

**STATE OF NEW HAMPSHIRE
PUBLIC UTILITIES COMMISSION**

DE 09-236

UNITIL ENERGY SYSTEMS, INC.

Petition for Authority to Issue Securities

Order Approving Petition

ORDER NO. 25,069

January 22, 2010

APPEARANCES: Meabh Purcell, Esq., of Dewey & LeBoeuf LLP for Unitil Energy Systems, Inc.; Rorie E.P. Hollenberg, Esq., for the Office of Consumer Advocate on behalf of residential ratepayers; Matthew J. Fossum, Esq., for the Staff of the Public Utilities Commission.

I. BACKGROUND

On November 23, 2009, Unitil Energy Systems, Inc. (UES or Company) filed a petition, pursuant to RSA chapter 369, for authority to issue securities. UES is a regulated electric utility that distributes electricity to various cities and towns in New Hampshire. By its petition, UES seeks authority to issue first mortgage bonds evidencing secured long-term debt in an aggregate amount of up to \$15,000,000. In support of its petition, UES filed the pre-filed testimony and schedules of David Chong, Director of Finance for Unitil Service Corporation, which provides various professional and administrative services to UES. In addition to the above financing, UES will receive a \$5,000,000 equity contribution from its parent, Unitil Corporation (Unitil), to support its capital structure. Another subsidiary of Unitil, Northern Utilities, Inc., has sought approval for financing concurrent with the instant request on substantially similar terms. *See* Docket No. DG 09-239. In total, UES would have approximately \$20,000,000 in available funds following the issuance of the bonds and receipt of the equity contribution.

The bonds are to be sold at par by private placement to institutional investors. According to the petition, the targeted term of the notes issued by UES is 10 years, and the notes are to bear an interest rate not to exceed 7.8 percent. By supplemental testimony of Mr. Chong dated December 21, 2009, UES noted that it had completed an auction of the notes and had established a coupon rate of 5.24 percent for the notes.

The primary purpose of the financing, as stated in the petition, is to refinance UES' short-term debt by paying off approximately \$16,696,000 in accrued debt. Of the funds from this financing not going to the repayment of short-term debt, most will be used for "other lawful corporate purposes." Also, a portion of the funds, about \$615,000, is to be used to pay the costs and expenses of the financing. UES proposes that these costs be incorporated as a portion of the costs of the financing and amortized over the life of the bonds.

UES notes that before it may issue additional debt, it must meet two tests under its twelfth and thirteenth supplemental indentures. First, it must have a minimum of 2.0 in its Earnings Available for Interest Charges (EAIC) to Annual Interest Requirements ratio. Second, UES must have a certain minimum amount of Net Bondable Expenditures. UES currently meets the requirement for Net Bondable Expenditures, but not its EAIC ratio.

Because UES does not meet the EAIC ratio requirement, it is in the process of negotiating a waiver and amendment with its current investors. According to the petition, the current investors are seeking: (1) a "temporary fee" of 100 basis points (bps) per annum to be paid to all of UES' bondholders if any one of them will be required under applicable insurance regulations to post additional reserves with respect to UES' bonds; (2) provisions designed to update UES' indentures; (3) a waiver fee of 10 bps of the principal amount of bonds held by each

investor; and (4) other representations and warranties. According to the petition, the temporary fee provision would expire in its entirety four consecutive quarters following the next final rate order from the Commission. Also according to the petition, UES believes that this fee has “little chance” of going into effect.

UES’ petition notes that the proposed financing and accompanying equity contribution will result in a stronger total debt to capitalization ratio for the Company and will allow the Company to retire outstanding short-term debt. UES estimates that the financing will result in a pro forma capital structure of about 44 percent equity and 56 percent debt.

On December 11, 2009, the Office of Consumer Advocate (OCA) submitted a letter to the Commission expressing various concerns about UES’ request. Specifically, OCA raised concerns relative to the proposed interest rate and proposed costs of the financing, whether a competitive process might have mitigated some of the costs, the proposed uses of the funds, the impact of the financing on customers, and the approval process sought by UES. On December 17, 2009, the Commission issued an order of notice setting a hearing in this matter for January 5, 2010. On December 21, 2009, UES submitted supplemental testimony of Mr. Chong which updated some of the information from the original petition, and provided the Company’s response to the concerns raised by OCA’s letter.

On December 24, 2009, OCA submitted a letter, pursuant to RSA 363:28, II, indicating that it would participate “for the purpose of monitoring” the financing. On December 31, 2009, representatives of the Company, OCA and Staff met in a technical session, and a hearing was held on January 5, 2010 as scheduled.

II. POSITIONS OF THE PARTIES AND STAFF

A. UES

As stated above, since the filing of the petition UES has completed the private placement auction for its bonds and achieved an interest rate of 5.24 percent, well below the requested maximum rate of 7.8 percent. Hearing Exhibit 2 (Ex. 2), Supplemental Pre-Filed Testimony of David Chong at 2. According to UES, it has locked in this rate and the rate fits within the range of rates for comparable utility market transactions. Ex. 2 at 2. UES noted that one of the reasons for seeking financing at this time was that markets presented such favorable terms. Ex. 2 at 2. Additionally, UES points out that any concerns OCA may have had about the amount of the interest rate have been addressed since the locked-in rate is well below that noted in the initial petition. Ex. 2 at 2-3.

As to the costs of the financing, UES provided a breakdown of the various costs incurred in the financing, which total about \$615,000. Some of the costs, such as the placement fee, are outside the control of UES and thus would not be changed by use of a request for proposals (RFP) or similar process. Ex. 2 at 3, 5. As to the costs within its control, UES noted that the estimated fees for its attorneys, approximately \$250,000, are appropriate. Ex. 2 at 3-4. Though it did not use an RFP or other competitive process, UES contends that hiring its attorneys was appropriate because of “the firm’s significant experience with utility financings, high quality of legal representation and its familiarity with UES.” Ex. 2 at 4. UES is also responsible for the legal fees of the lender’s counsel and the trustee’s counsel. Ex. 2 at 3, 5. Legal fees for this financing total about \$400,000. According to UES, it is interested in controlling legal fees to the degree possible because such fees are amortized over the life of the financing, in this case 10

years. Ex. 2 at 5. As noted by UES, the result of this treatment means that any money it pays out to cover fees will not be recouped until after it files for a base rate case, and even then recovery is spread out over time. Ex. 2 at 5. At the hearing, Mr. Chong indicated that he believed the final legal fees would be below the estimated amounts. Transcript of January 5, 2010 Hearing (Tr.) at 14.

UES also notes that other costs of financing are the product of seeking the waiver and amendment from its existing bondholders. Regarding the 100 bps “temporary fee,” UES notes that it does not intend to seek recovery of that fee in rates, should it be imposed. Hearing Exhibit 4, Response to Staff Data Request 2-1. Therefore, there is no impact to ratepayers from this fee, even if it goes into effect. Hearing Exhibit 4, Response to Staff Data Request 2-1; Tr. at 11. As to the 10 bps “waiver fee,” according to Mr. Chong this fee is about \$65,000 and adds approximately 7 bps to the “all-in” rate of the financing. Hearing Exhibit 5, Response to Staff Data Request 2-2; Tr. at 11. UES proposes that this fee be amortized over the life of the new bonds such that it will be recovered over time. Hearing Exhibit 6, Response to Staff Data Request 2-3; Tr. at 11. This is so because without the waiver the financing could not occur and the waiver fee is, therefore, a cost of the financing. Tr. at 24. According to UES, the “all-in” coupon rate, which includes the waiver fee and other costs, would be 5.89 percent, a rate still below that of UES’ other existing debt. Ex. 2, Schedule 2 at 2; Tr. at 15-16.

Regarding the uses of the proceeds of the debt issuance other than for financing costs, the majority is going to the repayment of short-term debt. UES provided a list of plant investments that it has made with short-term debt since its last bond issuance in 2006. Hearing Exhibit 2, Supplemental Pre-Filed Testimony of David Chong, Schedules 3(a) and 3(b); Hearing Exhibit 7,

Response to Staff Data Request 1-2. UES contends that the short-term debt to be repaid is that used to finance these plant investments. Tr. at 12-13. UES notes that because it will be continuing to use short-term debt up to the date of the actual issuance, which it projects to be around March 1, 2010, the short-term debt amount to be paid will be somewhat higher than shown in the petition and will reduce the amount available for other purposes. Tr. at 13-14. As to the “other lawful corporate purposes,” UES notes that in the context of this financing the phrase is synonymous with cash, which it may use for many purposes including capital expenditures and working capital. Hearing Exhibit 2, Supplemental Pre-Filed Testimony of David Chong at 7.

According to UES, its weighted average cost of capital will decrease as a result of this financing because the transaction will lower its overall cost of debt. Ex. 2 at 7; Tr. at 15. This decrease will not be immediately apparent to ratepayers since it will not be reflected in rates until UES’ next base rate case but, UES contends, lowering the cost of debt will result in lower rates in the long term. Ex. 2 at 7; Tr. at 15. As such, UES contends that this transaction will improve its debt to equity ratio as well as result in lower long-term costs for the Company. Ex. 2 at 7; Tr. at 15.

Finally, in response to OCA’s concern that the *nisi* order requested by UES was not an appropriate manner in which to address a request for financing approval, UES states that such a concern is mooted by the Commission conducting a noticed hearing on the matter. Ex. 2 at 8. Thus, UES states that there will be a public opportunity to explore the impact of the proposed financing and the issues potentially raised by the *nisi* process are no longer present. Ex. 2 at 8.

B. OCA

OCA's letter of December 11, 2009 expressed various concerns about UES' petition as it was originally filed. As noted above, OCA was initially concerned that the interest rate proposed by UES was excessive in that it seemed higher than the rates proposed in other long-term financing petitions filed by other utilities in 2009. OCA also questioned the appropriateness of various factors used by UES in establishing the proposed rate.

OCA also expressed concerns about the costs of the financing, particularly the amount of estimated attorneys' fees. OCA contended that UES had not provided any information in its filing to support a determination that the costs were objectively reasonable. Moreover, OCA contended that UES' filing was silent on the manner in which it hired its outside counsel and about how the rates or fee estimates for its attorneys were determined.

OCA also questioned the adequacy of detail provided with regard to uses of the short-term debt that was to be refinanced, as well as with regard to the uses of any funds not going to the repayment of short-term debt or financing costs. With regard to the funds intended to be used for the repayment of short-term debt, OCA contended that more information was needed about the uses of that money before a determination could be made about whether the proposed long-term financing was consistent with the public good. OCA contended that UES' filing also lacked detail about the impact of this financing on UES' customers.

Finally, OCA expressed concern about UES' request for an order *nisi*. According to OCA, UES' customers are entitled to notice regarding the Company's request, the proposed uses of the funds and the impact of the financing on customers' rates. OCA contended that an order

nisi would not provide such notice. At the hearing, OCA did not question Mr. Chong or make a closing statement.

C. Staff

Staff did not testify at the hearing. In questioning Mr. Chong, Staff inquired whether, given the favorable rate, it would make sense for Northern to refinance other portions of its existing debt. Tr. at 15-16. Mr. Chong responded that because of the “make whole” provisions governing its existing debt, it would have to obtain an interest rate far more favorable than was obtained here to make refinancing cost effective. Tr. at 16.

Staff also questioned Mr. Chong about the waiver and amendment it seeks from its current bondholders. Tr. at 18. Staff specifically questioned Mr. Chong about the likelihood of the 100 bps “temporary fee” going into effect. Tr. at 20. Mr. Chong stated that the fee was unlikely to go into effect because its investment quality credit score had just been confirmed and the fee would only occur if UES’ credit rating were downgraded. Tr. at 20. Moreover, Mr. Chong highlighted that the act of filing for a base rate increase would likely aid the Company’s rating and make the imposition of the fee less likely still. Tr. at 20. Mr. Chong stated that the Company was intending to file a base rate case in early to middle 2010. Tr. at 20-21. Mr. Chong also confirmed for Staff that, should the temporary fee go into effect, the Company would hold customers harmless for the fee and, therefore, there would be no rate impact from that fee. Tr. at 21.

In its closing, Staff noted that the interest rate obtained by the Company was a favorable one and below the rates of the Company’s existing debt. Tr. at 25. Regarding the uses of the proceeds, Staff noted that the majority would be used to repay short-term debt that was spent on

various capital projects. Tr. at 25-26. Staff noted that UES had provided an extensive list of the projects it completed using short-term debt and that the projects appear to be of the type done in the normal course of utility operations. Tr. at 26.

Regarding the costs of the financing, Staff agreed that many of the costs are outside the Company's control and therefore not subject to dispute. Tr. at 26. Staff stated that it found reasonable the Company's explanation that hiring its legal counsel without the use of an RFP or similar process was appropriate. Tr. at 26.

Regarding the waiver and amendment, Staff stated that, because the Company would not seek recovery of the "temporary" fee if it goes into effect, ratepayers were not in jeopardy for that fee. Tr. at 26. Regarding the 10 bps waiver fee, Staff noted that the fee was a condition of obtaining the waiver, which itself was a condition of being able to complete the financing. Tr. at 26-27. Staff stated that given the favorable interest rate the Company obtained, paying the fee seemed a reasonable trade-off for allowing the financing to proceed. Tr. at 27. Staff also noted that the fee had a minimal impact on the overall financing costs or the financial standing of the Company. Tr. at 27.

Staff stated that overall, it believed the financing request was in the public good and would help the Company control rates. Tr. at 27. Therefore, Staff supported the Company's request. Tr. at 27.

III. COMMISSION ANALYSIS

RSA 369:1 provides, in relevant part, that the Commission may approve the issuance and sale of securities "where it finds that the same is consistent with the public good."

Moreover, “after such hearing or investigation as it may deem proper,”¹ the Commission will authorize the issuance of securities upon terms found to be consistent with the public good. RSA 369:4. In determining the public good, the Commission is to consider the amount of the issuance authorized, the purpose or purposes to which the proceeds are to be applied, and the reasonableness of the terms and conditions of the financing. RSA 369:1, :4. Additionally, a securities issuance entails consideration of whether the object of the financing is reasonably required for use in discharging a utility company’s obligation to provide safe and reliable service, whether the plans to accomplish that object are economically justified when measured against any adequate alternatives, and whether the resulting capitalization would be supportable. *Appeal of Easton*, 125 N.H. 205, 211-213 (1984).

We recently stated that the review outlined by *Easton* requires looking “beyond merely the terms of the financing” *Public Service Company of New Hampshire*, Order No. 25,050 (Dec. 8, 2009). However, the review need not be the same in all instances, and some financing requests are more “routine” than others. *Id.* at 12. For example, a “routine” financing may be one “that will have no discernable impact on rates or deleterious effect on capitalization, [and] in which the funds are to enable numerous investments appropriate in the ordinary course of utility operations.” *Id.* We concluded that “[t]he lesson of *Easton* is that certain financing related circumstances are routine, calling for more limited Commission review of the purposes and impacts of the financing, while other requests may be at the opposite end of the spectrum, calling for vastly greater exploration of the intended uses and impacts of the proposed financing.” *Id.* at 14.

¹ The Company requested an order *nisi* in this docket, but it was determined that the circumstances were sufficiently complex that a hearing was appropriate.

For the reasons discussed below, we conclude that the instant financing is “routine,” and, as such, the manner of our review is tailored to the circumstances. We find such treatment appropriate because the amount of the financing is not excessive and will not have a deleterious effect on capitalization. Moreover, the vast majority of the funds will be used to fund numerous investments of the type made in the ordinary course of utility operations. With this understanding, we turn to the specific issues presented by UES’ proposed financing.

UES has marketed its bonds to investors through a private auction described by Mr. Chong and received a rate of 5.24 percent. The auction described by Mr. Chong appears to be a reasonable method that involves competitive market forces. Moreover, the interest rate obtained through this process is favorable in that it is well below the maximum rate initially requested by the Company as well as below the rates of the Company’s other outstanding debt, even when the “all-in” rate is considered. As such, we find that the terms and conditions of the financing are reasonable.

As to the proceeds to be received from the final sale and issuance of the bonds, the Company proposes to use the majority for the repayment of short-term debt. UES’ initial filing did not explain the generation of the short-term debt sufficiently, but the Company subsequently addressed that shortcoming. The Company has provided extensive and comprehensive lists of the capital projects it has completed on its distribution system in recent years. For example, UES notes that between 2006 and 2009 it spent nearly \$5,000,000 on customers’ services, as well as nearly \$3,000,000 on the installation of meters, which are the kinds of expenditures usually made in the normal course of utility operations. We note that we do not make a finding that the decisions to invest in these projects were prudent or that the costs for them were prudently

incurred. We find only that they are of the type generally undertaken by utilities, such as UES, in order to discharge their duty to provide safe and reliable service and to ensure the continuing viability of their distribution systems. Accordingly, with this understanding of the source of the short-term debt, we conclude that the repayment of short-term debt is in the public good.

Moreover, given the routine nature of the projects giving rise to the short-term debt to be repaid, we find the use of the proceeds of this financing to repay that debt to be in the public good without further review of possible alternatives of the financing. *See Public Service Company of New Hampshire*, Order No. 25,050 at 16.

As to the costs of the financing, as both UES and Staff pointed out, many of the costs are beyond the control of UES, yet are necessary to complete a transaction such as this. Regarding the costs within its control – specifically its attorneys’ fees – UES noted that it did not use an RFP or similar process because it decided the best course was to use a firm familiar with its business and with the business of corporate debt issuances. Moreover, UES noted that because it will not immediately recover amounts spent on its attorneys, it has an incentive to keep costs low. We find these explanations reasonable and likewise find that the costs of the financing are reasonable. The financing will also reduce UES’ overall cost of debt, improving its profitability and ultimately benefiting ratepayers.

Regarding the waiver and amendment, in order to obtain this financing UES must secure the waiver from its current bondholders. The reason for this is UES’ current inability to meet its EAIC ratio. This ratio is derived, as Mr. Chong described, by dividing the Company’s earnings before interest and taxes by the interest expense of the whole of UES’ capital structure. Tr. at 19. It is, thus, a comparison of the Company’s earnings and interest expenses. Though UES

does not meet this ratio, its failure to do so does not appear to indicate wider financial troubles for the Company. Given this, as well as the currently favorable market conditions, seeking such a waiver is reasonable to ensure that the Company's debt issuance can proceed.

In order to obtain the waiver, UES will have to agree to certain conditions, many of which are common and do not materially impact the financing, the Company, or customers. As to the conditions which may impact the Company or customers, UES stated that its bondholders are seeking a condition requiring UES to pay a 100 bps "temporary" fee should any of them be required by insurance regulations to post additional reserves with respect to UES' bonds. Mr. Chong stated that he believes the fee is unlikely to be imposed and that in the event it is imposed customers would not be harmed by its imposition. Because the Company has agreed that it will not seek recovery of any "temporary" fee in rates, we will hold the Company to that representation and will not object to that waiver condition.

Also, UES bondholders are seeking a 10 bps "waiver fee" essentially as a cost of permitting the waiver. As Staff described, this fee is a cost of obtaining the waiver, which is a requirement for obtaining the financing. The fee, according to Mr. Chong, adds approximately \$65,000 to the cost of the financing, or 7 bps to the "all-in" coupon rate. Given that the financing sought by UES is on terms more favorable than any of its existing debt, even when this fee is considered, and given that favorable long-term financing should help the Company control its long-run costs and, by extension, customers' rates, we agree that permitting this fee is reasonable. Allowing the fee to be imposed and included as a cost of financing will allow this financing to proceed, while having a minimal initial impact, and a long-term benefit, to

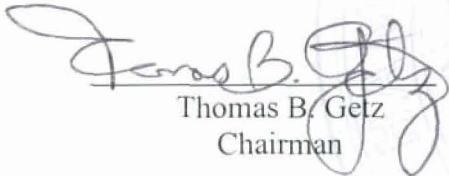
customers as a result of the Company's lower overall cost of capital. For the above reasons, we find that the financing as proposed by UES is in the public good.


Based upon the foregoing, it is hereby

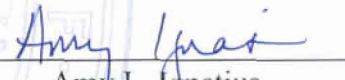
ORDERED, that the petition by Unitil Energy Systems, Inc. to issue up to \$15,000,000 in long-term debt, coincident with an equity contribution of \$5,000,000 from Unitil Corporation, is hereby APPROVED; and it is

FURTHER ORDERED, that Unitil Energy Systems, Inc. is authorized to include in the costs of its debt issuance the 10 bps waiver fee as described above

By order of the Public Utilities Commission of New Hampshire this twenty-second day of January, 2010.


Thomas B. Getz
Chairman


Clifton C. Below
Commissioner


Amy L. Ignatius
Commissioner

Attested by:


Debra A. Howland
Executive Director