STATE OF NEW HAMPSHIRE

BEFORE THE

PUBLIC UTILITIES COMMISSION

Re: Lakes Region Water Company

DW 09-____

DIRECT PREFILED TESTIMONY OF

STEPHEN P. ST. CYR

May 29, 2009

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. What are your responsibilities in this case?

A. My responsibilities are to prepare the financial schedules, the prefiled direct testimony, and the petition for authority to borrow funds and to increase rates ("petition"). In addition, I am prepared to testify in support of the Lakes Region Water Company's petition.

Q. Have you prepared testimony before this Commission?

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

Q. Have you prepared and presented testimony to this Commission on behalf of Lakes Region Water Company, Inc. ("Company")?

A. Yes.

Q. When was the most recent time and what was the subject matter, that you presented testimony on behalf of the Company?

A. In 2008 I prepared and presented testimony in DW 08-070, the Company's petition for financing and three step increases to rates.

Q. Were the step increases to rates granted by the Commission?

A. Yes. The Commission approved the Company's request to increase its revenues as indicated in the settlement agreement entered into by the PUC Staff and the Company.

Q. When did the step increases go into effect?

A. Steps 1 and 2 were combined and went into effect for bills issued on or after November 30, 2008. Step 3 is still waiting for completion of some of the projects prior to obtaining final approval. The Company anticipates that the projects will be completed in the next several months.

Q. Did all relevant parties to DW 08-070 sign the settlement agreement?

A. No. The Office of Consumer Advocacy (OCA) did not sign the agreement. The OCA prepared and presented testimony opposing the terms of the financing and the step increases. The OCA also expressed concerns about the Company's managerial, technical and operational abilities.

Q. Why did the OCA oppose the step increases?

A. According to the Joint Testimony of Mr. Traum and Mr. Eckberg dated September 4, 2008, the OCA "opposes Step Increases done in isolation for items not fully vetted in a general rate case." Also, according to the Joint Testimony, the OCA indicated "that the proposed step adjustment, which are not the result of prior rate proceedings, amount to inappropriate single issue ratemaking."

Q. Did the Commission approve the step increases despite the OCA's opposition?

A. Yes. The Commission, in its Order No. 24,925 dated December 30, 2008, indicated that "We are mindful that this Commission has limited the use of the step adjustment mechanism so as to allow recovery of expenditures which are in service and necessary for the provision of safe and adequate service." The Commission further indicated that "Typically, those expenditures are for large capital projects which, if not recoverable, would have a detrimental impact on a utility's rate of return."

Q. Now, Mr. St. Cyr, let us return to the present. What is the purpose of your current testimony?

A. My testimony is in direct support of Lakes Region Water Company's filing for Commission approval for both funding and expenditure of $1,500,000 for seven (7) different infrastructure projects to take place in five (5) of its seventeen (17) water systems. The Company is also asking the Commission to allow it to recover its project costs along with an appropriate rate of return based on the funding through a single step increase to go into effect at the end of the projects. The Company is also seeking an order "NISI" from the Commission.

Q. Why is the Company not only asking for approval of the financing and step increase, but is also asking that the Commission issue an order "NISI"?

A. The Company is asking the Commission to issue an order "NISI" due to the uniqueness of the situation.

Q. Mr. St. Cyr would you please explain the uniqueness of this situation?

A. With the recently passed Federal Legislation, the American Recovery and Reinvestment Act of 2009 (ARRA), or better known as the Federal Stimulus Package, funds became available to the State for "shovel ready" infrastructure projects.

Q. What process did the Company have to follow?

A. The New Hampshire Department of Environmental Services (NHDES), through its State Revolving Fund ("SRF"), received ARRA funds, which they have to spend in a prudent but expeditious manner in order to adhere to the Federal guidelines. As such the NHDES notified all water utilities in the state, posted the guidelines for qualifying projects and solicited pre-application filing for projects. The Company submitted pre-applications for 10 projects totaling $2,900,000. The NHDES received 265 project pre-applications. NHDES evaluated each project as to need, economics of the area, and other criteria, which lead to each project receiving a ranking from 1 to 265. The NHDES then started at the top until the money ran out. Of the Company's 10 projects, 5 qualified with a ranking low enough to potentially receive funds. Upon further review, NHDES determined that the ARRA funds had a mandatory "green" component to the money and not enough of the projects submitted had qualifying components. Because of the mandate to spend a certain amount of the ARRA funds on "green" projects, the NHDES extended the deadline for submission of projects which included meters. Lakes Region Water Co., submitted four (4) pre-applications for metering projects at Tamworth, 175 Estates, LOV, and Indian Mound. Within a week the NHDES had evaluated the projects submitted and accepted the metering projects at Tamworth ($32,000) and the 175 Estates ($21,000) and rejected LOV and Indian Mound for being ineligible due to being primarily 2nd home communities.

Q Is that the extent of the uniqueness of the process?

A. No. The speed demands on these projects are accelerated throughout the project life and over all governmental agencies from Federal to State to Local. The project administrators, the NHDES, have been instructed that if proper approvals for the projects are not received from the local communities, or in our case, the NHPUC, in an expeditious manner then the project dollars will be withdrawn and awarded to the next project in line. This is all being done, not to punish utilities that can not get approval, but to expend the "Stimulus Money" as quickly as possible in order to maximize the economic impact of the process.

Q Thank you, Mr. St. Cyr, for that explanation of uniqueness of the situation. Is that all?

A. No. The availability of funds and time are not the only factors that make this situation unique. These dollars come with another **wonderful** uniqueness for the Company and especially for the **customer**, one-half (1/2) of the funds received from the ARRA program will be **grant dollars**. The **grant dollars** do not have to be repaid, and will be treated as Contribution in Aid of Construction ("CIAC"). The contributed assets funded with grant dollars are not recoverable by the utility and do not earn a return on the funds, thereby having **no impact on rates**. The second half of the funds must be repaid over a 20 year period at an interest rate of 3.744%. Without speedy action by the Commission and its Staff, and especially the Company, these vital infrastructure improvements will be delayed and will cost the Company and its customers more.

Q. Thank you! Can you now explain in a little more detail, through your testimony, the Company's purpose for this proposed financing and step increase?

A. The purpose of my testimony is to support the Company's effort to obtain PUC approval to borrow funds from the State Revolving Funds and to use such capital (1) to purchase and install a uranium filter at Tamworth Water Works, (2) to purchase and install meters at Tamworth Water Works, (3) to replace mains at Gunstock Glen / Brake Hill, (4) to replace pump station including the structure, pumps, tank and SCADA system at Woodland Grove, (5) to replace mains at Echo Lake Woods, (6) to replace mains at 175 Estates and (7) to purchase and install meters at 175 Estates. In addition, the purpose of my testimony is to support the Company's effort to obtain PUC approval to increase rates via a step increase associated with the additions to plant.

Q. Please describe the uranium filter and meters at Tamworth.

A. At Tamworth, the Company has a well that is out of service due to high levels of uranium. With the addition of a uranium filter, the amount of uranium in the water will be within acceptable levels. Once the water is tested, and DES approves, the well will be used as a backup source of supply. In addition, the Company plans to purchase and install 70 residential meters. The installation of meters will allow both Company and its Tamworth customers to benefit. The Company will be able to monitor consumption and compare consumption data to production data. The customers will also be able to monitor their usage and potentially reduce water consumption.

Q. Why is it necessary to purchase and install the uranium filter and the meters?

A. The Company is required, under DES requirements, to add a backup source of supply to its Tamworth system. The Company has previously agreed with the PUC Staff (and such agreement has been approved by the PUC) to add meters.

Q. When does the Company anticipate that the uranium filter and meters will be purchased and installed?

A. The Company anticipates that the uranium filter will be purchased, installed, tested and approved by DES and placed in service in the fall of 2009.

Q. What are the costs of the uranium filter and meters?

A. The estimated costs of the uranium filter are $46,000. The estimated costs of the meters are $32,000.

Q. Please describe the main replacement project at Gunstock Glen / Brake Hill.

A. The water system is an old, developer built system. Presently, the Gunstock Glen / Brake Hill system has approximately 8,000 feet of 1 ¼" inch pipe. The size of the pipe is undersized for the system. The size of the pipe makes it susceptible to leaks. The Company proposes to replace the 1 1/4" pipe with 4" pipe. The increased size of the pipe will provide better water flow and pressure.

Q. Why is it necessary to replace the mains?

A. It is necessary to replace the mains so as to increase the reliability of the system, to improve water flow and pressure and to reduce water loss.

Q. When does the Company anticipate that the mains will be completed and placed in service?

A. The Company anticipates that the installation of the mains will be completed and placed in service in the spring/summer 2010.

Q. What are the costs of the installation of the mains?

A. The estimated costs of the mains are $750,000.

Q. Please describe the replacement of the pump station at Woodland Grove.

A. The present pump station is an "old pit" (in a hole, confined space). It is always wet because it is below the water table. It is difficult to access. The Company plans to built a new structure, replace the pumps and tank and install SCADA.

Q. Why is it necessary to replace the pump station?

A. It is necessary to replace the pump station in order to better able to access and operate it.

Q. When does the Company anticipate that the pump station will be completed and placed in service?

A. The Company anticipates that the pump station will be completed and placed in service by the end of the year.

Q. What are costs to replace the pump station?

A. The estimated costs to replace the pump station including the structure, pumps, tank and SCADA are $145,000.

Q. Please describe the replacement of mains at Echo Lake Woods.

A. Presently, the Echo Lake Woods water system has approximately … feet of 2" inch mains. The water system has experienced substantial water loss due to main leakage. The Company proposes to replace 2,000 feet of 2" mains with 3" mains. The increased size of the pipe will provide better water flow and pressure.

Q. Why is it necessary to replace the mains?

A. It is necessary to replace the mains to increase system reliability, to improve water flow and pressure and to reduce water loss.

Q. When does the Company anticipate that the main replacement project will be completed and placed in service?

A. The main replacement project will be completed and placed in service in spring/summer 2010.

Q. What are the costs to replace the mains?

A. The estimated costs are $161,000.

Q. Please describe the replacement of mains and purchase and installation of meters at 175 Estates.

A. Presently, the 175 Estates water system has approximately … feet of … inch mains. In 2007/2008 the Company replaced the mains on Primary Road. This project complements that project and replaces the substandard mains on the side roads. The Company plans to replace approximately 3,000 feet of mains. The increased size of the pipe will provide better water flow and pressure. In addition, the Company plans to purchase and install 44 residential meters. The Company has previously agreed with the PUC Staff (and such agreement has been approved by the PUC) to add meters.

Q. Why is it necessary to replace the mains and add meters?

A. It is necessary to replace the mains in order to increase the system reliability, to improve water flow and pressure and to reduce water loss. It is necessary to add meters in order to meet PUC requirements and allow the Company and its 175 Estates' customers to monitor consumption.

Q. When does the Company anticipate that the mains and the meters will be completed and placed in service?

A. The Company anticipates that the mains and the meters will be completed and placed in service in spring/summer 2010.

Q. What are the costs to replace the mains and purchase and install meters?

A. The estimated costs to replace mains and purchase and install meters are $366,000.

Q. Please summarize the total costs to be financed.

A. A summary is as follows:

Uranium Filter at Tamworth	$ 46,000
Meters at Tamworth	32,000
Mains at Gunstock Glen / Brake Hill	750,000
Pump Station including pumps, tank and SCADA at Woodland Grove	145,000
Mains at Echo Lake Woods	161,000
Mains at 175 Estates	345,000
Meters at 175 Estates	21,000
Total Financing	$1,500,000

Q. How does the Company propose to finance the projects?

A. The Company proposes to finance the project with state revolving funds provided by the federal government as part of the American Recovery and Reinvestment Act.

Q. How does the financing affect the debt to equity ratio?

A. In recent years, the Company's debt to equity ratio has been approximately 70%/30%. At December 31, 2008, the debt to equity ratio is approximately 52%/48%. The significant improvement in the debt to equity ratio is attributed to the owners' financing with additional paid in capital. The additional paid in capital funded significant capital additions in 2007/2008 that were the subject of and approved in DW 08-070. The Company believes that, with the additional paid in capital contributed in 2008, the Company is able to take on more debt and not adversely affect the capital structure. The Company further believes that, with the additional debt of $750,000, its proposed debt to equity ratio is in a reasonable and acceptable range.

Q. What opportunities are there for the debt to equity ratio to improve?

A. The debt to equity ratio should improve in 2009 as a result of two step increases approved by the Commission in DW 08-070. The Commission also approved a third step increase for projects expected to be completed and in service in 2009. In addition, the Company is requesting a step increase for the projects subject to this docket. The Company believes that, with the additional step increase, its equity position will improve.

Q. With the ARRA debt financing and an increase in revenues from the step increase, what will the proformed debt to equity ratio be?

A. The proformed debt to equity ratio will be approximately 60%/40%.

Q. Is there anything else that you would like to add about the debt to equity position?

A. Yes. The owners of the Company are also the lenders of some of the existing debt. The owners have the resources to provide additional capital if the Company needs additional capital in order to meet its obligations.

Q. How much is the total financing?

A. The total financing amounts to $1,500,000, of which $750,000 will be a grant and $750,000 will be a SRF loan.

Q. What are the terms and conditions of the SRF loan?

A. The term is 20 years. The interest rate is 3.744. The Company is assuming that the loan repayment begins January 1, 2011.

Q. Why should the Commission approve the ARRA financing?

A. The Commission should approve the financing because the proposed ARRA financing is in the best interest of the public and consistent with the public good. The financing enables the Company to complete various projects and enhance the Company's ability to provide safe, reliable and adequate water to its customers. The projects are necessary (and some of the projects are required by the NHDES) in order to insure present and future water supply.

Q. How is the Company proposing to recover the investments subject to this financing?

A. The Company is proposing one step increase to recover these investments.

Q. Why is a step increase appropriate?

A. It is appropriate because NHDES required that the Company undertake some of the projects, i.e., the backup well at Tamworth. Certain other projects are necessary in order to improve system reliability and reduce water loss. It is more cost effective and efficient to pursue step increases at the time of financing than waiting for a rate case. If the Company were to pursue a rate case, the Company would make proforma adjustments to the test year for such investments and incorporate them in the rate increase, most likely as a step increase.

Q. What are the consequences if the step increase is not approved?

A. **If the step increase is not approved, the Company would be unable to demonstrate the ability to repay the SRF loan to the State. If the Company cannot demonstrate the ability to repay the SRF loan, NHDES would have no choice but to disqualify the Company from receiving the funds for all projects. If the Company is disqualified from receiving the funds, the projects would be delayed indefinitely. If and when such projects were to go forward at a later date, both the Company and its customers will pay more.**

Q. Are there any other consequences if the step increase is not approved?

A. It would force the Company into pursuing a general rate increase. Even with the step increase, the Company is reviewing whether a general rate increase is appropriate.

Q. What is the Company proposing for a step increase?

A. The Company is proposing one step increase. The step increase would go into effect upon completion of all projects and when such projects are providing service to customers. The Company anticipates that all projects will be completed by spring/summer 2010. The Company believes that a likely timeline would be for rates to be billed on or about January 1, 2011.

Q. What is the revenue requirement associated with the step increase?

A. The revenue requirement is $67,930.

Q. Do you have any schedules as part of your testimony?

A. Yes. There is one set of schedules identified as SPS 1 thru 12.

Q. Would you please explain Schedule SPS 1-1, entitled Balance Sheet – Assets and Other Deferred Debits?

A. Yes. Generally, column (a) identifies the line number on the schedule. Column (b) identifies the account title and PUC account number. Column (c) identifies the actual December 31, 2008 account balances. Column (d) identifies the financing and step increase adjustments to the December 31, 2008 account balances. Column (e) is the sum of columns (c) and (d) and identifies the proformed December 31, 2008 account balances.

Q. Please explain the adjustments related to ARRA financing and step increases.

A. Schedule SPS 1-1 contains 5 adjustments.

The first adjustment to Utility Plant represents the net additions (additions less retirements) to plant in service for all the projects. The total of the net additions to rate base amounts to $1,398,279.

The second adjustment of ($82,553) to Accumulated Depreciation is for the net of the retirements and the half-year depreciation on the $1,500,000 of plant additions.

The third adjustment of $1,738 to Utility Plant Acquisition Adjustment is for the net of the Utility Plant Acquisition Adjustment and the Amortization of Utility Plant Acquisition Adjustment.

The fourth adjustment of ($6,350) to Cash is the net of the cash received from the financing and the proposed step increases, less payment for the new plant, the repayment of the new loan, and the payment of operating expenses.

The fifth adjustment of $2,375 to Unamortized Debt Expense is the net of the costs incurred in order to pursue PUC approval of the financing and the amortization of those expenditures related to the financing.

Q. Please explain Schedule SPS 1-2, entitled Balance Sheet – Equity Capital and Liabilities.

A. The description of the columns is the same as SPS 1-1.

Q. Please explain the adjustments related to the financing and step increases.

A. Schedule SPS 1-2 contains 4 adjustments.

The first adjustment of $11,714 to Retained Earnings represents the net income impact of the various income statement transactions (i.e., revenue, operating and maintenance expenses, depreciation and amortization expenses, taxes and interest expense).

The second adjustment of $724,310 to Other Long Term Debt represents the net amount of the additional debt financing of $750,000 and the first year repayment on the additional debt financing of $25,690.

The third adjustment of $750,000 to Contribution in Aid of Construction represents the amount of the federal grant.

The fourth adjustment of $10,905 to Accumulated Amortization of CIAC represents the half-year amortization on the $750,000 of contribution in aid of construction.

Q. Would you please explain Schedule SPS 2, entitled Statement of Income?

A. The description of the columns is the same as SPS1-1.

Q. Please explain the adjustments related to the ARRA financing and step increase.

A. There are a number of adjustments to the Statement of Income.

The first adjustment of $70,430 to Operating Revenue represents the revenue requirement of $67,930 associated with the additions to plant and a rate case surcharge of $2,500 associated with recovery of half the ARRA financing and step increase expenditures over a one year period. The revenue requirement allows the Company to recover its investment, earn a return on the unrecovered investment, and to recover its operating expenses.

The adjustments of $30,949 to Operating Expenses consists of adjustments to O & M expense, depreciation, amortization of CIAC, amortization of utility plant acquisition adjustments, taxes other than income and income taxes. The significant adjustments are the increase in depreciation expense associated with the new plant, the increase in amortization of CIAC associated with the portion of the new plant that was contributed via the federal grant and the increase in the taxes other than income associated with state and local property taxes on the new plant.

The adjustments to Interest Expense of $27,642 and Amortization of Debt Expense of $125 represents the first year interest expense on the additional debt financing and the first year amortization of the financing costs.

Q. Would you please explain Schedule SPS 3, entitled Capital Structure?

A. The actual 2004 – 2008 Year End Balances are reflected on this schedule. Also, the proformed 2004 balances approved in DW 05-137, the Company's most recent rate case, are reflected. In addition, the proformed 2008 balances reflect the impact of the ARRA financing and step increase. The related capitalization ratios are shown on the bottom half of the Schedule. Overall, in recent years, the Company's debt to equity position has remained relatively constant. In 2008 the Company's equity position improved due to the owners contribution of additional paid in capital. The additional paid in capital was used to fund significant improvements to the system in 2007/2008. The improvement in the Company's equity position was offset by $130,089 net loss in 2008. The Company expects to have net earnings in 2009 due to the recently approved step 1 and 2 increases in rates in DW 08-070. The Company believes that the present equity and debt positions are reasonable and acceptable and allows the Company to undertake additional debt financing. With the ARRA financing and step increase, the Company believes that the proforma 12/31/08 equity and debt positions are still reasonable and acceptable.

Q. Please explain Schedule SPS-4, entitled Journal Entries.

A. Schedule SPS-4 identifies the specific journal entries used to develop the proforma financial statements. The significant journal entries are the recording of

(1) the ARRA financing, (2) the utilization of the funds for the construction of plant, (3) the repayment of the principal and interest on the loan, and (4) the receipt of revenue, less the increase in operating expenses from the step increases.

Q. How does the Company propose to repay the new debt?

A. The Company's ability to repay the new debt is only possible with approval of the proposed step increase.

Q. Would you like to explain SPS-5 – Preliminary Calculation of Revenue Requirement?

A. The sum of the additions to plant of $1,500,000, less the related accumulated depreciation of $21,810, results in net plant of $1,478,190. The sum of the CIAC of $750,000, less the related accumulated amortization of $10,905, results in net CIAC of $739,095. The addition of the net plant of $1,478,190, less the net CIAC of $739,095, results in a total additional rate base of $739,095. The Company is applying the ARRA cost of debt of 3.744% to determine the additional net operating income required of $27,672. In addition, the Company adds total increase in operating expenses of $40,258 to the additional net operating income required in order to determine the total additional revenue requirement of $67,930. The additional revenue requirement of $67,930 added to the adjusted 2008 actual operating revenues results in a total revenue requirement of $840,643.

Q. Would you please explain SPS-6?

A. SPS-6 is a schedule of plant and depreciation. The Company is using "typical water company service lives and depreciation rates" on the new plant.

Q. Would you please explain SPS-7?

A. SPS-7 is a schedule of CIAC and amortization of CIAC. The Company is using the same service lives and depreciation rates for the amortization of CIAC as the Company used for the depreciation of the contributed assets.

Q. Would you please explain SPS-8, Taxes other than Income?

A. SPS-8 is a schedule of state utility property taxes and local property taxes. Please note that the Company is assuming that the assessed value for state and local property taxes is 50% of the total plant costs. The Company is then applying the 2008 state and local property tax rate to the state and local property tax assessment.

Q. Would you please explain SPS-9, Income Taxes?

A. SPS-9 is a schedule of state business taxes and federal income taxes. The Company is utilizing the business profit tax rate of 8.5%. The Company is utilizing the federal income tax rate of 15%. It is possible that some of the income will be subject to higher federal tax rates, i.e., 25%.

Q. Would you please explain SPS-10, Source and Use of Funds?

A. SPS-10 is a schedule showing the total costs of the projects, the total source of funds and the total use of funds. Half of the funds are a loan and half of the funds are a grant. The uses of the funds are identified for each of the projects.

Q. Would you please explain SPS-11, Estimated Financing and Step Increase Costs?

A. SPS-11 is a schedule showing the estimated costs to pursue and obtain PUC approval of the financing and the step increases.

Q. What does the Company propose to do with the estimated costs of the financing and step increase?

A. The cost to pursue and obtain PUC approval of the financing and step increases will be deferred. The financing costs (one half of the total financing and step increase expenditures) will be added to the annual cost of the debt and reflected in the weighted, average interest rate. The step increase costs (one half of the total financing and step increase expenditures) will be recovered via a surcharge over a one year period.

Q. Would you please explain SPS-12, Percent Increase and Average, Annual Rate per Customer?

A. SPS-12 is a schedule showing the calculation of the percent increase and the average, annual rate per customer. The calculation of the percent increase of 8.79% divides the proposed step increase over the 2008 adjusted revenue. The 2008 adjusted revenue is adjusted for other revenues, revenues associated with the Swissvale special contract and the DW 08-070 step 1 & 2 increases. The calculation of the average, annual rate per customer of $521.81 divides the average, step increase per customer over the average 2008 adjusted revenue.

Q. Is there anything else that the Company would like to bring to the Commission's attention?

A. No.

Q. Please summarize the approvals that the Company is requesting.

A. The Company respectfully requests that the PUC approve by NISI order the ARRA financing of $1,500,000, $750,000 of which is a loan and $750,000 of which is a grant and the related step increase amounting to an additional revenue requirement of $67,930.

Q. Does this conclude your testimony?

A. Yes.

SPSt. Cyr

05/29/09