

**STATE OF NEW HAMPSHIRE
BEFORE THE
PUBLIC UTILITIES COMMISSION**

Re: Pennichuck East Utility, Inc.

SRF Financing of Water Main Replacement in the Locke Lake Water System

DW 11-

DIRECT PRE-FILED TESTIMONY OF THOMAS C. LEONARD

December 2, 2011

1 **Q. What is your name and what is your position with Pennichuck Water Works, Inc.?**

2 **A.** My name is Thomas C. Leonard. I am the Chief Financial Officer of Pennichuck East
3 Utility, Inc. (“PEU” or the “Company”). I have been employed with the Company since
4 June 2008. I am a licensed Certified Public Accountant in Massachusetts.

5 **Q. Please describe your educational background.**

6 **A.** I have a Bachelor in Business Administration--Accounting from the University of
7 Wisconsin in Madison, Wisconsin.

8 **Q. Please describe your professional background.**

9 **A.** Prior to joining the Company, I was a Vice President with CRA International from June,
10 2006 to May 2008 and before that a Managing Director with Huron Consulting Group
11 from December 2002 to May 2006. My role at both organizations was to provide expert
12 accounting and financial analysis and testimony in connection with investigations and
13 disputes. Prior to joining Huron, I was the Head of the Audit Division in New England
14 for Arthur Andersen LLP and served as Audit Partner for a wide range of clients
15 including water, gas and electric utilities.

16 **Q. What are your responsibilities as Chief Financial Office of the Company?**

17 **A.** As Chief Financial Officer of the Company I am responsible for the overall financial
18 management of the Company including financing, accounting and budgeting. My
19 responsibilities include issuance and repayment of debt, issuance of common or other
20 forms of equity, and quarterly and annual financial reporting. I work with the President
21 of PEU to determine the lowest cost alternatives available to fund the annual capital
22 additions of PEU.

1 **Q. Please provide the Commission with an explanation of the purpose of the financing**
2 **proposed by the Company in its petition in this proceeding (the “Proposed**
3 **Financing”).**

4 A. The purpose of the Proposed Financing is to fund the cost to replace about 8,500 LF of
5 water main the Lock Lake Water System, hereinafter referred to as the “Locke Lake
6 water main replacement.” The testimony of Donald Ware, included with the Company's
7 filing in this case, provides the detail regarding the scope and need for the proposed
8 project.

9 **Q. Please describe the overall financing plan for the capital improvements.**

10 A. The estimated cost of replacing about 8,500 LF of water main in the Locke Lake Water
11 System is \$525,000. Substantially all the funding for this replacement is anticipated to be
12 provided by the proceeds of loan funds issued by the New Hampshire Department of
13 Environmental Services (“NHDES”) through the Drinking Water State Revolving Loan
14 Fund (“SRF”). In the event that the loan amount authorized by NHDES is not sufficient
15 to fund completely the cost of Locke Lake water main replacement, the balance, if any,
16 will be funded from a mix of PEU’s internal cash flow from operations and/or advances
17 to PEU from Pennichuck Corporation’s short term line of credit. PEU seeks approval in
18 this docket to borrow up to \$525,000 from the SRF. The actual borrowing amount will
19 be based on the actual costs of construction that the Company incurs. The use of the low
20 cost funds from the SRF will lower the overall cost of the financing needed to complete
21 the construction of the Locke Lake water main replacement.

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1 Q. **What are the terms of the proposed SRF financing?**

2 A. As the Commission is aware, the SRF provides public and private water systems the
3 opportunity to borrow funds at below-market interest rates to fund the construction of
4 qualified projects. Amounts advanced to PEU during construction will accrue interest at
5 a rate of 1%, and the total accrued interest will be due upon substantial completion of the
6 project. The terms of the SRF loans require repayment of the loan principal plus interest
7 over a twenty-year period commencing six months after the project is substantially
8 complete. The current interest rate on SRF borrowings is 3.1040% although the actual
9 rate will be based on the current rates available at the time the loan is actually closed.
10 Copies of the loan documents will be submitted to the Commission once they have been
11 finalized and executed. The loan is projected to come with 30% principal forgiveness
12 based on the current level of water rates relative to the Median Household Income for the
13 Locke Lake Water System.

14 Q. **What are the estimated issuance costs for these loans?**

15 A. The anticipated issuance costs total \$7,500, and relate primarily to legal costs which will
16 be incurred to (i) review and revise the necessary loan documentation prepared by the
17 State and (ii) obtain Commission approval of the loans. The issuance costs will be
18 amortized over the twenty-year life of the SRF loans. The annual amortization expense
19 of approximately \$375 associated with the issuance costs has not been considered in
20 Schedules TLC-1 through 3 due to its immateriality with respect to the overall analysis
21 and impact of this proposed financing.

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1 **Q. Please explain Schedule TCL-1, entitled “Actual and Pro Forma Balance Sheet at**
2 **September 30, 2011.”**

3 A. Schedule TCL-1 presents the actual financial position of PEU as of September 30, 2011
4 and the pro forma financial position reflecting certain adjustments pertaining to the
5 Proposed Financing.

6 **Q. Please explain the pro forma adjustments on Schedule TCL-1.**

7 A. Schedule TCL-1 contains two pro forma adjustments. The first adjustment for \$525,000
8 reflects the increase in PEU’s Plant in Service for the construction project and the related
9 funding sources. The second adjustment reflects the after-tax effect on retained earnings
10 for the annual interest expense accrued during the first year, with a corresponding credit
11 to accrued expenses payable.

12 **Q. Please explain Schedule TCL-2 entitled “Actual and Pro Forma Income Statement**
13 **for the Twelve Months Ended September 30, 2011.”**

14 A. Schedule TCL-2 presents the pro forma impact of this financing on PEU’s income
15 statement for the twelve month period ended September 30, 2011.

16 **Q. Please explain the pro forma adjustments on Schedule TCL-2.**

17 A. Schedule TCL-2 contains three adjustments. Adjustment one is to record the estimated
18 first year’s interest cost related to the new funding sources. Adjustment two is to record
19 the estimated depreciation and property taxes on the new assets. The third adjustment is
20 to record the after-tax effect of the additional pro forma expenses (interest and property
21 tax expense) resulting from the adjustments discussed above using an effective combined
22 federal and state income tax rate of 39.6%.

1 **Q. Please explain Schedule TCL-3 entitled “Actual and Pro Forma Statement of**
2 **Capitalization at September 30, 2011.”**

3 A. Schedule TCL-3 illustrates PEU’s actual total capitalization, as of September 30, 2011,
4 which is comprised of common equity, funded debt and net inter-company advances.

5 **Q. Please explain the pro forma adjustments on Schedule TCL-3.**

6 A. Schedule TCL-3 contains two adjustments. The first pro forma adjustment reflects the
7 after-tax decrease to retained earnings for the additional pro forma expenses related to the
8 new funding sources, while the second adjustment reflects the funding sources for the
9 project.

10 **Q. Are there any covenants or restrictions contained in PEU’s other bond and note**
11 **agreements which would be impacted by the issuance of debt under this proposed**
12 **financing?**

13 A. Yes. PEU’s existing agreement with the Business Finance Authority of the State of New
14 Hampshire contains a covenant which currently prevents the issuance of new PEU debt.
15 PEU expects to pay this debt off in the near term, however, and therefore the covenant
16 will no longer exist at the time PEU issues the new debt. Also, PEU’s existing agreement
17 with CoBank contains two covenants governing the issuance of new PEU debt. These
18 covenants specify minimum interest coverage ratio and maximum amounts of debt in
19 relation to total capitalization. PEU’s actual ratios, pro formed for the SRF loans
20 contemplated herein, are within the parameters set by these covenants.

21 **Q. Has PEU’s Board of Directors formally voted to authorize the Proposed Financing?**

22 A. A Resolution authorizing the subject financing has been circulated among the Board of
23 Directors for an authorization by consent. All the necessary signatures required from the

1 Board of Directors should be collected by the end of December 2011. Evidence of the
2 required resolution will be provided as soon as possible for the NHPUC's records.

3 **Q. Do you believe that the Proposed Financing is in the public interest?**

4 A. Yes, I do. The project being financed will enable PEU to continue to provide safe,
5 adequate and reliable water service to PEU's customers. For the reasons described in Mr.
6 Ware's direct testimony the Locke Lake Water Main replacement project will provide the
7 most cost effective solution to correct the leakage problem associated with a water
8 distribution system constructed with materials that were not designed for use in
9 purveying water. The terms of the financing through SRF are very favorable, and will
10 result in lower financing costs than would be available through all other current debt
11 financing options including tax-exempt bonds issued through the New Hampshire
12 Business Finance Authority.

13 **Q. Is there anything else that you wish to add?**

14 A. Yes. I respectfully ask the Commission to issue an Order in this docket as soon as
15 reasonably possible since the NHDES needs PEU to be authorized to enter into the loan
16 agreement associated with the SRF funds on March 1, 2012 in order to meet the NHDES
17 goal of disbursing all of its SRF funds by the end of 2012.

18 **Q. Mr. Leonard, does this conclude your testimony?**

19 A. Yes it does.
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