Direct Testimony of Stephen P. St. Cyr regarding Water Rates
DW 10-306

Q. Please state your name and address.

A. Stephen P. St. Cyr of Stephen P. St. Cyr & Associates, 17 Sky Oaks Drive, Biddeford, Me. 04005.

Q. Please state your present employment position and summarize your professional and educational background.

A. I am presently employed by St. Cyr & Associates, which provides accounting, tax, management and regulatory services. The Company devotes a significant portion of the practice to serving utilities. The Company has a number of regulated water utilities among its cliental. I have prepared and presented a number of rate case filings before the New Hampshire Public Utilities Commission. Prior to establishing St. Cyr & Associates, I worked in the utility industry for 16 years, holding various managerial accounting and regulatory positions. I have a Business Administration degree with a concentration in accounting from Northeastern University in Boston, MA. I obtained my CPA certificate in Maryland.

Q. Is St. Cyr & Associates presently providing services to Lakeland Management Company ("Lakeland" or "Company")?

A. Yes. St. Cyr & Associates prepared the various exhibits and the supporting schedules. In addition, St. Cyr & Associates assists the Company in preparing its year end financial statements, prepares the PUC Annual Report and prepares the tax returns.

Q. Are you familiar with the pending tariff change containing higher rates for the Company and with the various exhibits submitted as Schedules 1 through 5 inclusive, with related pages and attachments?

A. Yes, I am. The exhibits were prepared by me, utilizing the financial records of the Company.

Q. What is the test year that the Company is using in this filing?

A. The Company is utilizing the twelve months ended December 31, 2009.

Q. In what way are the schedules arranged?

A. There are two set of schedules, one for water rates and one for sewer rates. The testimony will address the water rate schedules.

Q. Please summarize the water rate schedules?

A. The schedule entitled "Computation of Revenue Deficiency – Water for the Test Year ended December 31, 2009," summarizes the supporting schedules. The actual revenue deficiency for the Company for the test year amounts to $37,589. It is based upon an actual test year with a beginning and ending average rate base of $206,973 as summarized in Schedule 2. The Company's rate of return should have been 9.36% for the test year. 9.36% when multiplied by the rate base of $206,973, results in an operating income requirement of $19,376. As shown on Schedule 4, the actual net operating loss for the Company for the test year was $18,213.

The operating income required, less the net operating income (loss), results in an operating income deficiency before taxes of $37,589. The Company did not calculate the tax effect of the operating income deficiency, resulting in a revenue deficiency for the Company of $37,589.

The proforma revenue deficiency for the Company for the test year amounts to zero. It is based upon a proformed test year rate base of $329,546, as summarized in Schedule 1. The Company is utilizing a proformed rate of return of 8.65% for the proformed test year. The proformed rate of return of 8.65% when multiplied by the rate base of $329,546, results in an operating net income requirement of $28,494.

As shown on Schedule 4, the proformed net operating income for the Company for the test year was $28,494. The operating income required less the net operating income results in a deficiency of zero. The tax effect of the deficiency is zero, resulting in a revenue deficiency for the Company of zero.

Q. Would you please explain Schedule 2 and supporting Schedule 2 Attachments?

A. Schedule 2 reflects the Company's Rate Base for both the actual test year and the proforma test year. Column b shows the actual 2009 balances. Column c shows the actual 2008 balances. Column d shows the average of the columns a and b balances. Column e shows the proforma adjustments. Column f shows the proformed balances.

The rate base consists of Utility Plant in Service less Accumulated Depreciation, plus Cash Working Capital, Material and Supplies, Prepayments less net Contributions in Aid of Construction and Accumulated Deferred Income Taxes.

The Total Actual Rate Base based on an average year end balances amounts to $206,973. The significant increase in rate base is due to the 2009 well being placed in service.

The Total Proforma Rate Base with adjustments amount to $329,546. The significant increase in rate base is due to fully reflecting the 2009 well and the 2010 projects in rate base. The adjustments are described below.

Q. Would you please explain Schedule 2A, Rate Base – Water Proforma Adjustments?

<u>Proforma Adjustment to Rate Base</u>

Plant in Service – $169,879

The first adjustment to plant in service is an adjustment to reflect the year end balance (rather than an average of the beginning and ending balances) in rate base. The reflection of the year end balance will allow the Company to begin to fully recover its full investment in the 2009 well. The adjustment to fully reflect the 2009 well amounts to $71,649.

The second adjustment to plant in service is an adjustment for the 2010 projects. In 2010 the Company completed the installation of two concrete water storage tanks and variable frequency drives for two existing booster pumps. The projects cost $98,230. As such, the Company has made an adjustment for $98,230. For additional support, please see schedule 2B.

Accumulated Depreciation - $6,618

The first adjustment to accumulated depreciation is an adjustment to reflect the year end balance (rather than an average of the beginning and ending balances) in rate base. The reflection of the year end balance will allow the Company to begin to fully recover its full investment in the 2009 well. The adjustment to fully reflect the 2009 well amounts to $5,117.

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The second adjustment to accumulated depreciation is an adjustment for the 2010 projects. In 2010 the Company completed the installation of two concrete water storage tanks and variable frequency drives for two existing booster pumps. The projects cost $98,230.

The accumulated depreciation on the 2010 projects amounts to $1,501. As such, the Company has made an adjustment for $1,501. For additional support, please see schedule 2B.

Contribution in Aid of Construction – ($40,105)

The 2010 projects are being financed with funds from the ARRA SRF loan of $81,504, of which $40,752 will be a grant and $40,752 will be a SRF loan. The $40,752 is being treated as a contribution in aid of construction.

The contribution will be amortized over the same period as the assets are being depreciated. The amortization of CIAC amounts to $646.

The net addition to rate base is ($40,105). For additional support, please see schedule 2C.

Cash Working Capital – ($583)

The Company adjusted cash working capital for the proforma change in operating and maintenance expenses. For additional support, please see schedule 2D.

Q. Please explain Schedule 2B.

A. Schedule 2B provides a brief description, the costs, the depreciation rates, the annual depreciation expense and the accumulated depreciation based on a half year depreciation of the 2010 projects.

The total costs of the 2010 projects amount to $98,230. The annual depreciation is $3,002. The accumulated depreciation based on a half year depreciation is $1,501.

Q. Please explain Schedule 2C.

A. Schedule 2C provides a brief description, the amount of the contribution, the amortization rates, the annual amortization of CIAC and the accumulated amortization of CIAC based on a half year amortization of the 2010 projects.

The total contribution associated with the 2010 projects amount to $40,752. The annual amortization of CIAC is $1,292. The accumulated amortization of CIAC based on a half year amortization is $646.

Q. Please explain Schedule 2D – Working Capital – Water.

Schedule 2D shows the computation of cash working capital for both the actual and proforma test years. The proforma cash working capital is based on the proforma test year operation and maintenance expenses.

The Total Proformed Rate Base amounts to $329,546.

Q. Would you please explain Schedule 3, Rate of Return Information?

A. Schedule 3 reflects the overall rate of return for both the actual test year and the proforma test year. The weighted average rate of return for the actual test year is 9.36%. It was developed by taking the actual component ratios times the actual component cost rates to determine the actual weighted average cost rate. The sum of the actual cost rates for equity and debt equals actual weighted average rate of return.

The weighted average rate of return for the proformed test year is 8.65%. It was developed by taking the proforma component ratios times the proforma component cost rates to determine the proforma weighted average cost rate. The sum of the proforma cost rates for equity and debt equals proforma weighted average rate of return.

Schedule 3 also reflects both the capital structure and the capital ratios. The Company has provided the capital structure for the actual test year and the proforma test year. It has also provided the actual capital structure for 2008 and 2007. Please note that even with the addition of the 2009 loan and the 2010 ARRA SRF loan, the Company's debt to equity ratio is favorable.

Schedule 3 also reflects the long term debt, interest expense, financing costs, total debt costs and debt costs rates for the actual test year. At 12/31/09 the Company has $47,192 of outstanding long term debt. Its 2009 total interest expense is $3,303. The 2009 actual cost of debt was 7.00%.

Schedule 3 also reflects the long term debt, interest expense, financing costs, total debt costs and debt costs rates for the proforma test year. In addition to the $47,192 of outstanding debt, the Company has added the ARRA SRF loan of $40,752 and the 2010 Owner Loan of $16,727. With the addition of the $40,752 ARRA SRF loan and the related financing costs, and the 2010 Owner Loan, the total proforma interest expense is $5,885. The 2009 proforma cost of debt is 5.62%.

Q. Please explain Schedule 4 – Statement of Income – Water

A. Schedule 4 reflects the Company's Statement of Income - Water. Column b shows the actual test year results for the Company (as reported to the PUC in its 2009 PUC Annual Report). Column c shows the proforma adjustments for known and measurable changes to test year revenues and expenses. The proforma adjustments are further supported by schedule 4A. Column d shows the proforma test year results. Column e and Column f are actual results for 2008 and 2007, respectively.

During the twelve months ended December 31, 2009, the actual operating revenues amounted to $81,259, an increase of $5,163 over 2008. The increase is due to an increase in water sold. At December 31, 2009 the Company supplied 187 dwelling/commercial units.

In 2009, the Company's total operating expenses amounted to $99,472, an increase of $36,473 over 2008. That was due to an increase in operating and maintenance expenses. The 2009 Net Operating Income (Loss) amounted to ($18,213). Net Income (Loss) for 2009 was also ($18,213).

The Company made one proforma adjustment to operating revenues in the amount of $59,452. A number of proforma adjustments to operating expenses were also made. The specific proforma adjustments are identified on the Statement of Income – Water Proforma Adjustments (Schedule 4A). A brief explanation is as follows:

Proforma Adjustment to Revenues

Sales of Water – Amount Necessary to Earn Return and Cover Operating Costs - $59,452

The Company has increased test year revenues in the amount necessary to cover its expenses and allow it to earn its proposed rate of return.

Proforma Adjustments to Expense

Operating and Maintenance Expenses – ($2,835)

In 2009 Fair Point filed for bankruptcy. Fair Point subsequently told the Company that it would not pay $4,952 of the amount owed. In addition, there were some other adjustments amounting to $2,117. The Company wrote the net amount off in 2009. The Company does not expect this to occur again and has eliminated the amount of the write off from test year expenses.

Depreciation Expenses - $5,374

In 2009 the Company recorded a half year depreciation expense on the 2009 well. This adjustment of $2,372 is for the other half year depreciation so that a full year of depreciation is reflected in the test year.

In 2010 the Company completed the installation of two concrete water storage tanks and variable frequency drives for two existing booster pumps. This adjustment of $3,002 is for a full year depreciation on the 2010 projects. For additional support, please see Schedule 2B.

Amortization of Contribution in Aid of Construction – ($1,292)

In 2010 the Company completed the installation of two concrete water storage tanks and variable frequency drives for two existing booster pumps. Half of the funding ($40,752) of these projects will be contributed. This adjustment of ($1,292) is for a full year amortization on the 2010 projects. For additional support, please see Schedule 2C.

Taxes other than Income – State Utility Property Taxes - $767

In 2009 the Company expensed two years worth of state utility property taxes. The proforma adjustments of ($802) eliminates the additional year.

In 2010 the Company anticipated that its state utility property taxes will increase with the addition to plant of the 2009 well. The Company calculated the increase in state utility property taxes as follows:

$143,405 - $2,366 / 1,000 x $6.60 = $931

In 2011 the Company anticipated that its state utility property taxes will increase with the addition to plant of the 2010 projects. The Company calculated the increase in state utility property taxes as follows:

$98,230 - $1,501 / 1,000 x $6.60 = $638

The total increase in state utility property taxes is $767.

Town of Belmont Property Taxes - $4,123

Similarly, the Company anticipates an increase in local property taxes

In 2010 the Company anticipated that the Town of Belmont property taxes will increase with the addition to plant of the 2009 well. The Company calculated the increase in the Town of Belmont property taxes as follows:

$143,405 - $2,366 / 1,000 x $17.34 = $2,446

In 2011 the Company anticipated that the Town of Belmont property taxes will increase with the addition to plant of the 2010 projects. The Company calculated the increase in the Town of Belmont property taxes as follows:

$98,230 - $1,501 / 1,000 x $17.34 = $1,677

Federal Income and State Business Taxes - $6,608

With the proposed increase in revenue offset by the proposed increase in expenses, there is also a related increase in the federal income and state business taxes. The increase in federal income taxes represents the additional tax liability due to the increase in taxable income. The increase in state business taxes represents the additional tax liability due to the increase in gross profits. The Company has provided the calculation of the federal income taxes and the state business taxes (Schedule 5). The Company has also provided the effective tax factor (Schedule 5A).

The total proforma adjustments to Operating Expenses amounts to $12,745.

The net of the proforma adjustments to operating revenue ($59,452) and the proforma adjustments to operating expenses ($12,745) results in net a proforma adjustment of $46,707. When the net operating income associated with the proforma adjustments is added to net operating income from the test year, the proforma test year net operating income totals $28,494. The proforma test year net operating income of $28,494 allows the Company to cover its expenses and earn a 8.65% return on its investments.

Q. Does that complete your description of the proforma adjustments to revenues and expenses?

A. Yes.

Q. Please comment upon the Report of Proposed Rate Changes.

A. The Company's revised tariff anticipates total water Operating Revenues of $140,711. The rate for Maple Hill Acres shows a greater percentage increase than the other classes of customers. When the Maple Hill project was completed and the Company began providing water, the Company discussed with the PUC Staff the appropriate rates to charge. Subsequent to such discussion, the Company was advised to charge the Class B rates on a temporary basis pending a future change in rates. In this revised tariff, the Company includes the Maple Hill complex in a multifamily residential category. Because of the shift in rate class, the percentage increase is greater than for those customers which did not experience a class shift.

Q. Does this conclude your testimony?

A. Yes.

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