BEFORE THE STATE OF NEW HAMPSHIRE

PUBLIC UTILITIES COMMISSION

Lakes Region Water Company

Petition for Emergency Rate Increase

Docket No. DW 13-

DIRECT TESTIMONY OF
STEPHEN 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. What are your responsibilities in this case?

A. My responsibilities are to present Lakes Region Water Company's ("Company" or "LRWC") request for approval of emergency rates, to oversee the preparation of the financial exhibits and to prepare prefiled direct testimony which describes the emergency and the financial exhibits. In addition, I am prepared to testify in support of request for emergency rates.

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 increases.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to present the Company's request for emergency rates.

Q. Before you describe the nature of the emergency and the financial exhibits, please provide the background leading up to the emergency.

A. In 2008 and 2009 Barbara and Tom Mason, the owners and operators for 33 and 34 years, respectively, retired from the Company. During their time with the Company, the Company did not set up any retirement plan for them, nor did they set up a retirement plan for themselves. Commencing in 2008 the Company recorded pension and health expenses for the Masons as follows:

	Barbara	Tom	Total
2008	$15,990		$15,990
2009	16,605	36,040	$52,645
2010	15,990	35,360	$51,350

In addition, the Masons provided cash for capital improvements and other expenditures and the Company recorded the expenditures and the related liability and interest expense. While the Company recorded the pension, health and interest expenses on the book and reported such information on its internal financial statements, PUC Annual Report and tax returns, the expenses were not reflected in the Company then existing rates.

In DW 10-141 the Company requested approval of rates based on a 2009 test year, which reflected the pension and health expenses for the retired owners. The Staff and the Office of the Consumer Advocate ("OCA") objected to the pension and health expenses being reflected as a component of test year expenses. After much discussion with Staff and the OCA, the Company accepted the Staff and the OCA's position and eliminated the pension and health expenses from test year expenses. Also, the liability to the Masons was converted to additional paid in capital and the related interest was eliminated. As a result, the Company reversed the expenses on its books and amended its internal financial statements, PUC Annual Reports and tax returns. After consultation with Staff, the Company amended its 2010 PUC Annual Reports and reflected changes that pertained to 2007 – 2009 as adjustments to retained earnings in the amended 2010 PUC Annual Report. The amended pages to the 2010 PUC annual Report were mailed to the PUC under a cover letter dated 3/2/12.

The amended tax returns for 2007, 2008 and 2009 were filed with the IRS and the NHDRA on 2/21/12. The 2010 tax returns were filed 5/23/12 with the changes incorporated into the returns. There was no tax consequence for the amended 2007 – 2009 tax returns and the 2010 tax returns since the Company had both adequate net operating loss carryforwards and section 179 carryforwards to offset any increase in the taxable income created by the amendments.

For 2011 the Company reported $159,696 of book income. The book income includes $0 and $2,814 of federal income taxes and state business taxes, respectively. Also, for 2011 the Company reported federal taxable income of $20,911 and no federal tax. The Company used all of its remaining federal net operating loss deductions and federal SEC 179 deductions in 2011. Unfortunately, with the use of such deductions, the Company has nothing from pre2012 to offset any 2012 federal taxable income.

With the recently approved rate increases (temporary and permanent) in DW 10-141, the Company expects to have both net income and taxable income in 2012.

Q. **Isn't the realization of net income and taxable income what the Company expected as a result of the rate increases?**

A. Yes.

Q. Didn't the Company expect to pay a tax on the 2012 taxable income?

A. Yes.

Q. Doesn't the recently approved rate increases from DW 10-141 reflect tax expense in the test year?

A. No.

Q. Didn't the Company propose tax expenses as part of its proforma adjustments to test year expenses?

A. Yes, however, Staff eliminated such expenses from its determination of test expenses and the Commission approved test year expenses without tax expenses reflected.

Q. Why did Staff eliminate the tax expense from test year expenses?

A. Staff eliminated the tax expense because "given the respective levels of previous years losses available to the Company to offset future taxable income, Staff does not anticipate an immediate need for the Company's current revenue requirement to include a provision for income taxes. Therefore, Staff is proposing that the Company's effective tax rates for both federal and state income taxes should be 0.00%." See page 10, lines 9 – 14 of the Direct Testimony of Jason P. Laflamme dated October 14, 2011in DW 10-141. Further, Mr. Laflamme indicates that "Staff is proposing that the proforma state and federal income tax expense proposed in the Company's filing of $47,158 should be eliminated because it is not anticipated that LRWC will owe income taxes for the foreseeable future due to the availability of net operating loss carryforwards that can be used to offset future taxable income." See page 29, lines 5 – 9 of the Direct Testimony of Jason P. Laflamme dated October 14, 2011in DW 10-141.

Q. Did Staff take into consideration the elimination of the pension, health and interest expenses when it made its determination that it is not anticipated that LRWC will owe income taxes for the foreseeable future due to the availability of net operating loss carryforwards that can used to offset future taxable income?

A. No.

Q. What is the consequence of not taking the elimination of the pension expense into consideration?

A. The consequence is that the Company does not have the cash to pay the 2012 federal income and state business taxes.

Q. When are the taxes due?

A. The taxes are due throughout the year, roughly ¼ of the tax is due each quarter.

Q. Has the Company paid any federal income or state business taxes during 2012?

A. No, it does not have the cash to do so.

Q. What is the consequence of not making timely tax payments?

A. In addition to owing the taxes, the Company will owe interest and penalties.

Q. Why does the inability to pay federal income and state business taxes constitute an emergency?

A. The Company believes that the inability to pay such taxes in and of itself constitutes an emergency. In the Company's case, the lack of cash to pay taxes further exasperates the Company cash position. The Company is already not paying its vendors on a timely basis and is requiring certain vendors to take a lesser amount for services provided. It also has significant accounts payables that it needs to address. It cannot begin to address them if it has to make significant tax payments that are not reflected in rates. While it has not gotten to the point of significantly effecting operation, such payments of taxes would have a detrimental effect on operations.

Q. Instead of a request for emergency rates, should the Company incorporate the tax expense in its next rate case?

A. No. It needs the cash now in order to pay the 2012 tax expense.

Q. If the Company were to file a rate case in 2013 based on a 2012 test year, wouldn't the 2012 tax expense be reflected in the 2012 test year expenses?

A. Yes. However, approval of such a rate increase would not be until late 2013 at the earliest and the rate increase would be required to pay for the 2013 tax expenses. In other words, a rate increase based on a 2012 test year which includes 2012 tax expense would be too late to pay 2012 tax expenses.

Q. What are the company's plans with respect to filing for an increase in rates?

A. At this point, the Company is waiting for 2012 financial results, but expects to file for a rate increase that would adjust 2012 test year expenses (including tax expenses, if necessary), that would include 2011 and 2012 additions to plant and that would include the Mt. Roberts property.

Q. Is there anything else that you would like to address before you describe the financial exhibits?

A. No.

Q. Please describe the financial exhibits.

A. The Company is providing financial statements (Exhibit 1), the anticipated 2012 book and tax depreciation (Exhibit 2) and the calculation of tax and income gross-up requirements (Exhibit 3).

Q. What periods are reflected on the financial statements (Exhibit 1)?

A. The financial statements reflect a proforma 2012 and 2011. The proforma 2012 reflects 11 months of actual data and 1 month of estimated data. 2011 reflects twelve months of actual data (as recorded on the Company's internal financial statements and reported to the PUC in its 2011 PUC Annual Report).

Q. Please describe the Balance Sheet.

A. This balance sheet reflected the Adjusted Proforma Dec. 2012 amounts and the December 31, 2011 amounts. Total adjusted proforma assets amount to $3,610,013 including $2,984,614 of net plant. The net plant includes construction work in progress and assets placed in service thru 12/31/12. Total cash amounts to $13,469. Total Equity Capital & Liabilities amount to $3,610,013. Total Equity Capital amounts to $1,445,248 including $950,703 of additional paid in capital provided by the owners. The Company estimates that net income will be $230,644. Total Long Term Debt amounts to $484,981. Total Accounts Payables amount to $620,012.

Q. Please describe the Statement of Operations and Retained Earnings.

A. This statement of operations reflected the Adjusted Proforma Dec. 2012 amounts and the December 31, 2011 amounts. Total Operating Revenue amounts to $1,360,327. The operating revenues include revenue generated from temporary rates approved in DW 10-141 from January 1, 2012 – July 12, 2012, from permanent rate from July 13, 2012 – December 31, 2012 and the temporary / permanent rate difference. Total Operating Expenses amount to $1,059,249. Net Operating Income amounts to $301,078. Net Income amounts to $230,644. Please note that the Company has estimated the provision for income taxes is $173,634.

Q. Please describe the adjustments reflected in the "Adjustment" column.

A. The Company made two adjustments to the balance sheet. The first adjustment to A/R – Gross up of Income Taxes represents the annual increase in revenue to be collected from customers. The second adjustment to Accrued Taxes represents the anticipated 2012 federal income and state business taxes. Similarly, the Company made two adjustments to the statement of operations. The first adjustment to Operating Revenues represents the annual increase in revenue to be collected from customers. The second adjustment to Provision for Income Taxes represents the anticipated 2012 federal income and state business taxes.

Q. Please describe Exhibit 2, Depreciation 2012 Proforma - Book / Tax schedule.

A. The schedule shows the Company's anticipated book and tax depreciation by plant account. Please note that the tax depreciation is less due to the utilization of SEC 179 and accelerated depreciation in prior years.

Q. Please describe Exhibit 3, Calculation of Tax & Income Gross-up Requirement.

A. Net Income per Books Pre-Tax amounts to $230,644. The Company makes two adjustments to Net Income per Books Pre-Tax. The first adjustment adds back the 2012 book depreciation (as reported on the profit / loss statement). The second adjustment subtracts the tax depreciation on pre2012 assets and 2012 assets subject to accelerated depreciation. The 2012 tax depreciation includes the 2012 SEC 179 deduction on 2012 eligible assets. After the two adjustments, the net taxable income subject to New Hampshire business profits tax ("BPT") is $264,726. Using the 8.5% BPT rate, the BPT is $22,502. The BPT of $22,502 is a deduction from federal taxable income, resulting in net taxable income for federal of $242,224. The federal tax on the net taxable income for federal is $77,717.

Q. Does the federal income and state business tax have to be gross-up for income?

A. Yes.

Q. Please explain the income gross-up calculation.

A. Before I explain the calculation, when you add the revenue to pay the tax, then you also have to add the tax on the increased revenue. The Company is utilizing a tax factor (commonly used by the PUC) to determine the amount of revenue needed to pay the taxes.

Q. Please explain the income gross-up calculation.

A. Net taxable income is $264,726. Utilizing a tax factor of 57.7185% applied to federal income and state business taxes of $100,219, the additional amount of revenue required is $173,634. Because the revenue collected to pay for the taxes is itself taxable, $173,634 is required to fund this tax liability. When the additional revenue required is added to net taxable income, the net taxable income subject to New Hampshire business profits tax ("BPT") is $438,360. Using the 8.5% BPT rate of 8.50%, the BPT is $37,261. The BPT of $37,261 is a deduction from federal taxable income, resulting in net taxable income for federal tax purposes of $401,100. The federal tax on the net federal taxable income is $136,373. This results in a total revenue required for federal income and state business taxes in 2012 of $173,634.

Q. What is the amount of revenue that the Company is requesting?

A. The Company is requesting $173,634.

Q. What if the actual federal income and state business taxes are different than what the Company estimates?

A. The Company is prepared to adjust its filing for emergency rates to whatever the actual federal income and state business expense is. The Company will provide the Staff with a copy of its 2012 federal income and state business tax returns.

Q. What is the Company doing with the costs incurred to prepare and present the emergency rate filing?

A. The Company is deferring such costs and will seek recovery of such expenditures at the conclusion of the proceeding.

Q. Why should the Commission approve the emergency rates?

A. The Commission should approve the emergency rates because (1) there is no federal income and state business taxes reflected in rates, (2) the tax obligation exist for 2012, (3) the Company does not have the cash to pay for the tax obligation and (4) it is in the best interest of the Company and its customers to make timely tax payments.

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

A. No.

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

A. The Company respectfully requests that the PUC approve the emergency rates that result in an increase in annual revenues of $173,634.

Q. Does this conclude your testimony?

A. Yes.