Hampstead Area Water Company

before the

New Hampshire Public Utilities Commission

DW 17-118

Direct Testimony of Stephen P. St. Cyr as it pertains to

TEMPORARY RATES

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 including a number of regulated water and sewer utilities. 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 (but not certified in NH due to different certificate requirements).

Q. Is St. Cyr & Associates presently providing services to Hampstead Area Water Company ("Company")?

A. Yes. St. Cyr & Associates assists the Company in its year end closing and preparation of financial statement and tax returns. St. Cyr & Associates assists the Company in various regulatory filings including expansion of its franchise, financing of construction projects and adjusting rates. It has been engaged to prepare the various rate case 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 on a temporary basis in the event that the NHPUC suspends the Company's request for an increase in permanent rates.

Q. Please provide an overview of the temporary rate filing.

A. The temporary rate filing is the same as the permanent rate filing, except for the elimination of certain expense proforma adjustments that are more appropriately reviewed as part of the permanent rate filing. The Company eliminated the portion of the wages and payroll taxes proformas (2 & 3) pertaining to the 3% wage increase for 2017, management agreement adjustment (6), audit expense adjustment (7), the depreciation expense adjustment (8), the amortization adjustment (10) and the state business tax adjustment (12). The Company also eliminated all of the rate base proforma adjustments (13 – 25) pertaining to the adjustments from a 13 month average to year end rate base and adjusted the cash working capital for the change in the level of operating and maintenance expenses. In addition, the Company eliminated the additional 2% increase in the cost of equity and the 2017 contribution of additional paid in capital. The Company believes that the temporary increase in rates / revenues is fair, reasonable and manageable, and allows the Company to earn a fair and reasonable rate of return on its prudently incurred investments and pay for its necessary operating expenses. The proposed increase will enable the Company to continue to provide good water at good pressure at good reliability at a good price. Finally, the temporary rates do not include the proposed step increase.

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, 2016.

Q. Would you summarize the schedule entitled "Computation of Revenue Deficiency for the Test Year ended December 31, 2016."

A. Yes. This schedule summarizes the supporting schedules. The actual revenue deficiency for the test period amounts to $95,894. It is based upon a 13 month average balance for 2016 of $5,105,137 as summarized in Schedule 3. The Company is utilizing its actual rate of return of 5.60% for the actual test year. The actual rate of return of 5.60%, when multiplied by the rate base of $5,105,137, results in an operating income requirement of $285,791. As shown on Schedule 1, the actual net operating income for the test period was $189,897. The operating income requirement less the net operating income results in an operating income deficiency of $95,894. The tax effect on the operating income deficiency is $0, resulting in a revenue deficiency of $95,894.

The pro forma revenue deficiency for the test year amounts to $0. The Company made only one adjustment to its rate base, namely the adjustment for cash working capital for $5,358. The Company adjusted the rate of return to reflect its pro forma cost of debt, resulting in a proposed rate of return of 5.44%. As such, the proposed rate of return of 5.44%, when multiplied by the rate base of $5,110,495, results in an operating income requirement of $277,937. The Company increased its revenue by $131,780 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 summarize Schedule 1, "Statement of Income," for the twelve months ended December 31, 2016?

A. The first column (column b) of Schedule 1 shows the actual operating results of the Company from January 1, 2016 through December 31, 2016. The Company has filed its 2016 NHPUC Annual Report, which further supports the rate filing. During the twelve months ended December 31, 2016, the Company operating revenues amounted to $1,790,467, a decrease of $53,516 or 2.90%. The decrease in operating revenue in 2016 was due to a decrease in number of thousand gallons sold and a decrease in other water revenues. The decrease was partially offset by an increase in revenue from metered sales to general customers. The increase in revenue from metered sales to general customers is due to an increase in the number of customers. The Company customer base continues to grow. The Company had 3,578 customers as of December 31, 2016.

The Company's operating expenses consist of operation and maintenance expenses, depreciation and amortization expenses, and taxes. Total 2016 operating expenses amounted to $1,600,570, an increase of $29,552 or 1.88%. Operation and maintenance expenses increased $67,748, primarily due to increased labor in part associated with an additional employee. The increase in operating and maintenance expenses was offset by lower depreciation expenses and lower taxes other than income taxes. The Company's net operating income amounted to $189,897.

The Company reviewed a number of expense accounts in its preparation of the temporary 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 pro forma 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 pro forma adjustment to revenue.

Operating Revenues

1. Operating Revenues

The pro forma adjustment to revenue represents the additional revenue of $131,780 needed to recover the increase in its expenses and to earn a reasonable return on its rate base.

Q. Did the Company make any pro forma adjustments to expenses?

A. Yes. The Company made a number of pro forma adjustments to expenses. Please note that the Company maintained the same numbering sequence for both the temporary and permanent pro forma adjustments. To the extent that the Company eliminated a pro forma adjustment for temporary rate purposes, it keeps the caption below but does not provide an explanation.

Operating and Maintenance Expenses

2. Wages. During 2017 three employees left the Company and three employees were added. As such, the actual wages for the three former employees were eliminated from test year expenses and projected wages for the three new employees were added. There were also other adjustments to reflect a full year of wages. When the total pro forma wages of $305,438 is compared to actual wages of $256,670, the resulting pro forma adjustment is $49,173. The pro forma adjustment is further supported by Schedule 1B.

3. Payroll Taxes. With an increase in wages, there is a related increase in payroll taxes. The Company applied the FICA tax rate of 7.65% to the increase in wages of $49,173 to determine a payroll tax pro forma adjustment of $3,320. The pro forma adjustment is further supported by Schedule 1B.

4. Benefits. With a change in employees, there were changes in benefits. See Schedule 1B for the change.

5. 401k. With a change in employees, there were changes in 401K. See Schedule 1B for the change.

6. Management Agreement.

7. Audit Expenses.

Total pro forma adjustments to operating and maintenance expenses amount to $43,447.

8. Depreciation Expenses

9. Amortization of CIAC

10. Amortization Expense - Other

11. Taxes other than Income.

12. Income Taxes

With the increase in wages and decrease in interest expenses, the changes impact the NH business enterprise value tax base and the NH business enterprise tax. The net change increases the enterprise value tax base and the NHBET by $293. See Schedule 1D.

The Company made no other pro forma adjustments to expenses. The total pro forma adjustments to expenses amount to $43,740.

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 pro forma 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, 2015 and 2014, 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 2016, 2015 and 2014.

Utility Plant consists of numerous structures, wells, pumps, tanks, mains, services, meters, vehicles and other plant. At December 31, 2016 the Company had utility plant of $16,622,778. Since the last rate case, the Company has added approximately $3.1 million in plant. Accumulated Depreciation represents the depreciation on these same assets from the date of purchase through December 31, 2016, using a straight line depreciation method over the estimated useful life. The Company's current assets amount to $1,095,394, including $619,179 of cash. The Company's strong cash position is the result of the Company's owner providing $650,000 ($150,000 in 2015 and $500,000 in 2016) of additional paid in capital. The Company also has deferred assets including $39,118 of unamortized debt expense, $82,652 of miscellaneous deferred debits and $14,590 of deferred tax assets.

The Company's Equity Capital consists of $16,767 of common stock, $2,754,354 of other paid in capital, and retained earnings of ($779,242). As previously mentioned, other paid in capital increased by $150,000 in 2015 and $500,000 in 2016. The Company's negative retained earnings have been decreasing in recent years due to the addition of net income. 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 $4,190,886. In 2016 the Company refinanced its two TD Bank loans with a new loan from Pentucket Bank. The Pentucket Bank loan provided a lower interest rate and better terms. The refinancing was approved by the PUC in DW 16-654. The Company long term debt balance has been decreasing in recent years. The Company has net contribution in aid of construction of $5,477,917. The Company and its customers continue to benefit from CIAC, primarily from Lewis Builders.

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

A. Columns (b) - (m) show the actual balances of the rate base items as per the Company's monthly financial statements. Column (n) shows the actual 13 month average balances, except for cash working capital, which reflects the cash working capital for 2016. Column (o) shows the 2016 pro forma adjustments. Column (p) shows the pro forma 2016 balances.

The rate base consists of Utility Plant, less Accumulated Depreciation, Material & Supplies, Prepayments – Other, Prepaid Taxes, Miscellaneous Deferred Debits, Accumulated Deferred Income Taxes – Assets, Accumulated Deferred Income Taxes – Liabilities, Contributions in Aid of Construction and Accumulated Amortization of CIAC plus Cash Working Capital. The actual 13 month average rate base amounts to $5,105,137. The Company made only one adjustment to rate base, namely a cash working capital adjustment for the higher operation and maintenance expenses. The computation of working capital is shown on schedule 3B.

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

A. The Company's overall rates of return are 5.60% and 5.44% for 2016 actual and 2016 pro formed, respectively. It is derived from the weighted average cost rates associated with actual and pro formed 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 $16,767 of Common Stock, $2,754,354 of Other Paid in Capital, and Retained Earnings of ($779,242). The Company has $4,190,886 of long term debt at year end. It consists of the one Pentucket Bank loan, two SRF loans and other loans.

The Company's overall capital structure is more weighted to debt. In 2015 and 2016 the owner contributed $150,000 and $500,000 of other paid in capital. The proposed rate increase should continue to improve earning, increase retained earnings and increase the equity portion of the capital structure.

Q. Would you please explain Schedule 5A and 5B entitled "Actual Long Term Debt" and "Pro forma 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 12/31/16 and 12/31/15, the 2016 interest expense, and cost rate. The total outstanding balance at 12/31/16 is $4,190,886. The total 2016 interest expense is $142,571. The total cost rate is 3.70%. As previously mentioned, in 2016 the Company refinanced the two TD Bank loans with one Pentucket Bank loan, resulting in a lower interest rate. The refinancing was approved by the PUC in Order No. 25,930 dated July 29, 2016.

Schedule 5B utilizes the same data as schedule 5A. The Company made no changes to the outstanding debt balance at 12/31/16, however, it did adjust interest expenses for changes that took place in 2016. Most notably, it eliminated the interest related to the TD Bank loans due to refinancing such debt with Pentucket Bank. It also adjusted the interest accordingly. After making such adjustments, the pro forma total cost rate is $3.46%.

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 9.6%.

Q. What is the pro forma weighted average cost rate?

A. The pro forma weighted average cost rate is 5.44%

Q. What is the proposed increase in temporary revenue?

A. The proposed increase in temporary revenue is $131,780.

Q. Please explain the Report of Proposed Rate Changes reflect in the temporary rate filing.

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 $131,780 or 7.36%. All of the change amounts apply to general customers. The average general customer will receive an annual increase of $37.30, resulting in an average annual bill of $512.77.

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. Please explain the calculation of rates.

A. The total revenue requirement including the proposed temporary rate increase amounts to $1,922,247. The Company reduces the total revenue requirement by the amount of revenue from fire protection and other water revenue, resulting in a total revenue requirement from general customers of $1,811,611. First, the Company calculates the portion of revenue from the base rates. In doing so, it applies the overall percent increase of 7.84% to the existing annual amounts per meter size to develop a new, proposed annual amount per meter size. It then takes the new, proposed annual amount times the number of meters to determine the revenue requirement from base rate, namely $450,480.

Second, the Company takes the remaining revenue of $1,361,131 to be realized from consumption. It divides the remaining revenue from the 2016 actual consumption to determine the consumption rate per 100 cubic feet, namely 7.47.

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 $135.00 (plus out of pocket costs) for work performed in preparation of the rate filing and in pursuit of the rate increase during the rate proceeding. The Company will also utilize the services, i.e., management, legal, accounting, etc., of its affiliate, Lewis Builders Development, Inc., in the preparation of the rate filing and throughout 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. No.

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

A. Yes, the Company is requesting a temporary revenue increase of $131,780, effective mid-September 2017. The temporary revenue increase of $131,780 enables the Company to earn a 5.44% pro forma rate of return on its investment, reflected in a pro forma rate base of $5,110,495. The average annual amount for a general customer will increase from $475.47 to $512.77, an increase of $37.30 or 7.84%.

Q. Does this conclude your testimony?

A. Yes.