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January 23, 2012

Debra A. Howland
Executive Director
New Hampshire Public Utilities Commission
21 S. Fruit Street, Suite 10
Concord, NH 03301



Re: DW 11-267, Pennichuck East Utility, Inc.
Petition for Approval of Increase in Short Term Debt Limit
Staff Recommendation

Dear Ms. Howland:

The purpose of this letter is to offer a recommendation concerning a petition filed by Pennichuck East Utility, Inc. (PEU) to increase its short term debt borrowing limit to 17% of its net fixed plant for the period through and including December 31, 2012. Staff reviewed PEU's petition and propounded data requests, the responses to which are attached to this letter. For the reasons that follow, Staff does not recommend approval of an increase in the short term debt limit to a level of 17% of net fixed plant. Staff recommends PEU be permitted to exceed its short term debt limit only to a level of 15% of its net fixed plant for the duration of 2012. PEU indicates in its response to Staff data request 1-3 that it will be formulating a new financing plan following the acquisition of Pennichuck Corporation by the City of Nashua.

Pursuant to Puc 608.05, a water utility is authorized to carry short term debt on its books at a level up to 10% of its net fixed plant without Commission approval. According to PEU's petition, as of September 30, 2011, PEU's short term debt totaled approximately \$2.0 million, or 6.7% of its net fixed plant. PEU indicates that percentage increased to 7.21% as of October 31, 2011. PEU seeks to increase its short term debt limit due to three primary reasons: it needs cash for its expected net capital expenditures in 2012 of \$2.0 million¹; the expectation that it will need to pay off an existing long term loan of about \$950,000 in order to access the SRF; and the company's desire to declare a dividend to its parent in the amount of \$900,000.

PEU's need for cash for its 2012 capital expenditures is self-explanatory. With respect to retiring an existing loan, PEU indicates that its current earnings level is not

¹ PEU expects to incur \$3.0 million in total capital spending, with about \$1.0 million of that financed by State Revolving Loan Funds (SRF). PEU's request for a portion of this SRF is pending in Docket No. DW 11-262.

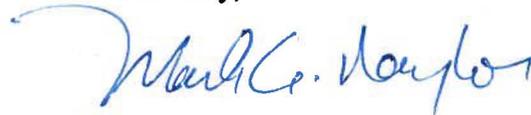
sufficient to permit the company to acquire additional long term debt. Its current Business Finance Authority (BFA) loan with a balance of \$950,000 requires PEU to have earnings of at least 1.5 times interest expense at the time of issuance of any new long term debt. In order to access the low cost SRF, PEU intends to use short term debt for repayment of the BFA loan and therefore avoid the earnings restriction.

With respect to the third reason for the requested increase in its short term debt limit, PEU's plan to declare and issue a \$900,000 dividend to its parent arises from PEU's efforts to reduce the equity component of its capital structure. As indicated in its petition, PEU cites the settlement agreement and Commission Order No. 25,051 issued in DW 08-052 which addressed PEU's capital structure². At that time, Staff felt that PEU's capital structure was too heavily weighted to equity at a level of about 60%, and that PEU should take steps to create a more balanced capital structure. At this time, however, PEU's capital structure is about 40% equity. See revised exhibit 3 attached to PEU's response to Staff data request 1-9, attached to this letter. It is the use of short term debt to pay this dividend which causes Staff to recommend a lower level of short term debt than that sought by PEU in the instant docket. If PEU is cash-short and must extend its short term debt limit and borrow funds from its parent in order to finance capital expenditures and retire an existing loan, it does not make sense to declare and pay a dividend. What in essence is occurring is that PEU acquires the short term debt through its money pool arrangement with Pennichuck Corporation, then declares a dividend and sends \$900,000 back to Pennichuck Corporation. PEU indicates in its petition that it expects its utility operations to show little if any earnings in 2011, which is another reason a dividend appears inappropriate. And, as indicated, there is no need to further reduce the level of equity in PEU's capital structure through issuance of this dividend.

Staff believes a short term debt limit for 2012 of 15% of net plant is appropriate. This level will provide the company with an additional \$2.5 million in cash. It is also noted that PEU receives about \$600,000 in net cash flow from depreciation expense through its current rates. Together this amount will permit PEU to finance its planned capital expenditures and retire its BFA loan so that it can obtain the SRF financing.

If you have any questions or request further information regarding this matter, please contact me.

Sincerely,



Mark A. Naylor
Director, Gas & Water Division

Attachments: Data Responses Set 1
cc: Docket-Related Service List

² Pittsfield Aqueduct Company, Inc. and Pennichuck East Utility, Inc., Order No. 25,051, 94 NH PUC 701 (2009).

**PENNICHUCK EAST UTILITY
DW 11-267**

**Pennichuck East Utility's Responses to
Staff's Data Requests – Set 1
PETITION FOR APPROVAL TO INCREASE SHORT TERM DEBT LIMIT**

**Date Request Received: January 3, 2012
Request No. Staff 1-1**

**Date of Response: January 13, 2012
Witness: Thomas C. Leonard**

REQUEST: Regarding the promissory note referenced on page 1 of the petition in the amount of \$725,389, to whom were these funds owed, and what was the original purpose of the borrowing?

RESPONSE:

The promissory note for \$725,389 dated May 9, 2006 was a financing between Pittsfield Aqueduct Company ("PAC") as the obligor and Pennichuck Corporation ("PennCorp") as the lender. The note carried an interest rate of 6.5% and a maturity date of May 1, 2011 and was authorized by the Commission in Order No. 24,610. The original purpose of the borrowing was to finance PAC's acquisition of the assets of Consolidated Water Company and Central Water Company (collectively, the "North Country assets"). The North Country assets, including their associated liabilities (which include the promissory note referred to above), were transferred to PEU effective January 1, 2010 as approved in the Commission's Order No. 25,051.

**PENNICHUCK EAST UTILITY
DW 11-267**

**Pennichuck East Utility's Responses to
Staff's Data Requests – Set 1
PETITION FOR APPROVAL TO INCREASE SHORT TERM DEBT LIMIT**

**Date Request Received: January 3, 2012
Request No. Staff 1-2**

**Date of Response: January 13, 2012
Witness: Thomas C. Leonard**

REQUEST: What is the current balance of the BFA loan referenced in paragraph 5 on page 2 of the petition?

RESPONSE:

As of December 31, 2011, the balance of the BFA loan was \$950,000.

**PENNICHUCK EAST UTILITY
DW 11-267**

**Pennichuck East Utility's Responses to
Staff's Data Requests – Set 1
PETITION FOR APPROVAL TO INCREASE SHORT TERM DEBT LIMIT**

**Date Request Received: January 3, 2012
Request No. Staff 1-3**

**Date of Response: January 13, 2012
Witness: Thomas C. Leonard**

REQUEST: How does the company anticipate being able to reduce its short term debt to 10% or less of net fixed plant by December 31, 2012?

RESPONSE:

The Company expects to formulate a new financing plan following the City of Nashua's acquisition of PennCorp, which plan would be approved by the new Board of Directors. The plan will be based on obtaining the lowest cost financing for PEU. Such a plan could include new long term loans from PennCorp, long term borrowings from private or quasi-private lenders such as CoBank as well as from public or quasi-public lenders such as the New Hampshire Bond Bank.

PENNICHUCK EAST UTILITY
DW 11-267

Pennichuck East Utility's Responses to
Staff's Data Requests – Set 1
PETITION FOR APPROVAL TO INCREASE SHORT TERM DEBT LIMIT

Date Request Received: January 3, 2012
Request No. Staff 1-4

Date of Response: January 13, 2012
Witness: Thomas C. Leonard

REQUEST: Would the need for a short term debt limit in excess of 10% be eliminated at the time of the acquisition of Pennichuck Corporation by the City of Nashua?

RESPONSE:

No. The acquisition of PennCorp by the City of Nashua will result in the City of Nashua owning all of the outstanding common stock of PennCorp, the parent company of PEU. Therefore, the acquisition will have no direct financial impact on PEU or any of PennCorp's subsidiaries.

Pursuant to Order No. 25,292 and the Settlement Agreement approved by that order, the City of Nashua was authorized to recognize a Municipal Acquisition Regulatory Asset ("MARA") associated with the excess of the actual purchase price over the book value of the equity acquired. Following the acquisition, this asset will be recorded on a pro rata basis on each of the three regulated utilities, including PEU whose estimated MARA amount is approximately \$9.3 million, with an offsetting amount to equity. Although the Company expects to include the MARA in Account 114 "Utility Plant Acquisition Adjustments," which is a separate account under the "Utility Plant" series of accounts, the Company's current short term debt limit calculations do not assume the inclusion of the MARA as a component of property, plant and equipment (net fixed plant) as used in the short term debt limit test. If, however, it were determined that Account 114 should be included in the Company's net fixed plant used to calculate the short term debt percentage, such inclusion would result in a lower short term debt percentage.

**PENNICHUCK EAST UTILITY
DW 11-267**

**Pennichuck East Utility's Responses to
Staff's Data Requests – Set 1
PETITION FOR APPROVAL TO INCREASE SHORT TERM DEBT LIMIT**

**Date Request Received: January 3, 2012
Request No. Staff 1-5**

**Date of Response: January 13, 2012
Witness: Thomas C. Leonard**

REQUEST: What does the company anticipate for a short term debt balance on PEU's books immediately after Pennichuck is acquired?

RESPONSE:

The Company expects the short term debt balance to be approximately \$3.2 million as of December 31, 2011 and anticipates that this balance will remain largely the same after PennCorp is acquired by the City of Nashua. Please note that the closing of the City of Nashua and PennCorp merger will not have a cash impact, either positive or negative, on PEU.

PENNICHUCK EAST UTILITY
DW 11-267

Pennichuck East Utility's Responses to
Staff's Data Requests – Set 1
PETITION FOR APPROVAL TO INCREASE SHORT TERM DEBT LIMIT

Date Request Received: January 3, 2012
Request No. Staff 1-6

Date of Response: January 13, 2012
Witness: Thomas C. Leonard

REQUEST: Regarding paragraph 6 on page 3 of the petition, with respect to PEU's debt/equity balance, page 8 of Order No. 25,051 does not appear to contain a discussion of reducing the company's equity balance. Please explain or provide the correct reference.

RESPONSE:

The correct page reference is page 5, which provides that "[t]he settling parties understand that PEU has undertaken, and will continue to undertake, efforts to reduce the amount of equity in its capital structure."

PENNICHUCK EAST UTILITY
DW 11-267

Pennichuck East Utility's Responses to
Staff's Data Requests – Set 1
PETITION FOR APPROVAL TO INCREASE SHORT TERM DEBT LIMIT

Date Request Received: January 3, 2012
Request No. Staff 1-7

Date of Response: January 13, 2012
Witness: Thomas C. Leonard

REQUEST: According to Order No. 25,051 on page 11, PEU's capital structure would contain around 60% equity after the transfer of the North Country assets. Paragraph 6 of the petition in the instant proceeding indicates PEU's current equity percentage is 44.2%. Why is the company looking to further reduce its equity, through a dividend or otherwise?

RESPONSE:

In Dockets DW 08-052 and DW 09-051, Commission staff indicated that it preferred PEU to have equity levels within the 40% to 45% range. *See* Order No. 25,051, page 11. Commission staff also indicated that it agreed to the Settlement Agreement in that proceeding despite the 60% equity immediately resulting after the transfer of the North Country assets, in part, because the Company committed to continue to undertake efforts to reduce the amount of equity in its capital structure after the transfer of the North Country assets. *See* Order No. 25,051, pages 5 and 11. The Company is looking to further reduce its equity through the \$900,000 dividend and otherwise in order to honor that commitment and stay compliant with the terms of the Settlement Agreement and Order No. 25,051.

The use of the 44.2% equity percentage in the petition may have inadvertently caused confusion. The 60% equity noted on page 11 of Order No. 25,051 was calculated after removing the Company's "North Country" investment from the debt component of the capital structure as a result of it being recovered separately through the Capital Recovery Surcharge ("CRS"). The CRS amount subtracted from the debt component was approximately \$4,752,000 (\$2,705,841 + \$1,878,504 + \$168,052) and is described on page 16 of Order No. 25,051. In contrast, the Company's equity percentage of 44.2% noted in its petition was calculated without removing the CRS. Removal of the investment associated with the CRS, while relevant for ratemaking, is not appropriate under generally accepted accounting principles and, therefore, was not reflected in the Statement of Capitalization, which is Exhibit 3 to the petition. The Company used the equity percentage from its Statement of Capitalization for its petition.

If the Company were to compute its current debt and equity levels on the same basis as the 60% and 40-45% equity noted in Order No. 25,051, namely, on a ratemaking basis and by subtracting the CRS from the debt component of capitalization, the Company's current debt and equity would be as follows (000's):

	<u>Per Exh. 3*</u>	<u>Percentage*</u>	<u>Remaining CRS</u>	<u>Proforma</u>	<u>Percentage</u>
Equity	\$ 5,826	36.3%		\$5,826	49.3%
LT Debt	<u>10,205</u>	<u>63.7%</u>	\$(4223)	<u>5,982</u>	<u>50.7%</u>
Total	\$16,031	100.0%		\$11,808	100.0%

*Amounts shown are from the revised Exhibit 3 submitted with response to Staff Data Request 1-9. Please note that equity percentages were updated in the revised Exhibit 3. Amounts shown reflect the \$900,000 dividend having already been paid.

**PENNICHUCK EAST UTILITY
DW 11-267**

**Pennichuck East Utility's Responses to
Staff's Data Requests – Set 1
PETITION FOR APPROVAL TO INCREASE SHORT TERM DEBT LIMIT**

**Date Request Received: January 3, 2012
Request No. Staff 1-8**

**Date of Response: January 13, 2012
Witness: Thomas C. Leonard**

REQUEST: Regarding the potential dividend discussed in paragraph 6 of the petition, is there any provision in the merger agreement with the City of Nashua which requires Nashua to approve issuance of this dividend?

RESPONSE:

There is no provision in the merger agreement which requires the City of Nashua's approval for PEU to issue a dividend. The Company notes, however, that the City of Nashua's approval is required for any issuance of long term debt by PEU.

**PENNICHUCK EAST UTILITY
DW 11-267**

**Pennichuck East Utility's Responses to
Staff's Data Requests – Set 1
PETITION FOR APPROVAL TO INCREASE SHORT TERM DEBT LIMIT**

**Date Request Received: January 3, 2012
Request No. Staff 1-9**

**Date of Response: January 13, 2012
Witness: Thomas C. Leonard**

REQUEST: Re: Exhibits:

- a) Exhibit 1: Please explain why the balance of "LTD – PCP Loan" in the amount of \$1,723,150 does not appear in the "Pro Forma September 30, 2011" column. The Total Assets and Total Equity and Liabilities amounts are out of balance by this same amount in this column.
- b) Exhibit 3: Please explain why the "LTD – PCP Loan" in the amount of \$1,723,150 does not appear in either the "Actual September 30, 2011" or "Pro Forma September 30, 2011" columns.

RESPONSE:

The \$1,723,150 amount was inadvertently omitted from these columns. Revised Exhibits 1 and 3 are attached here, which now reflect the \$1,723,150 LTD – PCP Loan amount.

Pennichuck East Utility, Inc.
Actual and Pro Forma Balance Sheet as of September 30, 2011
Unaudited

Revised Exhibit 1

	<u>Actual</u> <u>September 30, 2011</u>	<u>Pro Forma</u> <u>Adjustments</u>	<u>Pro Forma</u> <u>September 30, 2011</u>
Assets			
Plant In Service	\$ 38,797,319		\$ 38,797,319
Less: Accumulated Depreciation	(8,692,516)		(8,692,516)
Net Plant	30,104,803	-	30,104,803
CWIP	258,466	-	258,466
Total Net Utility Plant	30,363,269	-	30,363,269
Current Assets	1,029,858	-	1,029,858
Other Assets and Deferred Charges	875,124	-	875,124
Total Assets	\$ 32,268,251	\$ -	\$ 32,268,251
Equity and Liabilities			
Common Equity	\$ 6,726,311	\$ (900,000) ¹	\$ 5,826,311
Current Portion of Long-Term Debt	329,348		\$ 329,348
Other Current Liabilities	1,304,025		\$ 1,304,025
Advances from Associated Companies	2,036,837	900,000 ¹	\$ 2,936,837
Long-Term Bonds	5,050,032	-	5,050,032
LTD-PCP Loan	1,723,150		1,723,150
LTD-SRF Loans	3,102,499		\$ 3,102,499
Deferred Income Taxes	3,413,467	-	\$ 3,413,467
Contributions in Aid of Construction, Net	8,437,286	-	\$ 8,437,286
Other Liabilities and Deferred Credits	145,296	-	145,296
Total Equity and Liabilities	\$ 32,268,251	\$ -	\$ 32,268,251

Notes:

1 - To record a dividend of \$900,000 from PEU to PennCorp.

Pennichuck East Utility, Inc.
Actual and Pro Forma Statement of Capitalization as of September 30, 2011
Unaudited

Revised Exhibit 3

	<u>Actual</u> <u>September 30, 2011</u>		<u>Pro Forma</u> <u>Adjustments</u>		<u>Pro Forma</u> <u>September 30, 2011</u>	
Common Equity:						
Common Stock	\$ 100		\$ -		\$ 100	
Paid-in Capital	6,000,000		-		6,000,000	
Other Comprehensive Income	(492,140)		-		(492,140)	
Retained Earnings	<u>1,218,351</u>		<u>(900,000)</u>	1	<u>318,351</u>	
Total Common Equity	<u>6,726,311</u>	39.7%	<u>(900,000)</u>		<u>5,826,311</u>	36.3%
Debt:						
Current Portion of Long-Term Debt	329,348		-		329,348	
Long-Term Bonds	5,050,032		-		5,050,032	
LTD-PCP Loan	1,723,150		-		1,723,150	
LTD-SRF Loans	<u>3,102,499</u>		-		<u>3,102,499</u>	
Total Debt	<u>10,205,029</u>	60.3%	<u>-</u>		<u>10,205,029</u>	63.7%
Total Capitalization	<u>\$ 16,931,340</u>	<u>100.0%</u>	<u>\$ (900,000)</u>		<u>\$ 16,031,340</u>	<u>100.0%</u>

Notes:

1 - To record a dividend of \$900,000 from PEU to PennCorp.