STATE OF NEW HAMPSHIRE

BEFORE THE

PUBLIC UTILITIES COMMISSION

Petition of Pennichuck East Utility, Inc. for Approval of Financings From CoBank, ACB And Refinancing of Intercompany Loans

DW 20-___

DIRECT PREFILED TESTIMONY OF LARRY D. GOODHUE

May 22, 2020

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 and Chief Financial Officer of 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 and Chief Financial Officer 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 and Chief Financial Officer of the Company, and Chief Executive Officer and Chief Financial Officer 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 one new debt financings: a term loan for $803,275 from CoBank, ACB ("CoBank") to fund 2019 capital projects not funded by SRF loans, as a repayment and refinance of amounts borrowed under the Company's Fixed Asset Line of Credit ("FALOC") for those projects during 2019. The Company also seeks approval for the renewal and extension of the Company's current FALOC with CoBank (approved in DW 17-157, Order No. 26,117 (March 30, 2018)), as follows: renewing the current 3-year $3.0 million Fixed Asset Line of Credit ("FALOC") from CoBank to provide for short-term financing of capital projects, for a new 3-year term. This facility will continue to be paid-off or paid down on an annual basis and converted to long term debt in support of the QCPAC process currently in place from the modified rate structure included and approved in the Company's rate case under Docket No. DW 17-128. AS the Company's current FALOC with CoBank expires on September 30, 2020, the new $3.0 million FALOC will become available as a facility, as of October 1, 2020, or sooner. In addition, the Company proposes the refinance of nearly all of its outstanding short term intercompany payable balances currently in existence between PEU and its parent, Pennichuck Corporation, as a new long-term intercompany loan between the parties. This refinance is to be conducted on the outstanding balances on the loans as of 12/31/2019, in conformity with the actions contemplated and indicated as a part of the Company's Short-Term Debt Waiver proceeding as approved in Docket No. DW 19-112. As such, $5 million of short-term intercompany payables are proposed to be refinanced for 30 years at an interest rate of 0.25%, 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 2019, approximately $803,275 of capital improvements were made by PEU for a number of specific projects, routine maintenance capital projects, and other non-recurring capital expenditures, which were either not funded by the 0.1 DSRR account or 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 repay the amounts drawn on the Company's FALOC for these projects during 2019. This amount is consistent with the amounts included on the schedules submitted for PEU's QCPAC filing under Docket No. DW 20-019.

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, another loan with CoBank for

$350,078 for 25 years , pursuant to Order No. 26,117 in Docket No. DW 17-157, and another loan with CoBank for $1,297,379 for 25 years, pursuant to Order No. 26,253 in Docket No. DW 19-069.

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 a $803,275 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 4.30% per annum). The proceeds from this new CoBank loan will be used to paydown and refinance amounts used to fund 2019 capital expenditures, not funded by SRF loans. The new CoBank loan will provide permanent financing for these 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 $181,781.09 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. A copy of CoBank's Non-Binding Summary of Terms and Conditions is attached as LDG-4.

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, 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 all of the current amounts borrowed from CoBank, as highlighted earlier in this testimony, 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,
- 2016 earned patronage of $ 71,432,
- 2017 earned patronage of $20,706,
- 2018 earned patronage of $26,359, and
- 2019 earned patronage of $30,575.

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 2019 was paid to the Company in March 2020). 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 2017 the mix of cash and equity was 75% and 25% for the year 2018 the mix was 60%/40%, and for the year 2019 the mix was 65%/35%. 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. What are the basic terms of the FALOC, that is being requested for renewal?

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 as a renewal of its existing FALOC with CoBank, co-terminus with CoBank's normal financing year, which ends on September 30 of each calendar year, the term of this facility would be set to begin as of October 1, 2020 and expire on September 30, 2023. 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 4.30% per annum). Although this facility does not have an annual "clean-out" provision required by the Bank, the Company intends to repay it every year, by converting the balance to term loans tied to annual used and useful projects completed for the preceding 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. **A copy of CoBank's Non-Binding Summary of Terms and Conditions is attached as LDG-5.**

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

A. Under the modified rate methodology as approved under Docket No. DW 17-128, the Company requested and was approved for 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 surcharge mechanism operates 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 uses 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 as approved by the Commission.

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 or the Drinking Water and Groundwater Trust Fund, for certain eligible and qualifying capital projects. However, not all of the Company's capital projects for 2019 were eligible for these types of financing. As a result, the options to finance the remainder of the 2019 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 less than $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-1 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 short term intercompany payable amounts to a new long-term intercompany loan?

A. PEU has incurred certain short term intercompany payable amounts resulting from its activities and operations in utilizing the manpower and fleet resources of Pennichuck Water Works ("PWW"), as well as the net result of the repayment of its long term debt obligations and the daily sweep of operating cash amounts back and forth from Pennichuck. And, until the implementation of the modified rate structure approved in Docket No. DW 17-128, PEU did not have mechanisms in place to backstop its allowed revenues via RSF funds, and/or the ability to truly settle its intercompany transactions with Pennichuck or PWW, via cash settlement. As such, the short-term intercompany payables, as a component of the PEU's short term debt, has caused the Company to continually bump up against or exceed the 10% short term debt limit as statutorily required by the NHPUC, and for which the Company has a temporary expansion of that requirement to 18% through June 30, 2023. With this Petition PEU is seeking to convert the majority of its short-term intercompany amounts to a long-term intercompany note payable, in providing a cure to that short-term debt limit requirement (as discussed in Docket No. 19-112). This new long-term intercompany note payable would then be included in the underlying debt instruments supported by and comprising the Company's DSRR revenue requirement in its next filed rate case.

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 <u>Schedules LDG-1 through 3</u> due to its immateriality with respect to the overall analysis and impact of this proposed financing.

Q. Please explain <u>Schedule LDG-1</u>, entitled "Balance Sheet for the Twelve Months Ended December 31, 2019".

A. <u>Schedule LDG-1</u>, pages 1 and 2, presents the actual financial position of the Company as of December 31, 2019 and the pro forma financial position reflecting certain adjustments pertaining to the proposed CoBank $803,275 term loan financing, the intercompany loan refinancing, 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 capital projects funded by the CoBank term loan, and to record the net amount needed to record a full year of depreciation (as an adjustment to the half-year convention already booked for the assets as of 12/31/2019); there are no amounts reflected to adjust Plant Assets for the $803,275 cost of the net assets or to reflect the Cost of Removal, of $80,328, as the actual amounts for these entries and projects have already been included in the 12/31/2019 financial statements for these used and useful assets as of year-end.. This schedule also reflects the pro forma usage of the CoBank FALOC with $0 borrowed on that facility, as this instrument is used to finance CWIP on an annual going forward basis pursuant to the QCPAC, and is 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 loan of $803,275, as well as the repayment of $803,275 of FALOC advances related to the 2019 capital improvements that were funded out of the Company's working capital and intercompany borrowings from Pennichuck. This schedule reflects the entries to convert the $5.0 million of short-term intercompany payables to a long-term intercompany note payable. And, 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, 2019".

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 three adjustments. The first adjustment records the estimated increase in interest expense related to additional debt raised at interest rates of 4.30% per annum. The second adjustment records the estimated depreciation and property taxes on the new assets. The third adjustment records the income tax effect of the additional pro forma interest expense, depreciation and property tax expenses, using an effective combined federal and state income tax rate of 27.08%.

Q. Please explain Schedule LDG-3 entitled "Projected Rate Impact on Single Family Residential Home"

A. Schedule LDG-3 illustrates the Company's pro forma impact from this financing on the average single family residential home's water bill, as it pertains to the rates that were approved under Docket No. DW 17-128.

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 is providing written notice to the Bank concurrent and in parallel with this filing and will supply a copy of said notice as an attachment to this filing once that is provided to the bank.

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 as documented in LDG-6 and 7,and have been submitted, concurrently and in parallel, for approval by Pennichuck's sole shareholder, the City of Nashua. The Company will supplement its Petition with documentation showing the City's approval 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 are needed for PEU to remain in compliance with the ST Debt Limit waiver requirement, and to include the necessary revenue requirement for the payment of those obligations in the Company's DSRR revenue requirements.

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

A. Yes. I respectfully ask the Commission to issue an Order in this docket by June 30, 2020, if at all possible, such that the Order can be effective no later than the end of July. This will allow the Company to close upon the term loan as a requirement in establishing the final surcharge under the Company's QCPAC filing in pendency in Docket No. DW 20-019, as well as renew the FALOC in advance of the current facility's impending termination as of September 30, 2020. Timely closing on the CoBank term loan, will allow the Company to include the actual impact of this loan in its QCPAC surcharge under Docket No. DW 20-019.

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

A. Yes it does.