Docket No. DW 16-806
Pennichuck Water Works, Inc.
Request for Change in Rates

TAB 8

Testimony of Larry D. Goodhue

STATE OF NEW HAMPSHIRE

BEFORE THE

PUBLIC UTILITIES COMMISSION

Docket No. DW 16-806

Pennichuck Water Works, Inc.
Request for Change in Rates

DIRECT TESTIMONY OF LARRY D. GOODHUE

September 23, 2016

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I. INTRODUCTION

Q. Would you please state your name, address and position with Pennichuck Water Works, Inc.?

A. My name is Larry D. Goodhue. My business address is 25 Manchester Street, Merrimack, New Hampshire. I am the Chief Executive Officer of Pennichuck Water Works, Inc. ("PWW"). I am also the Chief Executive Officer of Pennichuck Corporation ("Pennichuck"), which is the corporate parent of PWW. I have been employed in the CEO capacity since November 6, 2015. Prior to serving as CEO, I served as Chief Financial Officer of Pennichuck and PWW. In addition to holding the CEO title for both PWW and Pennichuck, I have retained the title of CFO for both entities, as well as Treasurer for the two companies.

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. I am a licensed Certified Public Accountant in New Hampshire; my license is currently in an inactive status.

Q. Please describe your professional background.

A. Prior to joining Pennichuck, 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 with several private and publicly-traded companies.

Q. What are your responsibilities as Chief Executive Officer of Pennichuck?

A. As Chief Executive Officer, I am responsible for the overall management of Pennichuck and its subsidiaries, including PWW, and I report to the Board of Directors. I work with the Chief Operating Officer, the Corporate Controller, Assistant Treasurer, the Director of Human Resources and the Director of Information Technology to: (1) implement short and long-term financial and operating strategies, (2) insure the adequate funding of debt and expenses, and (3) enable Pennichuck's utility subsidiaries to provide high quality water service at affordable rates, on a consistent basis.

Q. Have you previously testified before this or any other regulatory commission or governmental authority?

A. Yes. I have submitted written testimony in the following dockets before the New Hampshire Public Utilities Commission (the "Commission"):

- Financings for Pennichuck East Utility – DW 13-017, DW 12-349, DW 13-125, DW 14-020, DW 14-321, DW 14-282, DW 14-191, DW 15-044, and DW 16-234;
- Financings for Pittsfield Aqueduct Company – DW 15-045 and DW 16-235;
- Financings for Pennichuck Water Works, Inc. – DW 14-021, DW 14-130, DW 15-046, DW 15-196, and DW 16-236.
- Permanent and Temporary Rate Increase Proceedings for: Pennichuck Water Works, Inc. – DW 13-130; Pennichuck East Utility, Inc. – DW 13-126; and Pittsfield Aqueduct Company, Inc. – DW 13-128.

II. PURPOSE OF THIS TESTIMONY

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to provide information supporting PWW's request for temporary and permanent rate relief, including: (1) relevant historical information regarding the City of Nashua's acquisition of Pennichuck in early 2012; (2) subsequent developments with respect to transformative changes in the capitalization of PWW as was presented to this Commission in more detail in two recent financing dockets, DW 14-130 and DW 15-196; (3) information concerning how the ratemaking structure set forth in the Settlement Agreement approved by this Commission in Order No. 25,292 in Docket No. DW 11-026 has been operating since the 2012 acquisition and within the context of subsequent PWW financing efforts; and (4) information supporting the rate relief requested by PWW and the specific modifications to PWW's current ratemaking structure and demonstrating that such requests are just, reasonable and in the public interest.

Q. Would you please identify the other witnesses in this case?

A. The other witnesses in this case, both of whom are providing written testimony in this proceeding, are Chief Operating Officer Donald Ware and Chief Engineer John Boisvert. Both of these individuals hold these roles for both PWW and Pennichuck, as well as the other subsidiaries of Pennichuck. Their testimonies will describe their qualifications, history and previous instances of testimony before the Commission.

III. HISTORY OF THE CITY OF NASHUA ACQUISITION

Q. Mr. Goodhue, before explaining the details of the proposed financings, would you please provide some history regarding the ownership of PWW and how that history supports PWW's request for approval of permanent and temporary rate relief?

A. Yes. Currently, PWW as a corporate entity is wholly-owned by Pennichuck, which is, in turn, a corporation that is wholly-owned by the City of Nashua, New Hampshire. The City of Nashua acquired its ownership of Pennichuck on January 25, 2012, pursuant to this Commission's Order No. 25,292 (November 23, 2011) (Approving Acquisition and Settlement Agreement). Prior to this acquisition by the City of Nashua, Pennichuck's shares were traded on the NASDAQ public stock exchange. For purposes of my testimony, I refer to the period prior to the City's acquisition as "pre-acquisition" and the period after as "post-acquistion."

Q. Did the City's acquisition affect the way in which PWW operates as a utility?

A. Yes. The change in the ultimate ownership of PWW's parent, Pennichuck, from a publicly-traded investor-owned utility to ownership by the City has had important consequences for the operation of PWW.

One of the most important consequences is that PWW, after the City's acquisition of Pennichuck, no longer has access to private equity markets as a method of financing its capital needs. As such, and as contemplated during the Commission's proceeding to approve the City's acquisition of Pennichuck in DW 11-026, after the acquisition, PWW expected to finance its on-going capital needs entirely through the issuance of debt.

Q. Does reliance solely on debt to finance PWW's operations have impacts on PWW's customers?

A. Yes. As contemplated during the acquisition proceedings, one positive result of this anticipated debt financing is that the weighted cost of PWW's capital structure is significantly lower than it was prior to the City's acquisition. This lower cost of capital has had and will continue to have direct benefits for PWW's customers. For example, in PWW's most recent rate case (DW 13-130); testimony in that case demonstrated that PWW's requested rate increase of 0.12% was significantly lower than the approximate 9.10% increase that would have been requested if PWW had continued to be owned by public company shareholders. (See Exhibit JLP-2, Testimony of John L. Patenaude in Docket No. DW 13-130.) The evidence provided by Mr. Patenaude in that case demonstrated that approximately half of the customer-favorable difference was due to lower operating costs, while the remainder was directly attributable to the lowering of PWW's effective weighted cost of capital. The lower cost of capital is a direct result of PWW's transition from a traditional investor-owned utility debt/equity capital structure to the new, primarily debt-financed capital structure. Under the Commission's final Order No. 25,693 in DW 13-130 (Order Approving Permanent Rates and Settlement Agreement), the actual impact on customer rates was a 0% increase, which was a direct result of this lower overall weighted cost of capital.

Q. Does reliance solely on debt to finance PWW's operations have consequences for PWW's rate setting methods and procedures?

A. Yes. As also contemplated in the acquisition Docket DW 11-026, the City's acquisition of Pennichuck and the resulting need to finance utility operations with debt has required modifications to PWW's (and Pennichuck's other utilities') ratemaking methods and procedures. As a result of its reliance on debt, PWW is much more dependent on the direct relationship of cash flow generated from rates, as it relates to the ongoing repayment of debt in support of ongoing capital investments. Under the previous ownership structure, the allowed return on public company equity, allowed for extra cash generated to cover the repayment of debt obligations, as well as adequate coverage of operating expenses and dividend obligations to shareholders. That ownership structure also allowed the Company to seek debt for infrastructure replacements that could have interest only repayment structures, with balloon maturities, that could either be refinanced at maturity or repaid by issuing more equity into the marketplace. Post-acquisition, the ability to raise additional equity to repay balloon maturity obligations is no longer available to PWW. These impacts were addressed directly in two post-acquisition financing dockets, DW 14-130 and DW 15-196. Pursuant to the financings and refinancings described in these dockets, PWW has taken very important steps in migrating its capital structure from a pre-acquisition "equity-based" model to the post-acquisition "debt-based" model.

The Commission's order approving the settlement agreement in the acquisition docket DW 11-026 expressly acknowledged this shift, as the Commission approved a "modified ratemaking structure" that had important differences from the traditional "equity-based" ratemaking method. This modified ratemaking structure recognized that for PWW in its post-acquisition periods it is much more important to set rates at levels that assure PWW's lenders that PWW will earn revenues sufficient to provide cash flow coverage for repayment of its debt obligations, and to satisfy on a continuing basis all associated debt covenant obligations associated with the debt used for infrastructure replacement and short-term working capital needs.

IV. OVERVIEW OF REQUESTS FOR RATE RELIEF AND MODIFICATIONS TO PWW'S RATEMAKING STRUCTURE

Q. Mr. Goodhue, before describing the details of the proposed request for permanent rate relief, could you provide an overview of the nature of the proposal?

A. Yes. The proposed rate relief proposal consists of two principal components. First, as set forth in our full rate filing materials which are described in more detail by Mr. Ware in his testimony, PWW is requesting a rate increase of 17.21%, bringing its allowed revenues to a level of $33,432,344, as shown at Tab 6 (see "Pro Forma Schedule 9 Combined") and as detailed at Tab 13 (see "Schedule A – Modified"). The second component of PWW's requested relief is its request, set forth in its Petition for Further Modifications in Ratemaking Structure, is to seek the Commission's approval of further modifications to the modified ratemaking structure previously adopted by this Commission in DW 11-026. As I will describe in more detail below, PWW is requesting the Commission to approve modifications to PWW's ratemaking structure that would allow PWW and its lenders to have reasonable expectations of future rates that are directly related in a common sense way to PWW's long-term, post-acquisition capital requirements that rely on debt. Essentially, these modifications expressly acknowledge that PWW's reliance on debt financing requires a ratemaking method that is based on a fixed multiple of the annual debt service on existing debt, with the balance of the allowed revenue requirement tied to coverage of prudent, normal and ongoing operating expenses.

Q. Mr. Goodhue, in practical terms, what would be the impact on the average residential monthly bill if all aspects of PWW's proposed rate relief were approved by the Commission?

A. The impact on the average residential monthly bill is shown in PWW's proposed customer notice filed as part of PWW's rate case filing. Assuming an annual water usage of 103 ccf (100 cubic feet), the average residential customer monthly bill under current rates, including the WICA surcharges is $50.13. Assuming approval of PWW's full request for rate relief, including both the proposed increase in base rates and the proposed step rate, the average residential customer monthly bill would increase to $57.16. This increase of $7.03 per monthly bill represents a 14.02% increase in total monthly bill. This 14.02% increase is less than the requested 17.21% increase notated in the schedules, as the current average monthly bill includes a surcharge for WICA, which represents the difference between these two percentages. The 17.21% requested overall rate increase is the increase between existing permanent rates, exclusive of the WICA surcharge, and the new overall requested permanent rates which do not include a WICA surcharges. As such, the actual economic impact on an average customer's bill, is the 14.02% increase above the $50.13 current bill including the WICA surcharges.

Q. Do you believe that the requested increase in PWW's rates is consistent with the history of the City of Nashua's acquisition of Pennichuck?

A. Yes. The increase being requested is consistent with the history of the City's acquisition of Pennichuck. In the forecasts underlying the settlement agreement and order approving the acquisition, it was assumed that PWW would realize rate increases over time of approximately 2.9% per year in order to fund projected increases in operating costs and debt repayment and procurement obligations. The increase being sought in this proceeding is consistent with these assumptions. PWW has not had any base rate increase since 2011. If PWW had experienced annual 2.9% rate increases over this period, the resulting rates would be near the level PWW is seeking in this proceeding. And as demonstrated in my testimony and the testimonies of Mr. Ware and Mr. Boisvert, the rate request takes into account the fact that certain operating expenses, specifically property taxes, have risen at a rate in excess of the average annual 3% increase assumed in the acquisition docket.

Q. And with respect to the second component of PWW's requested relief – the further modifications to the ratemaking methodology – do you believe that the modifications requested in PWW's petition are also consistent with the history of Nashua's acquisition of Pennichuck?

A. Yes. The City's acquisition resolved almost a decade of intense disputes between the City and the pre-acquisition management of Pennichuck, and was premised on the assumption that the City's ownership of the utilities would produce consistently lower rates for ratepayers, as compared to the previous investor-owned utility structure. This premise was based primarily on two top factors. First, a reduction in operating expenses attributable to the fact that Pennichuck would no longer be required to carry the management and administrative infrastructure required of publicly-traded companies. And second, the utilities, including PWW, would be transitioned from a traditional debt/equity capital structure subject to the traditional cost-of-service ratemaking model, to a debt capital structure that is more aligned with the ratemaking model typically applied to municipally-owned utilities. Accordingly, the modified ratemaking structure approved in DW 11-026 included a special requirement to allow the utilities to collect revenues sufficient to cover the City's obligations on the bonds it issued to accomplish the acquisition (the "CBFRR") and dispensed with the traditional idea that the City should be allowed to collect an "equity-based" rate of return on its investment in the utilities. Because the City only sought revenues sufficient to assure itself, its lenders and its rating agencies that it would meet its debt obligations and enable the utilities to continue to provide excellent and safe water service at affordable prices, the resulting rates were projected to be lower than if the City had sought a "profit" on its investment. This dynamic is much more aligned with the typical municipal utility model. The modifications requested by PWW's petition are absolutely consistent with this trend and reality. The resulting modified ratemaking methodology is required to properly, adequately and timely provide PWW with the necessary cash flows to fund all operating and debt service obligations, and to allow PWW to access lending markets in the future to meet its needs at reasonable costs.

Q. Are the requests for permanent rate relief and rate-making methodology modifications consistent with the 2014 and 2015 financing proceedings?

A. Again, my answer is "yes." The 2014 and 2015 capital financings were expressly constructed with the purpose of transitioning PWW's capital structure from a pre-acquisition "debt-equity" mix to one that is aligned with PWW's ownership by the City. These approved financings, now successfully completed, have allowed PWW (1) to issue debt with covenants that are better aligned with post-acquisition realities, (2) to replace bonds that were subject to "balloon" payments at maturity with bonds that are fully amortizing with terms that are consistent with the long-term nature of PWW's asset base, and (3) to take advantage of historically favorable interest rates, thereby mitigating risks that PWW would be forced to enter debt markets in the future when interest rates might be higher. These financings received favorable credit rating agency reviews, as Moody's has upgraded PWW's rating to Ba2, and Standard and Poors has improved PWW's rating twice to its current rating of "A+" with a stable outlook. The overall impact of these two capital markets efforts has been a decrease in PWW's weighted average cost of capital from 5.94% to 4.83%. It was my experience that the modified ratemaking method approved by the Commission in DW 11-026, especially the commitment to meet debt service obligations embodied in that method, provided comfort to possible borrowers and the rating agencies, which allowed PWW to access capital markets at lower costs. PWW's request for further modifications to its ratemaking methodology are based on knowledge acquired during these financings, and are consistent with post-acquisition ownership and requirements.

Q. Mr. Goodhue, why is PWW only now requesting these further modifications when it could have requested them in the original acquisition docket?

A. There are three principal reasons why PWW is requesting the Commission to approve the modifications to the ratemaking method now. First, as the Commission is aware, the settlement agreement approved in DW 11-026 provided that all three Pennichuck utilities would file their first full rate cases simultaneously not later than June 1, 2013. The purpose for this filing requirement was to allow all parties to develop experience and operating history under the new ownership structure. PWW, along with its sister utilities, filed its first rate case consistent with this requirement. However, at this relatively early time, PWW had not yet acquired direct experience with the capital markets with respect to its unique ownership structure. Second, PWW has indeed now acquired that experience as it has completed two significant financings that has allowed PWW to obtain direct input and insights into how capital markets will respond to its ownership structure. Third, PWW has now acquired actual experience with respect to the operation of the current ratemaking method and has been able to observe and test its benefits, and its potential deficiencies.

Q. Mr. Goodhue, has PWW sought the assistance of any investment advisor in connection with the development of the proposed rate relief and ratemaking methodology modifications?

A. Yes. PWW has consulted with representatives of TD Securities (USA) LLC in assessing the current and long term benefits of the proposed modified rate-making structure. TD Securities (USA) LLC served as the underwriter in connection with the issuance of tax-exempt bonds through the New Hampshire Business Finance Authority for the two recent financings. In discussions with TD Securities (USA) LLC, PWW has received favorable indications of the benefits of the proposed modifications to PWW's ratemaking method with respect to PWW's projected capability to access low cost, long term, financing for ongoing capital improvements and infrastructure replacement.

V. SUMMARY OF PROPOSED RATE RELIEF AND IDENTIFICATION OF PROPOSED MODIFICATIONS TO PWW'S RATEMAKING STRUCTURE

Q. Mr. Goodhue, would you please briefly describe the rate relief requested in this proceeding by PWW?

A. Yes. As summarized above, with the filing of its full rate case documents as required by the Commission's administrative rules, PWW is requesting the Commission to approve, pursuant to its general permanent rate-setting authority, a rate increase of 17.21%, bringing its allowed revenues to a projected level of $33,432,344, as delineated in PWW's rate case filing at Tab 6 (see "Pro Forma Schedule 9 Combined") and at Tab 13 (see "Schedule A – Modified").

Q. Would you briefly describe the basis for this requested rate relief?

A. The fundamental basis for this request is that it represents the revenues required to cover PWW's current operating expenses and to meet the demonstrated costs of servicing PWW's direct debt obligations plus its share of the CBFRR. PWW has prepared its ratemaking schedules to demonstrate this fundamental basis.

Q. Is the rate increase the only relief that PWW is seeking in this proceeding?

A. No. As described above, PWW is also requesting that the Commission approve, pursuant to its general ratemaking authority, further modifications to the ratemaking structure for PWW. PWW has filed its Petition for Further Modifications to Ratemaking Structure to effect this request in a formal manner. As described below, in order to provide a clear factual basis for the Commission's review of the proposed modifications, PWW has prepared its ratemaking schedules to reflect not only the operation of the current ratemaking method as established by the Commission in DW 11-026, but also operation of the modifications requested by PWW in its Petition. The rate increase being requested by PWW in this case is based on the modified methods reflected in the ratemaking schedules.

Q. Why is PWW filing a rate case at this time?

A. PWW is filing a rate case at this time for a number of reasons. First, PWW has invested approximately $40 million in capital improvements and infrastructure replacements since the beginning of 2013, for which debt was raised in 2014, 2015 and 2016, and the current rates do not include the necessary dollars in the existing revenue requirement to fund the repayment of those debt instruments. Second, operating expenses of the Company have increased due to inflation since the last filed permanent rate filing, and in some cases, well ahead of inflationary levels. Third, PWW has completed the refinancing activities discussed earlier in this testimony, converting all of its tax-exempt balloon maturity debt to fully-amortizing debt, with annual principal repayment obligations along with semi-annual interest repayment obligations. This requires the Company to seek a revenue requirement level adequate to fund the repayment of the principal and interest on these obligations, at a rate that is in excess of the cash flow traditionally created by a return on rate base and depreciation expense associated with that rate base. PWW's current aggregate depreciation lives are approximately 42 years, with some assets having lives as long as 80 years, whereas the maximum life of issued debt available to PWW is 30 years, with some instruments having repayment lives of 20-25 years. Overall, the rate case being pursued at this time is necessary to provide for the ongoing cash flow needs to fund ongoing operating expenses and fund the repayment of debt obligations, as available to the Company in support of its ongoing obligations to its ratepayers.

Q. Please discuss the format of the ratemaking schedules filed by PWW upon which the requested rate relief is based.

A. PWW's requested rate relief is based on the modified ratemaking structure set forth in its filed ratemaking schedules. As further described in the testimony of Mr. Ware, these schedules embody financial information and resulting rates attributable to three distinct scenarios: (1) application of the modified ratemaking structure approved by this Commission in DW 11-026; (2) application of this modified ratemaking structure including the modifications requested by PWW's Petition; and (3) application of ratemaking models assuming that PWW were still an investor-owned utility. PWW's requested rate relief is based upon the modified ratemaking structure including the modifications requested by PWW's Petition.

Q. Please identify the specific modifications to its ratemaking structure requested by PWW in this proceeding.

A. PWW's Petition requests the following modifications to the existing modified ratemaking structure approved for PWW:

(1) Using a 5-year trailing average of revenues versus a test year revenue level, as the revenue level to be used as the basis for the calculation of requested rate

increases. Associated direct operating costs, such as purchased water, power, and purification chemical costs are also adjusted to the 5-year trailing average.

(2) Enhancing the current CBFRR component of the allowed revenue requirement, to include an amount for the repayment of the City's eminent domain expenses, as allowed for in the Acquisition Order No. 25,292, but which did not include an allowance in the current rate structure to fund this payment. The effect of this modification is identified in the schedules discussed in Mr. Ware's testimony.

(3) Creating an enhanced fixed revenue component for the coverage of annual debt service beyond the CBFRR amount identified in the current modified ratemaking methodology. (I refer to this fixed revenue component as the "Debt Service Revenue Requirement" or "DSRR.") PWW's proposal is that this component include a multiple, so that it would equal the test period principal and interest obligations for PWW's debt, multiplied by 1.25. This multiple request is designed to achieve two objectives: (a) to allow the collection of revenues sufficient to satisfy the debt service coverage ratio requirements of PWW's bond financings and Pennichuck's covenant requirements of its line of credit, which is used by Pennichuck and all of its subsidiaries as a "back stop" to short-term working capital needs; and (b) to allow PWW to collect revenues over and above actual debt service costs similar to a municipal utility which will allow PWW to comply with cash flow coverage requirements typical for such borrowings and to meet obligations on new debt incurred between permanent rate case filings.

(4) Creating a Debt Service Rate Stabilization Fund. (I refer to this proposed fund as a "DSRSF.") This fund would be analogous to PWW's existing Rate Stabilization Fund ("RSF"), established as part of the modified ratemaking structure in DW 11-026 in order to provide rate stabilization and cash flow coverage for the CBFRR between permanent rate filings.

(5) Establishing that the remaining amount of the allowed revenue requirement would be based on the test period pro-formed operating expenses, using the 5-year trailing average for direct operating expense highlighted in paragraph (1) above.

(6) Creating an Operating Expense Stabilization Fund. (I refer to this proposed fund as an "OESF.") Similar to the DSRSF, this fund would be analogous to PWW's existing RSF. It would serve to provide rate stabilization and cash flow coverage for operating expenses between permanent rate filings.

(7) Establishing that the initial funding for the DSRSF and the OESF would be accomplished by dividing the current RSF into the three funds, each of which could be accessed and replenished, or refunded to customers, through rates pursuant to rules similar to those currently governing the RSF.

(8) Imposing a mandatory requirement that PWW file a full rate case every three years. This filing requirement will ensure that PWW must present its operations to this Commission on a consistent and regular basis to review the actual operations of the modified ratemaking structure and to "true-up" the stabilization funds.

(9) Establishing an enhanced "Step Increase Program" in place of PWW's existing WICA pilot program. In contrast to the WICA program, which includes interim rate relief tied to the replacement of mains, services, hydrants and gate valves, the proposed Step Increase Program would be tied to financings that have been approved by this Commission, the proceeds of which are used for PWW's entire infrastructure. This request is supported by the fact that, under the post-acquisition ownership structure, all funds for capital investments must be obtained through borrowings, and not through equity. PWW's proposal would allow a Step Increase to be implemented only upon filing with the Commission of an annual verification of capital assets placed in service.

Q. Mr. Goodhue, are these elements of PWW's requested modifications mutually exclusive, or are they related so that if the Commission were to approve one modification, others might be adjusted?

A. Most of the elements are "stand-alone" proposals, and PWW's ratemaking schedules reflect the effect on rates assuming that each element is approved. However, there is a relationship between the proposals for establishment of a Debt Service Reserve Requirement and a Step Increase Program. If the Commission were to authorize the Step Increase Program, the size of the multiple required for the DSRR could be reduced somewhat. This is because both the DSRR and the Step Increase Program are targeted to help PWW continue to satisfy debt covenant requirements typical for municipal utilities, and the ability to implement interim Step Increases upon completion of approved borrowings and infrastructure investments would reduce the need for permanent rates to include a 1.1 multiple component.

Q. Mr. Goodhue, do you believe the proposed modifications to PWW's ratemaking structure will better support PWW's ability to access credit markets to borrow funds to support future infrastructure requirements?

A. Yes. In discussions about these modifications with the PWW's existing investment bankers, we have come to the conclusion that these modifications would increase PWW's access to the credit markets, and most likely at an enhanced credit rating, giving the Company access to lower cost debt, to the benefit of its customers. As discussed earlier in my testimony, PWW has already experience two enhancements to its credit rating, based upon the debt refinancing it completed in 2014 and 2015, removing the "balloon" maturity debt obligations from its debt portfolio, and replacing those with fully amortizing debt instruments. This created an earned benefit to customers in the form of a lower overall weighted cost of capital since PWW's last rate case filing. The modifications being sought will bring more certainty to the credit markets about PWW's ability to fund its cash flow needs in the repayment of issued debt, and the creation of the Step Increase methodology requested will further enhance its credit position in the markets, as investors and the rating agencies will be assured of allowed revenues sufficient to fund the incremental debt service obligations of additionally procured debt over time.

Q. Mr. Goodhue, how do the rates resulting from applying these proposed modifications to PWW's ratemaking structure compare to the rates that would

result from application of the existing modified ratemaking structure approved by the Commission in DW 11-026?

A. As indicated on Exhibit DLW-1 (Customer Impact), the projected aggregate revenues estimated to be allowed under the current modified ratemaking methodology would be $32,~~656,581~~682,223, a percentage increase over the test period revenues of 1~~2.92~~3.01%. In contrast, as shown on the same Exhibit, the projected aggregate revenues estimated to be allowed when the proposed modifications are applied (including proposed step increases attributable to 2016 additions) would be $33,432,344, a percentage increase over the test period revenues of 17.21%.

Q. How do the rates resulting from applying these proposed modifications to PWW's ratemaking structure compare to the rates that would have resulted assuming that PWW had remained an investor-owned utility, as it was pre-acquisition?

A. As indicated on Exhibit DLW-1 (Customer Impact), based on the assumptions stated in that exhibit, the projected aggregate revenues estimated to be required for a pre-acquisition investor-owned utility would be $38,034,512, a percentage increase over the test period revenues of 31.52%. Accordingly, the rate increase that results under the post-acquisition ownership structure is materially lower than the pre-acquisition ownership structure.

Q. Mr. Goodhue, can you provide a projection of how PWW's rates would increase under the proposed modified ratemaking methodology in the future?

A. Yes. Based upon modeling that was performed in support of the 2015 Bond Financing completed by PWW, PWW anticipates that PWW's rates would increase over time at a rate of approximately 2.9-3.5% per annum, based upon an annual capital project investment of approximately $8-10 million per annum (which will increase over time from inflationary impacts on project costs), all of which would be funded by future debt issuances. This assumes an interest rate environment that remains fairly stable and consistent with current market rates. An interest rate market that increases significantly over current levels will have an elevated impact on the cost of debt to finance the Company's ongoing investment in infrastructure, but all expectations it would still be well below the 15.9% pre-tax return on equity generated from a traditionally-structured, investor-owned, 50/50 debt/equity regulated utility (based upon current levels evidenced in recent rate filings in the State where a 9.6% post-tax ROE is included in rates).

Q. How would these projected resulting rates compare to the rates that would likely have resulted under private ownership?

A. Based upon data calculated with both the 2012 test year rate filing, and this petition, PWW expects that future rate increases would result in increases approximately 2-3% per annum higher under the pre-acquisition private ownership structure, due to $4-5 million per annum of the capital improvements funded with equity having a pre-tax cost of 15.9%, instead of funding with debt at a cost of 4.5%, assuming a 50/50 debt/equity ratio. As such, instead of rate increases at approximately 2.9-3.5% per annum under PWW's post-acquisition ratemaking structure, including the modifications proposed in this proceeding, PWW would anticipate increases in support of ongoing infrastructure investment under that debt/equity ownership model would be more in the 5-7% per annum range.

Q. Has PWW prepared a cost of capital study in connection with this filing?

A. No. PWW is not seeking any change in rate design in this proceeding. There have not been any significant changes in the composition of PWW's customer base, and therefore PWW does not believe that a Cost of Service Study is required.

Q. Will PWW be seeking a temporary rate increase?

A. Yes. PWW will be seeking a temporary rate increase equivalent to 80% of the permanent rate increase being sought, exclusive of the Step Increase being sought for 2016 investments in capital assets. The basis for the temporary rate request is described in separate testimony to be offered jointly by Mr. Ware and me that supports PWW's Petition for Temporary Rates.

Q. Please describe PWW's efforts to communicate with the City of Nashua, other affected communities and customers relative to this filing.

A. PWW met with the officials of the City of Nashua prior to its filing of its Notice of Intent to File a Rate Case ("NOI"), and informed them of the Company's intentions to seek rate relief and modifications to the current ratemaking methodology. Additionally, upon filing the NOI, PWW communicated in writing with officials of all communities served by PWW. These communications included representatives of the City of Nashua government, officials of the other ten communities served by PWW, and State Senators and State Representatives who represent any of the eleven communities served by PWW.

VI. FURTHER COMMENTS IN SUPPORT OF THE PROPOSED MODIFICATIONS TO PWW'S CURRENT RATEMAKING METHOD

Q. Mr. Goodhue, do you have any further comments regarding the specific modifications identified above?

A. Yes.

Q. Would you please offer further comments regarding the first proposed modification, the establishment of a 5-year trailing average for the test period?

A. Yes. As described above, PWW is requesting the approval of a method that is more aligned with a typical municipal utility that finances all capital investments with debt. In such a case, the critical inquiry for rates is cash flow available to service prudent operating expenses and debt service. Adoption of a 5-year trailing average approach to establishing test period information allows for a more "normalized" approach, and minimizes the effect of unusual performance in a single year from abnormally dry or wet weather. PWW can have swings as large as $1.2-1.5 million in its annual revenues between wet and dry years, in spite of the fact that it is funded by a weighted average cost of capital that is nearly 100% debt, with fixed costs of repayment. Moving to this "normalized" basis will allow for more rate stability and predictability, which will enhance PWW's credit status, to the ultimate benefit of PWW's ratepayers. Under the current structure, PWW can generate extra revenues in a dry year, but fall below its cash flow needs within the next year, due to a negative swing in revenues, and not have the ability to recover this shortfall in a rate filing in a manner expeditious enough to satisfy its fixed debt payment obligations in the succeeding year.

Q. Mr. Goodhue, do you have further comments regarding PWW's proposed modification regarding the addition of a small component to the CBFRR to allow PWW to distribute limited monies to the City with respect to its prior eminent domain costs?

A. Yes. PWW is seeking this enhancement to the allowed CBFRR portion in order to facilitate funding of PWW's portion of an annual distribution to the City of Nashua of up to $500,000 to reimburse the City for its prior eminent domain costs. In the acquisition docket, DW 11-026, the Commission authorized payment of this annual amount, but not to exceed an aggregate of $5.5 million, but did not authorize PWW (or any of its sister utilities) to collect revenues to fund such payments. As demonstrated in PWW's ratemaking schedules filed in this proceeding, PWW is seeking revenues of $440,620 as PWW's pro-rata share of this $500,000 annual amount, based upon PWW's current pro-rata share of the allowed CBFRR revenues, for a period of 10 years. PWW requests the establishment of a deferred asset in the amount of $4,406,200 for this purpose, which will be amortized thru revenues over the 10-year allowed time frame. After the 10-year period has expired, this enhancement to the CBFRR will be eliminated. Based on the performance of the post-acquisition PWW, including its successful issuance of debt at favorable interest rates that will, along with the City's acquisition debt, provide PWW customers with materially lower rates than if the City had not acquired PWW, PWW believes that its request for this enhancement is an appropriately incurred cost that has been demonstrated to provide a benefit to all of PWW's customers. PWW believes that the inclusion of this amount is therefore prudent.

Q. Do you have further comments in support of PWW's proposed modification for the establishment of a Debt Service Reserve Requirement and the creation of a Debt Service Reserve Fund analogous to the current RSF?

A. Yes. Because PWW now is funding its capital investments with debt, it no longer has a return on rate base and an effective return on equity. Even though the Commission's Order No. 25,292 in DW 11-026 included provisions for a stated return on equity, the amount of equity that this return is earned on is minimal in amount, based upon the fact that 100% of earned profits are required to be paid up to Pennichuck, and then to the City, as CBFRR revenues on an annual basis. As such, PWW is left with a return on rate base based upon depreciation lives as the source of cash flow to repay principal on debt, which is insufficient to meet those cash flow requirements. The average life of PWW's fixes assets is approximately 42 years, with many assets having an 80-year life (as in the case of water mains). This depreciation as a source of cash flow to pay principal on debt is far less than the principal payment requirements on debt available to PWW, typically having terms of 20 to 30 years.

PWW's proposed enhancement to establish a DSRR tied to the total debt service during the test period for each successive rate case, beginning with this proceeding, with a proposed coverage ratio 1.25 times total debt service would serve to mitigate this deficiency. PWW believes that collecting this DSRR amount is just and reasonable in the unique circumstances of its post-acquisition ownership structure. It would allow for the collection of a fixed revenue level sufficient to provide sufficient cash flows for incurred debt, as well as coverage for additional debt incurred between rate cases to fund the replacement of aging infrastructure on an ongoing basis. The 1.25x coverage ratio is needed to provide security against revenue anomalies due to weather-related fluctuations, as well as provide an amount of cash to fund the incremental cost of debt service incurred between rate cases for this infrastructure replacement.

Similarly, PWW's proposal to create a DSRSF tied to the DSRR that would operate similarly to the RSF with respect to the CBFRR would provide further stabilization of revenues between rate cases. This stability will send a signal to credit markets that PWW will be a sound borrower and will result in more cost effective future borrowings. Under PWW's ratemaking method, these lower borrowing costs will serve to benefit its customers.

Q. Mr. Goodhue, do you have further comments supporting PWW's proposed creation of an Operating Expense Rate Stabilization Fund?

A. Yes. Under PWW's ratemaking structure with the proposed modifications, after the fixed revenues of the CBFRR and proposed DSRR are calculated, the remaining revenues are tied to operating expenses of the Company, exclusive of depreciation expenses and interest expense, as those would be covered by the DSRR revenues under the proposal. The OESRF would operate as an impress fund from which funds could be drawn upon or deposited into on a monthly basis, based upon anomalies in operating expenses and revenue fluctuations above or below allowed levels, in the same manner that the current Rate Stabilization Fund works under PWW's current approved ratemaking structure. Just as in the cases of the RSF and the DSRSF, the establishment of this reserve fund tied to this component of the overall allowed revenues would further seek to stabilize revenue levels between rate cases, and bring more rate stability to bear, to the benefit of PWW's ratepayers.

Q. Mr. Goodhue, do you have further comments supporting PWW's proposal to establish a mandatory requirement for a rate case every three years?

A. Yes. PWW believes this requirement will enhance its ability to provide assurances to both potential borrowers and to customers that its revenues will be subject to regular, stable and consistent review by an independent third party with regulatory expertise. This stable independent oversight was viewed by our advisors and rating agencies as a benefit, which ultimately would benefit ratepayers through lower borrowing costs.

Q. Do you have further comments supporting the proposed establishment of a Step Increase Program?

A. Yes. As discussed earlier in my testimony, this proposal may be viewed as an expansion of the existing WICA pilot program. The allowance of an annual step rate increase between rate cases, upon verification of capital investments under approved financings would provide further stability in the eyes of potential lenders, while mitigating customer surprise at larger rate increases that occur only at full rate cases. As noted earlier, implementation of this Step Increase Program would allow a lower DSRR multiplier (from 1.25 to 1.1). PWW believes that the Step Increase Program would be preferable to a 1.25 DSRR because it would allow for more regular and consistent rate increases over time and avoid the need for larger "shocks" to rates only at the time of full rate cases. Additionally, the Step Increase Program would accomplish a better synergy of rate increases for debt incurred at the time assets are placed in service, and be better aligned with the right generational equity for ratepayers.

Q. Mr. Goodhue, do you have any further comments regarding how PWW would propose to fund initially the DSRSF and the OERSF?

A. Yes. As stated earlier, PWW proposes to fund the establishment of the DSRSF and the OERSF by dividing the existing RSF into the three funds. These funds would all be drawn upon or overfilled based upon actual revenue and expense performance in the years between rate cases, with the ability to refill deficits or refund excess amounts in the funds at the next rate case, over the succeeding three years, consistent with the existing rules governing the RSF. PWW had determined that, based on the requested revenues in this proceeding, and the relative sizes of the CBFRR, DSRR and the OERR, the DSRSF should be established initially at an imprest level of $700,000, the OERSF at an imprest level of $1,600,000, with the remaining $2,700,000 remaining in the RSF for usage by PWW, and its sister utilities Pennichuck East Utility, Inc. and Pittsfield Aqueduct Company, Inc. in accordance with existing rules approved for the RSF in DW 11-026.

VII. REQUIRED APPROVALS AND CONSENTS

Q. Would you please identify any approvals and consents required to effect the rate relief and proposed modifications to PWW's ratemaking structure?

A. The principal approval required to effect the requested permanent rate relief and proposed modifications is the approval of this Commission under RSA 378:7 and :28. The requested rate relief and proposed modifications have already been approved by PWW's and Pennichuck's Board of Directors.

VIII. JUST AND REASONABLE FINDING AND CONCLUSION

Q. Mr. Goodhue, do you believe that PWW's proposed rate relief and modifications to the ratemaking structure established in DW 11-026 will result in just and reasonable rates?

A. Yes. I believe the requested rates and the proposed modifications are just and reasonable for several reasons.

First, the requested rates, including the effects of the proposed modifications to PWW's ratemaking structure, are generally consistent with the long-term projections presented in DW 11-026, which assumed an average annual increase in rates of approximately 3% and with the fundamental premises underlying the Commission's approval of the City of Nashua's acquisition of Pennichuck and its utilities. While the rate increase requested in this proceeding, which reflects the cumulative revenue and operating requirements of over six years with no permanent rate relief, is significant, when the cumulative increase is examined as an average annual increase, it is generally consistent with the original assumptions of the acquisition docket.

Second, the requested rates continue to be materially lower than the levels that are reasonably projected to result from continued private investor ownership under the pre-acquisition structure. This benefit to ratepayers, which was one of the principal reasons for the approval of the City's acquisition, is due in large part to the fact that PWW is migrating to a utility that will finance all of its material capital needs by the issuance of debt, which results in a materially lower weighted cost of capital than a private investor-owned utility with a more traditional debt and equity capitalization.

Third, the requested rates are necessary to maintain PWW's ability to continue to provide safe and high quality water service, by financing continued reasonable and prudent operations and by having access to borrowed funds necessary to finance required capital assets and infrastructure.

Fourth, the requested modifications to PWW's current ratemaking structure are the result of a careful examination of the experience obtained through the prior two major debt financings. This experience has allowed PWW to develop the specific modifications proposed in PWW's petition and further to have confidence that these modifications will enhance PWW's ability to access debt markets in the future at affordable interest rates and at reasonable covenants. In some ways, this experience was an important prerequisite to developing the specific proposed enhancements, which is why PWW is only now proposing them.

Fifth, based on the ratemaking schedules filed by PWW as part of this rate case, the requested rates will demonstrably enable PWW to generate sufficient cash flows to support its ongoing operational and capital needs.

Q. Mr. Goodhue, do you believe that the requested rate relief and adoption of the proposed modifications are required to ensure that PWW continues to be able to provide safe and high quality water service to its customers?

A. Yes. PWW's current ratemaking structure only provides a fixed coverage component in the revenue requirement for the repayment of principal and interest to the City of Nashua under the CBFRR. Without an equity return allowable to the Company, PWW does not have a rate structure that insures adequate cash flow coverage to cover all of its remaining operating expenses and the repayment of principal and interest on the balance of its debt obligations. This is further exacerbated by the fact that the cash flow generated from depreciation under the return on rate base is funded by assets with an average composite life of approximately 42 years, with some assets at 80 year lives. This cash flow is what is intended to provide the cash flow to repay the principal on debt used to fund the investment in rate base. However, the maximum life of debt available to PWW is 30 years, with some instruments requiring repayment in 20 years. As such, the cash flow from depreciation is not sufficient to cover the principal repayment cash flow requirements. Additionally, without the free cash flow generated by a return on equity, when PWW experiences reductions in revenue related to a wet year and a related reduction in outside irrigation, revenues are not sufficient to meet the fixed operating expenses of the Company. The completion of the 2014 and 2015 refinancings, to the long term benefit of ratepayers, coupled with the increase of operating expenses due to normal inflationary pressures, as well as increases above inflationary levels for certain expense items (i.e., State and local property taxes), has created a mismatch between the cash flow generated from a normal allowed rate of return and depreciation expense on rate base, to the coverage of the cash flow requirements of PWW's principal and interest payments and normal operating expenses. This inherent mismatch which exists for PWW under the existing ratemaking structure (as a nearly 100% debt financed entity), coupled with the regulatory lag of obtaining rate relief 12-18 months after a given test year, has created and will continue to result in the revenues allowed from traditional ratemaking being insufficient in generating the necessary operating cash flows required to cover all of the Company's operating expense and debt service needs, now and into the future. The requested rate relief and proposed modifications to PWW's ratemaking structure are precisely targeted to correct these deficiencies.

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

A. Yes, it does.