

STATE OF NEW HAMPSHIRE

BEFORE THE

PUBLIC UTILITIES COMMISSION

ORIGINAL	
N.H.P.U.C. Case No.	DW 11-026
Exhibit No.	#5
Witness	Panel #2
DO NOT REMOVE FROM FILE	

Re: City of Nashua Acquisition of Pennichuck Corporation

Docket DW 11-026

SECOND SUPPLEMENTAL TESTIMONY OF

JOHN L. PATENAUDE

October 18, 2011

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1 **Introduction and Purpose for Supplemental Testimony**

2 **Q. Please state your full name and business address.**

3 A. My name is John L. Patenaude. My business address is 1 Timber Lane, Hudson, New
4 Hampshire.

5 **Q. Have you provided written testimony in this proceeding?**

6 A. Yes, I provided original written testimony in this proceeding dated February 18, 2011,
7 and supplemental written testimony dated July 1, 2011.

8 **Q. What is the purpose for this supplemental testimony?**

9 A. The purpose for this second supplemental testimony is to provide an overview of the
10 Settlement Agreement among the Commission staff, the Joint Petitioners, and certain
11 intervenors.

12 **Q. How does this supplemental testimony impact your original pre-filed testimony?**

13 A. This testimony supplements my original pre-filed testimony and supplemental testimony,
14 and does not replace it.

15 **Overview of the Settlement Agreement**

16 **Q. Are you familiar with the Settlement Agreement among certain parties to this**
17 **proceeding, dated October 18, 2011 (the “Settlement Agreement”)?**

18 A. Yes.

19 **Q. Who are the parties to the Settlement Agreement, and when was it executed by the**
20 **parties?**

21 A. As indicated in the lead paragraph of the Settlement Agreement and on the signature
22 pages, the parties to the Settlement Agreement are the City of Nashua, Pennichuck
23 Corporation, Pennichuck Water Works, Inc., Pennichuck East Utilities, Inc., Pittsfield

1 Aqueduct Company, Inc., the Staff of the Commission, the Town of Milford, Anheuser-
2 Busch Incorporated, and Fred S. Teeboom. The Merrimack Valley Water District,
3 through its counsel, has indicated that it has no objections to the Settlement Agreement
4 and will consider whether to authorize execution of the Settlement Agreement at its
5 regularly scheduled meeting on October 20, 2011. In this testimony, I refer to these
6 parties who have joined the Settlement Agreement as the “Settling Parties.” Subject to
7 the possible later execution by the Merrimack Valley Water District, the Settlement
8 Agreement was executed by the Settling Parties effective October 18, 2011.

9 **Q. Please provide an overview of the Sections of the Settlement Agreement.**

10 A. Section I of the Settlement Agreement provides a procedural history of key points of the
11 City’s eminent domain efforts with respect to Pennichuck Corporation and its utility
12 subsidiaries and this proceeding. Section II provides background regarding the Special
13 Legislation that authorizes the City to acquire the stock of Pennichuck Corporation,
14 subject to a public interest determination by the Commission and also background
15 regarding the Agreement and Plan of Merger (the “Merger Agreement”) pursuant to
16 which the City proposes to acquire the stock of Pennichuck. This background summary
17 includes a reference to the conditions precedent to closing of the Merger, including the
18 approvals of the City’s Board of Aldermen and the Pennichuck shareholders that have
19 already occurred as evidenced by the documents provided in Exhibit A to the Settlement
20 Agreement. Section III provides the substantive terms of the Settlement Agreement,
21 pursuant to which the Settling Parties have agreed to recommend that the Commission
22 take the actions described in the Paragraphs of Section III.

1 **Description of the Substantive Terms and Recommendations of the Settlement Agreement**

2 **Q. Please provide an overview of the paragraphs set forth in Section III of the**
3 **Settlement Agreement.**

4 A. Section III is divided into five Paragraphs, A through E, each of which address a different
5 aspect of the approvals sought by the City and Pennichuck (the “Joint Petitioners”), in
6 this proceeding. Paragraph A recommends that the Commission approve the City’s
7 acquisition of Pennichuck stock and the terms of the Merger Agreement and further make
8 the public interest finding required by the Special Legislation. Paragraph B states
9 recommendations for approvals, findings and conditions relating to the ratemaking
10 structure proposed by the Joint Petitioners in this proceeding (the “Ratemaking
11 Structure”). These provisions reference exhibits prepared by Bonalyn J. Hartley that
12 provide an illustration of the application of the Ratemaking Structure using the schedules
13 typically required by the Commission for rate cases, and include a set of these schedules
14 as Exhibit B to the Settlement Agreement which reflect the changes required by the
15 Settlement Agreement. Paragraph C states recommendations for approvals and findings
16 regarding the Rate Stabilization Fund and its procedures that are described in more detail
17 in Exhibit C to the Settlement Agreement. Paragraph D states recommendations for
18 approvals and findings regarding the recognition of the “Municipal Acquisition
19 Regulatory Asset” (or “MARA”), as described in more detail in Exhibit D to the
20 Settlement Agreement, and related accounting and affiliate transaction matters. Finally,
21 Paragraph E recommends that the Commission establish several requirements relating to
22 the bonds issued by the City to finance the Merger and transaction costs (the “City
23 Acquisition Bonds”).

1 **Q. Mr. Patenaude, please summarize the essential elements of the substantive terms of**
2 **the Settlement Agreement as set forth in Section III.**

3 A. Pursuant to the substantive terms of the Settlement Agreement, the Settling Parties are
4 recommending that the Commission issue an order approving the City's acquisition of
5 Pennichuck Corporation stock through the Merger, with specific requirements in nine key
6 areas. These nine key areas are: (1) the ratemaking structure proposed by the Joint
7 Petitioners; (2) the treatment of the City's eminent domain costs; (3) the establishment
8 and operation of the rate stabilization fund; (4) the recognition of the Municipal
9 Acquisition Regulatory Asset as a regulatory asset of the utilities; (5) a proposed
10 limitation on dividends and distributions paid by the utilities; (6) proposed conditions
11 relating to the issuance of the City Acquisition Bonds; (7) one modification to the
12 corporate governance model proposed by the City for Pennichuck Corporation following
13 the Merger; (8) proposed conditions relating to the first rate cases to be filed by the
14 utilities; and (9) a proposed condition reporting regarding the closing of the Merger.

15 **Q. Mr. Patenaude, let's address each of these nine key areas in turn. To begin, please**
16 **describe the terms of the Settlement Agreement with respect to the ratemaking**
17 **structure proposed by the Joint Petitioners?**

18 A. The key modification to the ratemaking structure originally proposed by the Joint
19 Petitioners set forth in the Settlement Agreement is to the determination of how to
20 apportion the "City Bond Fixed Revenue Requirement" or "CBFRR" among the three
21 utilities. Under the Settlement Agreement, at Paragraph III. B., the Settling Parties
22 recommend that this allocation be made by reference to each utility's percentage share of
23 the total equity for all three utilities as of December 31, 2011. For purposes of this

1 calculation, the value of the equity of The Southwood Corporation will be included in the
2 determination of the equity of PWW. In contrast, under the ratemaking structure as
3 originally proposed by the Joint Petitioners, the CBFRR amount was determined based
4 on the asset values of the three utilities and The Southwood Corporation. The effect of
5 this change is illustrated in revised schedules prepared by Bonalyn Hartley and described
6 in more detail in Ms. Hartley's supplemental testimony addressing the Settlement
7 Agreement.

8 **Q. What is the basic effect of this modification?**

9 A. The Settling Parties recommend this modification because an allocation of CBFRR based
10 on the equity of the utilities is a more appropriate method than one based on rate base
11 values. In the context of the particular facts of this case, the modification will result in a
12 modestly greater allocation of the overall responsibility to PWW, and a corresponding
13 lower allocation to PEU and to PAC. Accordingly, at the time of future rate cases, the
14 proposed CBFRR allocation will result in modestly lower rates for PEU and PAC
15 customers, compared to the original allocation method proposed in this proceeding.

16 **Q. Does the Settlement Agreement make any other modifications to the ratemaking**
17 **structure proposed by the Joint Petitioners?**

18 A. Yes, the Settlement Agreement, also at Paragraph III. B., recommends two other
19 modifications with respect to the determination of each utility's allowed rate of return in
20 future rate cases. First, the Settling Parties recommend that the rate stabilization fund
21 that will be established at PWW shall not be included in the determination of PWW's
22 capital structure. Second, the Settling Parties recommend that if there is any equity
23 reflected in any of the utility's capital structure at the time of a future rate case, then the

1 ratemaking structure would apply a formula cost of equity based on the 12-month
2 average 30-year Treasury bond interest rates plus 300 basis points. In contrast, in the
3 ratemaking structure as originally proposed by the Joint Petitioners, the value of the rate
4 stabilization fund was included as equity in the capital structures of the utilities and a
5 traditional cost of equity return was applied for purposes of determining the utilities'
6 allowed rates of return.

7 **Q. What is the basic effect of these modifications?**

8 A. Compared to the original ratemaking structure proposal, these two modifications will
9 have the effect of modestly lowering rates for all retail customers of the utilities.

10 **Q. Does the Settlement Agreement recommend any conditions with respect to the first**
11 **rate cases to be filed by the utilities, which will use the proposed ratemaking**
12 **structure.**

13 A. Yes. The Settlement Agreement, at Paragraph III. B. 5., recommends that the
14 Commission require that the utilities file their first rate cases simultaneously following
15 the first year of operations after the Merger closing date not later than June 1, 2013. Such
16 first rate cases would use calendar year 2012 as the test year for these proceedings. If the
17 Merger does not close prior to March 31, 2012, then these first rate cases would be filed
18 later and use a fiscal year ending March 31, 2012 as the test year. The Settling Parties
19 recommend this condition because it will allow for the development of some experience
20 and operating history under the City's ownership, it will extend the period during which
21 PEU has avoided filing of a full rate case, and it will provide an early opportunity for
22 each utility's rates to be reviewed so that they can reflect the actual borrowing cost
23 finally realized on the City Acquisition Bonds.

1 **Q. Mr. Patenaude, please describe the terms of the Settlement Agreement with respect**
2 **to the treatment of the City’s costs incurred in pursuing the eminent domain effort.**

3 A. In its original proposal, the City sought approval to have rates established under the
4 ratemaking structure to collect revenues that would allow the utilities and Pennichuck to
5 transfer funds to the City to reimburse the City for its costs relating to its efforts to pursue
6 the eminent domain proceeding from January 1, 2002 until August 2009 (the “City’s
7 Eminent Domain Costs”). Under the Settlement Agreement, at Paragraph III. B. and as
8 illustrated in the attachments in Exhibit B, the Settling Parties recommend that the utility
9 rates should be designed not to include recovery of the City’s Eminent Domain Costs
10 from ratepayers. Instead, the Settling Parties recommend that, if sufficient funds are
11 available, the utilities be allowed to distribute funds with respect to their common stock,
12 through dividends or other distributions to Pennichuck, up to an amount that allows the
13 City to reimburse itself for the City Eminent Domain Costs. However, as provided in
14 Paragraph III. B. 4., these potential distributions may not exceed \$500,000 in any year.
15 Further, the Settlement Agreement makes clear that the amount of the City Eminent
16 Domain Costs will be subject to audit and review by the Commission as part of the first
17 rate cases filed by the utilities.

18 **Q. What effect does this Settlement Agreement treatment of the City’s Eminent**
19 **Domain Costs have on ratepayers?**

20 A. Compared to the original proposal, the Settlement Agreement recommendation to
21 exclude the City’s Eminent Domain Costs from the utilities’ revenue requirement will
22 result in a reduction of \$5,000,000 in the principal amount of the City Acquisition Bonds,

1 which will reduce the CBFRR and, therefore, the rates paid by customers relative to the
2 Joint Petitioners' original proposal.

3 **Q. Please describe the terms of the Settlement Agreement with respect to the rate**
4 **stabilization fund proposed by the Joint Petitioners.**

5 A. Under the Settlement Agreement, at Paragraph III. C., the Settling Parties recommend
6 that the \$5,000,000 rate stabilization fund be established and maintained as an account at
7 PWW only. In contrast, the Joint Petitioners had originally proposed that the rate
8 stabilization fund be allocated among the three utilities. The Settling Parties recommend
9 this modification because establishing the rate stabilization fund only at PWW, which
10 principally serves residents of the City of Nashua, more clearly aligns the purpose of this
11 fund – that is, to serve as a form of debt service reserve fund with respect to obligations
12 on the City Acquisition Bonds – with the fact that the City of Nashua is the issuer of the
13 City Acquisition Bonds.

14 **Q. Mr. Patenaude, please describe the terms of the Settlement Agreement with respect**
15 **to the Municipal Acquisition Regulatory Asset.**

16 A. The Settlement Agreement, at Paragraph III. D., recommends that the Commission
17 approve the establishment and amortization of the MARA as a regulatory asset for each
18 of PWW, PEU and PAC substantially as described in my supplemental testimony dated
19 July 1, 2011. The MARA, which reflects the premium paid to acquire Pennichuck
20 Corporation and its subsidiaries, will be computed in accordance with the provision set
21 forth in Exhibit D to the Settlement Agreement. The Settlement Agreement makes clear
22 that the amount of the MARA will be subject to audit and review by the Commission as
23 part of the first rate cases filed by the utilities.

1 **Q. Please describe the terms of the Settlement Agreement with respect to the**
2 **restrictions on distributions from the utilities to Pennichuck Corporation.**

3 A. During this proceeding, the City stated to parties that it did not intend to cause the
4 utilities to pay dividends or other distributions of any current earnings and profits to
5 Pennichuck. The statement is consistent with the City's fundamental approach to this
6 acquisition which is, on the one hand, to ensure that the utilities can generate sufficient
7 cash to enable the City to pay its obligations on the City Acquisition Bonds, and, on the
8 other hand, to make clear that the City does not view this transaction as a venture that
9 will generate excess cash, ultimately from ratepayers, that could be used for regular City
10 operations. The Settlement Agreement, at Paragraph III. D. 4., clarifies this commitment
11 in writing, by expressly stating the intended limitation on dividends and other
12 distributions to provide funds solely to cover each utility's CBFRR amount. The only
13 exception to this limitation is with respect to amounts that may be distributed to
14 reimburse the City for the City Eminent Domain costs, as I earlier described in this
15 testimony.

16 **Q. Mr. Patenaude, please describe the Settlement Agreement's recommended**
17 **conditions with respect to the City Acquisition Bonds.**

18 A. Under the Settlement Agreement, at Paragraph III. E. 1., the Settling Parties recommend
19 that the Commission provide that its approval of the Merger is subject to two conditions
20 with respect to the City Acquisition Bonds: first, that the City Acquisition Bonds must be
21 issued with terms substantially consistent with the terms described in Exhibit E to the
22 Settlement Agreement; and second, that the true interest cost on the City Acquisition
23 Bonds does not exceed 6.50% per annum. As long as the City Acquisition Bonds satisfy

1 these conditions, the customer rates that would result under the proposed ratemaking
2 structure should be lower than the rates of the utilities under the current ownership.

3 **Q. Please describe the Settlement Agreement's recommended condition with respect to**
4 **the corporate governance structure of Pennichuck.**

5 A. Under the Settlement Agreement, at Paragraph III. E. 2., the Settling Parties recommend
6 that the Commission provide that its approval of the Merger is subject to a single
7 condition with respect to the structure of the corporate board of directors of Pennichuck
8 Corporation. This condition would require that the By-Laws of Pennichuck Corporation
9 include a provision allowing the Merrimack Valley Regional Water District to nominate
10 one board member, subject to approval by the City in its capacity as the sole shareholder
11 of Pennichuck Corporation. This member would be subject to the same conditions that
12 apply to any other board member, as stated in the current form of By-Laws attached to
13 the Merger Agreement. The Settling Parties recommend this condition because it will
14 help to establish a more diverse board that is sensitive to the regional nature of the
15 Pennichuck utility operations.

16 **Q. Mr. Patenaude, please describe your last key Settlement Agreement point relating to**
17 **a recommendation regarding a requirement to file a report following the Merger**
18 **closing.**

19 A. The Settlement Agreement, at Paragraph III. E. 3., recommends that the Commission
20 require that the utilities file within 90 days following the Merger closing date a detailed
21 accounting report of the transactions impacting the utilities as contemplated by the
22 Merger. This filing would include copies of the executed transaction documents, a

1 presentation of accounting entries made to the books of each utility, a calculation of the
2 MARA and an accounting of all final Acquisition Costs.

3 **Update on Prevailing Interest Rates**

4 **Q. Mr. Patenaude, do you have any information regarding the possible interest rate at**
5 **which the City may be able to issue its general obligation bonds to finance the**
6 **Merger and related Acquisition Costs?**

7 A. Yes. Based on discussions with the City's financial advisor, First Southwest Company,
8 prevailing interest rates for general obligation bonds issued by a municipality with the
9 City's general credit rating have been falling since the original testimony in this case was
10 filed on February 18, 2011. The most recent information indicates that interest rates for
11 taxable, general obligation bonds issued by a City with the City's credit rating are in a
12 range from 4.5 to 4.7 percent per annum. I would caution that interest rates and the
13 capital markets can be volatile, and we have no assurance that interest rates will continue
14 to be available at these historically low levels. However, if the City were able to issue
15 the City Acquisition Bonds with interest rates at these levels, customers of all of the
16 utilities would benefit because the ratemaking structure proposed by the Joint Petitioners
17 ensures that any benefits of the City's borrowing capacity are "flowed-through" to
18 ratepayers in the form of a lower CBFRR.

19 **Overall Conclusions Regarding the Merger and the Settlement Agreement**

20 **Q. Mr. Patenaude, based on the Settlement Agreement and the other testimony**
21 **provided in this proceeding, does the City continue to believe that the proposed**
22 **Merger is consistent with the public interest?**

1 A. Yes. The City's Board of Aldermen has reviewed the principal terms of the Settlement
2 Agreement and authorized the execution of the Settlement Agreement. The City remains
3 very committed to this opportunity to resolve the long-standing eminent domain dispute
4 between the parties on the basis of the terms of the Merger Agreement and the provisions
5 contained in the Settlement Agreement I have discussed in this testimony. For the
6 reasons stated in the original testimony presented by the Mayor and the other witnesses
7 for the Joint Petitioners, the City strongly believes that the proposed acquisition of
8 Pennichuck stock in accordance with the Merger Agreement, and subject to the terms and
9 conditions set forth in the Settlement Agreement discussed in this testimony, is consistent
10 with the public interest and should be approved.

11 **Q. Do you have any further testimony at this time?**

12 A. No.