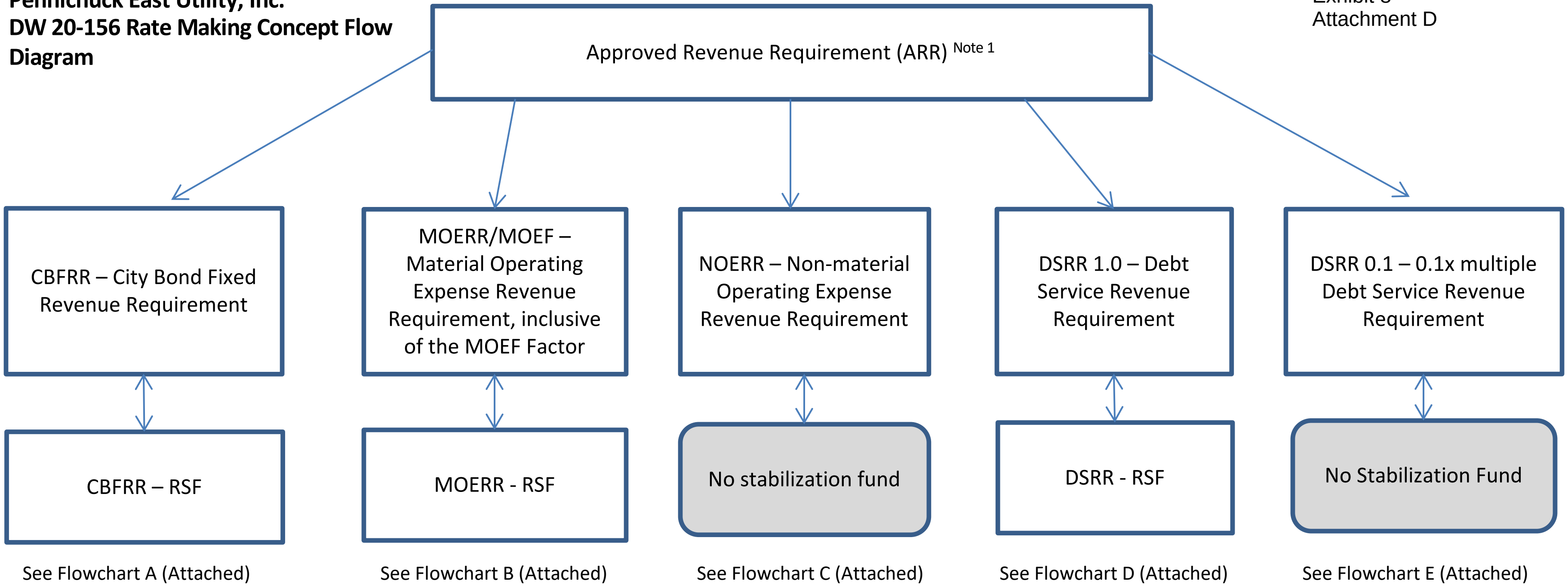
In conformity with the methodology established in DW 11-026 for the CBFRR account, monthly accounting is prepared by the Company, to establish and calculate the actual revenue performance versus the allowed revenue levels, on a monthly basis. These calculations will be the basis for the transfer of cash into and out of the Rate Stabilization funds for each fiscal month end.

At each successive rate case, the excess or deficit in the CBFRR RSF, DSRR-1.0 RSF, and MOERR RSF, is either refunded to or collected from ratepayers over the succeeding three years, in the form of a Deferred Credit or Deferred Debit on the books of the Company, as established in that successive rate case proceeding.

10. Impact of Annual Step Increases for Incremental Debt Approved and Incurred between Rate Cases, under the Qualified Capital Project Adjustment Charge

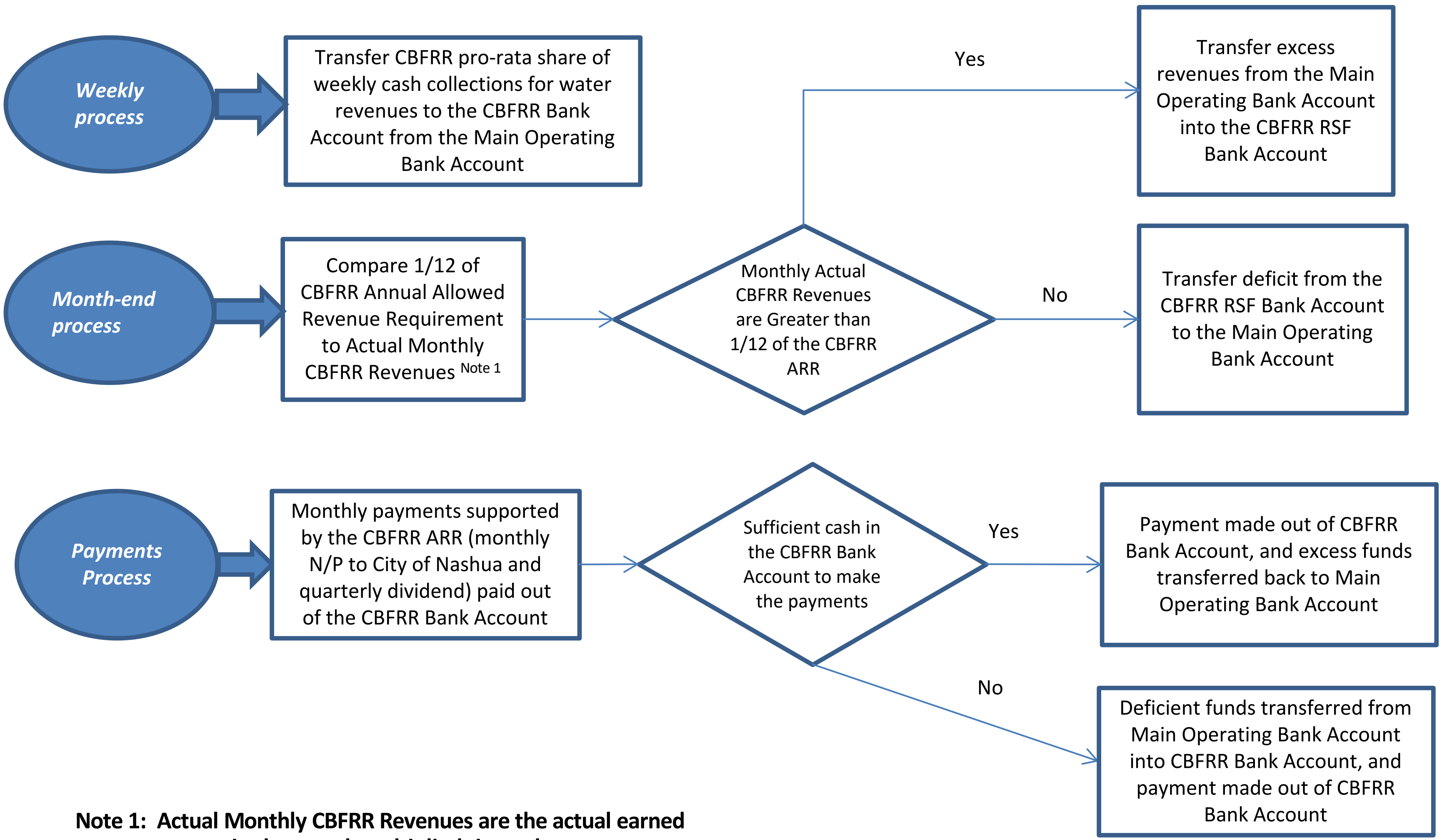
Upon approval of the annual Qualified Capital Project Adjustment Charge (QCPAC), the incremental revenues generated from this QCPAC at a 1.1x multiple of total incremental approved debt service, plus property taxes, will incrementally impact the deposit of funds, or withdrawal of funds from the DSRR-1.0, DSRR-0.1 and MOERR Checking Accounts, for their prospective shares of the total incremental debt service, the 0.1x multiple of debt service, and the amount collected for incremental property taxes. The balance of the accounting for these incremental amounts will be accounted for as an incremental amount to the processed described immediately above.

Pennichuck East Utility, Inc.
DW 20-156 Rate Making Concept Flow Diagram



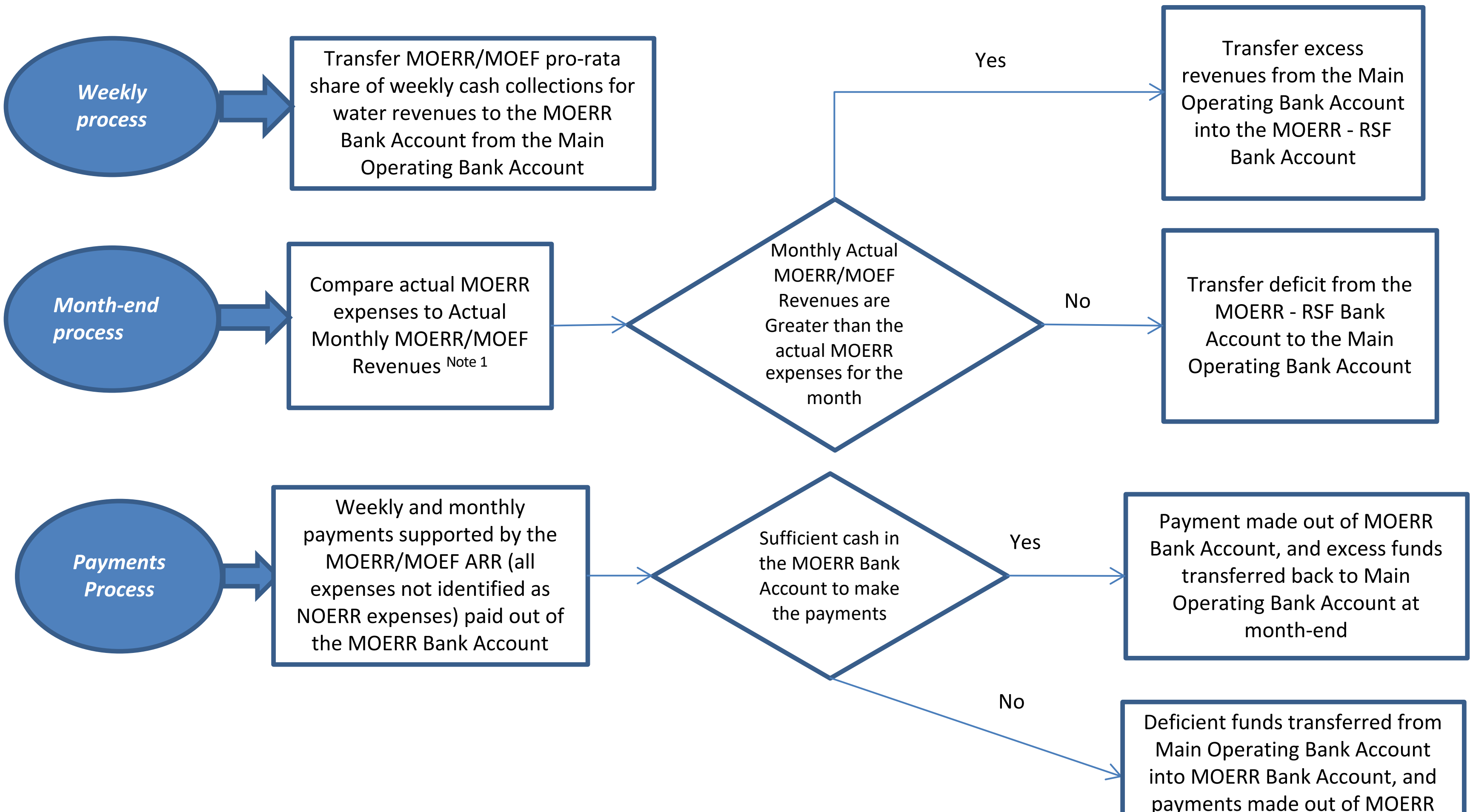
Note 1 – The Approved Revenue Requirement equals the annual revenue requirement established at the most recent rate case. This ARR is divided amongst the component Revenue Requirement items into the identified CBFRR, MOERR/MOEF, NOERR, DSRR-1.0 and DSRR 0.1 revenue "buckets."

Pennichuck East Utility , Inc. - DW 20-156
Rate Making Concept Flow Diagram - Flowchart A



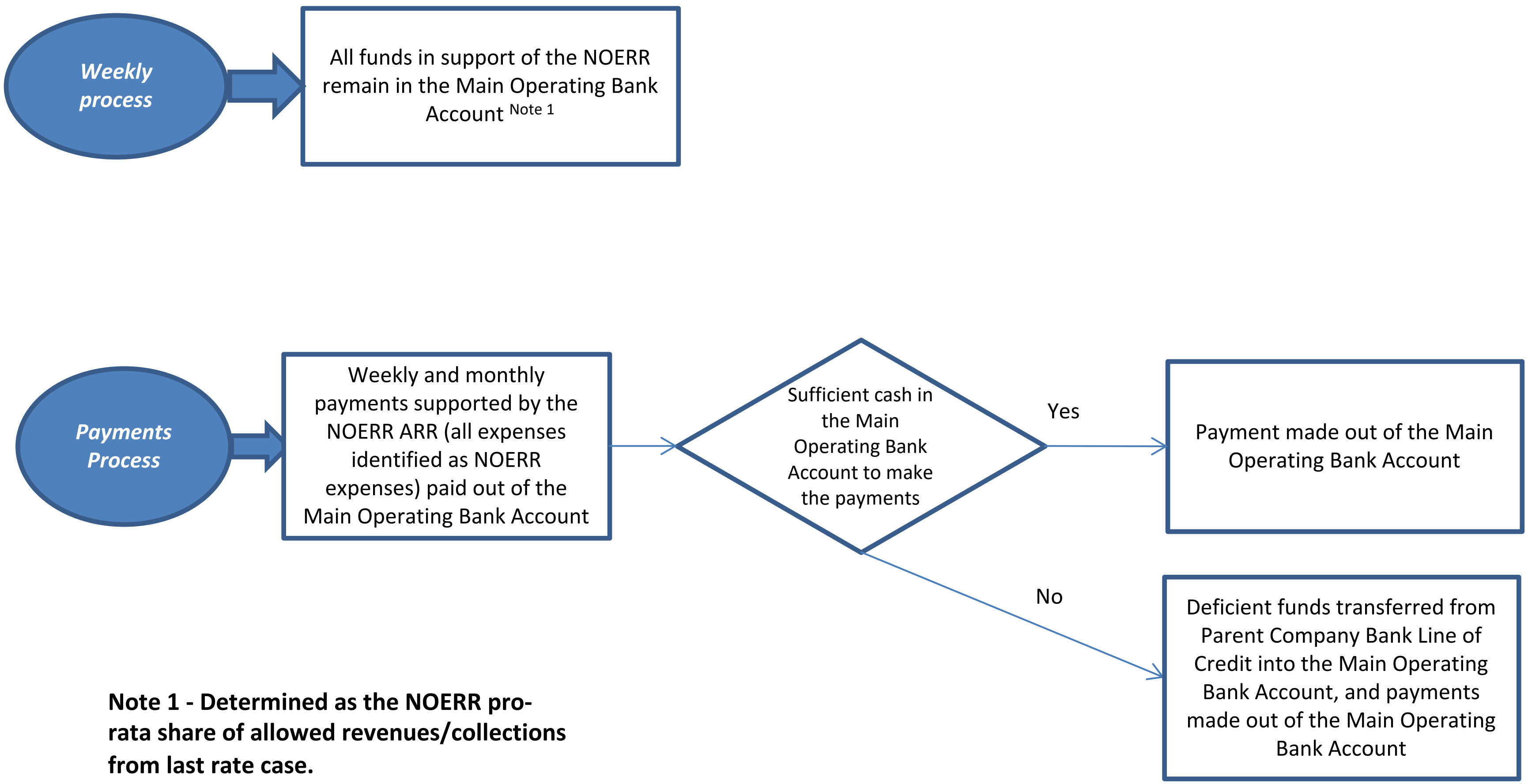
Note 1: Actual Monthly CBFRR Revenues are the actual earned water revenues in the month multiplied times the pro-rata percentage of revenues allocated to the CBFRR, per the last rate case.

Pennichuck East Utility, Inc. - DW 20-156
Rate Making Concept Flow Diagram - Flowchart B



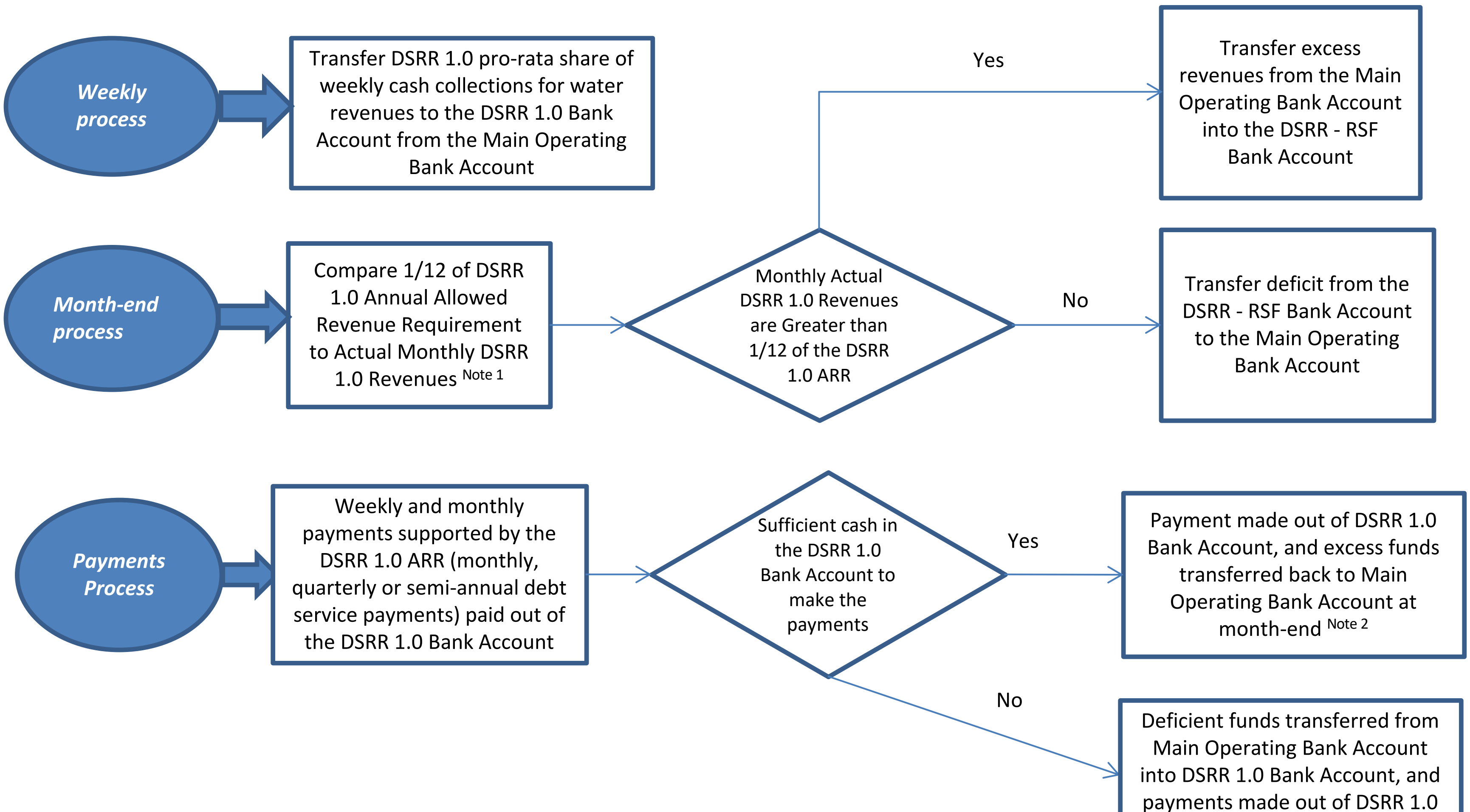
Note 1: Actual Monthly MOERR/MOEF Revenues are the actual earned water revenues in the month multiplied times the pro-rata percentage of revenues allocated to the MOERR/MOEF, per the last rate case.

Pennichuck East Utility, Inc. - DW 20-156
Rate Making Concept Flow Diagram - Flowchart C



Note 1 - Determined as the NOERR pro-rata share of allowed revenues/collections from last rate case.

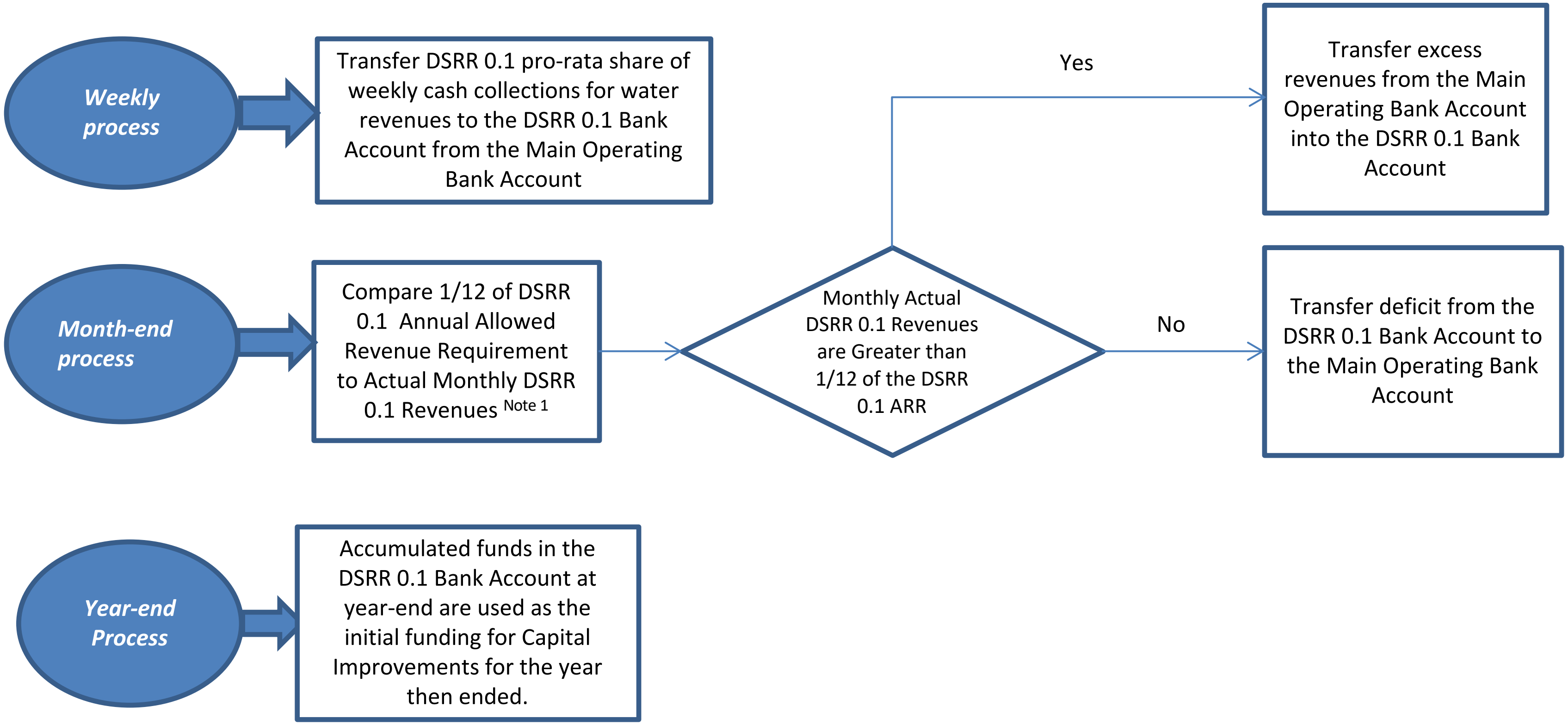
Pennichuck East Utility, Inc. - DW 20-156
Rate Making Concept Flow Diagram - Flowchart D



Note 1: Actual Monthly DSRR 1.0 Revenues are the actual earned water revenues in the month multiplied times the pro-rata percentage of revenues allocated to the DSRR 1.0, per the last rate case.

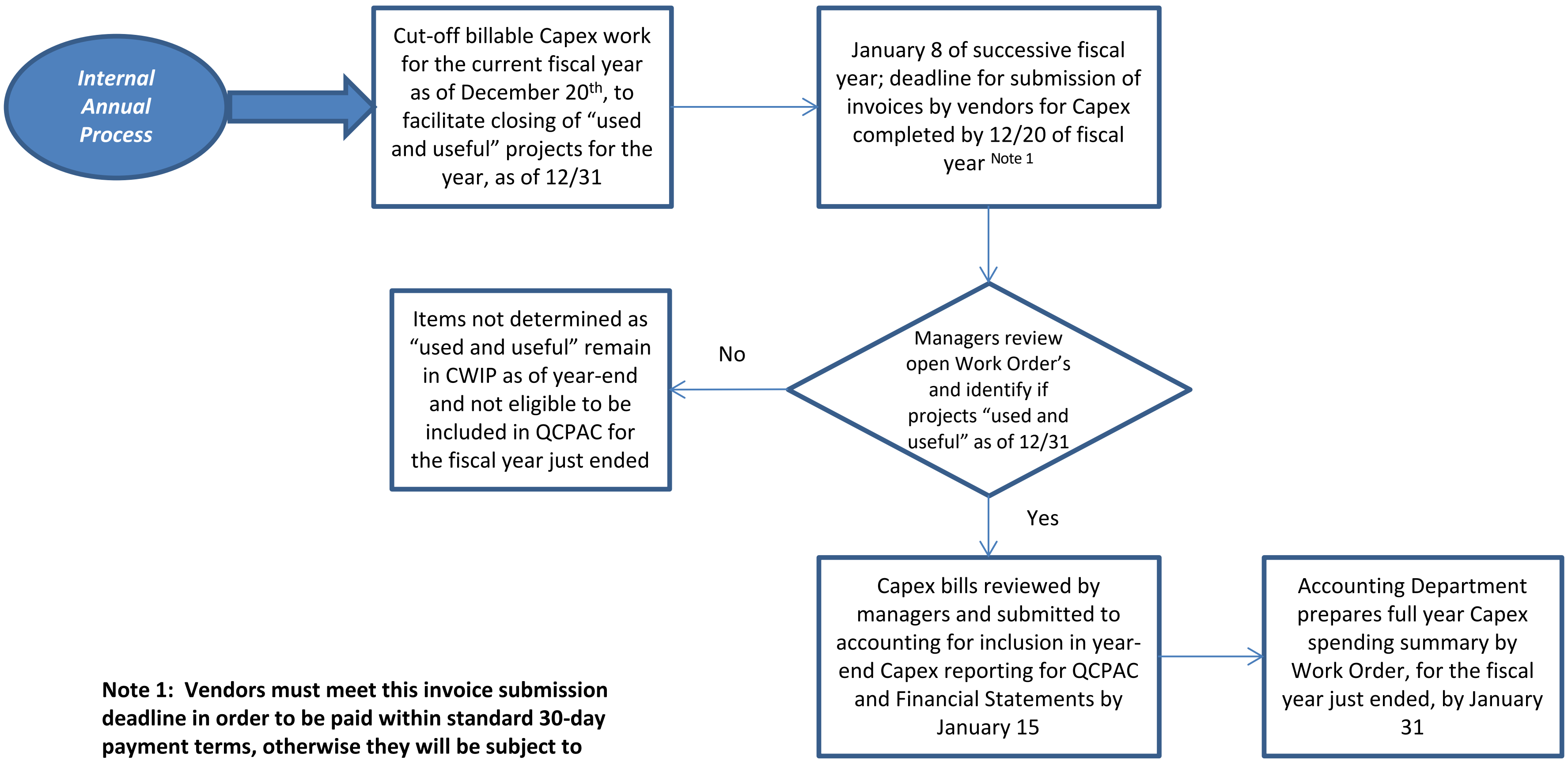
Note 2: Adequacy of funds in the DSRR Bank Account each month will be determined as 100% of monthly payment obligations, 33 1/3% of quarterly payment obligations and 1/12 of the annual debt service for semi-annual payment obligations.

Pennichuck East Utility, Inc. - DW 20-156
Rate Making Concept Flow Diagram - Flowchart E



Note 1: Actual Monthly DSRR 0.1 Revenues are the actual earned water revenues in the month multiplied times the pro-rata percentage of revenues allocated to the DSRR 0.1, per the last rate case.

Pennichuck East Utilities, Inc. - DW 20-156
QCPAC Process Flow Diagram

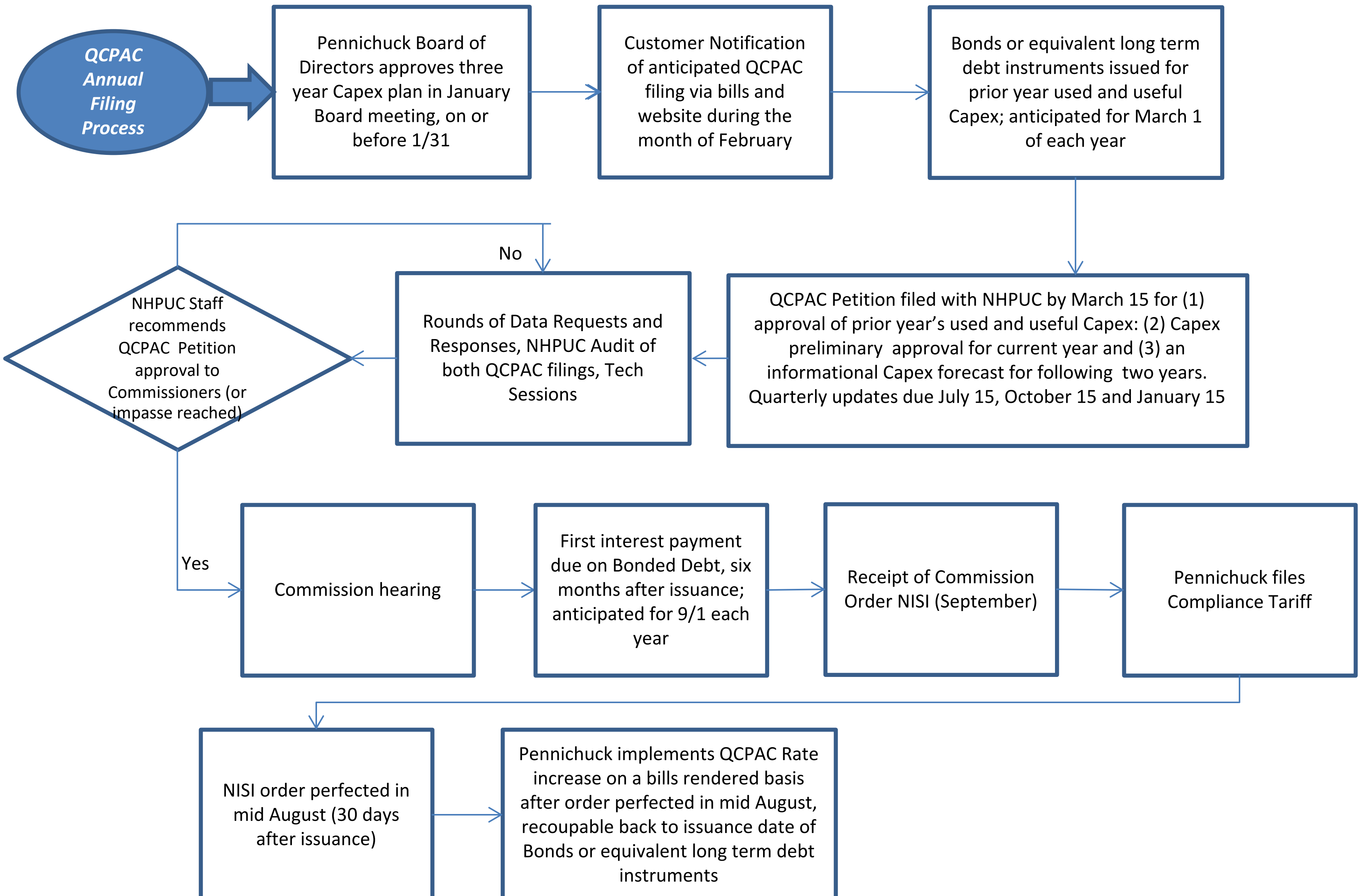


Note 1: Vendors must meet this invoice submission deadline in order to be paid within standard 30-day payment terms, otherwise they will be subject to delayed "penalty" payment terms. This requirement to be implemented in all vendor contracts gong forward.

Note 2: No Capex projects/purchases allowed except for emergencies and/or essential carryover projects – 1/1-2/28 of successive fiscal year

Note 3: Submission of invoices by vendors for Capex completed by 12/20 of fiscal year, after January 8 of successive fiscal year, subject to delayed 60-day payment terms (as a facilitator to receive invoices timely for year-end QCPAC and Financial reporting purposes).

Pennichuck East Utilities, Inc. - DW 20-156
QCPAC Process Flow Diagram



Pennichuck East Utility, Inc. - DW 20-156
Definition of Terms

- **Approved Revenue Requirement**: equals the annual revenue requirement established at the most recent rate case. This ARR is divided amongst the component Revenue Requirement items, inclusive of the annual QCPAC surcharge increase allocated amounts, into the identified CBFRR, OERR and DSRR revenue "buckets."
- **Actual Revenues and Actual Expenses:** In all cases with regards to the flowcharts and processes included on Flowcharts A thru E, Actual Revenues and Actual Expenses are on a GAAP basis, inclusive of accrued amounts.
- **CBFRR RSF**: Same as the former RSF as authorized and described in DW 11-026 and reaffirmed in DW 17-128. Allows for the maintenance of stable water utility rates, while providing a mechanism to ensure the Company's ability to meet its obligations under the promissory note to the City.
- **MOERR RSF**: Funds used to provide cash flow for allowable expenses, defined as PAC's Operation and Maintenance Expenses (less those in the NOERR), Property Tax Expense, Payroll Tax Expense, and Amortization Expense.
- **MOEF and MOERR/MOEF:** The MOEF is a factor embedded in the calculation of overall allowed revenues allocated to the MOERR portion of those revenues from the Company's last rate case. This factor is included in the pro-rata allocation of allowed revenues by multiplying the allowed MOERR portion of the OERR revenues by a factor inclusive of the allowed MOEF. It calculated as:
  - (MOERR allowed revenues) x (1+MOEF) = MOERR/MOEF allowed revenues.
- **NOERR**: Funds expenses that are potentially imprudent expenditures within the context of a rate proceeding. The categorization of an expense item in the NOERR does not preclude PAC's recovery of such in rates, as long as that expense item is found to be prudently incurred within the pro forma test year. They may not, however, be included in any use of or replenishment from the MOERR RSF.
- **DSRR-1.0 RSF**: used to support the payments related to the principal and interest obligations for PAC, in existence as of the most recent rate case test year. The establishment of this DSRR-1.0 RSF bucket is to allow the collection of revenues sufficient to pay the principal and interest of PAC's debt and to satisfy the debt service coverage ratio requirements of PAC's bond financings and Pennichuck Corporation's covenant requirements of its line of credit, which is used by Pennichuck Corporation and its subsidiaries as a "back stop" to short-term working capital needs.
- **DSRR-0.1**: The intended purposes for the establishment of the DSRR-0.1 are 1) to allow for the collection of revenues sufficient to satisfy the debt service coverage ratio requirements of PAC's bond financings and Pennichuck Corporation's covenant requirements for its line of credit, which is used by Pennichuck Corporation and its subsidiaries as a "back stop" for short-term capital needs; and 2) to allow PAC to collect revenues over-and-above its actual debt service in order to comply with cash flow coverage requirements which are typical for such financings.