STEPHEN P. ST. CYR & ASSOC.

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

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Rosebrook Water Company

before the

New Hampshire Public Utilities Commission

DW 12-306

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 Rosebrook Water Company ("Company")?

A. Yes. St. Cyr & Associates assists the Company in its year end closing and preparation of financial statements and tax returns. St. Cyr & Associates assists the Company in various regulatory filings including financing of construction projects and adjusting rates. It has been engaged to prepare the various revenue / rates 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 2012 additions to plant and its 2011 expenses adjusted for known and measurable changes.

Q. Briefly, please describe the 2012 additions to plant.

A. In February 2012 the Company replaced a turbine pump at well #1. In April 2012 the Company added a generator to provide permanent backup at the well site. The purchase and installation of a generator cured a minor deficiency noted in the 10/22/10 DES sanitary survey. The construction of a new storage tank cover is expected to be completed in October 2012. The new storage tank cover cures a major deficiency in the 10/22/10 DES sanitary survey. The 10/22/10 DES sanitary survey cites that "The storage tank roof slab is seriously deflected; indicating possible structural failure. Collapse of the cover would have serious consequences in system operation."

Q. How are the 2012 additions to plant being funded?

A. Over the years the Company has accumulated contributions in aid of construction ("CIAC") from the Mt. Washington Hotel and the Town of Carroll. The Company is utilizing such funds to pay for the tank cover and generator.

Q. How are the 2012 additions to plant and the related CIAC reflect in the rate filing?

A. The Company has proformed the impact of the 2012 additions and related CIAC into the rate filing as a step adjustment. The step adjustment is shown on schedule 6 and will be discussed later in my testimony.

Q. Is there anything that you would like to discuss before you continue your testimony?

A. Yes, in 2011, BW Club and MWH Construction wrote off intercompany balances owed by Rosebrook including $30,302 and $16,932 for management and operations, respectively. The result of the write offs were to reduce 2011 expenses. The proforma adjustments related to management and operations are essentially to restore the proper level of expense.

Q. Is there anything that you would like to discuss before you continue your testimony?

A. No.

Q. Are you familiar with the pending rate application of the Company and with the various exhibits submitted as Schedules 1 through 7 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, 2011. Although it is late 2012 when the Company is making this filing, the Company believes that the proforma 2011 test year is appropriate for setting rates going forward.

Q. Would you summarize Schedule 1 entitled "Computation of Revenue Deficiency for the Test Year ended December 31, 2011"?

A. Yes. This schedule summarizes the supporting schedules. The actual revenue deficiency for the test period amounts to $32. It is based upon a 5 quarter average balance for 2011 of $433,109 as summarized in Schedule 2. The Company is utilizing its actual rate of return of 9.38% for the actual test year. The actual rate of return of 9.38% when multiplied by the rate base of $433,109, results in an operating income requirement of $40,607. As shown on Schedule 4, the actual net operating income for the test period was $40,575. The operating income requirement less the net operating income results in an operating income deficiency of $32. The tax effect on the operating income deficiency is $0,

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resulting in a revenue deficiency of $32. The operating income and revenue deficiencies would have been greater if not for the write off of certain management and operation expenses.

The proforma revenue deficiency for the test year amounts to $0. The Company made various adjustments to its rate base, mostly related to adjusting the 5 quarter average balances to 2011 year end balances. The Company adjusted the rate of return to reflect an 11.25% cost of equity. The net of the adjustment to the cost of equity results in a rate of return of 10.78%. As such, the rate of return of 10.78%, when multiplied by the rate base of $455,043, results in an operating income requirement of $49,041. The Company increased its revenue by $68,499 in order to allow the Company to recover its expenses and to earn a fair and reasonable return on its investment.

Q. Would you please explain Schedule 2 entitled "Rate Base"?

A. The columns (a) – (e) show the actual balances of the rate base items as per the Company's quarterly, internal financial statements. Column (f) shows the actual 5 quarter average balances, except for cash working capital, which reflects the cash working capital for 2011. Column (g) shows the 2011 proforma adjustments. Column (h) shows the proforma 2011 balances.

The rate base consists of Utility Plant, Accumulated Depreciation, Plant Acquisition Adjustment, Accumulated Amortization of Plant Acquisition Adjustment, Cash Working Capital, Material & Supplies, Prepayments, CIAC,

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Accumulated Amortization of CIAC and Accumulated Deferred Income Taxes. The actual 5 quarter average rate base amounts to $433,109. The Company made eight adjustments to rate base as shown on Schedule 2A & 2B. Four of the eight adjustments pertain to adjusting the 5 quarter average balances to the year end balance. In order to properly reflect rate base, all of its plant and plant related items at year end are completed and providing service to customers. To not fully reflect plant and the related items in rate base would be to not allow recovery of a portion of the assets. The specific proforma adjustments related to year end rate base are 1, 2, 4 and 6.

Two of the eight adjustments pertain to adjusting the year end balance for the additional half year of depreciation and amortization of CIAC. These adjustments pertain to test year expense adjustments for depreciation (adjustment 20) and amortization of CIAC (adjustment 21). Since the Company has proposed adjusting depreciation expense and amortization of CIAC to reflect a full year's expense, the Company also has to adjust accumulated depreciation and accumulated amortization of CIAC for a like amount. The specific proforma adjustments related to the additional half year of expenses are 3 and 7.
The proforma adjustment to CIAC (#5) amounts to ($108,624). In 2011 the Company's transferred funds of $50,000 and $80,000 from its CIAC fund to its operating account. $21,376 of such funds was used for the purchase and

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installation of a telemetry system. The remaining amount of $108,624 related to the engineering and construction of the 2012 projects.

The final adjustment to rate base is the adjustment to cash working capital amounting to $10,007. Working capital is determined by utilizing a percentage that represents the lag between the time in which the Company bills its customers and receives the cash from such billing and the time that it pays for expenses to provide services. It is derived by applying 75/365 days or 20.55% to operating expenses. The computation of working capital is shown on schedule 2B. The proforma adjustment results in a cash working capital of $37,309.

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

A. The Company's overall rates of return are 9.38% and 10.78% for 2011 actual and 2011 proformed, respectively. It is derived from the weighted average cost rates associated with actual and proformed long term debt and equity. The Company's capital structure consists of Equity and Debt Capital. The Company has no short term debt. Its Actual Equity Capital consists of $1,000 of Common Stock, $451,303 of Additional Paid in Capital and $52,952 of Retained Earnings. The Company has $35,483 of long term debt at year end. It consists of one SRF loan. The Company's overall capital structure is more weighted to equity. The Company made no adjustments to the capital structure. Also, Schedule 3 shows the Company's capital structure amounts for 2010 and 2009 and related percentage for 2011 – 2009.

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Q. Would you please explain Schedule 3A and 3B entitled "Actual Long Term Debt" and "Proforma Long Term Debt", respectively.

Schedule 3A shows a brief description of the debt, the balance at 12/31/11, the 2011 interest expense and cost rate. The total outstanding balance at 12/31/11 is $35,483. The total 2011 interest expense is $1,436. The total cost rate is 4.05%.

Schedule 3B utilizes the same data as schedule 3A. The Company made no adjustments to this data. As such, the proforma cost rate of 4.05% is the same as the actual costs rate.

Q. What is the Company using for the cost of common equity?

A. The Company is using the PUC determined cost of common equity of 9.75% plus 1.50%. The Company believes that the 9.75% is appropriate for national, publicly traded, multi-state water utilities. It also knows that it is not one of them. It is a small size, private water company that serves a portion of northern New Hampshire. It is owned by a single entity. It is fortunate to have two affiliated companies that provide management and administrative services and has construction resources and technical ability to support the water systems. Even with the management and construction resources, it is difficult for a small size company to meet the increasing regulatory requirements. In management's judgment, the Company believes that an additional 1.5 percentage points is necessary due to the increased risks associated with the Company size and resources available to meet the Company's requirements. As such, the Company is using a 11.25% cost of equity.

Q. What is the proforma weighted average cost rate?

A. The proforma weighted average cost rate is 10.78%

Q. Would you please summarize Schedule 4, "Income Statement for the twelve months ended December 31, 2011"?

A. The first column (column b) of Schedule 1 shows the actual operating results of the Company from January 1, 2011 through December 31, 2011. The Company has filed its 2011 NHPUC Annual Report, which further supports the rate filing. During the twelve months ended December 31, 2011, the Company operating revenues amounted to $209,518, an increase of $15,862 or 8.2%. The increase in operating revenue in 2011 was primarily due to an increase in water sold to commercial customers. The Company customer base is stable. The Company had 404 customers at December 31, 2011.

The Company's operating expenses consist of operation and maintenance expenses, depreciation and amortization expenses, and taxes. Total 2011 operating expenses amounted to $168,943, a decrease of $40,186 or 19.2%. As previously mentioned, operation and maintenance expenses decreased by the write off of management and operation expenses. The Company has also experienced increases in depreciation and amortization of CIAC expenses and taxes other than income taxes, offset by a decrease in income taxes.

The Company's net operating income amounted to $40,575.

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.

A. The Company made one proforma adjustment to revenue.

Operating Revenues

9. Revenue

The proforma adjustment to revenue represents the additional revenue of $68,499 needed to recover the increase in its expenses and to earn a reasonable return on its rate base.

The total proforma adjustment to revenue amounts to $68,499.

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

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

Operating and Maintenance Expenses

10. Pumping Expenses

Pumping expenses consist of purchased power and miscellaneous expenses. The Company has experienced some fluctuation, particularly in miscellaneous pumping expenses, during 2009 – 2011. As such, the Company has used a 3 year average to determine and appropriate annual amount. The 3 year average amounts to $22,777. The 2011 pumping expenses amount to $20,878. Therefore, the proforma adjustment is $1,899. Also, see Schedule 4B.

11. Treatment Expenses

Treatment expenses consist of chemical and miscellaneous expenses. The Company has experienced some fluctuation in both chemical costs and miscellaneous treatment expenses during 2009 – 2011. As such, the Company has used a 3 year average to determine and appropriate annual amount. The 3 year average amounts to $15,116. The 2011 treatment expenses amounts to $12,936. Therefore, the proforma adjustment is $2,180. Also, see Schedule 4B.

12. Maintenance

Maintenance consists of repairs to pumping and treatment equipment, mains, services, meters, hydrants and miscellaneous equipment. The Company has experienced significant fluctuation related to maintenance. In 2009 the Company incurred total maintenance of $19,935. In 2011 the Company incurred total maintenance of $1,731. As such, the Company has used a 3 year average to

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determine and appropriate annual amount. The 3 year average amounts to $9,592. The 2011 maintenance expenses amounts to $1,731. Therefore, the proforma adjustment is $7,861. Also, see Schedule 4B.

13. <u>Outside Services – Management</u>

Effective August 1, 2011 the Company began paying $6,700 per month for management services under the Management Agreement between BW Services, LLC ("BWS Management Agreement") and the Company. BW Services, LLC. is a related party. The annual amount under the BWS Management Agreement amounts to $80,400. In 2011 the Company incurred $46,898 ($77,200 - $30,302). As a reminder, 2011 expenses were reduced by the write off $30,302 for management services that Rosebrook owed BW Club. Therefore, the proforma adjustment is $33,502.

14. <u>Outside Services – Operations</u>

The Company also has a Management Agreement with MWH Construction ("MWHC Management Agreement") for management, engineering / contractors, regulatory and equipment matters. MHW Construction is a related party. Under the MWH Management Agreement, the Company pays $1,250 per month plus labor and materials for all construction projects. In 2011 the Company incurred $772 ($17,704 - $16,932). As a reminder, 2011 expenses were reduced by the write off $16,932 for operational services that Rosebrook owed MWH Construction. In this case, the Company is simply restoring the expense to the level before the write off. Therefore, the proforma adjustment is $16,932.

15. Outside Services – Legal

In 2011 the Company incurred $14,818 in legal expenses associated with regulatory matters including compliance issues, CIAC funds and tariff costs. Such costs are of a one time nature and not likely to be incurred in the future. As such, the Company is proposing to recover the legal expenses associated with the regulatory matters over 5 years, resulting in an annual expense of $2,964 ($14,818 / 5 years). Therefore, the proforma adjustment is ($11,854).

16. Outside Services – Legal

In 2011 the Company incurred no legal expenses associated with normal and reoccurring legal matters such as corporate and / or customer matters. It does not seem prudent to expect that the Company will incur no legal expenses going forward. As such, the Company proposes an estimated $2,000 to be included in test year expenses.

17 & 18 Outside Services – Accounting / Regulatory

In 2011 the Company incurred $10,858 in accounting expenses. Certain accounting expenses related to regulatory matters associated with compliance issues, CIAC funds and tariff costs are of a one-time nature and not likely to be incurred in the future. As such, the Company is proposing to reduce the accounting expenses by $4,659 and to recover that amount over 5 years. Therefore, the proforma adjustments are a reduction to accounting expenses of

$4,659 and an increase to regulatory expenses of $931 ($4,659 / 5 years).

19. Outside Services – Auditing

In 2012 the Company anticipates incurring $2,500 in accounting expenses to address matters, issues and finds associated with the PUC audit. To the extent that the actual costs are more or less than the proposed amount, the Company will plan to adjust accordingly. The Company also proposes to recover such amount over a 3 year period. As such, the Company is proposing to increase accounting expenses by $833 ($2,500 / 3 years).

The total proforma adjustment to operating and maintenance expenses amounts to $48,694.

20. Depreciation Expenses

In 2011 the Company recorded $36,482 of depreciation expenses on plant that was used and useful and providing service to customer. The 2011 additions to plant reflect only a half year depreciation on such assets. This adjustment represents a half year depreciation so that the test year can fully reflect depreciation on the 2011 additions.

21. Amortization of CIAC

In 2011 the Company recorded ($6,709) of amortization of CIAC. The 2011 amortization of CIAC reflects only a half year amortization on such CIAC. This adjustment represents a half year amortization so that the test year can fully reflect amortization on the 2011 CIAC.

22. <u>& 23 Federal Income and State Business Taxes</u>

If the Company is successful in obtaining the proposed increase in rates and revenue, then such revenue should produce both book and taxable income. The Company is utilizing a 15% federal tax rate and a 8.5% state business tax rate applied to taxable income. See schedule 4C. The proforma adjustments for federal income and state business taxes are $7,099 and $4,076, respectively.

The Company made no other proforma adjustments to expenses. The total proforma adjustments to expenses amount to $60,032.

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, 2010 and 2009, respectively?

A. Yes it does.

Q. Would you please explain Schedule 5 entitled "Balance Sheet"?

A. Yes. This schedule shows the year end balances reflected on the balance sheets of the Company for 2011, 2010 and 2009.

Utility Plant consists of structures, wells, pumps, treatment equipment, tanks, mains, services, meters, hydrants, a vehicle and other plant. At December 31, 2011 the Company had utility plant of $1,217,277. Utility Plant consisted of $1,134,254 and $83,023 of utility plant in service and construction work in progress, respectively. In 2011 the Company added $22,501 to plant consisting of meters and communication equipment. The Company also retired plant amounting to $1,203 in 2011. Accumulated Depreciation represents the depreciation on these same assets from the date of purchase through December 31, 2011, using a straight line depreciation method over the estimated useful life. The Company's current assets amount to $223,244, which includes $165,160 of cash, $51,645 of accounts receivable, $853 of plant material and supplies and $5,586 of prepaid expenses. The Company also has miscellaneous deferred debits of $25,342, representing preliminary survey and investigation costs associated with a new water supply as well as engineering expenditures related to a water study preliminary well siting report. Total assets and other debits amount to $901,694.

The Company's Equity Capital consists of $1,000 of common stock, $451,303 of other paid in capital, and retained earnings of $52,952. The Company's sole shareholder is BW Land and Holdings LLC. The number of shares authorized and outstanding is 200 and 200, respectively, with no par value. The Company's other long term debt outstanding amounts to $35,483. The debt is owed to the State of New Hampshire. The Company's current and accrued liabilities amount to $14,608, which includes $15,233 of payables. The Company's other liabilities include advances for construction of $79,144, net contribution in aid of construction of $180,344 and accumulated deferred income taxes of $86,860. The Company and its customers continue to benefit from CIAC.

Q. Generally, please explain the nature and purpose of the step increase.

A. The step increase is a rate mechanism that allows for the recovery of post test year additions to plant and related expenses. The purpose of the proposed step increase is to allow the Company to recover 2012 additions to plant including replacing the tank roof, purchasing and installing a diesel generator and purchasing and installing a submersible pump. The Company estimates that the proposed expenditures will be paid for with funds from contribution in aid of construction. Therefore, there is a net zero increase in rate base. However, the increase in plant will increase the Company state utility property taxes and local property taxes. As such, the step increase reflects the estimated increase in property taxes.

Q. Would you explain Schedule 6 and the supporting schedules related to the step increase?

A. Yes. Schedule 6 summarizes the supporting schedules related to the revenue requirement associated with the step increase. It shows total additions to rate base of $0. It shows an increase in depreciation expense offset by an increase in the amortization of CIAC and an increase in property taxes of $1,559.

Schedule 6a shows the projected 2012 additions, retirements and contribution in aid of construction and the related depreciation and amortization. In total, the Company projects additions to plant of $233,114, retirements from plant of $0 and contributions in aid of construction of $233,114. The Company anticipates that the annual depreciation will increase $9,035 and annual amortization of CIAC will increase $9,035. Also, schedule 6A shows an estimated increase of $560 and $999 of state utility property taxes and local property taxes, respectively.

Q. What is the combined increase in revenue?

A. The combined increase in revenue is $70,058. It consists of $68,499 from the proposed permanent rate increase and $1,559 from the proposed step rate increase. The combined increase in revenues is shown on Schedule 7.

Q. Please explain the Report of Proposed Rate Changes.

A. The Report of Proposed Rate Changes shows the rate class, the effect of the revenue change, the number of customers, the authorized present revenue, the proposed revenue, the proposed change amount and percentage. The proposed change amount is $70,058 or 33.56%. All of the change amounts apply to residential and commercial customers. The average residential customer will receive an annual increase of $71.24, resulting in an average annual bill of $283.54.

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

A. No. The Company has applied the proposed rate increase to all its residential and commercial customers.

Q. Please explain the calculation of rates.

A. The total revenue requirement including the proposed rate increase and step increase amounts to $279,576. The Company reduces the total revenue requirement by other water revenues, resulting in total revenue requirement of $278,826 from residential and commercial customers.

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First, the Company calculates the portion of revenue from the initial charges. In doing so, it applies the overall percent increase of 33.56% to the present initial charge per year per meter size to develop a new, proposed initial charge per year per meter size. It then takes the new, proposed initial charge per year times the number of meters to determine the revenue requirement from initial charges, namely $79,954.

Second, the Company takes the remaining revenue of $198,872 to be realized from consumption. It divides the remaining revenue by the 2011 actual consumption of 37,832 (1000 gallons) to determine the consumption rate per 1000 gallons, namely $5.26.

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

Yes, the Company has engaged the services of Stephen P. St. Cyr & Assoc. The Company has agreed to an hourly fee of $125.00 (plus out of pocket costs) for work performed in preparation of the rate filing and pursuit of the rate increase during the rate proceeding. The Company will make every effort to minimize its rate case expenses.

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

A. Yes. The Company proposes to make the existing rates temporary until such time as the NHPUC makes a final decision on permanent rates. The temporary rate date would be the date in which the Company provides notice of the rate increase to its customers. The Company would have incurred a net loss in 2011 if it was not for the write off of certain management and operational costs that Rosebrook owed BW Club and MWH Construction. The Company anticipates a net loss in 2012. The Company believes that the net loss position justifies making the existing rates temporary.

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

A. Yes, the Company is requesting a permanent revenue increase of $68,499. The permanent revenue increase of $68,499 enables the Company to earn a 10.78% proforma rate of return on its investment, reflected in a proforma rate base of $455,043. Also, the Company is requesting a step increase of $1,559, effective upon completion of the work anticipated no later than December 31, 2012. The step increase of $1,559 enables the Company to recover the increase in property taxes as a result of increase in plant. The average annual amount for a residential customer will increase from $212.30 to $283.54, an increase of $71.24 or 33.56%. Finally, the Company is requesting that the existing rates be made temporary pending the NHPUC decision on permanent rates.

Q. Does this conclude your testimony?

A. Yes.