STATE OF NEW HAMPSHIRE

BEFORE THE

PUBLIC UTILITIES COMMISSION

Petition of Pennichuck East Utility, Inc. for Approval of Financings From CoBank, ACB For Regulatory Compliance, Maintenance and Non-Recurring Projects And Refinancing of Intercompany Loans

DW 17-___

DIRECT PREFILED TESTIMONY OF LARRY D. GOODHUE

October 19, 2017

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 Executive Officer Pennichuck East Utility, Inc. (the "Company" or "PEU"). I have been employed with the Company since December, 2006. I also serve as Chief Executive Officer, Chief Financial Officer, and Treasurer 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 Executive Officer of the Company, and Chief Executive Officer, Chief Financial Officer and Treasurer of Pennichuck?

A. Including my primary responsibilities as Chief Executive Officer, with ultimate responsibility for all aspects 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 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 two new debt financings: (1) a term loan for up to $0.5 million from CoBank, ACB ("CoBank") to fund 2017 capital projects not funded by SRF loans, and (2) a 3-year $3.0 million Fixed Asset Line of Credit ("FALOC") from CoBank to provide for short-term financing of capital projects, which on an annual basis will be paid off and converted to long term debt in support of the QCPAC process currently being sought in the modified rate structure included in the Company's rate case under DW 17-128. The $3.0 million FALOC will become available as a facility, as of January 1, 2018. In addition, the Company proposes the refinance of two intercompany loans currently in existence between PEU and its parent, Pennichuck Corporation. This refinance is to be conducted on the outstanding balances on the loans as of 12/31/2016, in conformity with the amounts documented for this refinancing in PEU's rate case under DW 17-128. The Company proposes the refinance of the full remaining balance of the 2015 Intercompany loan, which had an original balance of $1,000,000 at 2.7% interest over ten years, and an outstanding balance as of 12/31/2016 of $843,884. *See* Docket DW 14-282. Additionally, the Company seeks to refinance of the PEU Capex portion of the 2013 Intercompany loan, which had an original balance of $3,000,000 at 2.65% interest over ten years, for which $1,723,150 was in support of the North Country Surcharge Capex, and $1,276,850 was for PEU Capex. *See* Docket DW 13-017. The remaining balance of the PEU Capex portion of the 2013 Intercompany loan as of 12/31/2016 was $857,632. These two amounts are proposed to be refinanced for 30 years at an interest rate of 3.2%, on a fully amortizing basis.

Q. Did you supervise the preparation of the Company's petition for authority to issue long term debt?

A. Yes.

Q. Does the Company have on file with the Commission a certification statement in its Annual Report with respect to its book, papers and records?

A. Yes.

Q. Please explain the purpose of the proposed CoBank term loan financing.

A. During 2017, approximately $368,844 of capital improvements have or will be made by PEU for a number of specific projects, routine maintenance capital projects, and other non-recurring capital expenditures that did not qualify for SRF funding. An overview of these projects is further described in the testimony of the Company's Chief Engineer, John Boisvert, included with the Company's filing, which provides the details regarding the scope and need for these completed and/or planned projects. The financing with CoBank is needed to fund projects planned for completion during 2017. Although the current estimated cost of capital improvements planned for completion in 2017 is approximately $368,844, the Company is seeking a $0.5 million approval on this petition to allow for any unforeseen significant capital projects that may occur due to a failure of equipment or infrastructure in the last months of the year. To the extent less than $0.5 million of projects are completed as of the end of 2017, which were not funded by previously approved SRF loans, that amount actually drawn on this loan will be reduced to that lower sum.

Q. Please describe CoBank and its relationship with the Company.

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 entered into a Master Loan Agreement with CoBank effective 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 No. DW 09-134. In March 2010, the Company utilized CoBank to replace $4.5 million of maturing debt and to establish a $1.5 million revolving line of credit pursuant to Order No. 25,041 in Docket No. DW 09-134. The $1.5 million revolving line of credit expired in March 2012. Additionally, in May, 2013, the Company entered into two new loans with CoBank, in the amount of $925,000 and $1,723,150, for terms of 20 years and 10 years, respectively, pursuant to Order No. 25,480 in Docket No. DW 13-017. Also, the Company entered into a new loan with CoBank in March 2015, in the amount of $625,000, for a term of 25 years, pursuant to

Order No. 25-746 in Docket No. DW 14-282, and another loan with CoBank for $2.2 million for a term of 25 years, pursuant to Order No. 25,890 in Docket No. DW 16-234. 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 businesses like the Company that meet its charter requirements. As a result of the implicit backing of the US Government, CoBank's borrowing costs are less than commercial banks and financial institutions and the 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 term loan 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 up to a $500,000 term loan with a 25-year amortization, with level monthly principal and interest payments with an interest rate to be determined based on market conditions (currently estimated at 3.25% per annum). The proceeds from this new CoBank loan will be used to finance 2017 capital expenditures not funded by SRF loans. The new CoBank loan will provide permanent financing for the long-lived assets. The new CoBank loan will be secured by (i) a security interest in the Company's equity interest in CoBank (consisting of the Company's $104,140.79 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 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 No. DW 09-134. The Company's equity investment in CoBank consists of an initial $1,000 investment pursuant to the Master Loan Agreement cited earlier, as well as the accumulation of the equity portion of the annual patronage earned by the Company, associated with its existing debt obligations with CoBank.

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, as well as the aggregate $2,648,150 financed in 2013 and $625,000 financed in 2015, is as follows:

- 2010 earned patronage of $37,355,
- 2011 earned patronage of $43,108,
- 2012 earned patronage of $41,482,
- 2013 earned patronage of $57,351,
- 2014 earned patronage of $63,638,
- 2015 earned patronage of $66,012, and
- 2016 earned patronage of $ 71,432.

In general, CoBank's annual patronage has been 1% of the one year average daily loan balance, paid to the Company in March of the following year (i.e. patronage earned in calendar year 2016 was paid to the Company in March 2017). The 1% is distributed as a mix of cash and equity stock in CoBank; for the years 2010 and 2011, the mix of cash and equity was 35% and 65%, whereas for the years 2012 thru 2016 the mix of cash and equity was 75% and 25%. The amount of patronage, as well as the mix of cash and equity distribution of the patronage earned for 2017, has not yet been determined and/or received. 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. **Are there any other benefits attributed to this term loan that will be beneficial to the Company or its customers?**

A. Yes. In addition to securing a term sheet for this loan from CoBank, they have agreed to reduce the Debt Service Coverage ratio requirement from 1.25x to 1.1x, effective on all of the Company's outstanding loans with CoBank. This would bring that covenant in conformity with the DSRR 1.0 and DSRR 0.1 revenue components being requested in PEU's rate case filing, Docket DW 17- 128.

Q. What are the basic terms of the FALOC?

A. The FALOC has a term of up to 3 years, for which the Company can borrow funds for projects during the year. Funds may be borrowed and repaid under this facility at any time during the term. As the FALOC is being entered into mid-year as it relates to CoBank's normal financing year, which ends on September 30 of each calendar year, the initial term of this facility is set to expire on September 30, 2020. The interest rate on the FALOC will be set on a weekly basis throughout the term of the facility, with monthly interest payments at an interest rate to be determined based on market conditions (currently estimated at 3.25% per annum). Although this facility does not have an annual "clean-out" provision required by the Bank, the Company intends to repay it in its entirety once a year, by converting the balance to term loans tied to annual used and useful projects completed in each calendar year. Like the new CoBank term loan, this facility will be secured by (i) a security interest in the Company's equity interest in CoBank, and (ii) the unconditional guarantee of the Company's obligations to CoBank by Pennichuck pursuant to the Guarantee of Payment, 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 No. DW 09-134.

Q, What is the basis and need for the FALOC with CoBank?

A. Under the modified rate methodology being requested under DW 17- 128, the Company has requested the implementation of a Qualified Capital Project Annual Charge ("QCPAC") annual surcharge mechanism, allowing for the funding of assets placed in service in each fiscal year, to be granted in the succeeding year, recoupable back to the debt of issuance for the long term debt used to fund those capital projects. This will be in conjunction with the DSRR revenue components of the allowed revenue structure, which is designed to provide sufficient revenue to fully fund the debt service obligations on existing debt, plus a 10% surplus to be collected and deposited into a separate account, as the initial funding for capital projects in the succeeding year, without debt funding needed to support those projects. The FALOC is the mechanism that the Company will use to fund the projects during the year, leading up to the repayment of the line and conversion to long term debt in conformity with the QCPAC process if approved by the Commission. In the event the Commission does not approve the modified rate structure requested in DW 17-128, the Company would file finance petitions each year to convert the amount borrowed as short-term debt to long-term debt and ultimately add it to the computation of PEU's rate base in its next rate case filing.

Q. What other options has the Company considered other than the proposed CoBank financings?

A. The Company has explored options with several potential funding agencies over the past several years. The Company has determined that tax exempt debt bond financing through the Business Finance Authority of New Hampshire ("BFA") lending is not available, as the overall borrowing levels for the Company do not meet the minimum bonding threshold amounts, even when aggregated over a three-year needs analysis. As evidenced in this petition, as well as petitions filed and approved in previous years, the Company has been able to access some funding from the State Revolving Fund, for certain eligible and qualifying capital projects. However, not all of the Company's capital projects for 2017 were eligible for this financing. As a result, the options to finance the remainder of the 2017 capital projects was limited to taxable debt from banks or other financial institutions. For banks, the Company has determined over the past several years that there are a limited number of truly eligible lending candidates due to considerations including the financial structure of the Company with respect to normal debt-equity ratios, the overall capital borrowing needs, meeting normal financial covenants, or due to acceptable credit ratings. At the end of the process, CoBank has become the only viable option currently to finance these current needs.

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

A. The anticipated issuance costs total $10,000, and relates primarily to legal costs which will be incurred to (i) review and revise the necessary loan documentation prepared by CoBank, and (ii) obtain Commission approval of the loans. The issuance costs will and amortized over the life of the CoBank loans. The annual amortization expense of $500, associated with the issuance costs, has not been reflected in Schedules LDG-2 through 3 due to its immateriality with respect to the overall analysis and impact of this proposed financing.

Q. What is the rationale behind the proposed refinance of the intercompany loans?

A. In preparing the PEU rate case in DW 17-128, the Company was seeking elements which might allow for the reduction of the requested rate increase, as it applies to the impact on its customers. As these two intercompany loans are attributed to assets which were financed in 2013 and 2015, and have useful lives that will in the aggregate extend beyond the new expiration date of the proposed refinancing's (the end of 2046), there would be no negative cash impact to the Company, and allow for the extension of the repayment term for these loans well within the useful life of the underlying assets. This allows for the reduction in the revenue requirement request in that case, of approximately $188,000, which was deemed to be significant in the filing of that case. The interest rate of 3.2% was deemed to approximate the current available interest rate for the Company, based upon the rates for which it can currently borrow funds from the State Revolving Fund and/or CoBank.

Q. What is the estimated cost of processing the proposed refinance of the intercompany loans?

A. The processing of the refinancing of these intercompany loans will require minimal legal work to document the new loan agreements between PEU and Pennichuck Corporation, which should be less than $2,000. The issuance costs will and amortized over the life of the new intercompany loans. The annual amortization expense of $67, associated with the issuance costs, has not been reflected in Schedules LDG-2 through 3 due to its immateriality with respect to the overall analysis and impact of this proposed financing.

Q. Please explain Schedule LDG-1, entitled "Balance Sheet for the Twelve Months Ended December 31, 2016".

A. Schedule LDG-1, pages 1 and 2, presents the actual financial position of the Company as of December 31, 2016 and the pro forma financial position reflecting certain adjustments pertaining to the proposed CoBank $0.5M term loan financing, the intercompany loan refinancing's, as well as, assuming the Line of Credit with $0 of utilization, based upon the anticipated future usage in support of the QCPAC, as further described in the next question response.

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

A. Schedule LDG-1, page 1, reflects the pro forma adjustments to record the net assets related to the replacement of the water main and connections in the amount of $368,844 (identified to the CoBank Term Loan funding), and to record a full year of depreciation and the adjustments required to reflect the Cost of Removal, of $22,158. This schedule also reflects the pro forma usage of the CoBank FALOC with $0 borrowed on that facility, as this instrument will be used to finance CWIP on an annual going forward basis pursuant to the QCPAC, and will be subject to repayment of usage annually for fixed assets that have gone used and useful, and for which future annual financing petitions will be filed in support of the term debt needed to repay the line of credit each year. Schedule LDG-1, page 2 (Asset Line of Credit funds), establishes the total CoBank loans of $368,844, as well as the repayment of $368,844 of intercompany advances related to the 2017 capital improvements that were funded out of the Company's working capital and intercompany borrowings from Pennichuck. This schedule also reflects the income impact on retained earnings related to costs associated with the financings, as reflected on Schedule LDG-2. Schedule LDG-1, page 2, also records the use of a small amount of intercompany funds to support some of the related expenses.

Q. Mr. Goodhue, please explain Schedule LDG-2 entitled "Operating Income Statement for the Twelve Months Ended December 31, 2016".

A. As indicated previously, the issuance costs associated with the financing are not expected to be significant and are not reflected in Schedule LDG-2, page 1. Schedule LDG-2, page 1, presents the pro forma impact of this financing on the Company's income statement for the twelve month period ended December 31, 2016.

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

A. Schedule LDG-2, page 1, contains four adjustments. The first adjustment records the estimated increase in interest expense related to additional debt raised at interest rates of 3.25 per annum. The second adjustment records the estimated depreciation and property taxes on the new assets. The third adjustment records the after-tax effect of the additional pro forma interest expense using an effective combined federal and state income tax rate of 39.41%.

Q. Please explain Schedule LDG-3 entitled "Pro Forma Capital Structure for Ratemaking Purposes for the Twelve Months Ended December 31, 2016."

A. Schedule LDG-3 illustrates the Company's pro forma total capitalization as of December 31, 2016, which comprises common equity and long term debt, including the proposed CoBank financing.

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

A. Schedule LDG-3 contains two adjustments. The first adjustment reflects the elimination of debt related to Capital Recovery Surcharge Assets pursuant to Order No. 25,051 in Docket No. DW 08-052 and the second adjustment reflects the elimination of the Municipal Acquisition Regulatory Asset ("MARA"), and the related equity as of the date of the Nashua acquisition pursuant to Order No. 25,292 in Docket No. DW 11-026.

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

A. Yes. Section 6(c) of the Loan Agreement between Pennichuck and TD Bank, NA (the "Bank") prohibits Pennichuck or its subsidiaries from incurring additional indebtedness without the express prior written consent of the Bank, except for certain allowed exceptions. One of the listed exceptions, in Section 6(c)(v) the Company may incur new indebtedness up to $1.5 million per annum, on an unsecured basis, with CoBank, ACB or equivalent lender, provided that TD Bank, N.A. is provided at least 30 days prior to written notice related to said indebtedness. The Company has provided written notice to the Bank as of October 11, 2017. See Attachment C. As the amount being requested exceeds the annual limitation, the Company awaits a response from the Bank as to whether, because the aggregate amount pertains to two separate years, written notice is sufficient, or written approval is required.

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

A. The CoBank financings have been approved by the Company's and Pennichuck's Boards 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 approvals when available.

Q. Do you believe that the CoBank Financings and the Intercompany Refinancing will be consistent with the public good?

A. Yes. The CoBank loans and the refinanced Intercompany Loans will enable PEU to continue to provide safe, adequate and reliable water service to PEU's customers. For the reasons described in Mr. Boisvert's direct testimony, the projects funded by the CoBank loans, will provide the most cost effective solutions, in support of this overall benefit for PEU's customers. The terms of the financing through the CoBank loans are very favorable compared to other alternatives, and will result in lower financing costs than would be available through all other current debt financing options. And, the refinancing of the Intercompany Loans will have a positive impact on PEU's customers, in the form of a lower revenue requirement request, as delineated in DW 17-128.

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

A. Yes. I respectfully ask the Commission to issue an Order in this docket no later than the end of November, such that the Order can be effective no later than the end of December, but possibly sooner than that, for financing and covenant compliance reasons. This will allow the Company to draw down the funds on the term loan at year-end to reimburse fund it has internally funded for capital projects for 2017, within the fiscal year, and to have the FALOC available for usage as of the beginning of 2018. Timely closing on the CoBank term loan, as well as the Intercompany Loans, will also allow the Company to include the actual impact of these loans in its step increase request under DW 17-128.

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

A. Yes it does.