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Direct Testimony of Stephen P. St. Cyr in DW 17-165

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 clientele. 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 Abenaki Water Company ("Abenaki" or "Company")?

A. Yes. St. Cyr & Associates prepared the various exhibits and supporting schedules and prepared the written testimony and other rate case filing requirements. In addition, St. Cyr & Associates prepares Abenaki's PUC Annual Report.

Q. Are you familiar with the pending rate application of Rosebrook and with the various exhibits submitted as Schedules 1 through 4 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 Rosebrook is using in this filing?

A. Rosebrook is utilizing the twelve months ended September 30, 2017.

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Q. Before you explain the schedules, please provide a brief overview of Rosebrook.

A. In 2016 Rosebrook was purchased by Abenaki. Since its purchase, Abenaki has invested in Rosebrook's plant, mostly meters. Rosebrook has a well-documented pressure problem. Rosebrook is looking at ways to address the pressure problem including designing the engineering plans and specification and obtaining the necessary easements reflected in the proposed step increase. Rosebrook will need additional financing for the pressure reduction project.

For the twelve months ended September 30, 2017 (the test year) the actual net loss amounted to $27,247. Abenaki has been losing money on Rosebrook since its acquisition. With the proposed increase in rates and revenues, Rosebrook should be able to eliminate the net loss, recover its investments, earn a fair and reasonable rate of return on its investment and continue to provide service to its customers at fair and reasonable rates.

Q. Is there anything else prior to summarizing the schedules?

A. Yes. Rosebrook seeks Commission approval of a year-end rate base. While the Company has always believed that a year-end rate base is appropriate, that is particularly true for Rosebrook given the investments Abenaki has made since the purchase of the water system. All of these investments are "used and useful" and providing service to customers.

Rosebrook is also seeking recovery of its due diligence costs. These are the costs that were incurred in the process of purchasing the water system and gaining PUC approval (DW 16-448). The recovery of these costs consistent with the PUC's approval of similar due diligence costs incurred when Abenaki purchased Lakeland and White Rock. Rosebrook is proposing to amortize the due diligence costs over an 8 year period.

In addition, Rosebrook is also seeking recovery of its 10% premium. These are the costs incurred above the book value of the assets purchased. Abenaki's parent company, New England Service Company, brings management, operational, financial and administrative strengths that have not been previously available to Rosebrook. Abenaki's purchase of Rosebrook has been seamless and a beneficial transition for its customers. There have been several enhancements within the first year of ownership that demonstrate Abenaki's commitment to prudent investments that not only improve the system's integrity but customer experience as well. There has been a commitment to address the long standing pressure

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problem. Rosebrook proposes to amortize the 10% premium over an 8 year period.

Finally, Rosebrook is using an 11.6% return on equity. This represents a 2% increase in percentage above what the Commission has recently allowed for water companies. Rosebrook believes that the 2% is probably the minimal, acceptable percentage. It believes that it arguably could be in the range of 2% - 4%. As such, Abenaki is collaborating with two other small water companies in engaging a cost of equity expert to prepare testimony focused on size and risk The companies expect a petition pertaining to the subject will be filed with the Commission in the next 45 – 60 days.

Q. Would you please summarize the schedules?

A. Yes. The schedule entitled "Computation of Revenue Deficiency for the Test Year ended September 30, 2017," summarizes the supporting schedules. The actual revenue deficiency for Rosebrook for the test year amounts to $48,905. It is based upon an actual test year with a 4 quarter average rate base of $488,114 as summarized in Schedule 3. The Company's actual rate of return is 6.74% for the actual test year. The rate of return of 6.74%, when multiplied by the rate base of $488,114, results in an operating income requirement of $32,920. As shown on Schedule 1, the actual net operating income (loss) for the Company for the test year was ($15,985). The operating income required, less the net operating income (loss), results in an operating income deficiency before taxes of $48,905. The Company did not calculate the tax effect of the revenue deficiency, resulting in a revenue deficiency for the Company of $48,905.

The pro forma revenue deficiency for the Company for the test year amounts to zero. It is based upon a pro formed test year rate base of $625,578, as summarized in Schedule 3. The Company is utilizing a pro formed rate of return of 7.78% for the pro formed test year. The pro formed rate of return of 7.78% when multiplied by the rate base of $625,578, results in an operating net income requirement of $48,673.

As shown on Schedule 1, the pro formed net operating income for the Company for the test year is $48,673. 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.

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Q. Would you please explain Schedule 1 and supporting Schedule 1A – 1C?

A. Schedule 1 reflects Rosebrook's Statement of Income. Column b shows the actual Oct. – Dec. 2016 3 months' balances. Column c shows actual Jan. – Sept. 2017 nine months' balances. Column d actual Oct. 2016 – Sept. 2017 combined balances. Column e shows the pro forma adjustments for known and measurable changes to test year revenues and expenses. The pro forma adjustments are further supported by schedule 1A. Column f shows the pro forma test year balances.

During the twelve months ended September 30, 2017, the actual operating revenues amounted to $270,092. Rosebrook's total operating expenses amounted to $286,077, resulting in a net operating loss of ($15,985). Net Income (Loss) for the same period is ($27,247).

The Company made 1 pro forma adjustment to operating revenues totaling $102,232 and a few pro forma adjustments to operating expenses totaling $37,574. The specific pro forma adjustments are identified on the Statement of Income – Pro forma Adjustments (Schedule 1A). A brief explanation is as follows:

<u>Pro forma Adjustment to Operating Revenues</u>

<u>Operating Revenues – $102,232</u>

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

<u>Pro forma Adjustments to Expense</u>

Operating Expenses:

<u>PUC Audit - $1,000</u>

In anticipation of a PUC audit, the Company estimated that it will incur $3,000. No such audit expenses are reflected in the test year. The Company is proposing to recover the proposed audit expense of $3,000 over 3 years, resulting in a test year adjustment of $1,000.

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Lease Agreements - $342

During the test year Rosebrook incurred $7,794 for rent of lease space, both at Laconia. NH. and Plainville, CT. Going forward, Rosebrook expects to pay $618 per month or $7,416 per year at Laconia, NH and $60 per month or $720 per year at Plainville, CT., totaling $8,136. The difference between what Rosebrook expects to pay and what it did pay during the test year results in a pro forma adjustment of $342.

Amortization of Organizational Costs - $6,491

Abenaki incurred due diligence costs in the process of purchasing the water system and gaining PUC approval (DW 16-448). The recovery of these costs are consistent with the PUC's approval of similar due diligence costs incurred when Abenaki purchased Lakeland and White Rock. Rosebrook is proposing to amortize the due diligence costs over an 8 year period.

Amortization of Utility Plant Acquisition Costs - $4,529

Abenaki incurred a 10% premium above the book value of the assets purchased. The recovery of these costs is based on its management, operational, financial and administrative strengths of the organization. The recovery also would align the premium with other jurisdictions such as MA. and CT. Rosebrook proposes to amortize the 10% premium over an 8 year period.

During the twelve months ended September 30, 2017, Rosebrook incurred $5,090 and $17,614 in state and local property taxes. At this point, the Company is unaware of any increase or decrease in property taxes. As such, the Company has not made any pro forma adjustments. However, it reserves the right to increase and / or decrease property taxes for any known and measurable change likely to be known later this year.

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.

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The Company has provided the calculation of the federal income taxes and the state business taxes (Schedule 1B). The Company has also provided the effective tax factor (Schedule 1C).

The total pro forma adjustments to Operating Expenses amount to $37,574.

The net of the pro forma adjustments to operating revenue of $102,232 and the pro forma adjustments to operating expenses of $37,574 results in a net pro forma adjustment of $64,658. When the net operating income associated with the pro forma adjustments is added to net operating income from the test year, the pro forma test year net operating income totals $48,673. The pro forma test year net operating income of $48,673 allows Rosebrook to cover its expenses and earn its proposed 7.78% return on its investments.

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

A. Yes.

Q. Please describe Schedule 2, the Balance Sheet.

A. Please note that the Balance Sheet is for Abenaki (Total Company) and not just Rosebrook. Abenaki has $2,002,892 total assets at September 30, 2017. $1,689,653 of the $2,002,892 total assets is net plant, of which is completed and providing service to customers. Abenaki has $636,755 of total equity capital. Abenaki incurred a loss in 2016, which reduced retained earning and total equity. Abenaki has $576,965 of long term debt. The long term debt balance has decreased due to payment of principal on the two outstanding loans. Accounts payable to Associated Co. has increased during the test year. A portion of the plant has been contributed.

Q. Please continue with an explanation of Schedule 3, Rate Base and the supporting schedule.

A. Schedule 3 reflects Rosebrook's Rate Base for both the 4 quarter average and the pro forma year-end balance. Column b – e shows the actual balance at the end of each quarter. Column f shows the average of the 4 quarter balances. Column g shows the pro forma adjustments. Column h shows the pro forma year-end balance.

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Schedule 3A shows the Rate Base – Pro forma Adjustments. Pro forma adjustments 1, 3, 6, 7, 8, 9 & 10 adjust the 4 quarter average balances to the September 30, 2017 balances. It is appropriate to use the September 30, 2017 balance since all of the invested capital is fully “used and useful” and providing service to customers.

Adjustments 2 & 4 pertain to due diligence costs of $51,931, which represents the expenditures incurred in pursuing and gaining PUC approval to purchase Rosebrook. The Company proposes to recover such costs over 8 years.

Adjustment 5 pertains to the amortization of the Rosebrook 10% premium. The premium is being amortized over 8 years.

Adjustment #11 pertains to cash working capital and shows the additional cash working capital due to the proposed increase in O&M expenses. The cash working capital balances are further supported by Schedules 3C.

Schedule 3B shows the reclassification of the Rosebrook due diligence costs to organizational costs. The due diligence costs amounted to $51,931. The Company proposes to recover such costs over 8 years.

The Total Pro forma September 30, 2017 Rate Base balance amounts to $625,578.

Q. Would you please explain Schedule 4, Rate of Return Information?

A. Please note that the Rate of Return Information is for Abenaki (Total Company) and not just Rosebrook. Schedule 4 reflects the overall rate of return of 6.74% and 7.78% for actual and pro foma, respectively. The weighted average rate of return for the actual test year is 6.74%. 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. Rosebrook made only one adjustment to the actual rate of return. It added 2% to the PUC determined 9.6% cost of equity.

The 2% represents a minimal percentage increase for the size, the increased risk to own and operate a smaller water company and the increased costs of both debt and equity capital. As such, the weighted average rate of return for the pro forma test year is 7.78%.

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Schedule 4 also reflects both the capital structure and the capital ratios. Abenaki has provided the capital structure for the actual test year and the pro forma test year. It should be noted that prior to the purchase of Rosebrook, Rosebrook's capital structure consisted entirely of equity capital. With both debt and equity used to finance the purchase, the Capital structure is better balanced and results in a lower rate of return.

In addition, Schedule 4 reflects the long term debt, interest expense, financing costs, total debt costs and debt costs rates for the actual test year. At 9/30/17 Abenaki has $592,281 of outstanding long term debt. Total interest expense for the twelve months ended September 30, 2017 is $21,762. The September 30, 2017 actual cost of debt was 3.67%. There was no change to the long term debt, interest expense and financing costs for the pro forma test year.

Q. Please explain the Report of Proposed Rate Changes.

A. If Rosebrook's filing is approved as submitted, its total water Operating Revenues will amount to $372,324.

Q. Is Rosebrook proposing any changes to the methodology used in calculating the rates?

A. Yes. Rosebrook needs to increase its revenue from the quarterly charges. The present rates generate approximately 31% of the total revenues via the quarterly charges. Rosebrook believes that the percentage from quarterly charges should be closer to 50%, particularly due to the seasonal nature of the service area. As such, Rosebrook proposes to double the quarterly charges. With doubling the quarterly charges, the proposed rates would generate approximately 45% of the total revenue.

Q. When is Rosebrook proposing that the new rates be effective?

A. The proposed effective date is January 1, 2018.

Q. Is there anything else that Rosebrook would like to address?

A. Yes.

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Q. Has Rosebrook prepared Step Increase schedules? If so, please describe.

A. Yes. Rosebrook is proposing 2018 additional to plant of $210,000 including designing the engineering plans and specifications and obtaining the necessary easements reflected in the proposed step increase. The proposed additional revenue requirement associated with the planned additions to plant is $22,645. It is derived from the net addition to rate base of $206,563. The return on the additional plant at 5.12% is $10,570. The additional operating expenses are $12,075. The sum of the return of $10,570 and the additional operating expenses of $12,075 results in an additional revenue requirement of $22,645.

Please see Page 1 of 4 of the Step Increase schedule. Page 2 of 4 shows how the annual cost rate of 5.12% was derived. Page 3 of 4 shows the costs of the plant and the related depreciation. Page 4 of 4 shows the additional state and local property taxes.

Q. Is there anything else that the Company would like to address?

A. Yes. The Company has decided to pursue temporary rates as part of this rate case filing. The temporary rate filing will be filed under a separate cover letter.

Q. Is there any other rate matter that you would like to discuss?

A. Yes. The Company has engaged the services of Stephen P. St. Cyr & Associates to prepare the rate filing and pursue the rate increase throughout the rate case proceeding. St. Cyr & Associates and Abenaki have agreed on a per hour fee of $135.00 for each hour of work performed. Abenaki and I believe that the fees are fair and reasonable. At this point, Abenaki does not anticipate utilizing outside legal council.

Q. Would you please summarize what the Company is requesting in its rate filing?

A. The Company respectfully requests that the Commissioners approve an increase in annual revenues of $102,232 for permanent rates. Also, the Company respectfully requests that the PUC approve the Company requests for step increase of $22,645.

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Q. Is there anything further that you would like to discuss?

A. No, there is nothing further.

Q. Does this conclude your testimony?

A. Yes.

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12/04/17