STEPHEN P. ST. CYR & ASSOC.

17 Sky Oaks Drive, Biddeford, ME 04005
PHONE: (207) 282-5222 FAX: (207) 282-5225

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STATE OF NEW HAMPSHIRE

PUBLIC UTILITIES COMMISSION

FOREST EDGE WATER COMPANY

DW 08-160

PETITION FOR APPROVAL OF FINANCING AND RATE INCREASES

PREFILED DIRECT TESTIMONY OF STEPHEN P. ST. CYR

Q. What is your name and business address?

A. My name is Stephen P. St. Cyr and my business address is 17 Sky Oaks Drive, Biddeford, Me.

Q. Who is your employer?

A. My employer is Stephen P. St. Cyr & Associates.

Q. Please provide a brief overview of Forest Edge Water Company.

A. Forest Edge Water Company is a subsidiary of Kearsarge Building Company, Inc. ("KBC") of North Conway, N. H. It was granted its franchise area in 1985 to serve in a limited area in the Town of Conway, specifically the area of the Forest Edge II subdivision. At December 31, 2007 the Company served 38 customers. It is managed by KBC. FXLyons is the licensed operator. It has no employees. The Company has two wells including the redevelopment an existing well placed in service in 2007. The water supply is plentiful. The water is not treated.

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The Company's customers are not metered. The Company expects little or no growth in customers.

Q. Please provide a brief overview of the Company's financial position.

A. At December 31, 2007 the Company has total assets of $50,688. Its total net utility plant is $28,117. The Company has no cash. The Company has total long term debt of $117,082 owed to KBC. The Company made no payments to KBC in 2007. In fact, it borrowed $25,509 from KBC. It has a retained earning (deficit) of ($88,164). The retained deficit represents numerous years of net losses. In 2007 the total operating revenues amounted to $7,600. Its total operating expenses amounted to $23,470, resulting in net income (loss) of ($15,870).

Q. What are your responsibilities in this case?

A. My responsibilities are to support Forest Edge Water Company's ("Company" or "Forest Edge") effort to obtain Public Utilities Commission ("PUC") approval of financing from KBC and approval of an increase in the water rate. My responsibilities include preparing the financial schedules and prefiled direct testimony which describes the financing, the rate increase and the financial schedules. In addition, I am prepared to testify in support of the financing and rate increases.

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Q. Have you prepared testimony before this Commission?

A. Yes, I have prepared and presented testimony in numerous cases before the Public Utilities Commission, including requests for new and expanded franchises, requests for approval of State Revolving Fund ("SRF"), commercial bank and owner financings and requests for rate and step increases.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to support the Company's effort to borrow $25,509 from KBC, which allowed the Company to redevelop an existing well, install new pumping equipment and meet its operating expense requirements in 2007 and to increase rates so as to generate enough revenue in order to pay its expenses and repay the loan.

Q. Please describe the redeveloped well and pumping equipment.

A. The Company cleaned out and deepened an existing well that was drilled in 1973. The well was deepened 200 feet, which increased the flow to 150 gallons per minute. The Company dug a trench from the well to the pump house and laid new water and electrical lines. The Company installed new wiring at the pump house. The Company also installed two new pumps.

Q. When was the redeveloped well and pumping equipment placed in service?

A. The new well and pumping equipment were placed in service in December 2007.

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Q. What were the costs of the new well and pumping equipment?

A. The costs were as follows:

Structures	$2,265
Well	7,029
Pumping Equipment	7,081
Total	$16,375

Q. How much of the costs will be financed?

A. All of the costs.

Q What other costs needed to be financed?

A. The other costs amount to $9,134, which represent 2007 operating costs. In 2007 the Company experienced a net income (loss) of ($15,870). The net loss was due to inadequate revenues and increased expenses, particularly maintenance and water testing. The increased maintenance expenses eventually led to the redevelopment of an existing well and the installation of new pumping equipment.

Q. How much is the total proposed financing?

A. The total proposed financing is $25,509.

Q. What was the source of financing?

A. The Company borrowed the money from KBC.

Q. What are the terms and conditions of the financing?

A. The length of the loan is 20 years. The interest rate is 7%.

Q. How does the Company propose to recover its investment?

A. The Company proposes to recover its investment through an increase in the water rate.

Q. What is the impact of the financing and the additions to plant on the Company's financial statements?

A. The Company's utility plant in service increased from $34,313 to $50,688, an increase of $16,375. The Company's long term debt increased from $91,573 to $117,082, an increase of $25,509. The increases in utility plant in service and long term debt are reflected in the actual 2007 year end balances.

Q. Is there anything else related to the additions to plant and the financing that you would like to address before you address the rate filing and the rate schedules?

A. No.

Q. Is there anything that you would like to address before you explain the specifics of the rate schedules and rate increase?

A. Yes.

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Q. Please continue.

A. The present authorized annual rate of $200 was authorized in DE 84-376 by PUC order number 17,490, dated March 12, 1985. At the time, the Company served 31 customers. It's authorized revenue requirement amounted to $6,205 (to recover its operating expenses). The Company sought no return on its rate base. In 1993 the Company filed for a rate increase, but later decided not to pursue the rate increase due to the complexity, process and costs associated with a rate case. In March of 2009, it will be 24 years since the last rate increase.

Q. Are you familiar with the pending rate application of the Company and with the various exhibits submitted as Schedules 1 through 4 inclusive, with related pages and attachments?

A. Yes, I am. The schedules were prepared by me, utilizing the financial records of the Company with the assistance of Company personnel.

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, 2007.

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Q. Would you summarize the schedule entitled "Computation of Revenue Deficiency for the Test Year ended December 31, 2007"?

A. Yes. This schedule summarizes the supporting schedules. The actual revenue deficiency for the test period amounts to $15,870. It is based upon an actual test year beginning and ending 2007 average rate base of $27,809, as summarized in Schedule 3. The Company is utilizing its authorized rate of return of 0.00% for the actual test year. The authorized rate of return of 0.00% when multiplied by the rate base of $25,095, results in an operating income requirement of $0. As shown on Schedule 1, the actual net operating income (loss) for the test period was ($15,870). The operating income requirement less the net operating income results in an operating income deficiency of $15,870. The Company assumed a tax effect on the operating income deficiency of $0, resulting in a revenue deficiency of $15,870.

The proforma revenue deficiency for the test year amounts to $0. The Company made three adjustments to its rate base to reflect the year end balances for the 2007 additions to plant, the year end balance for accumulated depreciation, and the decrease in cash working capital for the decreases due to decreased proforma operating and maintenance expenses. The Company adjusted the rate of return to reflect its proforma capital structure and its proforma cost of debt.

The net of the adjustments to the capital structure and the adjustments to the cost rates results in a rate of return of 7.00%. As such, the rate of return of 7.00% when multiplied by an adjusted rate base of $32,552, results in an operating income requirement of $2,279. The Company increased its revenue by $10,852 in order to allow the Company to recover its costs and to earn a fair and reasonable return on its investment. The Company has determined that if the proposed revenue is approved, the average annual amount for a residential customer will increase from $200.00 to $485.58, an increase of $285.58 or 143%.

Q. Please explain Schedule 1, "Statement of Income," for the twelve months ended December 31, 2007.

A. Yes. Generally, column (a) identifies the account title and PUC account number. Column (b) identifies the actual December 31, 2007 account balances. Column (c) identifies the proforma adjustments. Column (d) reflects the adjusted December 31, 2007 account balances. Column (e) identifies December 31, 2006 account balances. Column (f) identifies the December 31, 2005 account balances.

Q. Please continue.

A. Column b of Schedule 1 shows the actual operating results of the Company from January 1, 2007 through December 31, 2007. The Company has filed its 2007 NHPUC Annual Report, which further supports the rate filing.

During the twelve months ended December 31, 2007, the Company operating revenues amounted to $7,600, an increase of $200. The Company's revenue increased slightly due to the addition of one customer. The Company customer base has remained stable. The Company had 38 customers at December 31, 2007. The Company's operating expenses consisted of operation and maintenance expenses, depreciation and taxes other than income. Total 2007 operating expenses amounted to $23,470, an increase of $14,702 or 168%. Operation and maintenance expenses increased $14,222, primarily due to increases in maintenance. The Company's net operating income (loss) amounted to ($15,870). The Company reviewed a number of expense accounts in its preparation of the rate filing. In its review, the Company determined that certain expenses needed to be adjusted in order to reflect what would be considered normal and reoccurring.

Q. Please explain each of the proforma adjustments made to revenue as shown on Schedule 1, column c and further supported on Schedule 1A.

A. The Company made one proforma adjustment to revenue.

<u>Revenue</u>

The proforma adjustment to revenue for $10,852 represents the additional revenue needed to recover the increase in its costs and to earn a reasonable return on its rate base. The total proforma adjustment to revenue amounts to $10,852.

Q. Did the Company make any proforma adjustments to expenses?

A. Yes. The Company made a few proforma adjustments to expenses as follows:

Maintenance of Pumping Equipment

In 2007 the Company incurred $13,255 of expense associated with the maintenance of the system. The 2007 expense includes $4,108 for various maintenance incurred during mid February – March and $1,619 for locating and repairing leak in September. The Company recognizes that its 2007 expenses are significantly higher than most years and, as such, has averaged its maintenance expenses incurred in 2007 with its maintenance expenses incurred in 2006 and 2005. The sum of the maintenance expenses for the three years amounts to $19,850 ($13,255 + $1,438 + $5,157). When the sum of the maintenance expenses for the three years is divided by three, the average is $6,617 ($19,850 / 3). With the three year average equaling $6,617, the Company made a proforma adjustment for $6,638, reducing test year maintenance expense by that amount.

Regulatory Commission Expenses (Water Testing)

In 2007 the Company incurred $1,912 of expense associated with water testing. The 2007 expense includes $1,240 for various samples incurred in August. The Company recognizes that its 2007 expenses are higher than most years and, as such, has averaged its water testing expenses incurred in 2007 with its water testing expenses incurred in 2006 and 2005.

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The sum of the maintenance expenses for the three years amounts to $2,740 ($1,912 + $357 + $471). When the sum of the water testing expenses for the three years is divided by three, the average is $913 ($2,740 / 3). With the three year average equaling $913, the Company made a proforma adjustment for $999, reducing test year water testing expense by that amount.

Depreciation Expenses

In 2007 the Company recorded $1,243 of depreciation expenses. In reviewing such expenses, the Company determined that its 2007 depreciation expense should have been $1,555. As shown on Schedule 3B, the Company reclassified certain plant. With the reclassification, particularly the $4,416 to pumping equipment, the revised plant amount for pumping equipment is larger and subject to a shorter depreciation life. With the increase in 2007 depreciation expense to $1,555, the Company made a proforma adjustment for $311, increasing test year depreciation expense by that amount.

Taxes other than Income

In 2007 the Company incurred $79 of state utility property taxes. The 2008 state utility property taxes amounted to $91. As such, the Company made a proforma adjustment for $12, increasing test year taxes other than income by that amount.

Also, in 2007 the Company incurred $138 local property taxes. The 2008 the local property taxes amounted to $155. As such, the Company made a proforma adjustment for $17, increasing test year taxes other than income by that amount. The total proforma adjustment to expenses amounts to ($7,297).

Q. Did the Company review its other expenses?

A. Yes. The Company reviewed a number of other operating expenses. While most other expenses were determined to be reasonable and reoccurring, and provided a proper basis in which to establish future rates, the Company is still reviewing its management agreement and accounting fees. To the extent that it is later determined that these expenses need to be adjusted, the Company will submit such expenses to be included as an adjustment to test year expenses.

Q. Does column d of Schedule 1 represent the sum of the actual test year amounts (column b) plus the proforma adjustments (column c)?

A. Yes it does.

Q. Does column e and f represent the revenue and expenses for the twelve months ended December 31, 2006 and 2005, respectively?

A. Yes it does.

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Q. Would you please explain Schedule SPS 2, Page 1 of 2, entitled Balance Sheet – Assets and Other Debits?

A. Yes. Generally, column (a) identifies the account title and PUC account number. Column (b) identifies the actual December 31, 2007 account balances. Column (c) identifies the actual December 31, 2006 account balances. Column (d) identifies the actual December 31, 2005 account balances.

At December 31, 2007 the Company has $28,117 of total net utility plant, including the 2007 addition to plant for $16, 375. The Company has no cash and relies on Kearsarge Building Company to meet its cash requirements when the Company is unable to do so. The Company has retained earnings of ($88,164), which represents the accumulation of numerous years of net losses. The Company also has other long term debt amounting to $117,082. The other long term debt represents advances provided by Kearsarge Building Company in order for the Company to meet its ongoing obligations. The Company is unable to repay a substantial part of the advances.

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Q. Would you please summarize Schedule 3, "Rate Base"?

A. Column (a) identifies the account title. Columns (b) & (c) show the actual balances of the rate base items as per the Company's financial statements for the years 2007 and 2006. Column (d) shows the actual average beginning and ending 2007 balances, except for cash working capital, which reflects the cash working capital for 2007. Column (e) shows the 2008 proforma adjustments. Column (f) shows the proforma beginning and ending 2007 balances.

The rate base consists of Utility Plant, less Accumulated Depreciation, plus Cash Working Capital and Prepayments. The actual beginning and ending average rate base amounts to $27,809. The Company made three adjustments to rate base. The first adjustment to plant in service is $8,188. The second adjustment to accumulated depreciation is ($933). The third adjustment to cash working capital is ($2,511). The proforma beginning and ending average rate base amounts to $32,552. The proforma amounts are shown and further supported by Schedules 3A – 3C.

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Q. Please explain Schedules 3A – 3C.

A. Schedule 3A shows the adjustments to plant in service and accumulated depreciation. In 2007 the Company added $16,375 to plant in service. With the use of the beginning and ending actual balances, only one half of the 2007 additions are reflected in the actual rate base. The Company proposes to fully reflect the 2007 additions in rate base. In order to fully reflect the 2007 additions, the Company has added the other half of the 2007 additions. The Company made a proforma adjustment for $8,188 ($16,375 / 2).

Likewise, with the use of the beginning and ending actual balances, only one half of the accumulated depreciation related to the 2007 additions is reflected in the actual rate base. The Company proposes to fully reflect the accumulated depreciation on the 2007 additions in rate base. In order to fully reflect the 2007 accumulated depreciation related to the 2007 additions, the Company has added the other half of the accumulated depreciation on the 2007 additions. The Company made a proforma adjustment for ($933).

In addition to fully reflecting the accumulated depreciation related to the 2007 additions, the Company made other adjustments to accumulated depreciation as described on Schedule 3B.

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Schedule 3B shows adjustments to plant in service. In 2007 the Company reported a total of $50,688 plant in service. Upon further review, certain expenditures charged to wells and springs should have been charged to structures and pumping equipment. The Company charged $14,110 as wells and springs in 2007. $2,265 for electrical work should be charged to structures. $4,816 for additional costs related to pumping equipment should have been charged to pumping equipment. The sum of the two adjustments reduces wells and springs by $7,081. With the adjustments to plant in service, the related depreciation expense needs to be adjusted. In 2007 the Company reported a total of $1,243 depreciation expenses. Because the depreciation rates are different for each account, the depreciation expense needs to be adjusted. Depreciation expense for structures increase because of the additional plant. Depreciation expense for pumping equipment increases because of the additional plant and the shorter life. Depreciation expense for wells and springs decrease due to less plant. The net effect of the adjustments is $311. The adjustment effects both the income statement and rate base.

Schedule 3C shows working capital. Working capital is determined by 120/365 days of operating expenses. The computation of working capital is shown on schedule 3C.

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

A. The Company is proposing an overall rate of return of 7.00%. It is the Company's best judgment in determining what an interest rate on a loan might be for the Company (assuming that a lender would be willing to lend money to the Company). In all likelihood, no lender would loan the Company funds without some guarantee from the Company's owner. The Company's capital structure consists of negative equity and long term debt. The Company has no short term debt. The negative equity is due to the Company's retained deficit position. The Company added $25,509 to its long term debt in 2007, resulting in total long term debt of $117,082.

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

A. Yes. The Company is considering converting some of its long term debt to additional paid in capital. Even after conclusion of the rate case, the Company's rate base will not be sufficient to support the substantial long term debt. As such, the Company is considering converting some of the long term debt so that the recovery of and return on the Company's investment in plant generates enough revenue to repay the resulting long term debt.

Q. Is the Company proposing to change the rate design?

A. No. The Company has applied the proposed water rate increase proportionally to its 38 customers.

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

A. Yes. There are two matters. First, the Company is considering requesting temporary rates. To the extent that the Company decides to request temporary rates, the Company will make such a filing. Second, the Company has engaged the services of Stephen P. St. Cyr & Assoc. The Company has agreed to an hourly fee of $105.00 (plus out of pocket costs) for work performed in preparation of the rate filing and pursuit of the rate increase during the rate proceeding. At this point, the Company does not anticipate utilizing outside legal council. The Company will make every effort to minimize its rate case expense.

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

A. No.

Q. Would you please summarize what the Company is requesting in this docket?

A. Yes, the Company is requesting PUC approval of a financing of $25,509 and an increase in the annual water revenue from $7,600 to $18,452, effective immediately. The approval of the financing will enable the Company to repay its owner, Kearsarge Building Company for 2007 water system improvements and other expenditures.

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The increase in the water revenues will enable the Company to earn a return of 7.00% on its investment, reflected in a proforma rate base of $32,552, and recover its ongoing operating expenses. The average annual amount for the 38 residential customers will increase from $200.00 to $485.58, an increase of $285.58 or 143.79%.

Q. Does this conclude your testimony?

A. Yes.

SPSt. Cyr

2/09/09