HAMPSTEAD AREA WATER COMPANY, INC.

BEFORE THE

NEW HAMPSHIRE PUBLIC UTILITIES COMMISSION

DW 08-065

DIRECT TESTIMONY OF STEPHEN P. ST. CYR

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 primarily provides accounting, management, regulatory and tax services. The Company devotes a significant portion of the practice to serving utilities. The Company has a number of regulated water and sewer utilities among its cliental. I have prepared and presented a number of rate case filings before the New Hampshire Public Utilities Commission ("PUC"). 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 Hampstead Area Water Company (Company)?

A. Yes. St. Cyr & Associates assist the Company in its year end closing and preparation of financial statement and tax returns. St. Cyr & Associates assist the Company in various regulatory filings including expansion of its franchise, financing of construction projects and adjusting rates. It has been engaged to prepare this rate filing including the various exhibits, supporting schedules and written testimony.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to support the Company's efforts to increase rates to its customers so as to reflect in rates its 2008 additions to plant and its 2008 adjustments to expenses.

Q. Does the Company have PUC approval of the financing for the 2008 additions?

A. On March 4, 2008 the Company filed a petition requesting PUC approval to finance the purchase and installation of SCADA, the development of a water system model and a system wide geographic information system (GIS) and the construction of additional wells amounting to $165,329. The Company's request is subject to PUC docket DW 08-033, which was granted by the Commission's Order 24,864 on June 20, 2008.

Q. How does the 2008 Lewis financing impact this rate filing?

A. The Company has proformed the impact of the 2008 Lewis financing into the rate filing. The plant additions and the related depreciation have been added to rate base. The loan amounts and related interest have been added to the long term debt.

Q. In addition to the 2008 Lewis financing, is there anything else that you would like to address before you address the rate filing and the rate schedules?

A. Yes. In 2006 the Company sought and received permission from the PUC to finance three projects and to receive related step increases (Docket DW 06-104). The three projects consist of (1) a hydrology study, (2) a new billing software system and (3) three vehicles. The hydrology study is ongoing. The new billing software system went into service in 2007 and is reflected in the 2007 plant in service balance. Two of the three vehicles went into service in 2007 and are reflected in the 2007 plant in service balance. Because the new billing system and two of the three vehicles are in service and reflected in test year rate base, the Company will not seek the related step increases.

Q. In addition to the 2008 Lewis and 2006 Lewis financings, is there anything else that you would like to address before the rate filing and rate schedules?

A. Yes. In the interest of full disclosure, the Company is in the process of preparing a petition for PUC approval of a State Revolving Fund financing and step increase for the interconnection of its Hampstead and Atkinson water systems. The 2008 SRF financing and relate step increase will allow the Company to construct approximately 1,500 feet of mains to interconnect the two systems. The 2008 SRF financing and related step increase is separate and distinct from this rate filing. As such, the plant costs are not reflected in rate base, the debt costs and interest expense are not reflected in the capital structure and the operating costs are not reflected in operating expenses.

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

A. No.

Q. Are you familiar with the pending rate application of 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 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.

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 $7,438. It is based upon an actual test year beginning and ending 2007 average rate base of $3,631,773 as summarized in Schedule 3. The Company is utilizing its actual rate of return of 4.81% for the actual test year. The actual rate of return of 4.81% when multiplied by the rate base of $3,631,773, results in an operating income requirement of $174,688. As shown on Schedule 1, the actual net operating income for the test period was $167,250. The operating income requirement less the net operating income results in an operating income deficiency of $7,438. The tax effect on the operating income deficiency is $0, resulting in a revenue deficiency of $7,438. The proforma revenue deficiency for the test year amounts to $0. The Company made three adjustments to its rate base, including an adjustment for cash working capital, which increases due to increased proforma operating and maintenance expenses. The Company adjusted the rate of return to reflect its proforma capital structure, its proforma cost of debt, and a 9.75% cost of equity. The net of the adjustments to the capital structure and the adjustments to the cost rates results in a rate of return of 6.28%. As such, the rate of return of 6.28% when multiplied by the rate base of $3,797,775 results in an operating income requirement of $238,490. The Company increased its revenue by $167,193 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 $424.92 to $483.42, an increase of $58.50 or 13.77%.

Q. Would you please summarize Schedule 1, "Statement of Income", for the twelve months ended December 31, 2007?

A. The first column (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 $1,268,877, an increase of $192,100 or 18%. The increase in operating revenue in 2007 compared to 2006 was due to increased consumption and increased number of customers. The Company customer base has remained stable. The Company had 2,858 customers at December 31, 2007. The Company's operating expenses consist of operation and maintenance expenses, depreciation and amortization expenses, and taxes. Total 2007 operating expenses amounted to $1,101,627, an increase of $127,090 or 13%. Operation and maintenance expenses increased $85,791, primarily due to increases in maintenance, purchased power, customer records and collection, office supplies and expenses, management, engineering, legal, and pension and benefits. The Company has also experienced increases in depreciation expenses, amortization expenses, and taxes other than income taxes. The Company's net operating income amounted to $167,250. 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, in the second column (column c) and further supported on Schedule 1A, Page 1 of 2.

A. The Company made one proforma adjustment to revenue:

Revenue

The proforma adjustment to revenue represents the additional revenue of $167,193 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 $167,193.

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

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

Purchased Power

In 2007 the Company incurred $177,371 of purchased power expenses. The Company reviewed its kwh rate for electric service in May 2008 ($0.1434 per kwh) and compared it to its per kwh rate for electric service in May 2007

($0.1392). The increase in the kwh rate represents approximately a 3% increase. The Company applied the 3% increase to its 2007 purchased power costs resulting in a proforma adjustment of $5,321.

Chemical Costs

In 2007 the Company incurred $11,917 of chemical costs. The chemical costs include 4,980 gallons of chlorine at a cost of $9,962. The most recent price per gallon of chlorine is $2.20 per gallon. The Company applied the most recent cost of $2.20 per gallon to the 4,980 gallons resulting in an increase in the cost of chlorine of $994.

Customer Records & Collection Costs

In 2007 the Company incurred $48,650 of customer records and collection costs. The $48,650 of customer records and collection costs increased due to increased effort to collect customer payments more timely, to reduce accounts receivable, and to improve cash flow. In 2008 the Company plans to switch from a quarterly billing cycle to a monthly billing cycle. The switch to a monthly billing cycle will allow the Company to continue to receive payments more timely, to reduce accounts receivable, and improve cash flow. The switch to a monthly billing cycle will reduce the amount of the billings to approximately 1/3 of the quarterly billings and allow customers to more easily afford the smaller, more frequent billings. It will also allow customers to more quickly respond to water usage. In addition, in order to make the switch to a monthly billing cycle, the Company needs to hire a new fulltime person. The Company projects that it will pay the new fulltime person $27,456 including benefits.

Office Supplies and Expenses

In 2007 the Company incurred $45,546 for office supplies and expenses. As part of the $45,546, the Company incurred $9,374 related to billing supplies (i.e., bill form, envelope, return envelope) and postage. With the monthly billing cycle, the Company anticipates incurring $28,466 related to billing supplies, which includes billing supplies for eight additional billings per year, and an increase in postage from .41 to .42 per mailing.

Outside Services - Management

In 2007 the Company incurred $104,167 for management costs under the Company's management agreement with Lewis Builders. In 2007, Lewis Builders added an information technology individual to provide in house hardware, software and other computer expertise. The individual supports all of Lewis Builders computer related activities, including those for the Company. Such computer activities include operating and maintaining the computer systems and telephone equipment, troubleshooting any problems with the hardware and software and interacting with third party hardware/software vendors. Lewis Builders and the Company agreed that Lewis Builders would charge $10,000 for such services. The Company began incurring such costs in August 2007. The proforma adjustment adds another seven months to the five months that are reflected in the test year.

Miscellaneous Expenses

In 2007 the Company incurred -$2,322 in miscellaneous expenses. The negative miscellaneous expense was due to the software program not being able to allocate labor burden (payroll taxes, etc.) correctly to time charged to various plant accounts. The purpose of the proforma adjustment is to eliminate the negative balance and to restore a reasonable amount of miscellaneous expense.

Salaries and Wages

In 2007 the Company incurred $197,235 in salaries and wages. During 2007 the Company made minor adjustments to salaries and wages. The net effect of the minor adjustments results in a 1.6% increase in salaries and wages. As such, the Company made a proforma adjustment of $3,156, 1.6% of the $197,235 in salaries and wages. The adjustment does not take into consideration any salaries and wage increases for 2008.

Vehicle Expenses

In 2007 the Company incurred $20,253 in vehicle expenses. Of the $20,253, $13,568 was for gasoline for the three vehicles. During the twelve months July 2007 – June 2008 the Company used 4,495 gallons of gas. With the recent, rapid increase in the price per gallon of gasoline, and the expectation that the price per gallon will remain high or go even higher, the Company anticipates that the same gallons used of gasoline will cost the Company $17,980, at $4 per gallon in 2008.

Depreciation Expense

In 2007, the Company incurred $332,650 in depreciation expense. As stated earlier, in 2008, the Company filed a request for PUC approval to finance certain capital expenditures (the 2008 Lewis financing). The proforma adjustment to depreciation expense reflects the annual depreciation associated with the 2008 additions.

Taxes other than Income

As stated earlier, in 2008, the Company filed a request for PUC approval to finance certain capital expenditures (the 2008 Lewis financing). The proforma adjustment to taxes other than income reflects the increase in state and local property taxes related to the 2008 additions.

State Business Taxes

Again, as stated earlier, in 2008, the Company filed a request for PUC approval to finance certain capital expenditures (the 2008 Lewis Financing). The proforma adjustment to income taxes reflects the increase in state business taxes associated with the increase in interest on the 2008 loan.

The Company made no other proforma adjustment to expenses. The total proforma adjustments to expenses amounts to $95,953. The Company did review a number of other operating expenses, but decided that the expenses are reasonable and reoccurring, and provide a proper basis in which to establish future rates.

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.

Q. Would you please explain Schedule 2 entitled "Balance Sheet"?

A. Yes. This schedule shows the year end balances reflected on the balance sheets of the Company for 2007, 2006 and 2005. Utility Plant consists of numerous wells, pumps, tanks, services, meters and mains. At December 31, 2007 the Company had utility plant of $10,790,925. Utility Plant consisted of $10,560,296 and $230,629 of utility plant in service and construction work in progress, respectively. In 2007 the Company added $187,623 to plant consisting of structures, pumping equipment, water treatment equipment, meters and meter installations, vehicles and billing software. The Company also retired plant amounting to $20,240 in 2007 including pumping equipment, water treatment equipment, and vehicles. Accumulated Depreciation represents the depreciation on these same assets from the date of purchase through December 31, 2007, using a straight line depreciation method over the estimated useful life. The Company's current assets amount to $298,381, which includes $23,596 of cash, $78,435 of accounts receivable, $28,977 of prepaid expenses and $167,373 accrued utility revenues. The Company also has deferred assets including $56,818 of miscellaneous deferred debits and $26,227 of deferred tax assets. The Company's Equity Capital consists of $16,767 of common stock, $1,113,401 of other paid in capital, and retained earnings of -$1,413,934. The Company's sole shareholder is Christine Lewis Morse. The number of shares authorized and outstanding is 300 and 100, respectively, with no par value. The Company's other long term debt outstanding amounts to $3,205,855. It consists of related party debt amounting to $1,651,038 and non related party debt of $1,554,817, including $1,315, 291 of state revolving funds. The Company has no short term debt. The Company's current and accrued liabilities amount to $1,107,085, which includes $51,947 of accounts payable, $990,353 of accounts payable to a related party, and $65,694 of accrued interest. The Company has net contribution in aid of construction of $4,678,605.

Q. Would you please explain Schedule 3 entitled "Rate Base"?

A. Columns (b) & (c) show the actual balances of the rate base items as per the Company's internal financial statements. 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, Prepayments, and Accumulated Deferred Income Taxes – Assets and Net Contributions in Aid of Construction. The actual beginning and ending average rate base amounts to $3,631,773. The Company made three adjustments to rate base. The first adjustment to plant in service is $163,039. As stated earlier, in 2008, the Company filed a request for PUC approval to finance the purchase and installation of SCADA, the development of a water system model and a system wide geographic information system (GIS) and the construction of additional wells (the 2008 Lewis financing). The specific costs are further supported by schedule 3A. The second adjustment to accumulated depreciation reflects the depreciation associated with the 2008 additions. The third adjustment to cash working capital is $14,300. Working capital is determined by 75/365 days of operating expenses. The computation of working capital is shown on schedule

3B. The proforma beginning and ending average rate base amounts to $3,797,775.

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

A. The Company's overall rates of return are 4.81% and 6.28% for 2007 actual and 2007 proformed, respectively. It is derived from the weighted average cost rates associated with actual and proformed long term debt. The weighted average cost rates for common equity were not utilized due to the Company negative equity position. The Company's capital structure consists of Equity and Debt Capital. The Company has no short term debt. Its Equity Capital consists of $16,767 of Common Stock, $1,113,401 of Other Paid in Capital, and Retained Earnings of -$1,413,934. The Company has $3,205,855 of long term debt at year end. It consists of both related parties and unrelated parties loans, including a 2005 State Revolving Fund Loan for a water storage tank of $1,315,291 at 3.35% for 20 years. The Company's overall capital structure is more weighted to debt than it would prefer. However, with the recent amounts of additional paid in capital, the recent rate increases, and the proposed rate increase, earnings should continue to improve, adding to retained earnings while increasing the equity portion of the capital structure. The Company is proposing that the weighted average rate of return be 6.28%.

Q. Would you please explain Schedule 5A and 5B entitled "Actual Long Term Debt" and "Proforma Long Term Debt", respectively.

A. Schedule 5A shows the date of the notes, the borrower and lender, the original note amount, note term, interest rate, outstanding balance at 12/31/07, 2007 interest expense, and cost rate. The total outstanding balance at 12/31/07 is $3,205,855. The total 2007 interest expense is $154,183. The total cost rate is 4.81%. Schedule 5B utilizes the same data as schedule 5A, except that it adjusts the outstanding long term debt balances for additional long term debt and it adjusts the 2007 interest expense for additional interest expenses. The additional long term debt includes the 2008 financing. The additional long term debt also reduces the outstanding balance by the debt that is associated with construction work in progress. The additional interest expense represents the annual interest expense associated with the 2008 financing.

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

A. No. The Company has applied the proposed rate increase to all its metered customers. The Company is not proposing to change its fire protection rates.

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

A. Yes. 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 counsel. The Company will make every effort to minimize its rate case expense.

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

A. Yes. The Company has not yet determined whether to file a separate petition for consideration of temporary rates. The Company reserves the right to file for temporary rate if it determines that temporary rates are appropriate.

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

A. Yes, the Company is requesting a permanent revenue increase of $175,263, effective July 1, 2008. The permanent revenue increase of $175,263 enables the Company to earn a 6.28% proforma rate of return on its investment, reflected in a proforma rate base of $3,797,775. The average annual amount for a residential customer will increase from $424.92 to $483.42, an increase of $58.50 or 13.77%.

Q. Does this conclude your testimony?

A. Yes.

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