

**BEFORE THE PENNSYLVANIA PUBLIC
UTILITY COMMISSION**

ORIGINAL

**PENNSYLVANIA PUBLIC UTILITY
COMMISSION**

v.

AUDUBON WATER COMPANY

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DOCKET NO. R-2012-2286118

**DIRECT TESTIMONY OF
MARILYN J. KRAUS**

**ON BEHALF OF
THE OFFICE OF CONSUMER ADVOCATE**

MAY 23, 2012

2012 JUL -6 PM 4:24
OFFICE OF CONSUMER ADVOCATE

1 INTRODUCTION

2 Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND OCCUPATION.

3

4 A. My name is Marilyn J. Kraus. My business address is 555 Walnut Street, Forum Place,
5 5th Floor, Harrisburg, Pennsylvania 17101. I am a certified public accountant currently
6 employed as a Senior Regulatory Analyst by the Pennsylvania Office of Consumer
7 Advocate (OCA).

8

9 Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND
10 QUALIFICATIONS IN THE UTILITY REGULATORY FIELD.

11

12 A. Appendix I to this testimony describes my educational background and includes a list of
13 the various rate cases and regulatory matters in which I have participated.

14

15 Q. WHAT WAS YOUR ASSIGNMENT IN THIS CASE?

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17 A. My assignment in this case was to review the rates proposed by Audubon Water
18 Company (AWC or Company) in the current filing and recommend adjustments pursuant
19 to generally accepted accounting and rate making principles. My review included an
20 analysis of the elements of rate base and net operating income as outlined in AWC's
21 Supporting Data in this proceeding (AWC Exhibit No. 1).

22

1 Q. PLEASE DESCRIBE THE GENERAL NATURE OF THE COMPANY'S RATE
2 INCREASE REQUEST.

3
4 A. The Company is requesting an increase of \$517,968, or 25%, over pro forma revenues for
5 the future test year ended September 30, 2012. This amount reflects updates to the
6 Company's originally filed supporting data, as outlined on pages 27 and 28 of AWC
7 Statement DMK-1. The updates to the filing increase rate base by \$1,711 and decrease
8 expenses by \$22,979. The Company cites "substantial investment in water utility assets"
9 since its prior rate case as well as new facilities to be added during the future test year as
10 reasons for the requested increase in this case. The Company indicates further, that
11 system reliability will be enhanced by these plant additions (AWC Supporting Data, page
12 A-10.)

13
14 Q. WHAT ISSUES ARE YOU ADDRESSING IN THIS CASE?

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16 A. I am addressing issues related to the Company's rate base and net operating income
17 claims, including future test year plant additions, cash working capital, salaries and
18 wages and associated payroll taxes, health insurance expenses, the Company's claim for
19 "new" maintenance projects, office rent, special services, rate case expense and
20 amortization of tank painting. I will also comment on the Company's proposal for return
21 on equity. My recommended adjustments are summarized in the attached OCA Exhibit
22 MJK-1. The amounts of Company-claimed rate base and pre-tax net operating income

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shown on OCA Exhibit MJK-1 reflect the updates made by the Company, as referenced above.

1 PROFORMA PLANT ADDITIONS

2 Q. PLEASE DISCUSS YOUR RECOMMENDATION REGARDING THE COMPANY'S
3 CLAIM FOR PROFORMA PLANT ADDITIONS.

4
5 A. As outlined on Schedule E-3 of the AWC Supporting Data, the Company is including
6 proforma plant additions of \$631,079 in rate base in this case. In responses to I&E-RB-6
7 through 14-D and OCA-III-1 through 4, AWC provided the status of each of the plant
8 addition projects claimed. With respect to the following projects, the Company indicated
9 that bids or proposals have not yet been requested, no amounts have been expended and
10 no starting or in-service dates have been determined:

11 <u>Project</u>	<u>Rate Base Claim</u>	<u>Depreciation Expense Claim</u>
12 New Road to Featherbed Well	\$14,850	\$300
13 Generator at Well #15	\$48,333	\$3,333
14 Mains Projects (except VFCC)	\$68,921	\$1,158
15 Office Equipment	\$46,800	\$10,400
16 Backhoe	<u>\$109,250</u>	<u>\$11,500</u>
17	\$288,154	\$26,691

18
19 As such, there is no support for the amounts claimed by the Company for these items as
20 used and useful plant in this rate case. I have removed the net plant amounts (i.e., rate
21 base claims) related to these items totaling \$288,154 from rate base, and the
22 corresponding amounts of annual depreciation totaling \$26,691 from expenses in this
23 case. These adjustments are shown on Lines 2 and 21 of OCA Exhibit MJK-1. It is
24 interesting to note that the only pro forma plant additions claimed by the Company in this
25 case that have actually been completed are those that were funded with contributions in
26 aid of construction (CIAC). With respect to the projects listed above, allowance of these
27 capital additions in this case would, in effect, be treating the ratepayers as investors, in

1 that ratepayers would be providing funds for projects that are not used and useful and, in
2 fact, have not even commenced.

3
4 CASH WORKING CAPITAL

5 Q. WHAT ADJUSTMENTS ARE YOU RECOMMENDING TO THE COMPANY'S
6 CLAIM FOR CASH WORKING CAPITAL?

7
8 A. The Company calculated its claim for cash working capital based on the formula method,
9 or one-eighth (12.5%) of operating and maintenance (O&M) expenses. I have made an
10 adjustment to cash working capital of \$30,474, representing 12.5% of the total
11 adjustments I am recommending to O&M expenses. This adjustment should be modified
12 to comport with the total adjustments to O&M as accepted by the Commission.

13
14 SALARIES AND WAGES

15 Q. DESCRIBE THE COMPANY'S CLAIM FOR SALARIES AND WAGES.

16
17 A. As outlined in AWC Exhibit No. 1, Pro forma Adjustment 4 and Schedule 1-4, the
18 Company is claiming a 2% salary increase for the president and a 4% salary increase for
19 each of the other current 13 employees. This results in a total salary increase of \$27,072
20 (from \$747,623 to \$774,695). Additionally, AWC is claiming a \$23,400 salary for a new
21 part-time laborer. I am recommending adjustments to both of these claims.

1 Q. WHAT ADJUSTMENT ARE YOU RECOMMENDING TO THE COMPANY'S
2 CLAIMED 4% SALARY INCREASE?

3
4 A. As indicated by the Company in response to I&E-RE-8-D, since 2008, annual salary
5 increases have only been 1.5%. As such, the Company's claim for a 4% salary increase
6 is not supported by the historical increases that were actually awarded. Additionally, the
7 Company states that "[t]he 4% increase is a general overall estimate to provide for both
8 general cost of living increases, i.e., annual wage increase, as well as potential merit
9 increases..." (Emphasis added.) Thus, the Company's request in this case is an estimate,
10 a portion of which will only "potentially" be awarded. Because the Company's claim is
11 not supported by actual annual increases awarded during recent years, and a portion may
12 not be paid at all, I am recommending that the salary increases allowed in this case be
13 limited to the 1.5% actually awarded in the past three years. This provides for a total
14 salary increase of \$11,214 (\$747,623 current annualized payroll x 1.5%), which is
15 \$15,858 lower than the \$27,072 increase claimed by the Company. The associated
16 payroll tax adjustment is \$1,213 (\$15,858 x 7.65%). These adjustments are shown on
17 lines 10 and 11 of OCA Exhibit MJK-1.

18
19 Q. WHAT IS YOUR RECOMMENDATION WITH RESPECT TO THE COMPANY'S
20 CLAIM FOR THE ESTIMATED SALARY OF A NEW PART-TIME EMPLOYEE?

21
22 A. As indicated above, the Company is claiming an estimated salary of \$23,400 for a new
23 part-time employee. In response to I&E-RE-8-D, the Company indicated that, this

1 employee has not yet been hired and, in fact, “[t]he job description for the new part time
2 laborer has not yet been developed.” As such, the Company’s claim for this new
3 employee does not represent a known and measurable expense increase that will occur by
4 the end of the future test year. Thus, I am recommending that the estimated “new” salary
5 of \$23,400 be disallowed in this case. This adjustment is shown on line 12 of OCA
6 Exhibit MJK-1. The associated payroll tax adjustment of \$2,433 ($\$23,400 \times$
7 $7.65\% = \$1,790$ FICA plus \$643 state and federal unemployment, per AWC Exhibit No. 1,
8 Schedule I-5) is shown on line 13.

9
10 HEALTH INSURANCE

11 Q. PLEASE EXPLAIN THE ADJUSTMENT YOU ARE RECOMMENDING TO THE
12 COMPANY’S CLAIM FOR EMPLOYEE HEALTH INSURANCE.

13
14 A. As shown in AWC Exhibit No. 1, Schedule I-6, the Company is claiming an expense of
15 \$171,062 related to employee health insurance. In response to I&E-RE-10-D, the
16 Company provided a copy of the March 2012 invoice related to employee health
17 insurance. This invoice shows a total monthly cost of \$12,415.43. Additionally, the
18 Company indicated that it provides for a \$204.86 monthly supplemental insurance for an
19 employee who is over the age of 65. As such, the total current annual cost for employee
20 health insurance is \$151,443 ($\$12,415.43 + \204.86×12). This amount is \$19,619 less
21 than the Company’s claim in this case. The amount of the expense for ratemaking
22 purposes should be based on actual costs. Thus, I have included an adjustment to reduce
23 the Company’s claim for health insurance by \$19,619 on line 14 of OCA Exhibit MJK-1.

1 PREVENTATIVE MAINTENANCE PROJECTS

2 Q. PLEASE EXPLAIN YOUR RECOMMENDATIONS RELATED TO THE
3 COMPANY'S CLAIM FOR THE COSTS OF PREVENTATIVE MAINTENANCE
4 PROJECTS.

5
6 A. As outlined in AWC Exhibit No. 1, Schedule I-9, The Company is requesting the costs of
7 four new preventative maintenance projects, totaling \$94,150, as annual ongoing
8 expenses in this case. These projects include wellhead maintenance, maintenance of
9 generators, maintenance of chlorine analyzers and recording equipment, and exercising of
10 valves. For several reasons, I am recommending that the Company's entire \$94,150
11 claim be denied in this case. First, information provided by the Company in its responses
12 to I&E-RE-12-D and OCA-III-6 through 13 indicate that none of these project costs
13 represent known and measurable expense increases. Specifically, no costs have actually
14 been incurred, no bids, proposals, etc. have been procured, no contractors have been hired
15 and no support whatsoever has been provided by the Company for the estimated expenses
16 associated with any of these projects.

17
18 For example, in response to I&E-RE-12-D, the Company stated, "Costs have not yet been
19 incurred as the projects are currently in the planning and organization stage." The
20 Company stated further, "No formal study was prepared; rather, the need for the projects
21 was determined by the Company's Chief of Operations based upon his discussions with
22 the Company's consulting engineers." In response to OCA-III-8, with respect to a
23 portion of the claim for Maintenance of Wells and Springs, AWC stated "the Company

1 intends to hire a contractor who will annually operate and check the VFDs to make sure
2 they work properly.” (Emphasis added.) The Company has given no assurance as to
3 when a contractor might be hired, or whether such a contractor will be hired at all in the
4 near future, nor has it given any support as to what the actual costs charged by a
5 contractor may be. Similarly, in response to OCA-III-10, with respect to the
6 Maintenance of Power and Pumping Equipment, the Company stated that it “plans to hire
7 a contractor” to inspect electric and heating equipment and replace or repair parts “if
8 necessary.” Finally, in response to OCA-III-11, with respect to maintenance of the
9 chlorine analyzers, the Company stated that they “possibly will need repair or
10 replacement in the future.” Based on the Company’s responses, it is clear that there are
11 no concrete plans with respect to the performance of these maintenance projects and,
12 even if there were plans, no reasonable means of determining the actual costs. In fact, it
13 appears that the Company itself does not know, at this time, what work would actually be
14 needed with respect to the projects claimed in this case. Thus, these claims for new
15 maintenance expenses do not represent known and measurable maintenance expense
16 increases and, therefore, should not be included in expenses for ratemaking purposes in
17 this case.

18
19 Q. ARE THERE OTHER CONSIDERATIONS IN DETERMINING WHETHER THE
20 COMPANY’S CLAIMS FOR THESE MAINTENANCE PROJECTS ARE
21 APPROPRIATE FOR RATEMAKING PURPOSES?

1 A. Yes. The responses provided by the Company related to these maintenance projects, as
2 referenced above, also indicate that much of the work on the projects claimed would not
3 be done on an annual basis. For example, in response to OCA-III-6, with respect to the
4 Borehole/Wellhead project, the Company stated that an “initial” treatment would involve
5 cleaning and inspecting the borehole and wellhead and, “if necessary,” re-drilling and
6 reconstruction of the top of the wellhead. The Company stated further, that “[o]nce the
7 initial treatment has taken place, the annual maintenance will include a visual inspection
8 of the facilities (and repair if needed).” Similarly, in response to OCA-III-11, with
9 respect to the Company’s claim for annual maintenance of the chlorine analyzers, AWC
10 stated that “this equipment has not been in use long enough for Audubon to know exactly
11 what type of annual maintenance work will need done” (sic). The Company stated
12 further, that the analyzers and recorders have electrical parts that “possibly will need
13 repair or replacement in the future.” As such, even if there was reasonable assurance that
14 these projects would be performed and there was a reasonable means of determining the
15 actual costs, there is no way to determine the frequency with which any part of the work
16 on these projects would be done (e.g., annually, every five or ten years, one time, etc.)
17 Thus, the Company has not supported its claim for the costs of these maintenance
18 projects in terms of the appropriate normal, annual level of expense for ratemaking
19 purposes, yet it is claiming the total amount of these project costs as annual, ongoing
20 expenses in this case.

21
22 Finally, it appears that some of the maintenance work claimed by the Company as part of
23 the “new” projects is already being done. For example, in response to OCA-III-13, with

1 respect to the exercising of valves, the Company stated “Audubon exercises valves (and
2 repairs or replaces, if necessary) during its maintenance of the distribution system, when
3 fixing leaks or when operating fire hydrants. The check valves have been replaced and
4 maintained on an annual basis and main valves have been added to the system.” To the
5 extent that this work is already being done, the related costs are already reflected in
6 expenses. In its claim for the maintenance projects, as outlined in AWC Exhibit No. 1,
7 Schedule I-9, the Company did not deduct any current expenses (i.e., historic test year)
8 from the amount shown as pro forma increases for these maintenance items.
9 Furthermore, to the extent that this maintenance is performed by in-house personnel, the
10 associated labor costs are already considered in the salaries and wages expense
11 allowance. Thus, to the extent that any of this type of maintenance was performed during
12 the test year, or can be performed in-house, there is a double count of the associated
13 costs.

14
15 Q. DO YOU HAVE ANY FURTHER COMMENTS RELATED TO THE COMPANY’S
16 CLAIM FOR NEW PREVENTATIVE MAINTENANCE?

17
18 A. Yes. I note that the same type of claim, i.e., request for expenses associated with “new”
19 preventative maintenance projects, was made by AWC in its last two rate filings. In
20 AWC’s 2007 rate case at Docket No. R-00072100, the Company claimed a pro forma
21 annual expense increase in Maintenance of Mains of \$50,000, related to “Pro Forma New
22 T&D Preventative Maintenance Projects”. In the Settlement of that case, the Company
23 agreed to expend \$50,000 for the maintenance projects identified in the filing in order to

1 implement a second phase rate increase. By letter dated October 1, 2008, the Company
2 advised the parties in that case that \$66,000 had been spent on maintenance projects in
3 fulfillment of the requirements of the Settlement. I would note that these expenditures
4 included a project that was not identified in the 2007 rate filing, but that was believed by
5 the Company to have been a higher priority than projects that had been claimed in that
6 case. Thus, the projects that were identified by the Company in the 2007 rate filing as
7 necessary ongoing maintenance were not all performed

8
9 I also note that the Statement of Water Income & Deductions, provided in response to
10 I&E-RE-18-D, shows that expenses actually incurred and charged to the account,
11 Maintenance of Mains, were \$12,899, \$11,608 and \$15,405 for the years ended 9/30/09,
12 9/30/10 and 9/30/11, respectively. This is the account for which the Company requested
13 an ongoing annual expense of \$50,000 in the 2007 rate filing. Thus, the Company
14 actually spent far less than its last rate case claim of \$50,000 annually during the last
15 three years.

16
17 Given this history and the lack of support for the present maintenance expense claim
18 discussed above, it appears that the allowance of the Company's claim for \$94,150
19 related to "new" maintenance projects in this case would be tantamount to allowing
20 AWC to collect a pool of dollars from the ratepayers to use at its discretion. This is
21 contrary to accepted ratemaking procedures, which require the Company and its investors
22 to provide funding for projects and allow for recovery from ratepayers, the actual
23 amounts spent upon completion of the projects.

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For all of the reasons discussed above, I recommend that the Company's claim for \$94,150 associated with new preventative maintenance be denied in this case. This adjustment is shown on line 15 of OCA Exhibit MJK-1.

OFFICE RENT

Q. EXPLAIN YOUR RECOMMENDED ADJUSTMENT TO THE COMPANY'S CLAIM FOR OFFICE RENT IN THIS CASE.

A. As shown in AWC Exhibit No. 1, Schedule I-9, the Company is claiming an annual office rent expense of \$49,616. In response to I&E-RE-14-D, the Company provided a copy of the current lease agreement relative to its office space. AWC indicated in this response, that the monthly rental fee of \$3,078.83 (\$36,946 annually) for the year ended 4/28/2012, shown on page 2 of the lease agreement, was "exclusive of additional triple net charges", which purportedly increased the monthly rent to \$3,994.86 (\$47,938 annually). The Company increased the \$47,938 amount by \$0.50 per square foot (3.5%), as required by the lease agreement for extension through 4/28/2013, in developing its \$49,616 claim.

The lease agreement provided by the Company does not support its claim for office rent expense. Specifically, the annual rental fee amount of \$36,946, shown on page 2 of the agreement, is identified on page 1 as "annual triple net rent payable". This indicates that the amount outlined in the lease agreement is inclusive of "triple net rent charges".

1 Furthermore, the lease agreement itself does not identify any additional amounts, or even
2 mention that there are any such amounts, that must be paid by the "Tenant", i.e., AWC.
3 Additionally, the lease agreement was the only document provided by the Company in
4 support of its office rent expense. Thus, the Company has not supported its claim, which
5 reflects a rental fee that is higher than the amount identified in the lease agreement, in
6 this case. I recommend that the allowable office rent expense be based on the \$36,946
7 amount at 4/28/2012, increased by \$0.50 per square foot (3.5%) factor for the period
8 ending 4/28/2013, resulting in an allowable annual rent expense of \$38,220. This amount
9 is \$11,396 less than the Company's claim for this item (\$49,616 - \$38,220). This
10 adjustment is shown on line 16 of OCA Exhibit MJK-1.

11
12 SPECIAL SERVICES

13 Q. PLEASE EXPLAIN YOUR RECOMMENDED ADJUSTMENT TO THE
14 COMPANY'S CLAIM FOR SPECIAL SERVICES EXPENSE.

15
16 A. As shown in AWC Exhibit No. 1, Schedule H-4, page 2, the Company is claiming
17 \$52,087 for Special Services expense, based on the actual expense incurred during the
18 historic test year ended 9/30/11. In response to OCA-I-7, the Company provided the
19 invoices, which it claims support the Special Services expense. A review of these
20 invoices indicate that a number of charges from the Company's outside accounting firm,
21 Maillie, Falconiero & Company, LLP, relate to personal issues of the employees. These
22 issues include preparation of Form 1041, U. S. Income Tax Return for Estates and Trusts
23 and PA-41, Fiduciary Income Tax Return, review of will, investment statements and

1 settlement sheets on property sold and preparation of individual Federal, State and Local
2 Income Tax Returns. Charges for these personal issues total \$6,725.00. (See invoices
3 dated 1/31/2011, \$2,274, 2/28/2011, \$147, 3/31/2011, \$2,110, 2nd invoice dated
4 3/31/2011, \$1,400 and 4/30/2011, \$794.) It is highly inappropriate for AWC's ratepayers
5 to be paying for Company executives' and employees' personal expenses. I have
6 included an adjustment to remove the \$6,725 test year amount from expenses in this case,
7 as shown on line 17 of OCA Exhibit MJK-1. The Commission should direct the
8 Company to cease this practice and ensure that, on a going-forward basis, all charges for
9 personal services provided by the Company's outside contractors are billed separately
10 from AWC utility services.

11
12 RATE CASE EXPENSE

13 Q. PLEASE DESCRIBE THE RATE CASE EXPENSE CLAIM MADE BY THE
14 COMPANY IN THIS CASE AND YOUR RELATED ADJUSTMENT.

15
16 A. As shown on Schedule I-11 of the AWC Exhibit No. 1, the Company is claiming rate
17 case expense of \$230,000, normalized over 2 years (\$115,000 annually) for this
18 proceeding. In response to I&E-RE-15-D, the Company lists the filing years of the last
19 three prior rate cases as 1998, 2002 and 2007. This list shows that the intervals between
20 the last three cases are four and five years, respectively. Additionally, there was a five-
21 year interval between the last case and this case. Based on the historical filing intervals,
22 the two-year normalization period used by the Company in this case is too short. I am
23 recommending that a five-year normalization period be used instead, resulting in an

1 annual allowance for rate case expense of \$46,000 ($\$230,000 / 5$). This results in an
2 adjustment to reduce expenses by \$69,000 ($\$115,000 - \$46,000$). This adjustment
3 appears on Line 18 of OCA Exhibit MJK-1. I should note that in its last rate case, which
4 was filed five years ago in 2007, the Company requested a two-year normalization period
5 for rate case expense. (Docket No. R-00072100, AWC Supporting Data, Schedule I-10.)
6 I should also note that, with respect to the Company's claim for total rate case expense of
7 \$230,000, \$63,050 has actually been spent as of May 8, 2012. (Company's 2nd updated
8 response to I&E-RE-16-D.) The basis for the five-year normalized amount to be
9 reflected in this case should be the final actual amount incurred, assuming it represents a
10 reasonable expense.

11
12 TANK PAINTING

13 Q. PLEASE EXPLAIN YOUR RECOMMENDATION RELATED TO THE COMPANY'S
14 CLAIM FOR AMORTIZATION OF TANK PAINTING EXPENSES.

15
16 A. As outlined in AWC Exhibit No. 1, Schedule I-12, the Company is requesting a ten-year
17 amortization of the estimated costs of painting two storage tanks, totaling \$107,500, or
18 \$10,750 annually. In response to I&E-RB-15-D, AWC indicated that no money has been
19 expended to date with respect to these tank painting projects. Additionally, in response to
20 I&E-RE-17-D, the Company stated that it has not entered into any contracts for this
21 project and it has not even estimated a date for these projects to commence. Furthermore,
22 the Company has provided no support, whatsoever, for the costs of this project which it
23 has included in expenses in this case. Considering these facts, the Company's claim for

1 this item does not represent a known and measurable expense for ratemaking purposes in
2 this case. Just as in the cases of some of the requested plant additions and “new”
3 maintenance projects, as discussed above, allowance of this expense would be
4 tantamount to placing the ratepayers in the role of investors by collecting funds for this
5 project in advance of the project completion or even its commencement. For all of these
6 reasons, I am recommending that the Company’s claim for amortization of tank painting
7 of \$10,750 be denied in this case. This adjustment is shown on line 20 of OCA Exhibit
8 MJK-1.

9
10 RETURN ON EQUITY

11 Q. HOW DID AWC DEVELOP ITS CLAIM FOR THE RETURN ON EQUITY FACTOR
12 INCLUDED IN ITS OVERALL RATE OF RETURN?

13
14 A. As outlined in AWC Exhibit No. 1, Schedule F-3, the Company is claiming an overall
15 rate of return of 9.06%. This factor reflects a capital structure of 45% debt, with a cost
16 rate of 6.70% (weighted cost rate of 3.02%), and 55% equity, with a cost rate of 10.98%
17 (weighted cost rate of 6.04%). As indicated on page 2 of Schedule F-3, the Company
18 “backs into” its return on equity claim of 10.98%, based on a debt interest coverage
19 factor of 3.0x. I have not performed an analysis of the appropriate capital structure or
20 return on equity factor to be used in this case. Thus, though I do not accept the
21 Company’s proposed hypothetical capital structure, I am not making a recommendation
22 with respect to the capital structure. However, I am making a recommendation with
23 respect to the return on equity factor.

1 Q. EXPLAIN YOUR RECOMMENDATION WITH RESPECT TO THE APPROPRIATE
2 RETURN ON EQUITY FACTOR TO BE USED IN THIS CASE.

3
4 A. The method used by the Company to develop its claimed return on equity factor, i.e., the
5 “fallout” of an interest coverage calculation, is not accepted by the Commission as
6 support for an equity return. Rather, the Commission has consistently used a discounted
7 cash flow (DCF) analysis to determine the appropriate return on equity. As indicated
8 above, I have not performed an independent analysis of the return on equity in this case.
9 Therefore, I am recommending that the most recent equity return factor calculated by the
10 Commission’s Bureau of Technical Utility Services for use by water utilities in
11 calculating their Distribution System Improvement Charges (DSIC) be used in this case.
12 As indicated on page 18 of the “Report on the Quarterly Earnings of Jurisdictional
13 Utilities for the Period Ended September 30, 2011,” approved by the Commission on
14 January 27, 2012, the current equity return factor for the DSIC is 9.5%. This factor,
15 which is calculated based on a DCF analysis as accepted by the Commission, is
16 prescribed for use in determining the return for DSIC purposes by utilities that do not
17 have specific equity factors approved by the Commission within the prior two-year
18 period. Using the 9.5% equity return factor and the Company’s claims for capital
19 structure and debt cost, the overall rate of return in this case is 8.24% (55% equity ratio x
20 9.5% = 5.22%; 5.22% + weighted cost of debt of 3.02, referenced above, = 8.24%). I
21 have used this 8.24% overall rate of return factor in calculating the recommended
22 increase in this case, as shown on OCA Exhibit MJK-1. I should note that the Company
23 attempts to justify its request for a 10.98% return on equity by comparing this factor to

1 those requested by other utilities, specifically, the request made by Aqua Pennsylvania
2 (Aqua) in its most recent base rate case for an equity return of 11.75%. (AWC Statement
3 DMK-1, pages 19-20.) Because the Aqua rate case was settled, its requested equity
4 return has not and will not be specifically approved by the Commission. Thus, the
5 comparison of the Company's requested equity return to the equity return requested by
6 Aqua is not relevant in this case.

7
8 SUMMARY

9 Q. PLEASE SUMMARIZE YOUR RECOMMENDATIONS IN THIS CASE.

10 A. As shown on OCA Exhibit MJK-1, the overall revenue increase recommended by the
11 OCA in this case is \$208,895, which compares to AWC's requested increase of
12 \$517,968. The OCA's recommended revenue increase incorporates the combined
13 effective federal and state income tax rate calculated by the Company on Schedule I-14,
14 adjusted for interest synchronization and the removal of tax depreciation on the new
15 truck. As discussed above, the OCA also recommends that the Company be directed to
16 separate personal and utility charges from its outside contractors.

17
18 Q. DOES THAT CONCLUDE YOUR TESTIMONY?

19
20 A. Yes, it does.

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APPENDIX I

BACKGROUND AND QUALIFICATIONS

MARILYN J. KRAUS, C.P.A.

Education

Madonna College, Livonia, Michigan, Bachelor of Science Degree in accounting, 1984.
Passed C.P.A. examination in 1986 and certified in 1987.

Larkin & Associates Staff Training Seminar in the application of Lotus 1-2-3 software package to financial analysis of utilities and to tax and financial planning and projections.

Experience

I am currently employed by the Pennsylvania Office of Attorney General, Office of Consumer Advocate in the capacity of Senior Regulatory Analyst. My responsibilities include the review of utility filings related to base rate requests, fuel adjustment clauses and other petitions and applications, as well as the analysis of other regulatory matters handled by the Office of Consumer Advocate. My duties also include appearing as a witness on behalf of the OCA at hearings related to regulatory matters to present the results of my analyses and recommendations for the disposition of such matters with regard to generally accepted accounting and ratemaking principles.

From April 1985 to October 1989, I was employed by Larkin & Associates, a firm of certified public accountants and utility regulatory consultants. At Larkin & Associates, my assignments included: analysis of expense and balance sheet accounts; testing of accounting systems for compliance with management policies and standards; the evaluation of accounting systems for their effectiveness; the preparation and review of financial statements and tax returns; pre-audit interviews with management including submitting bids for engagements; preparation of management letters and the advice and training of client personnel in the maintenance of proper accounting records.

In the utility regulatory area, I was involved in the review of rate case testimonies, exhibits, responses to discovery requests and commission orders and in the analysis of financial data for various rate cases. I was responsible for the preparation of rate case testimony, exhibits and briefs, and evaluations of commission orders.

During my employment with this firm, I worked on the analysis of the New England Power Company's request for a change in the treatment of abandoned plant losses before the Federal Energy Regulatory Commission. I also performed analyses, interviewed Company employees, attended various hearings and assisted in cross examination of utility witnesses, prepared workpapers, exhibits and testimony concerning the rate increase requests of United Telephone Company of Missouri, El Paso Electric Company, Central Maine Power Company, Pennsylvania Power Company, Southern California Edison Company, Carolina Power & Light Company, St. Augustine Shores Utilities, Pennsylvania Gas and Water Company and Orange Osceola Utilities.

I was involved in the analyses of the effects of the provisions of the Tax Reform Act of 1986 on regulated utilities which were performed generically for the California Public Utilities Commission and for the Hawaiian Electric Company before the Hawaii Public Utilities Commission on behalf of the Department of the Navy. I also actively participated in the budget audit of the Georgia Power Company on behalf of the Staff of the Georgia Public Service Commission, and the management audit of the Anchorage Water and Wastewater Utility on behalf of the Staff of the Alaska Public Utilities Commission.

Prior to my employment with Larkin & Associates, I worked for Michigan Consolidated Gas Company, a major utility in Detroit, Michigan, as an accounting clerk. My duties included: preparation of financial statements and supporting statements; preparing journal vouchers for monthly entries, including support data; handling accounts receivable billings and cost allocations; assisting in preparation of entries for year-end closing; and special assignments in other departments, including Payroll and Internal Auditing. I was also assigned to a special project group initiated to implement a new general ledger computer system.

Previously, I had worked at Northland Underwriters, Inc. as a full-charge bookkeeper. There, I was responsible for an entire accounting system through trial balance, including accounts receivable and payable, payroll and income taxes.

List of cases in which I have testified or provided substantial assistance:

<u>Docket Number</u>	<u>Company Name and Jurisdiction</u>
9283	Kentucky American Water (Kentucky Public Service Commission)
Tr-85-179	United Telephone Company of Missouri (Missouri Public Service Commission)
6350	El Paso Electric Company (Public Utility Commission of Texas)
U-8091/U-8239	Consumers Power Company-Gas-Refunds (Michigan Public Service Commission)
85-212	Central Maine Power Company (Maine Public Service Commission)

ER-85646001 & ER-85647001	New England Power Company (Federal Energy Regulatory Commission)
R-850267	Pennsylvania Power Company (Pennsylvania Public Utility Commission)
R-850267 (Rebuttal)	Pennsylvania Power Company (Pennsylvania Public Utility Commission)
R-860378 (Surrebuttal)	Duquesne Light Company - OCA Statement No. 2D (Pennsylvania Public Utility Commission)
87-01-03	Connecticut Natural Gas (Department of Public Utility Control)
86-12-047	Southern California Edison Company (California Public Utilities Commission)
86-11-019	Tax Reform Act of 1986 Commission Investigation (California Public Utilities Commission)
5740	Hawaiian Electric Company Tax Reform Act of 1986 (Hawaii Public Utilities Commission)
3673-U	Georgia Power Company - Budget Audit (Georgia Public Service Commission)
7460	El Paso Electric Company (Public Utility Commission of Texas)
8747	Anchorage Water & Wastewater Utility - Management Audit (Alaska Public Utilities Commission)
U-8924	Consumers Power Company - Gas (Michigan Public Service Commission)
E-2, Sub 537	Carolina Power & Light Company (North Carolina Utilities Commission)

870980-WS	St. Augustine Shores Utilities, Inc. (Florida Public Service Commission)
870853	Pennsylvania Gas and Water Company (Pennsylvania Public Utility Commission)
871134-WS	Orange Osceola Utilities, Inc. (Florida Public Service Commission)
R-881084 et al	Pocono Water Company, et al. (National Utilities, Inc.) (Pennsylvania Public Utility Commission)
881503-WS	Poinciana Utilities, Inc. (Florida Public Service Commission)
	Pennsylvania Public Utility Commission:
R-891364	Philadelphia Electric Company
R-891473	Pennsylvania Water Co.-Sayre Division
R-891557	Arrowhead Public Service Corporation
R-901625	Roaring Creek Water Company
R-901663	Citizens Utilities Water Company of Pennsylvania
R-901664	Citizens Utilities Home Water Company
C-903013	Waymart Water Company
C-902815	GTE North, Inc.
R-911918 C-892706 C-892531	Clean Treatment Sewage Company
A-211770 et al	L.P. Water and Sewer Co.

R-911963	Roaring Creek Water Company
R-912060	Shenango Valley Water Company
R-912000	Dauphin Consolidated Water Co.
R-912064	Bloomsburg Water Company
R-912114	Lemont Water Company
R-912117	Fawn Lake Forest Water Company
A-230013	Broad Run Sewer Co.
C-913749	North Penn Gas Company
R-922209	Citizens Utilities Home Water Co.
R-922319	Glen Alsace Water Company
R-922326 et al	Dallas Water Company, et al
R-00922372	Lake Heritage Utilities, Inc.
R-00922502	Mechanicsburg Water Company
R-00922493	L.P. Water and Sewer Company - Sewer Division
A-210025F002	Public Service Water Company
A-230026	MPW Utilities, Inc.
R-00932604	Dauphin Consolidated Water Supply Company
R-00932795	General Waterworks of Pennsylvania, Inc.
R-00932673	Lemont Water Company
R-00932681	Kane Gas Light and Heating Company

L-00930089	Advance Notice of Proposed Rulemaking RE: Line Extensions
R-00932670	Pennsylvania-American Water Company
R-00932866	The Peoples Natural Gas Company
R-00932873	Blue Mountain Consolidated Water Company
R-00932828	National Utilities, Inc.
R-00943124	City of Bethlehem - Bureau of Water
R-00943152	General Waterworks of PA, Inc.
R-00943157	Newtown Artesian Water Company
C-00946402	North Penn Gas Company
R-00943245	North Penn Gas Company
R-00953346	Harrisburg Steam Works, Ltd.
R-00953300	Citizens Utilities Water Company of Pennsylvania
C-00945867, et al.	Valley Utilities Company, Inc., et al.
C-00957205, et al	Four Seasons Water Company, Inc. Four Seasons Sewer Company, Inc.
R-00943155	Pennsylvania-American Water Company
R-00963856	Western Utilities, Inc.
R-00973947	United Water Pennsylvania, Inc.
C-00968442	Linda Fenske, et al. v. GTE North, Inc.
R-00974150	Pike County Power & Light Company
C-00970643, et al.	Andrew J. Koban, et al. v. GTE North, Inc.

C-00970430	Haines Twp., et al. v. Bell Atlantic PA
R-00984567	City of Lancaster - Water Fund
C-00981941	Keith R. McCall, et al. v. Bell Atlantic PA
C-00981878, et al.	Vincent Golden, et al. v. Bell Atlantic PA & GTE North, Inc.
C-00992270, et al.	Susan Balla, et al. v. Redstone Water Company
A-212285F0071	Pennsylvania-American Water Company
R-00005212	Pennsylvania-American Water Company, Wastewater Operations
R-00005050	Emporium Water Company
C-00992980	Lois A. Norton, et al. v. Bell Atlantic PA, Inc.
R-00005997	Jackson Sewer Company
R-00005945	Emporium Water Company
C-00004254	Harry and Loretta Thomas v. Verizon PA, Inc.
R-00016297	City of Lancaster - Water Fund
R-00016236	The York Water Company
C-00004308	Marjorie L. Bubner v. Verizon North, Inc.
C-00003500	Thomas L. Walters v. National Fuel Gas Distribution Corp.
C-00015337	Cindy Parks v. Pennsylvania-American Water Company
C-00014733	Edward D. Morra Jr. v. Pennsylvania-American Water Company
C-20016207	Township of Collier v. Pennsylvania-American Water Company
A-210103	Ds Water Company
P-00021979	Columbia Water Company

C-20016646	Elizabeth A. Marconi v. Gasco Distribution Systems, Inc.
R-00027982	Pennsylvania-American Water Company
R-00038304	Pennsylvania-American Water Company
R-00038805	Pennsylvania-American Water Company
C-20028372	Office of Consumer Advocate v. Verizon Pennsylvania, Inc
C-20030153	William G. Botti, et al v. Verizon Pennsylvania, Inc.
R-00038805	Aqua Pennsylvania, Inc.
R-00038429	Penn Estates Utilities, Inc. - Water Division
R-00038498	Penn Estates Utilities, Inc. - Sewer Division
R-00049862	City of Lancaster Sewer Fund
C-20055453, et al.	Sylvester et al. v. W.P. Water Company
A-210104F0074	Aqua Pennsylvania, Inc.
C-20026959	Mary Harvey, et al v. Commonwealth Telephone Co.
C-20043414	Keith Tompkins v. United Water Pennsylvania, Inc.
R-00050678	Mesco, Inc.
R-00051167	City of Lancaster Bureau of Water
R-00050671	City of DuBois Water Bureau
R-00061297	Emporium Water Company
A-210104F0074	Application of Aqua Pennsylvania
I-00070114	Investigation of WP Water Co., Inc and WP Sanitary Co., Inc.
R-00072492	City of Bethlehem Bureau of Water

A-230056F2002	Application of CMV Sewage Company
R-00072493	Total Environmental Solutions, Treasure Lake Water Division
R-00072495	Total Environmental Solutions, Treasure Lake Sewer Division
C-20078197, et al.	Stephen Sutter, et al. v. Clean Treatment Sewage Company
R-2008-2028395	NRG Energy Center Harrisburg LLC
R-2008-2039261	Superior Water Company
R-2008-2045157	Columbia Water Company
R-2008-2079310	Aqua Pennsylvania, Inc.
R-2009-2097323	Pennsylvania-American Water Company
R-2009-2117402	Utilities, Inc. of Pennsylvania
R-2009-2117532	Penn Estates Utilities, Inc. – Water Division
R-2009-2117740	Penn Estates Utilities, Inc. – Sewer Division
R-2009-2117389	Utilities, Inc. – Westgate
R-2009-2117550	Newtown Artesian Water Company
R-2009-2121928	Clean Treatment Sewage Company
R-2009-2132019	Aqua Pennsylvania, Inc.
R-00072492	City of Bethlehem (Remand)
R-2010-2171918	TESI Treasure Lake Water Division
R-2010-2171924	TESI Treasure Lake Sewer Division
R-2010-2194577	Deer Haven Sewer Company
R-2010-2207833	Little Washington Wastewater Co. – Masthope Division
A-2010-2174191	Application of KH Wastewater Treatment Company, LLC.

R-2011-2230259 Newtown Artesian Water Company
R-2011-2218562 CMV Sewage Company
I-2009-2109324 Clean Treatment Sewage Company
C-2011-2251178 et al. UGI Penn Natural Gas, Inc.

Affiliations

I am a certified public accountant licensed in the state of Pennsylvania and registered in the state of Michigan. I am a member of the Michigan Association of Certified Public Accountants and the Pennsylvania Institute of CPA'S. I am also a member of the Tax and Accounting Committee of the National Association of State Utility Consumer Advocates.

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OCA EXHIBIT MJK-1

Audubon Water Company
 Summary of Adjustments

Docket No. R-2012-2286118
 OCA Exhibit MJK-1

Line No.	Description	Amount
1	Rate Base Per Company	2,548,081
2	Remove Estimated Cost of Future Plant Additions	(288,154)
3	Adjust Cash Working Capital for O&M Adjs.	(30,474)
4	Adjusted Rate Base	<u>2,229,453</u>
5	Rate of Return	<u>8.24%</u>
6	Net Operating Income Requirement	<u>183,707</u>
7	Gross Revenue Conversion Factor	<u>1.4335</u>
8	Pre-tax NOI Requirement	263,344
9	Less: Pre-tax NOI - Present Rates	(216,036)
	Add: OCA Adjustments to NOI	
10	Adjust Salaries to Reflect 1.5% Increase	(15,858)
11	Payroll Tax Adjustment on Salary Reduction	(1,213)
12	Remove Salary of New Employee Not Hired	(23,400)
13	Payroll Taxes on New Employee Salary	(2,433)
14	Reduce Health Insurance to Reflect Current Actual Cost	(19,619)
15	Remove Unsupported New Preventative Maint. Projects	(94,150)
16	Adjust Office Rent to Reflect Lease	(11,396)
17	Remove Personal Acctg. Exp. From Special Services	(6,725)
18	Increase Rate Case Exp. Norm. Period from 2 to 5 Yrs.	(69,000)
19	Total O&M Adjustments	<u>(243,794)</u>
20	Remove Amortization of Tank Painting	(10,750)
21	Remove Depreciation on Future Plant Additions	<u>(26,691)</u>
22	Recommended Revenue Increase	<u>208,895</u>
23	Percentage Increase	10.16%
24	Revenue Increase per Company	<u>517,968</u>
25	Percentage Increase per Company	25.19%

**BEFORE THE PENNSYLVANIA PUBLIC
UTILITY COMMISSION**

ORIGINAL

**PENNSYLVANIA PUBLIC UTILITY
COMMISSION**

v.

AUDUBON WATER COMPANY

:
:
:
:
:
:

DOCKET NO. R-2012-2286118

SURREBUTTAL TESTIMONY OF

MARILYN J. KRAUS

**ON BEHALF OF
THE OFFICE OF CONSUMER ADVOCATE**

JUNE 15, 2012

2012 JUL -5 PM 4:24
RECEIVED
OFFICE OF CONSUMER ADVOCATE

1 INTRODUCTION

2 Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND OCCUPATION.

3
4 A. My name is Marilyn J. Kraus. My business address is 555 Walnut Street, Forum Place,
5 5th Floor, Harrisburg, Pennsylvania 17101. I am a certified public accountant currently
6 employed as a Senior Regulatory Analyst by the Pennsylvania Office of Consumer
7 Advocate (OCA).

8

9 Q. HAVE YOU PREVIOUSLY PROVIDED TESTIMONY IN THIS CASE?

10

11 A. Yes. I provided direct testimony in this case in OCA Statement 1.

12

13 Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?

14

15 A. I am providing surrebuttal testimony in response to the rebuttal testimony of Audubon
16 Water Company's (AWC or Company) witnesses, J. H. Russell (Statement JHR-1R) and
17 Dennis M. Kalbarczyk (Statement DMK-1R). My recommended adjustments, which
18 reflect modifications to the adjustments outlined in my direct testimony, are summarized
19 in the attached OCA Exhibit MJK-1S.

20

1 PROFORMA PLANT ADDITIONS

2 Q. PLEASE DISCUSS THE COMPANY'S REBUTTAL TESTIMONY RELATED TO
3 YOUR ADJUSTMENTS TO THE COMPANY'S CLAIM FOR PROFORMA PLANT
4 ADDITIONS.

5
6 A. As discussed on page 4 of my direct testimony, I recommended disallowance of the
7 Company's claim for various proforma plant additions, based on the fact that bids or
8 proposals have not yet been requested, no amounts have been expended and no starting or
9 in-service dates have been determined. That is, the Company did not provide support for
10 these projects as used and useful plant for purposes of this case. These projects include:

11	<u>Project</u>	<u>Rate Base Claim</u>	<u>Depreciation Expense Claim</u>
12	New Road to Featherbed Well	\$14,850	\$300
13	Generator at Well #15	\$48,333	\$3,333
14	Mains Projects (except VFCC)		
15	Level Rd. Loop	\$18,346	\$308
16	Wells #6 & #9 Pipe Upgrade	\$14,875	\$250
17	Featherbed Tank Pipe Upgrade	\$20,825	\$350
18	Arcola Rd. Tank Pipe Upgrade	\$14,875	\$250
19	Office Equipment		
20	Server & Backup	\$21,600	\$4,800
21	Customer Billing Program	\$25,200	\$5,600
22	Backhoe	<u>\$109,250</u>	<u>\$11,500</u>
23		\$288,154	\$26,691

24
25 In rebuttal, Company witness J. H. Russell indicated that some of these projects have
26 since, commenced. Specifically, he states that materials are on site and construction is
27 scheduled to begin in August 2012 for the Road to Featherbed Well (Statement JHR-1R,
28 page 5). On page 6 of Statement JHR-1R, Mr. Russell indicates that the Generator at
29 Well #15 was installed on June 1, with testing to begin on June 11, 2012. With respect to
30 the Mains Projects, he states that the materials are on site for the Level Road Looping

1 project (rate base claim of \$18,346, depreciation expense claim of \$308), with
2 construction to begin when the school term ends (Statement JHR-1R, page 7). Finally,
3 on page 7 of Statement JHR-1R, Mr. Russell indicates that a welder was hired, who is
4 configuring the piping for the Wells #6 & #9 Upgrade (rate base claim of \$14,875,
5 depreciation expense claim of \$250). Since construction has commenced on these four
6 projects, I will reduce my recommended adjustments to rate base and depreciation
7 expense by the related amounts. Thus, my recommended adjustment to rate base is
8 reduced by \$96,404 ($\$14,850 + \$48,333 + \$18,346 + \$14,875$), from \$288,154 to
9 \$191,750. My adjustment to depreciation expense is reduced by \$4,191 ($\$300 + \$3,333$
10 $+ \$308 + \250), from \$26,691 to \$22,500. The updated adjustments to rate base and
11 depreciation expense are shown on OCA Exhibit MJK-1S, lines 2 and 21, respectively.

12
13 With respect to the other Mains Projects, the Office Equipment and the Backhoe, these
14 projects still have not been supported by the Company as used and useful plant in this
15 rate case. In response to I&E-RB-13-D, Updated June 8, 2012 (marked "Highly
16 Confidential"), and as stated in the testimony of Mr. Kalbarczyk, the Company indicated
17 that it received two proposals for a new computer billing system, but has not accepted
18 either proposal or otherwise "made a final decision on the billing system." Statement
19 DMK-1R at 19. The Company stated that it does not intend to acquire hardware and
20 software prior to that decision. With regard to the Backhoe claim, on page 13 of
21 Statement JHR-1R, Mr. Russell indicates that the Company is "likely" to purchase a
22 backhoe within several months, but does not have the revenues to support purchasing a
23 backhoe at this time. *It is not the responsibility of the ratepayers to provide the funds*

1 needed for capital projects in advance of their completion. As I indicated in my direct
2 testimony, it is not appropriate to treat the ratepayers as investors, by requiring them to
3 provide funding for capital projects that are not used and useful and, in fact, have not
4 even commenced.

5
6 CASH WORKING CAPITAL

7 Q. WHAT IS THE NATURE OF THE COMPANY'S REBUTTAL TESTIMONY
8 RELATED TO YOUR ADJUSTMENT TO ITS CLAIM FOR CASH WORKING
9 CAPITAL?

10
11 A. On page 24 of Statement DMK-1R, Mr. Kalbarczyk states that the Company accepts my
12 approach to adjusting the cash working capital claim. That is, the adjustment to this item
13 should be based on 1/8 of the total adjustments to O&M as accepted by the Commission.

14
15 SALARIES AND WAGES

16 Q. WHAT IS THE NATURE OF THE COMPANY'S REBUTTAL TESTIMONY
17 RELATED TO YOUR ADJUSTMENT TO THE COMPANY'S CLAIMED 4%
18 SALARY INCREASE?

19
20 A. As discussed on page 6 of my direct testimony, I recommended that the increase to
21 salaries & wages in this case be limited to the 1.5% factor that has actually been awarded
22 in each of the last three years. That is, an annual salary increase of 1.5% is supported by
23 the Company's recent history. This provided for a total salary increase of \$11,214

1 (\$747,623 current annualized payroll x 1.5%), which is \$15,858 lower than the \$27,072
2 increase claimed by the Company. On pages 31 and 32 of Statement DMK-1R, Mr.
3 Kalbarczyk claims that the merit increases actually awarded in February 2012 should be
4 included in the determination of proforma salaries & wages in this case. He also claims
5 that incentive payments made in December 2011 should be reflected in salaries & wages
6 expense. Finally, he states that the Company now “approximates” its annual wage
7 increase to be 2% for officer/executives and 2.5% for remaining staff. I will accept the
8 Company’s suggested modification to my adjustment for the merit increases actually
9 awarded in February 2012. As indicated by Mr. Kalbarczyk on page 31 of Statement
10 DMK-1R, the actual increases totaled \$4,733. Including my recommended proforma
11 salary increase of 1.5%, the additional salary expense amount (i.e., the reduction to my
12 recommended adjustment) is \$4,804. I do not accept the Company’s proposal to reflect
13 *incentive payments made in December 2011 for the reasons explained below.* Thus, my
14 updated adjustment to salaries and wages is \$11,054 (\$15,858 - \$4,804). My related
15 adjustment to payroll taxes is reduced by \$368 (\$4,804 x 7.65%), from \$1,213 to \$845.
16 These adjustments are shown on lines 10 and 11 of OCA Exhibit MJK-1S.

17
18 I do not agree that incentive payments, which are discretionary each year, should be
19 included in salaries and wages expense for ratemaking purposes. That is, there is no
20 assurance that such payments will be made on an annual basis. I note that the Company,
21 itself, did not include these incentive payments in its proforma claim for salaries & wages
22 in the filing. With respect to the Company’s new approximation of proforma wage
23 increases of 2% to 2.5%, there is no difference between this claim and its original claim

1 for 4% wage increases. That is, this new claim is still only an estimate that is not
2 supported by the salary increases actually awarded by AWC in recent years. Thus, my
3 adjustment does not reflect any modifications for these items.

4
5 Q. PLEASE DISCUSS THE COMPANY'S REBUTTAL TESTIMONY RELATED TO
6 YOUR RECOMMENDED ADJUSTMENT TO THE CLAIM FOR THE ESTIMATED
7 SALARY OF A NEW PART-TIME EMPLOYEE.

8
9 A. As discussed on page 7 of my direct testimony, I recommended that the estimated salary
10 of \$23,400 (based on 30 hours per week at \$15 per hour) for a new part-time employee be
11 disallowed because the position had not been filled. On page 14 of Statement JHR-1R
12 and in response to I&E-RE-8-D, updated on June 8, 2012, the Company indicated that
13 this employee was hired on June 5, 2012 to work 20 hours per week at a rate of \$15 per
14 hour. As such, I will modify my recommended adjustment to reflect the actual, known
15 salary of the new employee of \$15,600 (20 x 52 x \$15). Thus, my adjustment is reduced
16 by \$15,600, from \$23,400 to \$7,800. The associated payroll tax adjustment is reduced by
17 \$1,836 ($\$15,600 \times 7.65\% = \$1,193$ FICA, plus \$643 state and federal unemployment)
18 from \$2,433 to \$597. These adjustments are shown on lines 12 and 13 of OCA Exhibit
19 MJK-1S.

20

1 HEALTH INSURANCE

2 Q. WHAT IS THE NATURE OF THE COMPANY'S REBUTTAL TESTIMONY
3 RELATED TO YOUR ADJUSTMENT TO THE COMPANY'S CLAIM FOR
4 EMPLOYEE HEALTH INSURANCE?

5
6 A. As discussed on page 7 of my direct testimony, based on the Company's response to
7 I&E-RE-10-D, I recommended an adjustment to reduce the Company's claim for health
8 insurance by \$19,619, to reflect the actual costs shown on current invoices. On page 33
9 of Statement DMK-1R, Mr. Kalbarczyk clarified the Company's response, indicating that
10 the charges from Independent Blue Cross and Aetna Insurance, totaling \$17,939 on an
11 annual basis, were in addition to the charges from the Chamber of Commerce. On this
12 basis, I am reducing my recommended adjustment by \$17,939, from \$19619 to \$1,680, as
13 shown on line 14 of OCA Exhibit MJK-1S. On page 34 of Statement DMK-1R, Mr.
14 Kalbarczyk states that the \$1,680 balance of my adjustment should not be accepted by the
15 Commission, "given that health insurance expenses will surely increase in the near term."
16 He gives no support whatsoever for this statement. Mr. Kalbarczyk's speculation as to
17 the costs of health insurance is not an appropriate basis for inclusion of an expense in
18 rates.

19

20 PREVENTATIVE MAINTENANCE PROJECTS

21 Q. PLEASE DISCUSS THE COMPANY'S REBUTTAL TESTIMONY RELATED TO
22 YOUR RECOMMENDED ADJUSTMENT TO THE COMPANY'S CLAIM FOR THE
23 COSTS OF PREVENTATIVE MAINTENANCE PROJECTS.

1 A. As discussed on pages 8 through 13 of my direct testimony, for many reasons, I
2 recommended that the Company's entire claim for the costs of four new preventative
3 maintenance projects, totaling \$94,150, be denied in this case. First, I explained that
4 none of these project costs represent reasonable, known and measurable expense
5 increases, since no costs have actually been incurred, no bids, proposals, etc. have been
6 procured, no contractors have been hired and no support whatsoever was provided by the
7 Company for the estimated expenses associated with any of these projects.

8
9 On pages 14 through 16 of Statement JHR-1R, Mr. Russell discusses the status of these
10 maintenance projects. Additionally, the Company provided updated responses to
11 interrogatory nos. OCA-III-9 and III-11, which dealt with portions of the Company's
12 claim. The only new information contained in Mr. Russell's rebuttal testimony and the
13 updated responses was an identification of the annual costs associated with two of the
14 maintenance projects. Specifically, the Company has accepted a proposal for the annual
15 maintenance of the generators totaling \$4,900, a begin date has been established with the
16 vendor, and some minor work has commenced. Statement JHR-1R at 15; OCA-III-9,
17 updated June 11, 2012. I have reduced my adjustment by \$4,900 to allow the expenses
18 associated with this project. With regard to the annual maintenance of the chlorine
19 analyzers, the Company has received a proposal totaling \$14,055 but it is not clear that
20 the proposal has been accepted (Statement JHR-1R at 15-16; OCA-III-11, updated June
21 11, 2012) and, therefore, I do not recommend this expense be allowed.

1 With respect to the balance of the \$94,150 claim, the Company still has provided no
2 information regarding actual costs incurred, bids or proposals, identification of
3 contractors, or support for the estimated expenses associated with any of these projects.
4 Mr. Russell merely states that “these projects are necessary to protect and maintain the
5 condition and reliability of the Company’s water system” and they are “evolving.” These
6 statements do not support these estimated project costs as reasonable, known and
7 measurable expenses for ratemaking purposes.

8
9 Q. DID THE COMPANY ADDRESS ANY OF THE OTHER CONCERNS YOU
10 IDENTIFIED WITH RESPECT TO THE CLAIM FOR PREVENTATIVE
11 MAINTENANCE IN ITS REBUTTAL TESTIMONY?

12
13 A. No, it did not. First, on page 10 of my direct testimony, I explained that the responses
14 provided by the Company related to these maintenance projects indicated that much of
15 the work on the projects claimed would not be done on an annual basis. The Company
16 provided no additional information that would allow a determination of how much of its
17 claim represents annual expenses versus how much represents one-time or non-annual
18 costs. The reasonableness of the Company’s claim of \$94,150 is cast into further doubt
19 because it includes annual costs of \$8,000 related to the annual maintenance of the
20 generators (AWC Exhibit No. 1, Schedule I-9). As referenced above, the Company
21 accepted a proposal for this work in the amount of \$4,900, or nearly half the amount in its
22 claim. Thus, the Company has not supported its claim for the costs of these maintenance
23 projects in terms of the appropriate normal, annual level of expense for ratemaking

1 purposes, yet it is claiming the total amount of these project costs as annual, ongoing
2 expenses in this case.

3
4 Second, the Company did not address the issue I outlined on pages 10 and 11 of my
5 direct testimony regarding some of the maintenance work claimed by the Company as
6 part of the “new” projects, which is already being done. As I indicated in my direct
7 testimony, to the extent that this work is already being done, the related costs are already
8 reflected in expenses. Furthermore, to the extent that this maintenance is performed by
9 in-house personnel, the associated labor costs are already considered in the salaries and
10 wages expense allowance. Thus, to the extent that any of this type of maintenance was
11 performed during the test year, or can be performed in-house, there is a double count of
12 the associated costs in the Company’s claim.

13
14 Finally, on pages 11 and 12 of my direct testimony, I showed that, with respect to the
15 same type of claim made by AWC in its last rate case (i.e., annual expense associated
16 with “new” preventative maintenance), the projects completed within a year after the
17 Commission Order were not the same as those identified by the Company in its rate
18 filing. Additionally, the related costs were not incurred on an annual basis. As such, the
19 allowance of the Company’s claim for \$94,150 related to “new” maintenance projects in
20 this case would be tantamount to allowing AWC to collect a pool of dollars from the
21 ratepayers to use at its discretion. This is contrary to accepted ratemaking procedures,
22 which require the Company and its investors to provide funding for projects and allow for
23 recovery from ratepayers, the actual amounts spent upon completion of the projects.

1 As noted above, the Company has supported \$4,900 as annual expenses related to the
2 maintenance projects claimed in this case. Thus, I will reduce my recommended
3 adjustment by \$4,900, from \$94,150 to \$89,250. I maintain that the \$89,250 balance of
4 the Company's claim for annual maintenance expenses related to new maintenance
5 projects be denied in this case. This adjustment is shown on line 15 of OCA Exhibit
6 MJK-1S. I note that, if the Company shows that it has accepted the proposal for \$14,055
7 of annual maintenance costs for the chlorine analyzers, I will further reduce my
8 adjustment by the \$14,055 amount.

9
10 OFFICE RENT

11 Q. PLEASE DISCUSS THE COMPANY'S REBUTTAL TESTIMONY RELATED TO
12 YOUR RECOMMENDED ADJUSTMENT TO THE COMPANY'S CLAIM FOR
13 OFFICE RENT IN THIS CASE.

14
15 A. As discussed on pages 13 and 14 of my direct testimony, I recommended an adjustment
16 to reduce the Company's claim for office rent expense by \$11,396, consistent with the
17 costs shown on the current lease (see Company response to I&E-RE-14-D). In DMK-1R,
18 Exhibit 3, the Company provided a paid invoice that confirms the additional annual rental
19 cost of \$11,396, related to operating expenses and real estate taxes. On this basis, I will
20 withdraw my recommended adjustment. I note that, generally, expenses and taxes are
21 included in the rent. A provision that requires the Company to pay these costs in addition
22 to the base rent should be included in the lease.

1 SPECIAL SERVICES

2 Q. WHAT IS THE NATURE OF THE COMPANY'S REBUTTAL TESTIMONY
3 RELATED TO YOUR RECOMMENDED ADJUSTMENT TO THE COMPANY'S
4 CLAIM FOR SPECIAL SERVICES EXPENSE?

5
6 A. On page 4 of Statement DMK-1R, Mr. Kalbarczyk indicates that the Company accepts
7 my adjustment to Special Services expense of \$6,725, for charges from the Company's
8 outside accounting firm, Maillie, Falconiero & Company, LLP, related to personal issues
9 of the employees. As such, this adjustment is reflected in the Company's updated
10 calculation of pre-tax net operating income at present rates. I have reflected the
11 Company's updated number on line 9 of OCA Exhibit MJK-1S. As noted in my direct
12 testimony, the Commission should direct the Company to cease this practice and ensure
13 that, on a going-forward basis, all charges for personal services provided by the
14 Company's outside contractors are billed separately from AWC utility services.

15
16 RATE CASE EXPENSE

17 Q. DESCRIBE THE COMPANY'S REBUTTAL TESTIMONY RELATED TO YOUR
18 RECOMMENDED ADJUSTMENT TO RATE CASE EXPENSE.

19
20 A. As explained on pages 15 and 16 of my direct testimony, I recommended that the
21 Company's rate case expense claim of \$230,000 be normalized over a period of five
22 years (rather than the Company's proposed two-year period). My recommendation is
23 consistent with the historical frequency with which AWC has filed this, and its last two

1 rate cases, and results in an adjustment to rate case expense of \$69,000. This
2 recommendation is also consistent with the Commission's policy regarding the
3 normalization of rate case expense. On pages 28 and 29 of Statement DMK-1R, Mr.
4 Kalbarczyk outlines the reasons for the Company's opposition to my recommended
5 adjustment. First, he states that the use of the historical frequency in determining the rate
6 case expense normalization period does not consider that frequency of rate case filings is
7 sometimes limited by agreements made in prior rate case settlements. I note that, in the
8 Settlement of AWC's last case, the Company agreed to a stay-out of three years from the
9 effective date of rates in that case. (Docket No. R-00072100, Settlement at 9.) This
10 agreement gave the Company the ability to file another rate case on October 13, 2010, i.e.
11 more than a year before this case was filed. (Docket No. R-00072100, Order entered
12 October 12, 2007.) Furthermore, these stay-out agreements allow for cases to be filed
13 prior to the end of the stay-out periods in the event of regulatory or legislative changes or
14 emergencies that effect a utility's cost of service. As such, these agreements can have
15 little or no bearing on the frequency of rate case filings.

16
17 Second, Mr. Kalbarczyk states that the Commission has allowed normalization periods
18 shorter than the historical frequency in "a number of cases." He provides no examples of
19 such cases.

20
21 Finally, Mr. Kalbarczyk states that a five-year normalization period for rate case expense,
22 together with some cost disallowances, will "more than likely" require more frequent rate
23 case filings. As noted in my direct testimony, in its last rate case, which was filed five

1 years ago in 2007, the Company requested the same two-year normalization period for
2 rate case expense as in this case. As shown in the Settlement Agreement that was
3 approved by the Commission, the revenue increase was nearly 25% less than requested
4 by AWC in that case. (Docket No. R-00072100, Settlement Agreement, pages 2 and 8.)

5
6 I should also note that, with respect to the Company's claim for total rate case expense of
7 \$230,000 in this case, \$89,528 has actually been spent as of June 8, 2012. (Company's
8 3rd updated response to I&E-RE-16-D.) The basis for the five-year normalized amount
9 to be reflected in this case should be the final actual amount incurred, assuming it
10 represents a reasonable expense.

11
12 TANK PAINTING

13 Q. WHAT IS THE NATURE OF THE COMPANY'S REBUTTAL TESTIMONY
14 RELATED TO YOUR RECOMMENDATION REGARDING THE CLAIM FOR
15 AMORTIZATION OF TANK PAINTING EXPENSES?

16
17 A. As discussed on pages 16 and 17 of my direct testimony, I recommended that, because
18 the Company had not supported its claim for amortization of costs associated with the
19 two tank painting projects as known and measurable expenses, the entire annual expense
20 of \$10,750 should be disallowed for ratemaking purposes in this case. On page 11 of
21 Statement JHR-1R, Mr. Russell indicates that my recommended adjustment should not be
22 accepted because the Company has subsequently provided copies of a proposal for each
23 of the two projects. I note that these two proposals, provided in response to I&E-RE-17-

1 D, updated June 8, 2012, have not been accepted by the Company and no dates for the
2 commencement of these projects have been established. Thus, the Company has
3 provided no assurance that these projects will actually be performed in the near future.
4 As noted in my direct testimony, allowance of this expense would be tantamount to
5 placing the ratepayers in the role of investors by collecting funds for these projects in
6 advance of completion or even commencement. This is contrary to accepted ratemaking
7 procedures, which allow for recovery of expenses from ratepayers, not advancement of
8 funds for capital or maintenance projects from ratepayers. Therefore, the Company's
9 claim for amortization of tank painting of \$10,750 should be denied in this case.

10
11 RETURN ON EQUITY

12 Q. PLEASE DISCUSS THE COMPANY'S REBUTTAL TESTIMONY RELATED TO
13 YOUR RECOMMENDATION REGARDING THE RETURN ON EQUITY FACTOR
14 THAT SHOULD BE REFLECTED IN THE OVERALL RATE OF RETURN.

15
16 A. As discussed on pages 17 through 19 of my direct testimony, I did not perform an
17 independent analysis of the appropriate capital structure or return on equity factor to be
18 used in this case. Thus, my only recommendation related to the Company's claim for
19 rate of return is that the return on equity factor of 9.5%, calculated by the Commission's
20 Bureau of Technical Utility Services (TUS) for use by water utilities in calculating their
21 Distribution System Improvement Charges (DSIC), be used in this case. Specifically,
22 while the Company's approach of "backing into" its return on equity claim of 10.98%,
23 based on a debt interest coverage factor is not a method approved by the Commission, the

1 factor calculated by TUS employs the Commission-approved practice of using a
2 discounted cash flow analysis.

3
4 On pages 9 through 17 of Statement DMK-1R, Mr. Kalbarczyk presents the Company's
5 rebuttal testimony related to rate of return. With respect to my recommendations, I first
6 note that Mr. Kalbarczyk states that the "OCA accepted my hypothetical capital
7 structure." Mr. Kalbarczyk is incorrect. I clearly stated on page 17 of my direct
8 testimony that, although "I do not accept the Company's proposed hypothetical capital
9 structure, I am not making a recommendation with respect to capital structure."

10
11 Second, with respect to my recommendation that the return on equity factor calculated by
12 TUS for the DSIC be used in this case, Mr. Kalbarczyk stated:

13 ...it is important to note that the equity rate used in the ultimate
14 determination of the DSIC surcharge is subject to reconciliation and
15 the intent of the surcharge is to assure that customers pay no more or
16 less than the amount intended to be recovered. While an equity return
17 in a rate case proceeding provides for an opportunity for the utility to
18 earn a return on investment, the equity rate in a DSIC provides for a
19 reasonable guarantee that the surcharge will produce no more or less
20 than the intended return on investment as it is subject to audit and
21 refund. Thus, the resultant equity rate in a DSIC, such as the 9.5% rate
22 recommended by Ms. Kraus, is generally less than that of the 10.98%
23 cost of equity risk capital in a rate case proceeding as I recommended
24 in this case. (Statement DMK-1R, page 13.)

25
26 Mr. Kalbarczyk seems to be implying that, because a DSIC surcharge is reconcilable, the
27 Commission-approved return on equity factor for use in calculating a DSIC will always
28 be lower than a return on equity factor approved by the Commission in a rate case. This
29 is definitely not the case. As I noted in my direct testimony, the factor calculated by TUS
30 is prescribed for use in determining the return for DSIC purposes, only by utilities that do

1 not have specific equity factors approved by the Commission within the prior two-year
2 period. That is, if the Commission has specifically approved an equity return factor in a
3 utility's rate case within two years of the DSIC filing, the equity return approved in the
4 rate case must be used for DSIC purposes. I note that Mr. Kalbarczyk is correct in stating
5 that the 9.5% factor calculated by TUS is less than the 10.98% factor requested by the
6 Company in this case. In my experience, the equity return factor actually allowed by the
7 Commission in a rate case is generally lower than that requested by the utility. Thus, I
8 maintain that it is reasonable to use the 9.5% equity return calculated by TUS in this case,
9 resulting in an overall rate of return of 8.24%

10
11 SUMMARY

12 Q. PLEASE SUMMARIZE YOUR RECOMMENDATIONS IN THIS CASE.

13 A. As shown on OCA Exhibit MJK-1S, the overall revenue increase recommended by the
14 OCA in this case, considering all of the adjustments discussed above, is \$285,170, which
15 compares to AWC's requested increase of \$486,483, as updated on June 7, 2012 (see
16 Statement DMK-1R, Exhibit 2, Schedule H-1). The OCA's recommended revenue
17 increase incorporates the combined effective federal and state income tax rate calculated
18 by the Company on its updated Schedule I-14, adjusted for interest synchronization. As
19 discussed above, the OCA also recommends that the Company be directed to separate
20 personal and utility charges from its outside contractors.

21
22 Q. DOES THAT CONCLUDE YOUR SURREBUTTAL TESTIMONY?

23 A. Yes, it does.

Audubon Water Company
Summary of Adjustments

Docket No. R-2012-2286118
OCA Exhibit MJK-1S

Line No.	Description	Amount	Reference
1	Rate Base Per Company	2,548,081	
2	Remove Estimated Cost of Future Plant Additions	(191,750)	I&E-RB-6 - 14-D; OCA-III-1 - 4
3	Adjust Cash Working Capital for O&M Adjs.	(22,528)	
4	Adjusted Rate Base	<u>2,333,803</u>	
5	Rate of Return	8.24%	Reflects ROE per Comm. Quarterly Earnings Rep.
6	Net Operating Income Requirement	<u>192,305</u>	
7	Gross Revenue Conversion Factor	<u>1.4312</u>	Tax Rates per Co. Sch. I-14(Updated), adjusted for interest sync.
8	Pre-tax NOI Requirement	275,227	
9	Less: Pre-tax NOI - Present Rates	(212,669)	
	Add: OCA Adjustments to NOI		
10	Adjust Salaries to Reflect 1.5% Increase	(11,054)	I&E-RE-8-D; Allow merit increases actually awarded
11	Payroll Tax Adjustment on Salary Reduction	(845)	Co. Sch. I-5
12	Remove Salary of New Employee Not Hired	(7,800)	I&E-RE-8-D; Allow actual salary-20 hrs/wk @ \$15
13	Payroll Taxes on New Employee Salary	(597)	Co. Sch. I-5
14	Reduce Health Insurance to Reflect Current Actual Cost	(1,680)	I&E-RE-10-D; Allow BC & Aetna billings
15	Remove Unsupported New Preventative Maint. Projects	(89,250)	I&E-RE-12-D; OCA-III-6-113; OCA-III-9 Updated 6/11
16	Adjust Office Rent to Reflect Lease	-	I&E-RE-14-D; Allow additional payments
17	Remove Personal Acctg. Exp. From Special Services	-	OCA-I-7; Co. accepted adj.-reflected in P-1 NOI
18	Increase Rate Case Exp. Norm. Period from 2 to 5 Yrs.	(69,000)	I&E-RE-15-D
19	Total O&M Adjustments	<u>(180,226)</u>	
20	Remove Amortization of Tank Painting	(10,750)	I&E-RB-15 & 17-D
21	Remove Depreciation on Future Plant Additions	<u>(22,500)</u>	Sch. J-2-1, p. 16; Response to OCA-I-1
22	Recommended Revenue Increase	<u>285,170</u>	
23	Percentage Increase	13.87%	
24	Revenue Increase per Company	<u>486,483</u>	
25	Percentage Increase per Company	23.66%	