STATE OF NEW HAMPSHIRE
BEFORE THE
PUBLIC UTILITIES COMMISSION

Re: Pennichuck East Utility, Inc.

Petition for Authority to Enter into
Long Term Loans from CoBank, ACB and
Pennichuck Corporation

DW 13-

DIRECT PREFILED TESTIMONY OF LARRY D. GOODHUE

January 16, 2013

Q. What is your name and what is your position with Pennichuck East Utility, Inc.?

A. My name is Larry D. Goodhue. I am the Chief Financial Officer of Pennichuck East Utility, Inc. (the "Company"). I have been employed with the Company since December, 2006. I also serve as Chief Financial Officer, Treasurer and Controller of the Company's parent, Pennichuck Corporation ("Pennichuck"). I am a licensed Certified Public Accountant in New Hampshire; my license is currently in an inactive status.

Q. Please describe your educational background.

A. I have a Bachelor in Science degree in Business Administration with a major in Accounting from Merrimack College in North Andover, Massachusetts.

Q. Please describe your professional background.

A. Prior to joining the Company, 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 in several companies.

Q. What are your responsibilities as Chief Financial Officer of the Company?

A. As Chief Financial Officer of the Company I am responsible for the overall financial management of the Company including financing, accounting, compliance and budgeting. My responsibilities include issuance and repayment of debt, as well as quarterly and annual financial and regulatory reporting and compliance. I work with the Chief Executive Officer and Chief Operating Officer of the Company to determine the lowest cost alternatives available to fund the capital requirements of the Company, which result from the Company's annual capital expenditures and its current debt maturities.

Q. What financings are proposed by the Company in its petition in this proceeding (the "Proposed Financings").

A. The Company is proposing three new long term debt financings: (1) a $925,000 loan from CoBank, ACB ("CoBank") to replace $925,000 of New Hampshire Business Finance Authority ("BFA") Series D ("Series D") bonds which were retired prior to full maturity, in April 2012; (2) a $1,723,150 loan from CoBank to refinance a 10-year $1,723,150 fixed rate intercompany note payable between the Company and Pennichuck Corporation ("Pennichuck") which matures in May 2018; and (3) a $3.0 million long term loan from Pennichuck to convert $3.0 million of short term intercompany debt to a long term note payable. The proceeds from the $925,000 CoBank loan will be utilized to repay short term (intercompany) borrowings from Pennichuck that were incurred to prepay the Series D bonds.

Q. Please describe the Company's arrangements with CoBank.

A. CoBank is a federally chartered bank under the Farm Credit Act of 1971, as amended. Unlike commercial banks and other financial institutions, it is restricted to making loans and leases and providing financial solutions to eligible borrowers in the agribusiness and rural utility industries and certain related entities as defined under the Farm Credit Act of 1971. The characteristics of the Company's service territory are consistent with CoBank's charter and mission, and CoBank can therefore provide short, intermediate and long-term loans to the Company in connection with its capital requirements.

The Company has entered into a Master Loan Agreement with CoBank dated as of February 9, 2010 (the "Master Loan Agreement"), which provides the framework for CoBank to make loans to the Company from time to time. The Master Loan Agreement was filed with the Commission in Docket DW 09-134 and can be found at:

http://www.puc.nh.gov/Regulatory/CASEFILE/2009/09-134/LETTERS,%20MEMOS/09-134%202010-03-31%20COBANK%20LOAN%20DOCS.PDF

In March 2010, the Company had utilized CoBank to replace $4.5 million of maturing debt and to establish a $1.5 million revolving line of credit pursuant to Order 25,041 in DW 09-134. The $1.5 million revolving line of credit expired in March 2012.

CoBank is a Government Sponsored Enterprise ("GSE") owned by its customers, who consist of agricultural cooperatives, rural energy, communications and water companies and other businesses that serve rural America. As a GSE, CoBank issues its debt securities with the implicit full faith and credit of the US Government and uses these low cost funds to make loans to companies like the Company that meet its charter requirements. As a result of the implicit backing of the US Government, CoBank's borrowing costs are lower than commercial banks and financial institutions and these lower costs are passed on to its borrowers. In addition to the lower rates, CoBank loans generally have fewer covenants or restrictions as compared to loans from commercial banks and other financial institutions.

Q. **What are the basic terms of the proposed CoBank financing**?

A. While the final terms and interest rates are subject to change based on CoBank's due diligence (which is in progress) and market conditions, the Company expects to obtain two (2) term loans. Loan 1 would be a $925,000 term loan with a 20-year amortization, with level monthly principal and interest payments with an interest rate to be determined based on market conditions (currently estimated at 4.35% per annum). The proceeds from this first new CoBank loan will be used to refinance intercompany short term loans from Pennichuck incurred to prepay the BFA bonds, Series D, the proceeds of which had been loaned to the Company to cover the costs of capital expenditures for plant used to provide water utility service to the public. The terms of the BFA financing had included interest coverage covenants that were precluding the Company from having access to additional long term debt, including economical infrastructure financing from the State Revolving Loan Fund. The new CoBank loan will provide permanent financing to replace the BFA bonds that were prepaid with short term debt. Loan 2 would be a $1,723,150 term loan with a 10-year amortization period, with level monthly principal and interest payments, to refinance the existing long term intercompany loan from Pennichuck to the Company. The interest rate on this loan will also be set based on market conditions and is currently estimated to be 3.75% per annum. The two new CoBank loans will be secured by (i) a security interest in the Company's equity interest in CoBank (consisting of the Company's $1,000 equity investment in CoBank and the Company's right to receive patronage dividends) and (ii) the unconditional guarantee of the Company's obligations to CoBank by Pennichuck pursuant to the Guarantee of Payment (Continuing), by Pennichuck in favor of CoBank dated as of February 9, 2010 (the "Guaranty"), a copy of which was also filed with the Commission in Docket DW 09-134.

Q. Are there any other important terms or benefits related to borrowing from CoBank?

A. Yes, as I mentioned earlier, CoBank is organized as a cooperative which means it is owned and controlled by its members who use its products or services (i.e. its borrowers). A key cooperative principle is the return to customers of a portion of net margins based upon their use of the bank. This is accomplished through the distribution of "patronage refunds"---the distribution to patronage customers of net margins remaining after payment of preferred stock dividends, deducting operating and interest expenses and amounts retained as core surplus. While not guaranteed, each year the Board of Directors of CoBank targets a distribution amount which is returned (in the subsequent year) to its borrower/members based on the annual average accruing loan volume. While these "patronage" payments are not guaranteed and therefore are not included in the pro forma cost of capital on Exhibit LDG-3, the Company expects to reflect the patronage refunds in rates in future test years based on the receipt of the payments. The Company's experience with patronage refunds associated with the March 2010 $4.5 million refinancing is as follows: 2010 patronage of $37,355 and 2011 patronage of $43,108. In general, CoBank's annual patronage has been 1% of the one year average daily loan balance. The 1% is distributed as a mix of cash and equity stock in CoBank; in 2010 and 2011, the mix of cash and equity was 35% and 65%, respectively. The Company accounts for the cash portion as a reduction in interest expense when received in accordance with GAAP. The equity portion is accounted for as a deferred debit on the balance sheet.

Q. Please describe the new loan from Pennichuck.

A, The Company proposes to enter into a new long term loan from Pennichuck in the principal amount of $3,000,000 to replace $3,000,000 of short term debt payable to

Pennichuck pursuant to the intercompany Money Pool Agreement dated as of January 1, 2006 (the "Money Pool Agreement"), a copy of which has been filed with the Commission pursuant to RSA 366:3. The proceeds of the short term debt had been used to acquire property used and useful to provide water utility service to the public. The new loan from Pennichuck will be evidenced by an unsecured promissory note from the Company payable to Pennichuck in the principal amount of $3,000,000 providing for level monthly payments, an amortization period of ten years and an interest rate of 2.65% per annum. Under the terms of the Master Loan Agreement and the Guaranty, the Company's indebtedness to Pennichuck will be subordinate to the Company's indebtedness to CoBank. The Company's level of short term debt has for some time been in excess of ten percent (10%) of its net fixed capital, requiring the Company to seek approval to exceed this amount pursuant to RSA 369:7 and Puc 608.05. Upon completion of the permanent financing for which approval is requested herein, the Company's level of short term debt is expected to be and remain below ten percent of net fixed capital.

Q. Please describe the benefits of the proposed financings.

A. The proposed debt would accomplish the following: (1) by extending the current obligations further into the future, allow for a better matching of the life of our long term debt to the underlying lives of the assets; (2) provide for favorable debt carrying costs of approximately 4.35% vs. 4.5% on Loan 1 and approximately 3.75% vs. 7.0% on Loan 2, offset by the rate of 2.65% on the new long term intercompany note payable, creating a revenue neutral result from this overall financing, which will be passed onto our customers through rates; and (3) reduce the level of our short term debt that is currently above the 10% limit of net fixed plant.

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

A. The anticipated issuance costs total $10,000, and relate primarily to legal costs which will be incurred to (i) review and revise the necessary loan documentation prepared by CoBank, (ii) document the new loan from Pennichuck and (iii) obtain Commission approval of the loans. The issuance costs will be pro-rated based on principal amounts and amortized over the respective lives of the CoBank loans. The annual amortization expense of less than $1,000 associated with the issuance costs has not been reflected in Schedules LDG-2 through 4 due to its immateriality with respect to the overall analysis and impact of this proposed financing.

Q. What other options the Company considered for the proposed CoBank financing?

A. The Company has explored options with several potential funding agencies over the past year. The Company determined that tax exempt debt such as State Revolving Fund (SRF) or Business Finance Authority of New Hampshire (BFA) lending is not available, since the monies would be used to refinance existing indebtedness rather than to finance new capital expenditures as required by the SRF and BFA lending programs. As a result, the options to refinance the existing debt were limited to taxable debt from banks or other financial institutions. For banks, the Company determined a similar lack of availability due to considerations including the financial structure of the Company with respect to normal debt-equity ratios or meeting normal financial covenants or due to acceptable credit ratings. At the end of the process, CoBank became the only viable option to refinance the existing debt on favorable terms.

Q. Please explain Schedule LDG-1, entitled "Actual and Pro Forma Balance Sheet at October 31, 2012".

A. Schedule LDG-1 presents the actual financial position of the Company as of October 31, 2012 and the pro forma financial position reflecting certain adjustments pertaining to the Proposed Financings.

Q. Please explain the pro forma adjustments on Schedule LDG-1.

A. Schedule LDG-1 reflects the pro forma adjustment to reduce the short term intercompany loan and establish the $ 925,000 CoBank long term loan. The schedule also reflects the elimination of the $1,723,150 long term intercompany debt, and establishes the $1,723,150 CoBank long term loan. Finally, embedded in the intercompany debt line is the conversion of $3.0 million of short term intercompany debt to a $3.0 million long term intercompany note payable.

Q. Mr. Goodhue, please explain Schedule LDG-2 entitled "Actual and Pro Forma Income Statement for the Twelve Months Ended October 31, 2012".

A. As I indicated above, the costs associated with the refinancing are not expected to be significant and are not reflected in Schedule LDG-2. Schedule LDG-2 presents the pro forma impact of this financing on the Company's income statement for the twelve month period ended October 31, 2012.

Q. Please explain the pro forma adjustments on Schedule LDG-2.

A. Schedule LDG-2 contains two adjustments. Adjustment one is to record the estimated net decrease in interest expense related to additional debt raised. I have assumed an interest rate of 4.35% for Term Loan 1 and 3.75% for Term Loan 2 for the CoBank financing based on discussion with CoBank personnel, however; the actual interest rate will be based on market conditions at the time of closing. The second adjustment is to record the after-tax effect of the additional pro forma interest expense using an effective combined federal and state income tax rate of 39.6%.

Q. Please explain how the interest rate of 2.65% was derived for the long term intercompany note payable of $3.0 million in Schedule LDG-2.

A. Company initially determined that the rate of 3.75% would be the appropriate rate for the 10 year note based on the external rate expected for the 10 year term loan from CoBank. However, the use of this rate would increase the overall interest expense of the Company and thereby negatively impact the customers. Therefore, the Company determined that a rate of 2.65% would be more appropriate in creating an income neutral result.

Q. Please explain Schedule LDG-3 entitled "Actual and Pro Forma Statement of Capitalization at October 31, 2012."

A. Schedule LDG-3 illustrates the Company's pro forma total capitalization as of October 31, 2012, which is comprised of common equity and long term debt including SRF financing.

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

A. Schedule LDG-3 contains two adjustments. The first column of pro forma adjustments reflect the elimination of debt related to Capital Recovery Surcharge Assets per Order 25,051 in DW 08-052 and the elimination of the Municipal Acquisition Regulatory Asset, ("MARA") and the related equity as of the date of the Nashua acquisition per Order 25,292 in DW 11-026. The second column of pro forma adjustments reflects the retirement of the $1,723,150 of long term intercompany debt and $925,000 of short term intercompany debt with the corresponding two (2) term loans from CoBank.

Q. Mr. Goodhue, are there any covenants or restrictions contained in the Company's other bond and note agreements which would be impacted by the issuance of debt under this proposed financing?

A. Yes. Section 6.4 of the Loan Agreement between Pennichuck and RBS Citizens, N.A. prohibits Pennichuck or its subsidiaries from incurring additional indebtedness without the express prior written consent of the Bank. The Company sought and obtained the Bank's consent in a letter dated December 3, 2012.

Q. What is the status of corporate approvals for the Proposed Financings?

A. The CoBank financings have been approved by the Company's Board of Directors and are being submitted for approval by Pennichuck's sole shareholder, the City of Nashua. The Company will supplement its Petition with documentation showing such shareholder approval promptly upon receipt thereof. The conversion of the $3 million of short term debt into the new long term loan will be considered by the boards of directors of the Company and Pennichuck on January 25, 2013. The Company will further supplement its Petition with copies of those resolutions promptly following such action. No shareholder approval is required with respect to intercompany loans.

Q. Do you believe that the Proposed Financings will be consistent with the public good?

A. Yes. CoBank, as a government sponsored entity whose mission is to assist vital industries across rural America, offers a low cost of capital source of financing to refinance the maturing debt. In addition, the potential patronage refunds which I expect the Company to receive will further reduce the cost of this capital over the longer term. The additional borrowings also being financed will significantly reduce the Company's short term debt and provide the Company with financial flexibility to finance appropriate capital improvements as necessary to continue to provide safe, adequate and reliable water service to the Company's customers. The use of CoBank as a lender will reduce the Company's reliance its parent, Pennichuck, for financing for capital expenditures. The terms of the financing through CoBank are very favorable, and lower than the alternative financing options available to the Company to refinance existing debt.

Q. Mr. Goodhue, does this conclude your testimony?

A. Yes it does.