

**BEFORE THE  
STATE OF NEW JERSEY  
BEFORE THE BOARD OF PUBLIC UTILITIES  
OFFICE OF ADMINISTRATIVE LAW**

**IN THE MATTER OF THE PETITION OF NEW )  
JERSEY AMERICAN WATER COMPANY, INC. )  
FOR APPROVAL OF INCREASED TARIFF ) BPU DOCKET NO. WR11070460  
RATES AND CHARGES FOR WATER AND ) OAL DKT NO. PUC09799-2011N  
SEWER SERVICE; CHANGE IN DEPRECIATION )  
RATES AND OTHER TARIFF MODIFICATIONS )**

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**DIRECT TESTIMONY OF**

**ROBERT J. HENKES**

**ON BEHALF OF THE  
NEW JERSEY  
DIVISION OF RATE COUNSEL**

**\*\*\*REDACTED VERSION\*\*\***

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**NEW JERSEY AMERICAN WATER COMPANY**  
**BPU Docket No. WR11070460**  
**OAL DOCKET NO. PUC09799-2011N**  
**Direct Testimony of Robert J. Henkes**

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**APPENDIX I: Prior Regulatory Experience of Robert J. Henkes**

**SCHEDULES RJH-1 THROUGH RJH-38**

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**I. STATEMENT OF QUALIFICATIONS**

**Q. WOULD YOU STATE YOUR NAME AND ADDRESS?**

A. My name is Robert J. Henkes and my business address is 7 Sunset Road, Old Greenwich, Connecticut 06870.

**Q. WHAT IS YOUR PRESENT OCCUPATION?**

A. I am Principal and founder of Henkes Consulting, a financial consulting firm that specializes in utility regulation.

**Q. WHAT IS YOUR REGULATORY EXPERIENCE?**

A. I have prepared and presented numerous testimonies in rate proceedings involving electric, gas, telephone, water and wastewater companies in jurisdictions nationwide including Arkansas, Delaware, District of Columbia, Georgia, Kentucky, Maryland, New Jersey, New Mexico, Pennsylvania, Vermont, the U.S. Virgin Islands and before the Federal Energy Regulatory Commission. A complete listing of jurisdictions and rate proceedings in which I have been involved is provided in Appendix I attached to this testimony.

1 **Q. WHAT OTHER PROFESSIONAL EXPERIENCE HAVE YOU HAD?**

2 A. Prior to founding Henkes Consulting in 1999, I was a Principal of The Georgetown  
3 Consulting Group, Inc. for over 20 years. At Georgetown Consulting I performed the same  
4 type of consulting services as I am currently rendering through Henkes Consulting. Prior  
5 to my association with Georgetown Consulting, I was employed by the American Can  
6 Company as Manager of Financial Controls. Before joining the American Can Company, I  
7 was employed by the management consulting division of Touche Ross & Company (now  
8 Deloitte & Touche) for over six years. At Touche Ross, my experience, in addition to  
9 regulatory work, included numerous projects in a wide variety of industries and financial  
10 disciplines such as cash flow projections, bonding feasibility, capital and profit forecasting,  
11 and the design and implementation of accounting and budgetary reporting and control  
12 systems.

13

14 **Q. WHAT IS YOUR EDUCATIONAL BACKGROUND?**

15 A. I hold a Bachelor degree in Management Science received from the Netherlands School of  
16 Business, The Netherlands in 1966; a Bachelor of Arts degree received from the University  
17 of Puget Sound, Tacoma, Washington in 1971; and an MBA degree in Finance received  
18 from Michigan State University, East Lansing, Michigan in 1973. I have also completed  
19 the CPA program of the New York University Graduate School of Business.

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**II. SCOPE AND PURPOSE OF TESTIMONY**

**Q. WHAT IS THE SCOPE AND PURPOSE OF THIS TESTIMONY?**

A. I was engaged by the New Jersey Division of Rate Counsel (“Rate Counsel”) to conduct a review and analysis and present testimony in the matter of the petition of New Jersey American Water Company (“NJAWC” or “the Company”) for increased tariff rates and charges for water and sewer service, change in depreciation rates and other tariff revisions.

The purpose of this testimony is to present to the New Jersey Board of Public Utilities (“BPU” or “the Board”) the appropriate rate base, pro forma operating income, revenue conversion factor and overall revenue requirement for NJAWC in this proceeding. In the determination of NJAWC’s appropriate revenue requirement, I have relied on and incorporated the recommendations of the following Rate Counsel witnesses:

- David Parcell, concerning the appropriate capital structure, capital cost rates and overall rate of return of NJAWC in this proceeding;
- Andrea Crane, concerning NJAWC’s appropriate cash working capital and consolidated income tax benefits;
- Michael Majoros, concerning NJAWC’s appropriate depreciation rates; and
- Howard Woods, concerning the issues of normalized sales per customer levels for the residential and commercial customers of NJAWC’s SA-1 and SA-2 tariff districts; post-test year capital additions; and certain public education expenses.

*Henkes Direct Testimony*  
*New Jersey American Water Company – BPU Docket No. WR11070460*

1 In developing this testimony, I have reviewed and analyzed NJAWC’s original July 29,  
2 2011 filing; supporting testimonies, exhibits and SIR workpapers; NJAWC’s November  
3 11, 2011 update filing and supporting exhibits and SIR workpapers; NJAWC’s responses  
4 to initial and follow-up data requests by Rate Counsel and BPU Staff; and other relevant  
5 financial documents and data.

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**III. CASE OVERVIEW AND SUMMARY OF FINDINGS AND CONCLUSIONS**

**Q. PLEASE DESCRIBE THE COMPANY’S RATE INCREASE REQUEST IN ITS ORIGINAL FILING.**

A. In its original filing dated July 29, 2011, the Company requested a base rate increase of \$95,465,856. On page 7 of its Petition, the Company states that this base rate increase represents a 15.5% increase over its projected pro forma present rate revenues.

**Q. DO YOU AGREE THAT THE REQUESTED RATE INCREASE OF \$95,465,856 REPRESENTS A RATE INCREASE OF 15.5%?**

A. No. The Company’s statement that its requested base rate increase is equal to a rate increase of 15.5% is misleading. The true and correct base rate increase is approximately 16.9% rather than 15.5%. This correct base rate increase percentage of 16.9% can be derived by dividing the requested *base rate* increase of \$95,465,856 into the Company’s proposed projected pro forma present *base rate* revenues of \$565,285,022.<sup>1</sup> In calculating its claimed rate increase number of 15.5%, the Company has divided the requested base rate increase of \$95,465,856 into a total pro forma present revenue number of \$615,099,293, consisting of not only the pro forma present base rate revenues of \$95,465,856, but also the pro forma present PWAC/PSTAC revenues of \$49,814,273.<sup>2</sup> PWAC/PSTAC revenues are not base rate revenues because they are not recovered in the Company’s base rates. Rather, they are recovered separately through the PWAC/PSTAC

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<sup>1</sup> This information can be found on P-2, Schedule 4.  
<sup>2</sup> See the response to RCR-A-5.



1 rate mechanisms. In fact, the Company recently requested PWAC/PSTAC rate increases in  
2 a docket separate from the instant base rate case docket. Thus, it is inappropriate and  
3 misleading to compare the requested base rate increase of \$95,465,856 (which excludes  
4 any PWAC and PSTAC revenue considerations) to a pro forma present revenue number of  
5 \$615,099,293 (which includes \$49,814,273 worth of PWAC/PSTAC revenues) in the  
6 determination and presentation of a claimed base rate increase percentage.

7  
8 **Q. HAS THE COMPANY UPDATED ITS ORIGINAL JULY 29, 2011 FILING?**

9 A. Yes. While the Company’s original filing included 5 months of actual and 7 months of  
10 projected data for the test year ended January 31, 2012, on November 11, 2011, the  
11 Company submitted an update of its rate case filing based on 9 months of actual and 3  
12 months of projected data.<sup>3</sup> This 9+3 filing was accompanied by the supplemental  
13 testimonies of 3 witnesses. While the 9+3 filing indicates a revised revenue deficiency  
14 claim of \$99,307,784, the Company is not changing its original rate increase request of  
15 \$95,465,856. Since the 9+3 filing incorporates corrections and revisions for a large  
16 number of issues that had previously been identified by me through the discovery process, I  
17 have used this updated filing as the starting point of the revenue requirement presentations  
18 contained in Schedules RJH-1 through RJH-37 that are attached to this testimony.

19  
20 **Q. IS THE COMPANY IN THIS CASE REQUESTING BASE RATE RECOVERY**  
21 **FOR ITS PURCHASED WATER AND SEWAGE TREATMENT AND DISPOSAL**  
22 **COSTS?**

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<sup>3</sup> Hereinafter, this update filing will be referred to as the “9+3” filing.

1 A. No. As previously mentioned, the Company is proposing that 100% of its purchased water  
2 and sewage treatment and disposal costs be recovered through its PWAC/PSTAC clauses.

3

4 **Q. COULD YOU NOW SUMMARIZE YOUR REVENUE REQUIREMENT**  
5 **FINDINGS AND CONCLUSIONS IN THIS CASE?**

6 A. Yes. I have reached the following revenue requirement findings and conclusions in this  
7 docket:

8 1. The appropriate rate base amounts to \$1,705,724,421 which is \$347,393,019  
9 lower than NJAWC's proposed 9+3 updated rate base of \$2,053,117,440.  
10 Schedules RJH-1, line 1 and RJH-3.

11

12 2. The appropriate forma operating income amounts to \$159,132,958 which is  
13 \$34,947,635 higher than NJAWC's proposed 9+3 updated pro forma operating  
14 income of \$124,185,323. Schedules RJH-1, line 4 and RJH-7.

15

16 3. The appropriate overall rate of return on rate base, as recommended by Rate  
17 Counsel witness David Parcell, is 7.83%, incorporating a recommended return on  
18 equity of 9.75%, which is the mid-point of Mr. Parcell's recommended return on  
19 equity range of 9.50% - 10.00%. This compares to NJAWC's proposed overall  
20 rate of return on rate base of 8.74%, including a requested return on equity rate of  
21 11.50%. Schedules RJH-1, line 2 and RJH-2.

22

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1           4.    The appropriate Revenue Conversion Factor to be used for ratemaking purposes in  
2                    this case is 1.79623. Schedule RJH-1, line 6.

3  
4           5.    The recommended ratemaking components outlined above indicate the need for a  
5                    rate decrease of \$45,884,225 (-7.84%). This recommended rate decrease is  
6                    \$145,192,009 lower than NJAWC’s proposed 9+3 updated revenue deficiency of  
7                    \$99,307,784 (17.58%). Schedule RJH-1, lines 7 and 8.

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**IV. REVENUE REQUIREMENT ISSUES**

**A. BASE YEAR, TEST YEAR AND POST-TEST YEAR**

**Q. PLEASE DESCRIBE THE BASE YEAR, TEST YEAR AND POST-TEST YEAR APPROACH USED BY NJAWC TO SUPPORT ITS REQUESTED RATE INCREASE IN THIS PROCEEDING.**

**A.** NJAWC’s proposed base year in this case is calendar year 2010, containing 12 months of actual data. NJAWC’s proposed test year in this case is the 12-month period ended January 31, 2012, containing 5 months of actual and 7 months of projected data in the original rate filing which was updated to 9 months of actual and 3 months of projected data in the 9+3 update filing. NJAWC then adjusted its test year results for post-test year rate base, revenue, expense and tax changes projected to occur during the six-month post-test year period February 1 through July 31, 2012 and beyond. Specifically, the rate base proposed by NJAWC consists of projected rate base balances as of July 31, 2012. To be consistent with this post-test year approach, NJAWC annualized its revenues based on projected billing determinants as of July 31, 2012; reflected depreciation expenses based on the projected July 31, 2012 depreciable plant balances; and reflected adjusted annualized O&M expenses and taxes based on expense and tax projections for the post-test year period ending July 31, 2012 and beyond.

**Q. DO YOU BELIEVE THAT THIS PROPOSED BASE YEAR, TEST YEAR AND POST-TEST YEAR RATE MAKING APPROACH IS REASONABLE FOR**

1       **PURPOSES OF DETERMINING NJAWC’S REVENUE REQUIREMENT IN THIS**  
2       **CASE?**

3       **A.** Not entirely. While I agree with the use of the proposed 2010 base year and 1/31/2012 test  
4       year, I have not reflected the majority of NJAWC’s proposed projected post-test year rate  
5       base balances as of July 31, 2012, together with annualized depreciation expenses based on  
6       the projected 7/31/12 plant balances and annualized revenues based on the projected  
7       7/31/12 billing determinants. I will discuss my disagreement on this point in more detail  
8       later in this testimony. At the time of this writing, actual test year results through October  
9       31, 2011 have been available for review and analysis and have been relied on in the  
10      preparation of this testimony.

11  
12      In summary, I believe it is reasonable and appropriate to use a calendar 2010 base and test  
13      year ended January 31, 2012 for purposes of determining NJAWC’s revenue requirement  
14      in this proceeding. However, the majority of NJAWC’s proposed projected post-test year  
15      rate base balances as of July 31, 2012, together with the associated annualized depreciation  
16      expenses and annualized revenues, should be rejected by the Board.

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**B. RATE BASE**

**Q. PLEASE SUMMARIZE NJAWC’S PROPOSED PRO FORMA RATE BASE, THE METHOD EMPLOYED BY NJAWC TO DETERMINE ITS PRO FORMA RATE BASE, AND THE RECOMMENDED RATE BASE ADJUSTMENTS.**

A. NJAWC’s proposed 9+3 rate base amounts to \$2,053,117,440 and is shown by rate base component on Schedule RJH-3. All of NJAWC’s proposed pro forma rate base balances except those for prepayments, materials & supplies, and cash working capital represent fully projected balances as of July 31, 2011. The proposed 9+3 rate base balances for prepayments and materials & supplies represent the 13-month average balances for the 12-month period ended 10/31/11 and the claimed cash working capital requirement has been determined through a detailed lead/lag study approach.

As summarized on Schedule RJH-3 and shown in more detail in subsequent RJH schedules, I have reflected numerous rate base adjustments that have the combined effect of reducing NJAWC’s proposed rate base by \$347,393,019. Each of these recommended rate base adjustments will be discussed in detail below.

- Utility Plant in Service

**Q. PLEASE DESCRIBE THE DERIVATION OF NJAWC’S PROPOSED PRO FORMA PLANT IN SERVICE BALANCE.**

1 A. NJAWC is proposing to claim in its rate base the utility plant in service balance projected  
2 as of July 31, 2011. To arrive at this projected utility plant in service balance, NJAWC  
3 used the actual plant balance as of December 31, 2010 as the starting point and then added  
4 19 months worth of projected plant additions through July 31, 2012. Since the proposed  
5 test year in this case is the 12-month period ended January 31, 2012, NJAWC is requesting  
6 rate recognition for projected plant additions extending 6 months beyond the end of the test  
7 year. As shown on Schedule RJH-3, line 1, the Company's proposed projected July 31,  
8 2012 plant in service balance amounts to \$3,511,958,106.

9

10 **Q. PLEASE EXPLAIN WHAT APPROACH YOU HAVE USED IN THE**  
11 **DETERMINATION OF RATE COUNSEL'S RECOMMENDED PRO FORMA**  
12 **PLANT IN SERVICE BALANCE IN THIS CASE.**

13 A. As shown on Schedule RJH-4, I started out with the Company's proposed projected plant  
14 in service balance of \$3,296,277,735<sup>4</sup> as of 1/31/12, the end of the test year. Whereas the  
15 Company then proposed to reflect gross plant additions totaling \$221,271,850 for the 6-  
16 month post-test year period 2/1/12 – 7/31/12, for reasons discussed in his testimony Rate  
17 Counsel witness Howard Woods has determined that the majority of these proposed post-  
18 test year plant additions should not be reflected for ratemaking purposes in this case.  
19 Instead, Mr. Woods has recommended that only the Canoe Brook Treatment Plant and  
20 Business Transformation ERP projects qualify for post-test year plant in service additions.  
21 Schedule RJH-4, footnote (3) shows that I have quantified the total gross plant balance of

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<sup>4</sup> In the Company's 9+3 update filing, this projected 1/31/12 plant balance amounted to \$3,300,017,351. However, in a subsequent update emailed to the parties on 12/7/11, the Company indicated that this projected 1/31/12 balance should be corrected to \$3,296,277,735.

1 these two plant projects to be \$94,860,401. This recommended plant addition balance  
2 represents 42.9% of the Company's proposed post-test year gross plant additions totaling  
3 \$221,271,850. Since the Company also reflected projected post-test year plant *retirements*  
4 totaling \$14,352,898, I have calculated Rate Counsel's recommended post-test year plant  
5 retirements to be 42.9% of \$14,352,898, or \$6,153,163, consistent with Rate Counsel's  
6 recommended gross plant addition approach. As shown on Schedule RJH-4, this results in  
7 Rate Counsel's recommended post-test year net plant in service balance of \$3,384,984,973.  
8 Schedule RJH-3, line 1 shows that this recommended post-test year plant balance is  
9 \$126,973,133 lower than NJAWC's proposed post-test year plant balance reflected in its  
10 9+3 update filing.

11  
12 **Q. DO YOU HAVE ANY OTHER RECOMMENDATIONS REGARDING THIS**  
13 **ITEM?**

14 A. Yes. Once available, NJAWC's projected plant in service balance as of the end of the test  
15 year, 1/31/12, should be replaced with the actual 1/31/12 reserve balance.

16  
17 **Q. PLEASE EXPLAIN HOW YOU QUANTIFIED THE RECOMMENDED POST-**  
18 **TEST YEAR PLANT ADDITIONS FOR THE CANOE BROOK TREATMENT**  
19 **PLANT AND BUSINESS TRANSFORMATION ERP PROJECTS TOTALING**  
20 **\$94,860,401.**

21 A. With regard to the Canoe Brook Treatment Plant, I have adopted the post-test year plant  
22 balance of \$73,228,696 contained in the testimony of Mr. Woods.

23



1 The quantification of the recommended post-test year Business Transformation ERP  
2 project is detailed on Schedule RJH-4A. As shown on this schedule, the total proposed  
3 ERP cost balance for American Water amounts to \$135,951,309, consisting of projected  
4 project costs of \$128,709,421 and projected contingency costs of \$7,241,888. The  
5 Company then proposed to allocate \$26,320,173, or 19.36% of this total ERP cost balance  
6 to NJAWC. The 19.36% allocation factor is based on the ratio of NJAWC’s number of  
7 customer as of 12/31/2010 to the total number of customers of all of American Water’s  
8 regulated subsidiaries.<sup>5</sup> As shown on Schedule RJH-4A, I recommended that three  
9 adjustments be made to the previously described NJAWC-quantified post-test year ERP  
10 project balance.

11  
12 **Q. PLEASE EXPLAIN EACH OF THESE RECOMMENDED ADJUSTMENTS.**

13 A. The first adjustment concerns my recommendation that the contingency costs of \$7.2  
14 million be removed as these costs are unsubstantiated and not known and measurable.

15  
16 The second adjustment concerns my recommendation that a portion of the total American  
17 Water ERP costs be allocated to American Water’s non-regulated affiliates. In its response  
18 to RCR-A-202, the Company confirms that all of the Business Transformation costs are  
19 allocated to American Water’s regulated operations and further states that:

20 ... if, and to the extent that, American Water’s market-based affiliates seek to  
21 use a portion of the BT information systems, American Water’s market-based  
22 operations will compensate the regulated utility companies for the fully loaded  
23 development costs as well as for a portion of the system’s ongoing maintenance.  
24 American Water’s decision to exclude its market based affiliates from design  
25 and ownership helps to reduce the costs and scope of the project. To the extent

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<sup>5</sup> See response to RCR-A-282.

1           that the market based companies use the BT system, requiring them to pay for a  
2           share of BT costs will reduce the overall costs to the regulated operations, as we  
3           will realize a credit from the market-based operations to defray BT costs.  
4

5           Thus, the Company acknowledges that its non-regulated affiliates could use part of the BT  
6           systems and that, in that case, the non-regulated affiliates would pay for a share of the BT  
7           development costs and ongoing maintenance expense on a fee basis, and those fees would  
8           be credited to the regulated utility companies, presumably through a credit or reduction in  
9           Service Company fees. The Company has also acknowledged that charging a share of BT  
10          costs to the market-based operations will reduce the overall costs to the regulated  
11          operations. However, this has not been reflected for ratemaking purposes in this case.  
12          Instead, the Company is proposing that 100% of the BT project costs be charged to the  
13          ratepayers of the regulated affiliates of American Water, thereby forcing the captive  
14          ratepayers to subsidize the costs associated with the non-regulated affiliates' use of the BT  
15          project.  
16

17   **Q. HOW DID YOU DETERMINE THE RECOMMENDED PORTION OF THE**  
18   **TOTAL AMERICAN WATER ERP COSTS TO BE ALLOCATED TO AMERICAN**  
19   **WATER'S NON-REGULATED AFFILIATES?**

20   A. The internal functions served by the BT systems are primarily Service Company functions.  
21   For the most recent calendar year, 2010, American Water's Service Company charges to  
22   non-regulated affiliates were \$23,627,794 out of \$250,654,721 in total Service Company  
23   charges, for a ratio of 8.61%.<sup>6</sup> Based on this cost-allocation estimate of the overall benefits  
24   of Service Company activities derived by market-based affiliates, I recommend that the

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<sup>6</sup> See response to RCR-A-201.

1 Board impute a 8.61% allocation of the BT ERP costs to American Water’s non-regulated  
2 affiliates. I have reflected this recommendation on Schedule RJH-4A, line 4.

3  
4 The third recommended adjustment concerns NJAWC’s allocation factor for the remaining  
5 (regulated) American Water BT ERP costs. As previously mentioned, the Company has  
6 proposed to allocate the American Water ERP costs to NJAWC based on the ratio of  
7 NJAWC’s number of customer as of 12/31/2010 to the total number of customers of all of  
8 American Water’s regulated subsidiaries, which ratio is 19.36%. By contrast, the actual  
9 allocation factors for the allocation of American Water ITS Services to NJAWC were  
10 18.38% for 2009, 18.23% for 2010 and 18.57% for 2011 for an actual historic 3-year  
11 average allocation factor of 18.39%. I recommend that this actual 3-year average  
12 allocation factor be used for ratemaking purposes in this case.

13  
14 **Q. PLEASE SUMMARIZE THE RECOMMENDED BUSINESS TRANSFORMATION**  
15 **ERP COSTS TO BE ALLOCATED TO NJAWC AFTER REFLECTING THE**  
16 **PREVIOUSLY DISCUSSED THREE ADJUSTMENTS.**

17 A. As shown on Schedule RJH-4A, the recommended BT ERP costs to be allocated to  
18 NJAWC amount to \$21,631,705, or \$4,688,469 lower than the Company’s proposed  
19 allocated cost balance of \$26,320,173.

20  
21 - **Accumulated Depreciation Reserve**

1 **Q. PLEASE EXPLAIN THE DERIVATION OF THE RECOMMENDED**  
2 **ACCUMULATED DEPRECIATION RESERVE BALANCE SHOWN ON**  
3 **SCHEDULE RJH-3, LINE 2.**

4 A. As shown in more detail on Schedule RJH-5, I started out with NJAWC’s projected reserve  
5 balance as of the end of the test year, 1/31/12, and then added 42.9% of the Company’s  
6 projected post-test year reserve additions. As shown on Schedule RJH-4, the ratio of  
7 42.9% represents the portion of NJAWC’s projected post-test year plant in service  
8 additions that Rate Counsel recommends be reflected for ratemaking purposes in this case.

9

10 **Q. DO YOU HAVE ANY OTHER RECOMMENDATIONS REGARDING THIS**  
11 **ITEM?**

12 A. Yes. Once available, NJAWC’s projected reserve balance as of the end of the test year,  
13 1/31/12, should be replaced with the actual 1/31/12 reserve balance.

14

15 - **Cash Working Capital**

16

17 **Q. PLEASE EXPLAIN YOUR RECOMMENDED CASH WORKING CAPITAL**  
18 **REQUIREMENT SHOWN ON SCHEDULE RJH-3, LINE 4.**

19 A. This recommended rate base component represents my adoption of the cash working  
20 capital recommendations contained in the testimony of Ms. Crane.

21

22 - **Plant Acquisition Adjustment and ADITC Balances**

23

1 **Q. PLEASE EXPLAIN THE RECOMMENDED ADJUSTMENTS TO THE**  
2 **COMPANY’S PROPOSED RATE BASE BALANCES FOR PLANT ACQUISITION**  
3 **ADJUSTMENT AND ACCUMULATED DEFERRED INVESTMENT TAX**  
4 **CREDIT (ADITC) SHOWN ON SCHEDULE RJH-3, LINES 5 AND 11.**

5 A. Whereas NJAWC’s proposed plant acquisition adjustment and ADITC balances represent  
6 projected balances as of the 7/31/12 end of the post-test year period, the recommended  
7 plant acquisition adjustment and ADITC balances represent balances as of 1/31/12, the end  
8 of the test year in this case.

9

10 - **Customer Advances and Contributions in Aid of Construction**

11

12 **Q. PLEASE EXPLAIN THE DERIVATION OF THE RECOMMENDED CUSTOMER**  
13 **ADVANCES AND CONTRIBUTIONS IN AID OF CONSTRUCTION (CIAC)**  
14 **BALANCES SHOWN ON SCHEDULE RJH-3, LINES 8 AND 9.**

15 A. As shown in more detail in Schedule RJH-6, I started out with NJAWC’s projected  
16 advances and CIAC balances as of the end of the test year, 1/31/12, and then added 42.9%  
17 of the Company’s projected post-test year advances and CIAC additions. As shown on  
18 Schedule RJH-4, the ratio of 42.9% represents the portion of NJAWC’s projected post-test  
19 year plant in service additions that Rate Counsel recommends be reflected for ratemaking  
20 purposes in this case.

21

22 **Q. DO YOU HAVE ANY OTHER RECOMMENDATIONS REGARDING THESE**  
23 **TWO ITEMS?**

1 A. Yes. Once available, NJAWC’s projected advances and CIAC balances as of the end of the  
2 test year, 1/31/12, should be replaced with the actual 1/31/12 advances and CIAC balances.

3

4 - MTBE CIAC

5

6 **Q. PLEASE EXPLAIN THE DERIVATION OF THE RECOMMENDED MTBE CIAC**  
7 **RATE BASE DEDUCTION BALANCE SHOWN ON SCHEDULE RJH-3, LINE 10.**

8 A. As shown in footnote (4) of Schedule RJH-3, the recommended MTBE CIAC balance of  
9 \$6,889,900 consists of the \$6,859,658 balance projected for the end of the test year,  
10 1/31/12, plus an additional MTBE CIAC balance of \$30,242 that should be reflected in  
11 accordance with the Company’s response to RCR-A-208. The recommended balance of  
12 \$6,889,900 is \$118,374 higher than the Company’s proposed balance of \$6,771,526  
13 projected for the end of the post-test year period, 7/31/12.

14

15 - Accumulated Deferred Income Taxes

16

17 **Q. PLEASE EXPLAIN THE DERIVATION OF THE RECOMMENDED**  
18 **ACCUMULATED DEFERRED INCOME TAX BALANCE SHOWN ON**  
19 **SCHEDULE RJH-3, LINE 12.**

20 A. As shown in more detail on Schedule RJH-7, I started out with NJAWC’s projected  
21 deferred income tax balance as of the end of the test year, 1/31/12, and then added 42.9%  
22 of the Company’s projected post-test year deferred income tax additions. As shown on  
23 Schedule RJH-4, the ratio of 42.9% represents the portion of NJAWC’s projected post-test

1 year plant in service additions that Rate Counsel recommends be reflected for ratemaking  
2 purposes in this case.

3

4 **Q. DO YOU HAVE ANY OTHER RECOMMENDATIONS REGARDING THIS**  
5 **ITEM?**

6 A. Yes. Once available, NJAWC's projected deferred income tax balance as of the end of the  
7 test year, 1/31/12, should be replaced with the actual 1/31/12 reserve balance.

8

9 - **Insurance Reserve**

10

11 **Q. PLEASE EXPLAIN YOUR RECOMMENDED ADJUSTMENT TO THE**  
12 **COMPANY'S PROPOSED INSURANCE RESERVE RATE BASE DEDUCTION**  
13 **SHOWN ON SCHEDULE RJH-3, LINE 13.**

14 A. The Company's proposed insurance reserve rate base deduction of \$60,148 was incorrectly  
15 calculated and should be corrected to a rate base deduction balance of \$132,464. In its  
16 response to RCR-A-210, the Company agrees that this latter corrected balance should be  
17 reflected in this case.

18

19 - **Consolidated Income Tax Benefits**

20

21 **Q. PLEASE EXPLAIN YOUR RECOMMENDED RATE BASE DEDUCTION FOR**  
22 **CONSOLIDATED INCOME TAX BENEFITS SHOWN ON SCHEDULE RJH-3,**  
23 **LINE 14.**

1 A. This rate base deduction adjustment represents my adoption of the consolidated income tax  
2 benefit recommendations contained in the testimony of Ms. Crane. The reasons for this  
3 rate base deduction are explained in detail in Ms. Crane’s testimony.

4

5 **C. OPERATING INCOME**

6

7 **Q. PLEASE SUMMARIZE NJAWC’S PROPOSED UPDATED PRO FORMA**  
8 **OPERATING INCOME, THE METHOD EMPLOYED BY NJAWC TO**  
9 **DETERMINE ITS PRO FORMA OPERATING INCOME, AND THE**  
10 **RECOMMENDED OPERATING INCOME ADJUSTMENTS.**

11 A. NJAWC’s proposed 9+3 net operating income amounts to \$124,185,323 and is shown by  
12 operating income component on Schedules RJH-8. In deriving this pro forma income  
13 level, NJAWC projected its pro forma operating revenues based on projected billing  
14 determinants as of July 31, 2012 and based on numerous assumptions regarding normalized  
15 consumption levels for each of the various customer classes. NJAWC’s proposed  
16 depreciation expenses were determined by applying its proposed new depreciation rates to  
17 its projected depreciable plant levels as of July 31, 2012. The proposed pro forma O&M  
18 expenses were determined by taking the unadjusted O&M expenses from the 2010 base  
19 year as the starting point and then adjusting these base year expense levels for actual and  
20 projected expense changes from the base year to 7/31/12 and beyond. Generally, the same  
21 approach was used by NJAWC to determine its pro forma revenue taxes and other taxes.  
22 NJAWC’s proposed income taxes were determined by taking the proposed pro forma net  
23 operating income before income taxes as the starting point, then deducting pro forma



1 interest expenses through the “interest synchronization” method and applying the statutory  
2 FIT rate of 35%.

3  
4 As summarized on Schedule RJH-8 and shown in detail on subsequent RJH schedules, I  
5 have recommended numerous operating income adjustments with the combined effect of  
6 increasing NJAWC’s proposed pro forma after-tax operating income by a total amount of  
7 \$34,947,635. Each of the recommended operating income adjustments will be discussed in  
8 detail below.

9  
10 - **SA-1 GMS Revenues**

11  
12 **Q. PLEASE EXPLAIN THE RECOMMENDED ADJUSTMENT TO NJAWC’S**  
13 **PROPOSED GMS REVENUES FOR ITS SA-1 TARIFF DISTRICT SHOWN ON**  
14 **SUMMARY SCHEDULE RJH-9, LINE 1.**

15 A. As shown in more detail on Schedule RJH-10, the recommended adjustment primarily  
16 results from the differences in NJAWC’s proposed normalized annual average thousand  
17 gallons (TG) consumption per residential and commercial customer and the normalized  
18 annual average TG consumption per residential and commercial customer recommended by  
19 Rate Counsel witness Howard Woods. While both NJAWC’s proposed and Mr. Woods’  
20 recommended normalized consumption numbers are based on water usage trend analyses,  
21 the methodologies and end results of these water usage trend analyses are different as  
22 described in detail in the testimony of Mr. Woods.

23

1 Another component of Rate Counsel’s recommended adjustment to the Company’s  
2 proposed SA-1 GMS revenues is the recommended removal of NJAWC’s proposed post-  
3 test year SA-1 GMS revenue additions totaling \$25,922 (see Schedule RJH-10, line 10),  
4 consistent with Rate Counsel’s recommended post-test year plant in service position.

5  
6 As shown on summary Schedule RJH-9, line 1 and Schedule RJH-10, line 12, Rate  
7 Counsel’s recommended adjustments increase NJAWC’s proposed SA-1 GMS revenues by  
8 \$12,287,686.

9  
10 **Q. DO YOU HAVE ANY ADDITIONAL COMMENTS REGARDING THIS ISSUE?**

11 A. Yes. In several of its prior base rate proceedings, NJAWC proposed that the normalized  
12 annual average TG consumption per SA-1 GMS residential and commercial customer be  
13 based on the unadjusted actual average usage during the most recent 5-year historic period.  
14 As detailed in the bottom part of Schedule RJH-10 (lines 13 – 23), the use of this 5-year  
15 average use per customer approach would increase NJAWC’s proposed SA-1 GMS  
16 revenues by \$20,506,119. Compared to this revenue adjustment, Rate Counsel’s  
17 recommended SA-1 GMS revenue adjustment of \$12,287,686 is conservative.

18

19 - **SA-2 GMS Revenues**

20

21 **Q. PLEASE EXPLAIN THE RECOMMENDED ADJUSTMENT TO NJAWC’S**  
22 **PROPOSED GMS REVENUES FOR ITS SA-2 TARIFF DISTRICT SHOWN ON**  
23 **SUMMARY SCHEDULE RJH-9, LINE 2.**

*Henkes Direct Testimony*  
*New Jersey American Water Company – BPU Docket No. WR11070460*

1 A. As shown in more detail on Schedule RJH-11, the recommended adjustment primarily  
2 results from the differences in NJAWC’s proposed normalized annual average thousand  
3 gallons (TG) consumption per residential and commercial customer and the normalized  
4 annual average TG consumption per residential and commercial customer recommended by  
5 Rate Counsel witness Howard Woods. While both NJAWC’s proposed and Mr. Woods’  
6 recommended normalized consumption numbers are based on water usage trend analyses,  
7 the methodologies and end results of these water usage trend analyses are different as  
8 described in detail in the testimony of Mr. Woods.

9  
10 Another component of Rate Counsel’s recommended adjustment to the Company’s  
11 proposed SA-2 GMS revenues is the recommended removal of NJAWC’s proposed post-  
12 test year SA-2 GMS revenue reduction totaling \$8,768 (see Schedule RJH-11, line 10),  
13 consistent with Rate Counsel’s recommended post-test year plant in service position.

14  
15 As shown on summary Schedule RJH-9, line 2 and Schedule RJH-11, line 12, Rate  
16 Counsel’s recommended adjustments increase NJAWC’s proposed SA-2 GMS revenues by  
17 \$7,568,115.

18  
19 **Q. DO YOU HAVE ANY ADDITIONAL COMMENTS REGARDING THIS ISSUE?**

20 A. Yes. In several of its prior base rate proceedings, NJAWC proposed that the normalized  
21 annual average TG consumption per SA-2 GMS residential and commercial customer be  
22 based on the unadjusted actual average usage during the most recent 5-year historic period.  
23 As detailed in the bottom part of Schedule RJH-11 (lines 13 – 23), the use of this 5-year

1 average use per customer approach would increase NJAWC’s proposed SA-2 GMS  
2 revenues by \$9,814,701. Compared to this revenue adjustment, Rate Counsel’s  
3 recommended SA-2 GMS revenue adjustment of \$7,568,115 is conservative.

4  
5 - **SA-3 GMS Revenues**

6  
7 **Q. PLEASE EXPLAIN THE RECOMMENDED ADJUSTMENT TO NJAWC’S**  
8 **PROPOSED GMS REVENUES FOR ITS SA-3 TARIFF DISTRICT SHOWN ON**  
9 **SUMMARY SCHEDULE RJH-9, LINE 3.**

10 A. As shown in more detail on Schedule RJH-12, the recommended adjustment primarily  
11 results from the differences in NJAWC’s proposed normalized annual average thousand  
12 gallons (TG) consumption per residential customer and the normalized annual average TG  
13 consumption per residential customer recommended by me. In its prior base rate cases,  
14 including the most recent 2010 base rate case, NJAWC based the normalized annual  
15 average consumption per residential SA-3 GMS customer on the actual average usage per  
16 customer during the most recent 5-year historic period. While Mr. Rex states on page 26,  
17 line 15 of his testimony claims that in the current case, the Company similarly based the  
18 normalized annual consumption per residential SA-3 customer on a “five-year average  
19 2006-2010 usage per customer,” this claim is incorrect. Rather, as clearly shown in SIR-  
20 14, the Company’s proposed normalized annual consumption per residential SA-3  
21 customer starts out with the 5-year average 2006-2010 use per customer which is then  
22 adjusted downward by the application of some sort of estimated trending factor through  
23 July 31, 2013. The use of this novel trending factor, introduced for the first time in this

1 case, should be rejected by the Board for several reasons. First, this concerns a proposed  
2 adjustment for a period that inappropriately ends 18 months beyond the end of the test year  
3 in this case. And, second, the trending for the 12-month period ended July 31, 2013 cannot  
4 be considered a known and measurable event at this time. Instead, I recommend that the  
5 normalized annual consumption per residential SA-3 customer be based on the unadjusted  
6 5-year average use per customer in the most recent 5-year period 2006 – 2010, consistent  
7 with the SA-3 normalization approach proposed by NJAWC and approved by the Board in  
8 the Company’s prior base rate proceedings. My recommended approach and the associated  
9 recommended revenue adjustments for each of the SA-3 districts are reflected on Schedule  
10 RJH-12.

11  
12 Another component of my recommended adjustment to the Company’s proposed SA-3  
13 GMS revenues is the recommended removal of NJAWC’s proposed post-test year SA-3  
14 GMS net revenue reduction totaling \$9,123 (see Schedule RJH-12, lines 5, 11 and 17),  
15 consistent with Rate Counsel’s recommended post-test year plant in service position.

16  
17 As shown on summary Schedule RJH-9, line 3 and Schedule RJH-12, line 19, my  
18 recommended adjustments increase NJAWC’s proposed SA-3 GMS revenues by \$297,592

19  
20 - **Manville Revenues**

1 **Q. PLEASE EXPLAIN THE RECOMMENDED ADJUSTMENT TO NJAWC'S**  
2 **PROPOSED GMS REVENUES FOR THE MANVILLE TARIFF DISTRICT**  
3 **SHOWN ON SUMMARY SCHEDULE RJH-9, LINE 4.**

4 A. As shown in more detail on Schedule RJH-13, the recommended adjustment results from  
5 the difference in NJAWC's proposed normalized annual average thousand gallons (TG)  
6 consumption per residential customer and the normalized annual average TG consumption  
7 per residential customer recommended by me. In its prior base rate cases, including the  
8 most recent 2010 base rate case, NJAWC based the normalized annual average  
9 consumption per residential Manville customer on the actual average usage per customer  
10 during the most recent 5-year historic period. However, in the current case the Company's  
11 proposed normalized annual consumption per residential Manville customer starts out with  
12 the 5-year average 2006-2010 use per customer which is then adjusted downward by the  
13 application of some sort of estimated trending factor through July 31, 2013, similar to what  
14 NJAWC has done for the previously discussed SA-3 residential usage normalization. The  
15 use of this newly introduced trending factor should be rejected by the Board for the same  
16 reasons as discussed in the prior section of this testimony regarding the SA-3 residential  
17 usage normalization. Instead, I recommend that the normalized annual consumption per  
18 residential Manville customer be based on the unadjusted 5-year average use per customer  
19 in the most recent 5-year period 2006 – 2010, consistent with the Manville normalization  
20 approach proposed by NJAWC and approved by the Board in the Company's prior base  
21 rate proceedings. My recommended approach and the associated recommended revenue  
22 adjustment for Manville are reflected on Schedule RJH-13.

23

1 As shown on summary Schedule RJH-9, line 4 and Schedule RJH-13, line 4, my  
2 recommended adjustment increases NJAWC’s proposed Manville revenues by \$56,271.

3  
4 - **SA-1A and SA-1B Revenues**

5  
6 **Q. PLEASE EXPLAIN THE RECOMMENDED ADJUSTMENTS TO NJAWC’S**  
7 **PROPOSED GMS REVENUES FOR THE SA-1A AND SA-1B TARIFF DISTRICTS**  
8 **SHOWN ON SUMMARY SCHEDULE RJH-9, LINES 5 AND 6.**

9 A. As shown in more detail on Schedules RJH-14 and RJH-15, the recommended adjustments  
10 result from the differences in NJAWC’s proposed normalized annual average thousand  
11 gallons (TG) consumption per residential customer for SA-1A and SA-1B and the  
12 normalized annual average TG consumption per residential customer for SA-1A and SA-  
13 1B recommended by me. While Mr. Rex states on page 26, lines 15-16 of his testimony  
14 claims that in the current case, the Company based the normalized annual consumption per  
15 residential SA-1A and SA-1B customer on a “three-year average 2008-2010” usage per  
16 customer, this claim is incorrect. Rather, in the current case the Company’s proposed  
17 normalized annual consumption per residential SA-1A and SA-1B customer starts out with  
18 the 3-year average 2008-2010 use per customer which is then adjusted downward by the  
19 application of some sort of estimated trending factor through July 31, 2013, similar to what  
20 NJAWC did for the previously discussed SA-3 and Manville residential usage  
21 normalizations. The use of this newly introduced trending factor should be rejected by the  
22 Board for the same reasons as discussed in the prior sections of this testimony regarding  
23 the SA-3 and Manville residential usage normalizations. Instead, I recommend that the

1 normalized annual consumption per residential SA-1A and SA-1B customer be based on  
2 the unadjusted average use per customer in the most recent 3-year period 2008 – 2010. My  
3 recommended approach and the associated recommended revenue adjustments for SA-1A  
4 and SA-1B are reflected on Schedules RJH-14 and RJH-15.

5  
6 Another component of my recommended adjustments to the Company’s proposed SA-1A  
7 and SA-1B GMS revenues are the recommended removals of NJAWC’s proposed post-test  
8 year SA-1A GMS revenue increase of \$19,668 (see Schedule RJH-14, line 5) and SA-1B  
9 GMS revenue decrease of \$9,486 (see Schedule RJH-15, line 5), consistent with Rate  
10 Counsel’s recommended post-test year plant in service position.

11  
12 As shown on summary Schedule RJH-9, lines 5 and 5 and Schedules RJH-14, line 6 and  
13 RJH-15, line 6, my recommended adjustments increase NJAWC’s proposed SA-1A  
14 revenues by \$36,578 and SA-1B revenues by 49,525.

15  
16 - **Off-Peak Revenues**

17  
18 **Q. HOW DID THE COMPANY CALCULATE THE PRO FORMA ANNUALIZED**  
19 **OFF-PEAK REVENUES OF \$1,908,962 THAT ARE SHOWN ON SUMMARY**  
20 **SCHEDULE RJH-9, LINE 11?**

21 A. The Company currently has 4 Off-Peak customers: Mt. Laurel Township MUA, Borough  
22 of Keansburg, Borough of Haddonfield, and the Borough of Farmingdale. For ratemaking  
23 purposes in this case, the Company has calculated the annualized revenues for each of these



1 Off-Peak customers based on their contractual Off-Peak demand. This resulted in the  
2 Company’s proposed pro forma Off-Peak revenues of \$1,908,962.

3

4 **Q. DOES THE COMPANY’S OFF-PEAK TARIFF ALLOW OFF-PEAK**  
5 **CUSTOMERS TO EXCEED THEIR CONTRACTUAL OFF-PEAK DEMAND?**

6 A. Yes. As described on page 19 of Mr. Rex’s direct testimony in the Company’s prior base  
7 rate case, ”Off-Peak Demand Service provides the purchaser with the flexibility of  
8 exceeding its contractual Off-Peak demand for the month by 15 percent (on an as-available  
9 basis at NJAWC’s sole discretion) while remaining subject to Off-Peak Service rates.”

10

11 **Q. HAS NJAWC EXPERIENCED NON-CONTRACTUALLY OBLIGATED SALES**  
12 **TO THESE FOUR OFF-PEAK CUSTOMERS ON A RECURRING ANNUAL**  
13 **BASIS?**

14 A. Yes. As confirmed in its response to RCR-A-58, the Company has experienced the  
15 following non-contractually obligated sales levels (TG) to these four Off-Peak customers  
16 during each of the years 2005 through the 2010 base year:

17	- 2005 (TG)	139,223
18	- 2006	136,024
19	- 2007	167,487
20	- 2008	29,460
21	- 2009	9,880
22	- 2010 base year	31,985

23

24 The same data response also quantifies that the revenues received by NJAWC for the  
25 31,985 TG non-contractually obligated sales in the 2010 base year amount to \$176,906.

26

1 **Q. HAS THE COMPANY REFLECTED THESE NON-CONTRACTUALLY**  
2 **OBLIGATED OFF-PEAK SALES REVENUES FOR RATEMAKING PURPOSES**  
3 **IN THIS CASE?**

4 A. No. As confirmed in its response to RCR-A-58, for ratemaking purposes in this case, the  
5 Company has eliminated the 2010 base year revenues of \$176,906 for non-contractually  
6 obligated sales. The Company has only reflected the Off-Peak revenues that are based on  
7 the contractual Off-Peak demand of its four Off-Peak customers.

8

9 **Q. BASED ON THE AFOREMENTIONED INFORMATION, WHAT IS YOUR**  
10 **RECOMMENDATION WITH REGARD TO THE COMPANY’S PROPOSED PRO**  
11 **FORMA OFF-PEAK REVENUES IN THIS CASE?**

12 A. The historic actual information in the above table clearly indicates that the Company’s four  
13 Off-Peak customers consistently engage in demand in excess of their contractual  
14 commitments; and it would be unreasonable and unrealistic to assume that this will not  
15 continue in the near-term future. I therefore recommend that the Company’s proposed pro  
16 forma Off-Peak revenues be increased by \$176,906 to reflect sales in excess of the  
17 contractual Off-Peak demand. My recommendation is shown on Schedule RJH-9, line 11.

18

19 - **SOS Revenues**

20

21 **Q. DO YOU RECOMMEND AN ADJUSTMENT TO THE COMPANY’S PROPOSED**  
22 **SERVICE TO OTHER SYSTEMS (SOS) REVENUES IN THIS CASE?**

*Henkes Direct Testimony*  
*New Jersey American Water Company – BPU Docket No. WR11070460*

1 A. Yes. As shown in the response to RCR-A-220, the Company has excluded for ratemaking  
2 purposes in this case annually recurring revenues associated with non-contractual SOS  
3 sales to the City of Trenton. Specifically, NJAWC has experienced the following non-  
4 contractually SOS sales levels (TG) to the City of Trenton during each of the years 2006  
5 through the 2010 base year:

	<u>TG Sales</u>
6 - 2006	24,676
7 - 2007	3,822
8 - 2008	4,150
9 - 2009	422
10 - 2010 base year	<u>98,439</u>
11 - 5-year average	26,302

12  
13  
14  
15 **Q. BASED ON THE AFOREMENTIONED INFORMATION, WHAT IS YOUR**  
16 **RECOMMENDATION WITH REGARD TO THE COMPANY’S PROPOSED PRO**  
17 **FORMA SOS REVENUES IN THIS CASE?**

18 A. The historic actual information in the above table clearly indicates that the Company  
19 consistently makes a certain level of annual non-contractual SOS sales to the City of  
20 Trenton and it would be unreasonable and unrealistic to assume that this will not continue  
21 in the near-term future. I therefore recommend that the Company’s proposed pro forma  
22 SOS revenues be adjusted to include an estimated level of annual non-contractual sales to  
23 the City of Trenton. As shown on Schedule RJH-9, footnote (3), I have calculated the  
24 recommended revenue adjustment by multiplying the actual average non-contractual TG  
25 sales to Trenton during the most recent 5-year period 2006 – 2010 by the rate per TG sales  
26 in the 2010 base year. This results in a recommended SOS revenue adjustment of  
27 \$120,410.

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- **Private/Public Fire and Sewer Revenues**

**Q. PLEASE EXPLAIN YOUR RECOMMENDED ADJUSTMENTS TO THE COMPANY’S PROPOSED PRIVATE AND PUBLIC FIRE REVENUES AND SEWER REVENUES SHOWN ON SCHEDULE RJH-9, LINES 16, 17 AND 24.**

A. These revenue adjustments represent the recommended removal of the Company’s proposed private/public fire and sewer revenue adjustments for the projected customer growth during the 6-month post-test year period 2/1/12 – 7/31/12. This recommended post-test year customer growth approach is consistent with Rate Counsel’s recommended post-test period plant in service position.

- **SREC Revenues**

**Q. WHAT ARE THE ACTUAL ANNUAL SREC REVENUE LEVELS EXPERIENCED BY NJAWC DURING THE LAST 6 YEARS?**

A. The table below indicates the actual net SREC revenues<sup>7</sup> booked by NJAWC from 2006, the year the SRECs were first introduced, through the 12-month period ended 8/31/2011<sup>8</sup>:

- 2006	\$ 97,685
- 2007	158,976
- 2008	184,186
- 2009	531,245
- 2010	572,307
- 2011	529,679

---

<sup>7</sup> Net SREC revenues represent gross revenues net of associated broker fees.

<sup>8</sup> See response to RCR-A-42(a).

1 **Q. WHAT IS THE LEVEL OF NET SREC REVENUES REFLECTED BY NJAWC IN**  
2 **ITS 9+3 UPDATE FILING?**

3 A. The Company has reflected pro forma annual SREC revenues totaling \$200,199 in its 9+3  
4 filing. The Company determined this substantially reduced annual SREC revenue level  
5 based on discussions with the Company’s “third party broker.” When the Company was  
6 asked for any written source documentation in support of these third party broker  
7 discussions, the Company responded that these “discussions with our SREC broker were  
8 oral and as a result there is no written documentation.”<sup>9</sup> Apparently, the Company’s 9+3  
9 updated SREC net revenue claim of \$200,199 is based on the Company’s estimate that  
10 each of its expected 1012 SREC units during the year 2012 would have an estimated value  
11 of \$205.<sup>10</sup>

12

13 **Q. DO YOU BELIEVE THAT THE COMPANY’S LATEST ESTIMATE FOR ITS**  
14 **PRO FORMA ANNUAL SREC REVENUES IS RELIABLE?**

15 A. No, I do not. I understand that the assumed SREC unit value for 2012 of \$205 represents  
16 an estimate at this time rather than a known and measurable event and would appear to be  
17 inconsistent with the BPU’s Solar Alternative Compliance Payment (SACP) program  
18 values for 2012 and the years after 2012.

19

20 **Q. WHAT IS YOUR RECOMMENDATION BASED ON THE PREVIOUSLY**  
21 **DISCUSSED FINDINGS AND CONCLUSIONS?**

---

<sup>9</sup> Response to RCR-A-42(d).

<sup>10</sup> Calculation of total proposed net SREC revenues: (1012 SREC units x \$205) less \$7,261 for estimated broker fees = net SREC revenues of \$200,199.

1 A. I recommend that the pro forma net SREC revenues to be reflected for ratemaking purposes  
2 in this case be based on the actual net SREC revenues for the most recent actual 12-month  
3 period available at the time of this writing. This recommended annual net SREC revenue  
4 level amounts to \$529,679. My recommendation is reflected on Schedule RJH-9, line 21.

5

6 - **Payroll Expenses**

7

8 **Q. PLEASE DESCRIBE YOUR RECOMMENDED ADJUSTMENTS TO NJAWC'S**  
9 **PROPOSED SALARY AND WAGE EXPENSES SHOWN ON SCHEDULE RJH-17.**

10 A. I have made four adjustments to NJAWC's proposed pro forma salaries and wages in this  
11 case. The first two adjustments concern the recommended removal of all incentive  
12 compensation from NJAWC's proposed payroll expenses. The third adjustment involves a  
13 recommended reduction in NJAWC's proposed summer time help expenses. And the  
14 fourth adjustment is for my recommendation that NJAWC's proposed labor capitalization  
15 ratio be increased. As shown on Schedule RJH-17, line 8, my recommended payroll  
16 expense adjustments reduce the Company's proposed payroll expenses charged to O&M by  
17 a total combined amount of \$5,084,213.

18

19 **Q. PLEASE EXPLAIN THE FIRST RECOMMENDED ADJUSTMENT**  
20 **CONCERNING INCENTIVE COMPENSATION EXPENSES.**

21 A. SIR-18, Updated 11/11/2011 shows that the Company's proposed pro forma payroll  
22 expenses include a total amount of \$3,710,345 for incentive compensation expenses,  
23 consisting of \$3,039,110 for Annual Incentive Plan ("AIP") expenses and \$671,235 for

1 Long Term Incentive Plan expenses. It should be noted, however, that additional incentive  
2 compensation expenses totaling \$2,226,928 are reflected by NJAWC in this case as part of  
3 the allocated Service Company charges. These incentive compensation expenses, which  
4 consist of \$1,608,629 for AIP expenses and \$618,299 for LTIP expenses, are shown on line  
5 1 of Schedule RJH-26. Thus, NJAWC is proposing to charge its ratepayers with total  
6 incentive compensation expenses of \$5,937,273, consisting of \$4,647,739 for AIP and  
7 \$1,289,534 for LTIP expenses.

8  
9 **Q. TURNING FIRST TO THE COMPANY’S PROPOSED RATE INCLUSION OF**  
10 **THE \$1,289,534 FOR LTIP INCENTIVE COMPENSATION EXPENSES, PLEASE**  
11 **PROVIDE ADDITIONAL DETAILS REGARDING THIS LTIP PROGRAM.**

12 A. As shown in RCR-A-100 Attachment of NJAWC’s prior rate case, Docket No.  
13 WR10040260, the purpose of the LTIP program is as follows:

14 ...to provide (i) designated employees of American Water Works Company,  
15 Inc. (the “Company”) and its subsidiaries and (ii) non-employee members of the  
16 board of directors of the Company with an opportunity to receive grants of stock  
17 options, stock units, stock awards, stock appreciation rights and other stock-  
18 based awards. The Company believes that the Plan will encourage the  
19 participants to contribute materially to the growth of the Company, thereby  
20 benefiting the Company’s stockholders, and will align economic interests of the  
21 participants with those of the stockholders.

22  
23 This same data response, as well as RCR-A-121 Attachment 1 in the current case, indicates  
24 that 100% of the awards to be paid out under the LTIP are based on corporate financial  
25 performance indicators, such as, for example, Total Shareholder Return, compounded  
26 earnings per share, and operational efficiency.<sup>11</sup>

27  

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<sup>11</sup> Ratio of operating expenses to operating revenues.

1 **Q. TURNING NOW TO THE COMPANY’S PROPOSED RATE INCLUSION OF THE**  
2 **\$4,647,739 FOR AIP INCENTIVE COMPENSATION EXPENSES, PLEASE**  
3 **PROVIDE ADDITIONAL DETAILS REGARDING THIS AIP PROGRAM.**

4  
5 A. The purpose of the AIP program has previously been described by NJAWC as follows:

6 ...to promote the financial interests and growth of American Water and  
7 Participating Companies by providing an opportunity to earn additional annual  
8 compensation over and above Base Salary for achieving and exceeding financial  
9 goals and performance objectives.<sup>12</sup>

10  
11 As shown in RCR-A-121 Attachment 2, page 70% of the awards paid out under the  
12 AIP program are dependent on the achievement of financial performance goals in the  
13 form of Diluted Earnings per Share and Operating Cash Flow.

14  
15 This same data response also indicates that a predetermined financial threshold for  
16 Company performance must be met in before the AIP award awards to be provided  
17 under the AIP can be funded.

18  
19 **Q. HAVE NJAWC’S NON-UNION EMPLOYEES THAT ARE ELIGIBLE FOR**  
20 **INCENTIVE COMPENSATION RECEIVED ANNUAL INCREASES IN THEIR**  
21 **“REGULAR” BASE COMPENSATION?**

22 A. Yes. During the most recent 5-year period 2007 – 2011, the average annual salary  
23 increases for NJAWC’s non-union employees were approximately 3.4% and in the current  
24 case, the

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<sup>12</sup> Section I “Purpose” description of the Company’s AIP program as per the Company’s response to ST-SR-27 in NJAWC’s prior rate case, Docket No. WR06030257.



1 Company has requested (and I have accepted) the annualized impact of an additional  
2 3.13% increase for the non-union employees.

3

4 **Q. BASED ON THE PREVIOUSLY DISCUSSED INFORMATION, WHAT IS YOUR**  
5 **RECOMMENDATION WITH REGARD TO THE RATE TREATMENT FOR THE**  
6 **INCENTIVE COMPENSATION EXPENSES PROPOSED BY NJAWC IN THIS**  
7 **CASE?**

8 A. I recommend that NJAWC’s proposed pro forma incentive compensation expenses of  
9 \$5,937,273 be disallowed for rate making purposes in this case. The recommended  
10 disallowance of the “direct” NJAWC incentive compensation expenses of \$3,710,345 is  
11 shown on lined 1 and 2 of Schedule RJH-17. The recommended disallowance of the  
12 Service Company-allocated incentive compensation expenses of \$2,226,928 is shown on  
13 line 1 of Schedule RJH-26.

14

15 **Q. WHAT ARE THE REASONS FOR THIS RECOMMENDATION?**

16 First, the criteria for determining the awards to be paid out under NJAWC’s LTIP and AIP  
17 incentive compensation programs are, respectively, 100% and 70% dependent on the  
18 achievement of corporate financial performance. NJAWC’s shareholders are the primary  
19 beneficiaries of such corporate financial performance improvements by virtue of the  
20 resulting increases in their stock value or dividend receipts. For that reason, NJAWC’s  
21 stockholders should be made responsible for these discretionary costs.

22

1 Second, the Company’s proposed incentive compensation bonuses of \$5,937,273 are not  
2 known and certain. They are dependent on American Water’s achievement of certain pre-  
3 determined financial thresholds and in determining its proposed pro forma incentive  
4 compensation awards, the Company has assumed that these financial thresholds will be  
5 achieved. However, if these financial thresholds are not reached, the incentive  
6 compensation could be substantially different from what the Company has assumed in this  
7 case.

8  
9 Third, during a time that employees in other industries, including many in New Jersey’s  
10 state government, have not had wage/salary increases as a result of the Great Recession and  
11 the associated budget crises, NJAWC’s non-union employees that are eligible for incentive  
12 compensation have continued to receive base salary increases averaging 3.4% and will  
13 continue to receive annual salary increases in excess of 3% as reflected for 2012 on a pro  
14 forma basis in this case. Moreover, in a time of increasing health insurance premium  
15 sharing by employees of private corporations and state government, New Jersey  
16 American’s non-union employees are still only contributing 17% towards their health care  
17 premiums. Given these facts, I do not believe it reasonable and appropriate to saddle the  
18 ratepayers with an additional amount of almost \$6 million for bonus awards to be paid out  
19 under the Company’s incentive compensation programs.

20  
21 Fourth, the Company has not presented any evidence in this case showing the specific  
22 benefits that are accruing to the ratepayers as opposed to NJAWC’s shareholders as a result

1 of the incentive compensation plans for which these same ratepayers are asked to pay  
2 100% of the costs. Neither has NJAWC presented any evidence in this case showing that  
3 there is any appreciable difference in the productivity level of NJAWC and NJAWC's  
4 employees or that the ratepayers are receiving more efficient service at reduced overall  
5 costs as a direct result of the Company's incentive compensation programs:

6 **REQUEST:**<sup>13</sup>  
7

8 With regard to the Company's incentive compensation programs, please provide  
9 the following information:  
10

- 11 a. Provide all studies and analyses that NJAWC has performed or commissioned  
12 that quantify the dollar benefits that the Company's incentive programs  
13 provide to the ratepayers.
- 14 b. Provide all studies and analyses that NJAWC has performed or commissioned  
15 that quantify the productivity gains achieved as a direct result of the  
16 Company's incentive compensation programs.
- 17 c. Provide all studies and analyses that NJAWC has performed or commissioned  
18 that the ratepayers are receiving more efficient service at significant cost  
19 reductions as a direct result of the Company's incentive compensation  
20 programs.
- 21 d. Provide all studies and analyses that NJAWC has performed or commissioned  
22 that prove based on convincingly reliable evidence that rate increases have  
23 been delayed and that rates are lower as a direct result of the Company's  
24 incentive compensation programs.  
25

26 **RESPONSE:**  
27

28 a, b, c, d

29 Please note that NJAWC has not independently commissioned or undertaken any of  
30 the studies or analyses listed above. The Company is not aware of any studies that  
31 have been conducted that have attempted to specifically focus on the extremely  
32 narrow instances of direct causation requested above.  
33  
34

35 Fifth, there is no incentive for management to control the level of the incentive  
36 compensation costs if 100% of these costs can be flowed through to the captive ratepayers.

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<sup>13</sup> RCR-A-122.

1 This would be particularly true given that the Company’s management is the primary  
2 beneficiary of these incentive compensation plans.

3  
4 Finally, I find the Company’s request for rate recovery of approximately \$6 million in  
5 bonus compensation on top of regular compensation particularly objectionable because this  
6 proposal is being made in the aftermath of the worst economic downturn since the Great  
7 Depression, where ratepayers are faced with job losses and plunging home values.. It is  
8 especially during these very difficult economic conditions that ratepayers need relief from  
9 these discretionary costs.

10  
11 **Q. DOES THE BOARD HAVE A STATED RATE MAKING POLICY WITH REGARD**  
12 **TO THE RATE TREATMENT OF INCENTIVE COMPENSATION?**

13 A. Yes. In its Final Decision and Order in the Jersey Central Power & Light Company rate  
14 case, Docket No. 91121820J, the Board stated on page 4 of this Decision and Order:

15 We are persuaded by the arguments of Staff and Rate Counsel that, at this  
16 time, the incentive compensation or “bonus” expenses should not be  
17 recovered from ratepayers. The current economic condition has impacted  
18 ratepayers’ financial situation in numerous ways, and it is evident that many  
19 ratepayers, homeowners and businesses alike, are having difficulty paying  
20 their utility bills or otherwise remaining profitable. These circumstances as  
21 well as the fact that the bonuses are significantly impacted by the Company  
22 achieving financial performance goals, render it inappropriate for the  
23 Company to request recovery of such bonuses in rates at this time.  
24 Especially in the current economic climate, ratepayers should not be paying  
25 additional costs to reward a select group of Company employees for  
26 performing the job they were arguably hired to perform in the first place.<sup>14</sup>

27  
28  

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<sup>14</sup> *I/M/O the Petition of Jersey Central Power & Light Company for Approval of Increased Base Tariff Rates and Charges for Electric Service and Other Tariff Revisions*, BRC Docket No. ER91121820J, Final Decision and Order Accepting in Part and Modifying in Part the Initial Decision at 4 (June 15, 1993).

1 With regard to the above-quoted Board policy statement, I would note that the ratepayers  
2 are currently again experiencing difficult economic conditions with plummeting home  
3 values and a still very high unemployment rate. Thus, this Board policy would be  
4 particularly applicable under the current economic circumstances.

5  
6 **Q. DID THE BOARD REITERATE THIS INCENTIVE COMPENSATION RATE**  
7 **MAKING POLICY IN A MORE RECENT LITIGATED BASE RATE CASE?**

8 A. Yes. In the fully-litigated 2000 Middlesex Water Company base rate case, the BPU Staff  
9 stated on page 37 of its Initial Brief with regard to Middlesex’s incentive compensation  
10 expenses:

11 Staff is persuaded by the arguments of the RPA that, at this time, the  
12 incentive compensation expenses should not be recovered from ratepayers.  
13 According to the record, incentive compensation expenses have tripled since  
14 1995. In addition, the record also indicated that the bonuses are  
15 significantly impacted by the Company achieving financial performance  
16 goals. These facts lend strength to the RPA’s position that it is  
17 inappropriate for the Company to request recovery of bonuses in rates at this  
18 time.

19  
20 While the ALJ in that case ruled that 50% of Middlesex’s incentive compensation expenses  
21 could be recovered in rates, the Board overruled the ALJ and ordered that 100% of these  
22 incentive compensation expenses be removed from Middlesex’s rates.<sup>15</sup>

23  
24 **Q. PLEASE EXPLAIN THE THIRD RECOMMENDED ADJUSTMENT**  
25 **CONCERNING SUMMER TIME HELP EXPENSES.**

---

<sup>15</sup> *I/M/O the Petition of Middlesex Water Company for Approval of an Increase in Rates for Water Service and Other Tariff Changes*, BPU Docket No. WR00060362, Order Adopting in Part/Modifying in Part/Rejecting in Part/Initial Decision at 25-26 (June 6, 2001).

*Henkes Direct Testimony*  
*New Jersey American Water Company – BPU Docket No. WR11070460*

1 A. As shown in SIR-18, NJAWC in this case is proposing total summer time help expenses of  
2 \$347,903. This is significantly higher than the actual summer time help expenses  
3 experienced by NJAWC in the most recent 3-year period from 2009 – 2011. Specifically,  
4 the response to RCR-A-134 shows that NJAWC experienced the following actual annual  
5 summer time help expenses:

6	2009	\$238,826
7	2010	209,662
8	2011	<u>214,823</u>
9	3-Year Average	<u>\$ 221,104</u>

10  
11 Based on this recent actual historic expense experience, which indicates that the  
12 Company’s actual expenses for the most recent 3 years have averaged \$221,104, I do not  
13 believe that the Company’s proposed projected expense level of \$347,903 is reasonable and  
14 appropriate. Rather, I recommend that the actual 3-year average summer time help expense  
15 be recognized for ratemaking purposes in this case. This recommended expense  
16 adjustment is shown on Schedule RJH-17, line 3.

17  
18 **Q. PLEASE EXPLAIN THE FOURTH RECOMMENDED ADJUSTMENT**  
19 **CONCERNING THE LABOR CAPITALIZATION RATIO.**

20 A. The Company has proposed a labor capitalization ratio of 23.28%. It determined this ratio  
21 based on the average labor capitalization ratio experienced by the Company in the 4 years  
22 2006, 2007, 2009 and 2010. The reason for choosing a historic 4-year average is because it  
23 is “consistent with the four-year average utilized in determining the average overtime  
24 hours.”<sup>16</sup> The Company chose not to use the average for the most recent 4-year period  
25 2007, 2008, 2009 and 2010 because it believes that the capitalization ratio in 2008 is

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<sup>16</sup> Lipchick testimony, page 11, lines 13-14.

1 unusually high and should therefore not be used in the determination of the normalized  
2 capitalization ratio based on an historic average.

3  
4 **Q. DO YOU AGREE WITH THE COMPANY’S PROPOSED APPROACH WITH**  
5 **REGARD TO THIS LABOR CAPITALIZATION ISSUE?**

6 A. No. First, while the Company’s proposed approach may be consistent with the 4-year  
7 average approach used in the normalization of overtime expenses, it is inconsistent with the  
8 3-year average approach used by the Company and Rate Counsel in the determination of  
9 the normalized capitalization ratios for all of NJAWC’s other expenses that require a  
10 capitalization ratio. Specifically, as shown on SIR-19, the Company has based the  
11 capitalization ratios for its pension, OPEB, Group Insurance, Workers Comp, and  
12 Transportation expenses on the average of the ratios experienced in 2008, 2009 and 2010.  
13 And as confirmed in the responses to RCR-A-129 and RCR-A-131, the Company’s  
14 proposed normalized capitalization ratios for its 401(k) and Defined Contribution Plan  
15 expenses are also based on the actual 3-year average for the years 2008, 2009 and 2010.

16  
17 Second, the whole purpose of using a historic average as the basis for determining a  
18 normalized quantity is that any unusual years should “average out” in the calculation of the  
19 normalized quantity. It would be wrong and unreasonable to then start “cherry picking” by  
20 removing unusual years.

21  
22 **Q. WHAT IS YOUR RECOMMENDATION BASED ON THE AFOREMENTIONED**  
23 **FINDINGS AND CONCLUSIONS?**

1 A. For the previously discussed reasons, I recommend that the labor capitalization ratio to be  
2 used for ratemaking purposes in this case be based on the 3-year average for the years  
3 2008, 2009 and 2010, consistent with what the Company has proposed for its pension,  
4 OPEB, Group Insurance, Workers Comp, 401(k), Defined Contribution, and Transportation  
5 expenses. This recommended labor capitalization ratio is 26.08% and is reflected on  
6 Schedule RJH-17, line 6.

7

8 - Group Insurance Expense

9

10 **Q. PLEASE EXPLAIN THE RECOMMENDED ADJUSTMENT TO THE**  
11 **COMPANY’S PROPOSED GROUP INSURANCE EXPENSE SHOWN ON**  
12 **SCHEDULE RJH-18.**

13 A. As shown on SIR-19 Updated 11/11/2011, the Company has allocated .92% of its group  
14 insurance expenses to American Water’s non-regulated affiliates (“Non Regs”). While the  
15 Company was asked for the basis of this .92% ratio in RCR-A-257, its response did not  
16 provide the answer. However, RCR-A-251 (part d) Attachment shows that the actual  
17 Group Insurance Non Regs allocation ratios for the 3-year period 2008 – 2010 was as  
18 follows: \*\*\* **BEGIN CONFIDENTIAL**

19   
20   
21   
22

23 **END CONFIDENTIAL \*\*\***

24 The average of these three years is 1.85%. Based on this information, I recommend that  
25 the Non Regs allocation factor for group insurance expenses be set at this historic 3-year



1 average of 1.85%. As shown on Schedule RJH-18, my recommendation decreases the  
2 Company's proposed pro forma test year group insurance charged to O&M expense by  
3 \$80,045.

4  
5 - **Pension Expense**

6  
7 **Q. PLEASE COMPARE THE PENSION EXPENSES PROJECTED BY NJAWC IN**  
8 **ITS PRIOR 2010 RATE CASE TO THE ACTUAL EQUIVALENT PENSION**  
9 **EXPENSES BOOKED BY NJAWC IN 2011.**

10 A. As shown in P-2, Schedule 11, Updated 7/21/10 of the prior rate case, the Company  
11 projected its pro forma gross pension expenses to be \$14,108,620 based on preliminary  
12 estimates received by the Company's actuary, Towers Watson. By contrast, the  
13 Company's actual equivalent gross pension expenses booked for 2011 (the first rate  
14 effective year of the prior rate case) amounts to \$9,120,278, or more than 35% lower than  
15 the Company's projection in the prior case.

16  
17 **Q. WHAT GROSS PENSION EXPENSE HAS THE COMPANY REFLECTED IN THE**  
18 **CURRENT CASE 9+3 UPDATE FILING OF NOVEMBER 11, 2011?**

19 A. The Company's 9+3 update filing in the current case reflects a gross pension expense of  
20 \$12,545,596 projected for 2012. Similar to the prior rate case, this projected pension  
21 expense amount is also based on preliminary estimates received from the Company's  
22 actuary, Towers Watson. Again, this projected gross pension expense amount is  
23 substantially higher than the equivalent actual 2011 gross pension expense of \$9,120,278.

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**Q. WHAT IS YOUR RECOMMENDATION BASED ON THE AFOREMENTIONED FACTS?**

A. At this time, I recommend the reflection of the actual 2011 gross pension expenses rather than the preliminary actuary estimate for 2012 which, in the prior case, proved to be grossly overstated. The Company has stated that the actual actuary-calculated gross pension expense for 2012 is anticipated to become available in late January 2012. If this actual gross pension expense becomes available prior to the close of record in this case, this actual 2012 expense could replace the actual 2011 expense, if found to be appropriate after a review by the parties in this case. My recommendation is shown on Schedule RJH-19, line 1.

**Q. DO YOU RECOMMEND ANOTHER ADJUSTMENT TO THE COMPANY’S PROPOSED PENSION EXPENSE?**

A. Yes. The Company has proposed to allocate 2.53% of its pension expense to American Water’s Non Regs. While the Company was asked for the basis of this 2.53% ratio in RCR-A-251(c), its response did not provide the answer. However, RCR-A-251 (part d) Attachment shows that the actual Pension Non Regs allocation ratios for the 3-year period 2008 – 2010 were as follows: **\*\*\* BEGIN CONFIDENTIAL**



**END CONFIDENTIAL \*\*\***

1 The average of these three years is 2.79%. Based on this information, I recommend that  
2 the Non Regs allocation factor for pension expenses be set at this historic 3-year average of  
3 2.79%. This is reflected on Schedule RJH-19, line 2.

4  
5 In summary, my recommended two adjustments decrease the Company's proposed pro  
6 forma test year group pension costs charged to O&M expense by \$2,525,112, as shown on  
7 Schedule RJH-19, line 7.

8  
9 - **OPEB Expense**

10  
11 **Q. PLEASE COMPARE THE OPEB EXPENSES PROJECTED BY NJAWC IN ITS**  
12 **PRIOR 2010 RATE CASE TO THE ACTUAL EQUIVALENT OPEB EXPENSES**  
13 **BOOKED BY NJAWC IN 2011.**

14 A. As shown in P-2, Schedule 13, Updated 7/21/10 of the prior rate case, the Company  
15 projected its pro forma gross OPEB expenses to be \$7,984,050 based on preliminary  
16 estimates received by the Company's actuary, Towers Watson. By contrast, the  
17 Company's actual equivalent gross OPEB expenses booked for 2011 (the first rate effective  
18 year of the prior rate case) amounts to \$4,777,995, or more than 40% lower than the  
19 Company's projection in the prior case.

20  
21 **Q. WHAT GROSS OPEB EXPENSE HAS THE COMPANY REFLECTED IN THE**  
22 **CURRENT CASE 9+3 UPDATE FILING OF NOVEMBER 11, 2011?**

1 A. The Company’s 9+3 update filing in the current case reflects a gross OPEB expense of  
2 \$6,380,784 projected for 2012. Similar to the prior rate case, this projected OPEB expense  
3 amount is also based on preliminary estimates received from the Company’s actuary,  
4 Towers Watson. Again, this projected gross OPEB expense amount is substantially higher  
5 than the equivalent actual 2011 gross OPEB expense of \$4,777,996.

6

7 **Q. WHAT IS YOUR RECOMMENDATION BASED ON THE AFOREMENTIONED**  
8 **FACTS?**

9 A. At this time, I recommend the reflection of the actual 2011 gross OPEB expenses rather  
10 than the preliminary actuary estimate for 2012 which, in the prior case, proved to be  
11 grossly overstated. The Company has stated that the actual actuary-calculated gross OPEB  
12 expense for 2012 is anticipated to become available in late January 2012. If this actual  
13 gross OPEB expense becomes available prior to the close of record in this case, this actual  
14 2012 expense could replace the actual 2011 expense, if found to be appropriate after a  
15 review by the parties in this case. My recommendation is shown on Schedule RJH-20, line  
16 1.

17

18 **Q. PLEASE EXPLAIN THE SECOND RECOMMENDED ADJUSTMENT TO THE**  
19 **COMPANY’S PROPOSED OPEB EXPENSE.**

20 A. The Company has proposed to allocate 2.55% of its OPEB expense to American Water’s  
21 Non Regs. While the Company was asked for the basis of this 2.55% ratio in RCR-A-  
22 252(d), its response did not provide the answer. However, RCR-A-251 (part d) Attachment

1 shows that the actual OPEB Non Regs allocation ratios for the 3-year period 2008 – 2010  
2 were as follows: \*\*\* **BEGIN CONFIDENTIAL**



8  
9 **END CONFIDENTIAL \*\*\***

10 The average of these three years is 2.90%. Based on this information, I recommend that  
11 the Non Regs allocation factor for OPEB expenses be set at this historic 3-year average of  
12 2.90%. This is reflected on Schedule RJH-20, line 2.

13  
14 **Q. PLEASE EXPLAIN THE THIRD RECOMMENDED ADJUSTMENT TO THE**  
15 **COMPANY’S PROPOSED OPEB EXPENSE SHOWN ON SCHEDULE RJH-20,**  
16 **LINE 4.**

17 A. The Company has proposed to reflect in this case an OPEB Stub Period amortization of  
18 \$126,963. As confirmed in the response to RCR-A-127(g), this annual amortization will  
19 expire in January 2013. Since this amortization expense will no longer be incurred shortly  
20 after the rates from this case become effective, I recommend that this expense be  
21 normalized over a 2-year period, consistent with the 2-year normalization period that both  
22 the Company and Rate Counsel have reflected for the rate case expenses associated with  
23 this case. My recommendation decreases the Company’s proposed OPEB expense by  
24 \$63,481.

25

1 **Q. PLEASE EXPLAIN THE LAST RECOMMENDED ADJUSTMENT TO THE**  
2 **COMPANY’S PROPOSED OPEB EXPENSE SHOWN ON SCHEDULE RJH-20,**  
3 **LINE 9.**

4 A. The Company has proposed to reflect in this case an OPEB-related Regulatory Asset  
5 amortization of \$740,457. As confirmed in the response to RCR-A-127(h), this annual  
6 amortization will expire in January 2013. Since this amortization expense will no longer be  
7 incurred shortly after the rates from this case become effective, I recommend that this  
8 expense be normalized over a 2-year period, consistent with the 2-year normalization  
9 period that both the Company and Rate Counsel have reflected for the rate case expenses  
10 associated with this case. My recommendation decreases the Company’s proposed OPEB  
11 expense by \$380,613.

12  
13 In summary, my recommended four OPEB adjustments decrease the Company’s proposed  
14 pro forma test year OPEB costs charged to O&M expense by \$1,601,159, as shown on  
15 Schedule RJH-19, line 7.

16  
17 - **401(k) Expense**

18  
19 **Q. PLEASE COMPARE THE 401(k) EXPENSES PROJECTED BY NJAWC IN ITS**  
20 **PRIOR 2010 RATE CASE TO THE ACTUAL EQUIVALENT 401(k) EXPENSES**  
21 **BOOKED BY NJAWC IN 2011.**

22 A. As shown in P-2, Schedule 14, Updated 7/21/10 of the prior rate case, the Company  
23 projected its pro forma 401(k) expenses to be \$1,892,228. By contrast, the Company’s

1 actual equivalent gross 401(k) expenses booked for 2011 (the first rate effective year of the  
2 prior rate case) amount to \$1,570,960, or approximately 17% lower than the Company's  
3 projection in the prior case.

4

5 **Q. WHAT GROSS 401(k) EXPENSE HAS THE COMPANY REFLECTED IN THE**  
6 **CURRENT CASE 9+3 UPDATE FILING OF NOVEMBER 11, 2011?**

7 A. The Company's 9+3 update filing in the current case reflects a gross 401(k) expense of  
8 \$1,940,502 projected for 2012. Again, this projected gross pension expense amount is  
9 substantially higher than the equivalent actual 2011 gross 401(k) expense of \$1,570,960.

10

11 **Q. WHAT IS YOUR RECOMMENDATION BASED ON THE AFOREMENTIONED**  
12 **FACTS?**

13 A. Since history has shown that the Company's 401(k) expense projections are unreliable, I  
14 recommend that the most recent available actual 2011 401(k) expense of \$1,570,960 be  
15 reflected for ratemaking purposes in this case. My recommendation is shown on Schedule  
16 RJH-21, line 1.

17

18 **Q. DO YOU RECOMMEND ANOTHER ADJUSTMENT TO THE COMPANY'S**  
19 **PROPOSED 401(k) EXPENSE?**

20 A. Yes. The Company has failed to allocate a portion of its 401(k) expense to American  
21 Water's Non Regs. The Company agrees in its response to RCR-A-258 that this should be  
22 done and proposes a Non Regs allocation factor of 2.42% based on the average of the  
23 actual 401(k) Non Regs allocation ratios in the 3-year period 2008 – 2010. I have accepted

1       this proposed allocation factor and have reflected my recommended adjustment on  
2       Schedule RJH-21, line 2.

3  
4       In summary, my recommended two adjustments decrease the Company’s proposed pro  
5       forma test year 401(k) costs charged to O&M expense by \$307,350, as shown on Schedule  
6       RJH-21, line 5.

7  
8               - **Defined Contribution Plan Expense**

9       **Q. PLEASE COMPARE THE DEFINED CONTRIBUTION PLAN (DCP) EXPENSES**  
10       **PROJECTED BY NJAWC IN ITS PRIOR 2010 RATE CASE TO THE ACTUAL**  
11       **EQUIVALENT DCP EXPENSES BOOKED BY NJAWC IN 2011.**

12       A. As shown in P-2, Schedule 15, Updated 7/21/10 of the prior rate case, the Company  
13       projected its pro forma DCP expenses to be \$1,121,464. By contrast, the Company’s actual  
14       equivalent gross DCP expenses booked for 2011 (the first rate effective year of the prior  
15       rate case) amount to \$980,341, or approximately 13% lower than the Company’s projection  
16       in the prior case.

17  
18       **Q. WHAT GROSS DCP EXPENSE HAS THE COMPANY REFLECTED IN THE**  
19       **CURRENT CASE 9+3 UPDATE FILING OF NOVEMBER 11, 2011?**

20       A. The Company’s 9+3 update filing in the current case reflects a gross DCP expense of  
21       \$1,279,372 projected for 2012. Again, this projected gross pension expense amount is  
22       substantially higher than the equivalent actual 2011 gross DCP expense of \$980,341.

23



1 **Q. WHAT IS YOUR RECOMMENDATION BASED ON THE AFOREMENTIONED**  
2 **FACTS?**

3 A. Since history has shown that the Company's DCP expense projections are unreliable, I  
4 recommend that the most recent available actual 2011 DCP expense of \$980,341 be  
5 reflected for ratemaking purposes in this case. My recommendation is shown on Schedule  
6 RJH-22, line 1.

7  
8 **Q. DO YOU RECOMMEND ANOTHER ADJUSTMENT TO THE COMPANY'S**  
9 **PROPOSED DCP EXPENSE?**

10 A. Yes. The Company has failed to allocate a portion of its DCP expense to American  
11 Water's Non Regs. The Company agrees in its response to RCR-A-258 that this should be  
12 done and proposes a Non Regs allocation factor of 1.13% based on the average of the  
13 actual DCP Non Regs allocation ratios in the 3-year period 2008 – 2010. I have accepted  
14 this proposed allocation factor and have reflected my recommended adjustment on  
15 Schedule RJH-22, line 2.

16  
17 In summary, my recommended two adjustments decrease the Company's proposed pro  
18 forma test year DCP costs charged to O&M expense by \$245,529, as shown on Schedule  
19 RJH-22, line 5.

20  
21 - **Tank Painting Expense**

22

1 **Q. HAS NJAWC IN THIS CASE INTRODUCED A PROPOSAL TO CHANGE THE**  
2 **ACCOUNTING AND RATEMAKING TREATMENT OF ITS TANK PAINTING**  
3 **EXPENSES?**

4 A. Yes. As described in the testimonies of Mr. Chopra and Ms. Chiavari, NJAWC in this case  
5 is proposing that a distinction should be made between routine tank maintenance<sup>17</sup> and the  
6 installation of engineered tank coating systems. NJAWC proposes that routine tank  
7 painting be booked as a current expense while engineered tank coating be capitalized as a  
8 regulatory asset and be depreciated over a 20-year period. In this regard, Mr. Chopra  
9 claims on page 5 of his testimony that his proposed capitalization of tank painting has been  
10 allowed by “Commissions throughout the country.”

11  
12 **Q. DO YOU BELIEVE THAT THE BOARD SHOULD ADOPT THIS PROPOSAL?**

13 A. No. I recommend that the Board reject this proposal. Under the Uniform System of  
14 Accounts, tank painting costs cannot be capitalized unless the Board specifically authorizes  
15 NJAWC to establish a regulatory asset for these costs. To allow NJAWC to treat its tank  
16 painting expenses as a regulatory asset is tantamount to allowing guaranteed rate recovery  
17 for these expenses and would significantly reduce NJAWC’s incentive to have its tanks  
18 painted only when really necessary and at prices that reflect careful attention to cost  
19 containment. Tank painting expenses should be treated for both book and ratemaking  
20 purposes as normal, ongoing expenses, similar to other ongoing maintenance expenses such  
21 as, for example, lagoon cleaning expenses. It should also be noted that the Board has never  
22 approved this proposed tank painting treatment and there are no other utilities in New

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<sup>17</sup> Involving such as activities as spot painting, over coating of existing paint systems, and power washing.

1 Jersey that are capitalizing their tank painting expenses.<sup>18</sup> With regard to Mr. Chopra’s  
2 testimony that the Company’s proposal to capitalize tank painting costs has been allowed  
3 by “Commissions throughout the country,” this capitalization method has only been  
4 authorized by 3 out of the 50 state commissions in the United States.<sup>19</sup>

5  
6 **Q. DOES THE COMPANY’S PROPOSED REVENUE REQUIREMENT IN THIS**  
7 **CASE REFLECT THE CAPITALIZATION OF ITS TANK PAINTING**  
8 **EXPENSES?**

9 A. No. While NJAWC prefers the previously described tanks painting capitalization  
10 approach, for ratemaking purposes in this case, it has proposed the reflection of annual  
11 normalized tank painting expenses amounting to approximately \$5.5 million. As shown in  
12 SIR-29, to derive this proposed normalized tank painting expense, NJAWC first made an  
13 assumption that all of its tanks should be painted over a 20-year period. NJAWC then  
14 estimated what it would cost to paint all of its tanks over the next 20 years and then divided  
15 this total estimated cost amount by 20 to arrive at its proposed normalized annual tank  
16 painting amount of \$5,450,500.

17  
18 **Q. WERE THE TANK PAINTING COST ESTIMATES CONTAINED IN SIR-29**  
19 **BASED ON ACTUAL TANK PAINTING CONTRACTS OR BIDS FROM**  
20 **OUTSIDE CONTRACTORS?**

21 A. No. NJAWC did not base its cost estimates on actual painting contracts and did not engage  
22 outside tank painting inspectors to prepare each of the tank painting expense estimates in

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<sup>18</sup> As confirmed by the Company in its response to RCR-A-112.

<sup>19</sup> As confirmed by the Company in its response to RAR-A-111.

1 SIR-29. As confirmed in its response to RCR-A-113, all of the tank painting cost estimates  
2 underlying the Company’s proposed normalized expense amount of approximately \$5.5  
3 million are estimates made by NJAWC’s Engineering Project Manager under the direction  
4 of Ms. Chiavari and there are no reports and/or studies prepared by outside tank painting  
5 experts in support of the cost estimates.

6  
7 **Q. DO YOU RECOMMEND THAT THE BOARD ACCEPT NJAWC’S PROPOSED**  
8 **NORMALIZED ANNUAL TANK PAINTING EXPENSE ESTIMATE OF**  
9 **APPROXIMATELY \$5.5 MILLION?**

10 A. No. Given the aforementioned information, I believe that the Company’s proposed  
11 normalized annual tank painting expense level of \$5.5 million is based on unreliable and  
12 unproven projections and cannot be considered known and measurable.

13  
14 **Q. WHAT ANNUAL TANK PAINTING EXPENSE LEVEL DO YOU RECOMMEND**  
15 **FOR NJAWC IN THIS CASE?**

16 A. As confirmed in the response to RCR-A-241, the actual tank painting expenses incurred by  
17 NJAWC in 2009, 2010 and 2011 amounted to \$3,698,767, \$5,326,624 and \$3,581,000<sup>20</sup>,  
18 respectively. I recommend that the pro forma tank painting expenses in this case be based  
19 on the \$4,202,130 average of the tank painting expenses in this 3-yr period. I believe that  
20 this recommended expense amount is more reasonable than the Company’s estimate since

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<sup>20</sup> As shown in the response to RCR-A-241, the 2011 tank painting expense of \$3,581,000 consists of actual tank painting expenses through October 2011 of \$1,825,575 and estimated tank painting expenses of \$1,755,425 for November and December 2011.

1 it is based on the most recent available actual and projected tank painting expenses of  
2 NJAWC.

3  
4 - **Regulatory Expense**

5  
6 **Q. PLEASE EXPLAIN YOUR ADJUSTMENT TO THE COMPANY’S PROPOSED**  
7 **REGULATORY COMMISSION EXPENSES SHOWN ON SCHEDULE RJH-24.**

8 A. I recommend that only one adjustment be made to the Company’s proposed regulatory  
9 commission expenses and that is a recommended reduction in the Company’s proposed  
10 expenses for the current rate case. In this case, the Company has proposed a total projected  
11 rate case expense of \$1,435,628. As indicated in its response to RCR-A-107(d), in  
12 estimating the current rate case expense of \$1,435,628, the Company has assumed that the  
13 current case would incur costs approximately similar to the \$1,514,477 expense actually  
14 incurred for NJAWC’s 2006 rate case. I do not believe it is reasonable to base the  
15 projected rate case expenses on the actual expenses incurred in one single prior base rate  
16 case. Instead, I recommend that the projected rate case expenses for the current case be  
17 based on the average rate case expenses actually incurred in the Company’s most recent  
18 three base rate cases, starting with the 2006 rate case. This 3-year average amounts to  
19 \$1,143,614 as shown in the table below:

	<u>Rate Case Expenses</u> <sup>21</sup>
- 2006 rate case	\$1,514,477
- 2008 rate case	1,178,665
- 2010 rate case	<u>737,699</u>
- 3-year average	<u>\$1,143,614</u>

20  
21  
22  
23  
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25  

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<sup>21</sup> SIR-10.

1  
2 As shown on Schedule RJH-24, the reflection of this recommended rate case expense of  
3 \$1,143,614, after applying a 50% stockholder sharing factor and a 2-year expense  
4 normalization period would reduce the Company’s proposed annual rate case expense  
5 amount by \$73,004.

6  
7 - **Insurance Other Than Group Expense**

8  
9 **Q. PLEASE EXPLAIN YOUR ADJUSTMENT TO THE COMPANY’S PROPOSED**  
10 **INSURANCE OTHER THAN GROUP EXPENSES SHOWN ON SCHEDULE RJH-**  
11 **25.**

12 A. I recommend that two adjustments be made to the Company’s proposed insurance other  
13 than group expenses. First, I recommend a reduction in the Company’s proposed property  
14 insurance expenses and, second, I recommend an increase in the Company’s proposed  
15 Retro Insurance credits.

16  
17 In the table below, I have listed the actual property insurance expenses experienced by the  
18 Company from 2007 through 2011:

	<u>Property Insurance Exp<sup>22</sup>.</u>
2007	\$ 1,259,720
2008	1,116,277
2009	1,349,804
2010	1,421,571
2011	<u>1,155,253</u>
5-Year Average	<u>\$ 1,260,525</u>

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23  
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26

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<sup>22</sup> Per response to RCR-A-237.

1 As is evident from the information in the above table, the Company's actual property  
2 insurance expenses fluctuate up and down from year to year. The 5-year average expense  
3 amounts to \$1,260,525. Compared to the expense information in the above table, the  
4 Company's projected pro forma property insurance expense of \$1,500,452 seems to be out  
5 of line. The Company's projected expense amount is based on its assumption that the  
6 insurance in 2012 will increase due to the earthquakes, floods and windstorms that have  
7 occurred around the world. I do not believe that the impact of these past natural disasters  
8 on the Company's 2012 property insurance is known and measurable at this time. For that  
9 reason, I believe a more reasonable basis for the normalized pro forma property insurance  
10 expense is the actual 5-year average expense of \$1,260,525. My recommendation is shown  
11 on Schedule RJH-25, line 2.

12  
13 The second recommended adjustment concerning the Company's proposed Retro Insurance  
14 credits is to reflect a required correction to increase the credit amount from \$467,912 to  
15 \$547,525. In its response to RCR-A-238, the Company agrees that this correction needs to  
16 be made. This recommended adjustment is shown on Schedule RJH-25, line 3.

17  
18  
19 In summary, my two recommended adjustments reduce the Company's proposed Insurance  
20 Other Than Group expenses by a total amount of \$319,540.

21  
22 - **General Service Company Expense Adjustments**

1 **Q. PLEASE EXPLAIN THE RECOMMENDED ADJUSTMENTS TO NJAWC'S**  
2 **PROPOSED SERVICE COMPANY EXPENSES SHOWN ON SCHEDULE RJH-26.**

3 A. As shown on Schedule RJH-26, I recommend that eight adjustments be made to the  
4 Company's proposed general Service Company fees which reduce the Company's  
5 proposed 9+3 test year general Service Company fees by a total amount of \$2,330,017.

6  
7 First, for the reasons previously discussed in this testimony, I recommend the removal of  
8 all AIP and LTIP incentive compensation expenses included in the Service Company fees.

9 As shown on Schedule RJH-26, line 1, these incentive compensation expenses total  
10 \$2,226,928, consisting of \$1,608,629 for AIP incentive compensation and \$618,299 for  
11 LTIP incentive compensation.

12  
13 Second, I have removed \$10,765 for SERP (Supplemental Executive Retirement Plan)  
14 expenses that were still included in the Service Company fees charged to NJAWC. SERP  
15 expenses represent retirement benefits paid to American Water's top executives over and  
16 above the regular retirement benefits for these same executives. These executive perks  
17 represent expenses that should not be borne by the ratepayers. This adjustment is shown on  
18 Schedule RJH-26, line 2.

19  
20 Finally, I have removed charitable contributions, promotional advertising expenses,  
21 promotional marketing expenses, fines and penalties, public/community relations expenses,  
22 employee award expenses, and country club dues which the Company proposed to charge  
23 to the ratepayers of NJAWC through the allocated Service Company expenses. These



1 Service Company-incurred expenses have nothing to do with the provision of safe,  
2 adequate and reliable water service to the NJAWC ratepayers. My recommendation is  
3 consistent with Board ratemaking policy to exclude these types of expenses for ratemaking  
4 purposes. These recommended Service Company expense adjustments are shown on  
5 Schedule RJH-26, lines 3-8.

6  
7 - **Call Center Expense**

8  
9 **Q. PLEASE COMPARE THE CALL CENTER EXPENSES PROJECTED BY NJAWC**  
10 **IN ITS PRIOR 2010 RATE CASE TO THE ACTUAL EQUIVALENT CALL**  
11 **CENTER EXPENSES BOOKED BY NJAWC IN 2011.**

12 A. In the prior rate case, the Company projected its pro forma Call Center expenses to be  
13 \$10,161,528. By contrast, the Company's actual equivalent Call Center expenses booked  
14 for 2011 (the first rate effective year of the prior rate case) amount to \$8,544,047, or  
15 approximately 16% lower than the Company's projection in the prior case.

16  
17 **Q. WHAT PROJECTED CALL CENTER EXPENSES HAS THE COMPANY**  
18 **REFLECTED IN THE CURRENT CASE 9+3 UPDATE FILING OF NOVEMBER**  
19 **11, 2011?**

20 A. The Company's 9+3 update filing in the current case reflects projected 2012 Call Center  
21 expenses of \$9,344,395. Again, this projected Call Center amount is substantially higher  
22 than the equivalent actual 2011 expense of \$8,544,047.

23

1 **Q. WHAT IS YOUR RECOMMENDATION BASED ON THE AFOREMENTIONED**  
2 **FACTS?**

3 A. Since history has shown that the Company's Call Center expense projections are unreliable,  
4 I recommend that the most recent available actual 2011 expense of \$8,544,047, increased  
5 by the Company's proposed April 2012 wage increase of 3.5%<sup>23</sup> be reflected for  
6 ratemaking purposes in this case. As shown on Schedule RJH-27, the resulting Call Center  
7 expense is \$8,843,089 which I then rounded up to arrive at the recommended expense level  
8 of \$8,850,000.

9

10 - **Central Services Expense**

11

12 **Q. WHAT REPRESENTS THE RECOMMENDED ADJUSTMENT TO THE**  
13 **COMPANY'S PROPOSED CENTRAL SERVICES EXPENSES SHOWN ON**  
14 **SCHEDULE RJH-16, LINE 17.**

15 A. The recommended adjustment of \$294,411 represents the removal of Business  
16 Development expenses included in the total Central Services charges allocated to NJAWC.

17

18 **Q. PLEASE EXPLAIN WHY YOU RECOMMEND THIS ADJUSTMENT.**

19 A. As shown in SIR-18, NJAWC has employees on staff who, presumably, are dedicated to  
20 business development specific to NJAWC and the Company's service territory. SIR-18  
21 indicates that the annual payroll costs associated with NJAWC's Business Development  
22 department amounts to approximately \$471,000. Adding an estimated additional

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<sup>23</sup> It should be noted that this approach is conservative because a portion of the total Call Center expense consists of non-labor charges.

*Henkes Direct Testimony*  
*New Jersey American Water Company – BPU Docket No. WR11070460*

1       \$264,000<sup>24</sup> for labor overhead expenses means that NJWC charges its ratepayers  
2       approximately \$735,000 in annual payroll and related labor benefit expenses for these  
3       business development activities. On top of this, the ratepayers are also being requested to  
4       fund additional business development expenses amounting to almost \$300,000 that are  
5       allocated to NJAWC from the Central Services division of American Water. Thus, in total  
6       the NJAWC ratepayers are being requested to pay in excess of \$1 million for business  
7       development activities. While I have taken no exception to the rate inclusion of the  
8       “direct” NJAWC business development expenses, I recommend that the additional business  
9       development expenses of \$294,411 allocated from Central Services be disallowed for  
10      ratemaking purposes in this case. I do not believe that American Water Works Services  
11      Company’s (AWWSC) business development costs that are simply allocated to NJAWC  
12      based on a formula allocation factor should be funded by NJAWC ratepayers. There is no  
13      quantitative information in the record of this case showing the direct dollar benefit received  
14      by the NJAWC ratepayers from business development activities performed by the Central  
15      Services division. In addition, given that NJAWC already spends almost three quarters of a  
16      million dollars on business development, it leaves one to wonder to what extent the  
17      additional business development charges allocated from Central Services are truly  
18      necessary or of value for the provision of safe, adequate and proper water and sewer  
19      services. In fact, this is confirmed in the recently completed management audit report<sup>25</sup>  
20      which, on page IV-9 concludes that:

21               The potential for cross-subsidization is significant because allocated charges  
22               represent over 90 percent of charges from AWWSC. For the portfolio of

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<sup>24</sup> Per response to RCR-A-143: labor benefit percentage of 56.13% x \$471,000 = \$264,372.

<sup>25</sup> *Comprehensive Management Audit of New Jersey American Water Company, Final Audit Report dated December 20, 2010 by NorthStar Consulting Group.*

1 allocated charges from AWWSC, approximately 90 percent are charged to  
2 regulated entities of which NJAW is a prominent member while approximately  
3 ten percent are charged to unregulated entities. For example, the New Jersey  
4 ratepayer receives questionable value from AWK business development  
5 activities but is charged for these activities on a regular monthly basis.  
6 (emphasis supplied)  
7  
8  
9

10 - **ITS Services Expense**

11  
12 **Q. PLEASE EXPLAIN THE RECOMMENDED ADJUSTMENTS TO THE**  
13 **COMPANY'S ITS SERVICES EXPENSES SHOWN ON SCHEDULE RJH-28.**

14 A. I recommend that three adjustments be made to the Company's proposed ITS Services  
15 expenses. First, I recommend that the Company's proposed allocation factor to allocate  
16 ITS Services Company expenses to NJAWC be reduced from 19.36% to 18.39%. This is  
17 shown on Schedule RJH-28, lines 3b, 4b, 5b and 6b. Second, I recommend that the  
18 Company's proposed ITS Services AWC Maintenance expenses be reduced from  
19 \$3,449,000 to \$2,862,823, as shown on Schedule RJH-28, line 4a. Finally, I recommend  
20 that the Company's proposed ITS Services AWC ERP Software Support expense be  
21 reduced from \$4,816,400 to \$476,000, as shown on Schedule RJH-28, line 6a. In total, my  
22 three recommended adjustments reduce NJAWC's allocated ITS Services expenses by  
23 \$1,068,418, as shown on Schedule RJH-28, line 7.  
24

25 **Q. PLEASE EXPLAIN THE FIRST RECOMMENDED ITS SERVICES EXPENSE**  
26 **ADJUSTMENT.**

1 A. In this case, the Company has used a proposed ratio of 19.36% to allocate the ITS Services  
2 expenses to NJAWC. The allocation factor is based on the ratio of NJAWC’s number of  
3 customer as of 12/31/2010 to the total number of customers of all of American Water’s  
4 regulated subsidiaries. In reality, however, the ITS Service expenses are not being  
5 allocated to NJAWC and the other AWC affiliates based on the number of customers.  
6 Rather, in response to RCR-A-270, in which the Company was asked to provide the actual  
7 ITS Service expense allocation factors for NJAWC in 2008 through 10/31/2011, as well as  
8 the bases for these actual allocation factors, the response was as follows:

9           The 2008 ratio was 17.89%. The 2009 ratio was 18.38%. The 12 month  
10 period ended 10/31/11 ratio was 18.57%. Regarding the criteria used – the  
11 allocation ratio is derived from all formulas used by Service Company ITS  
12 staff during the year for labor hours and expenses. A variety of formulas  
13 would have been used during this period, including direct charging and  
14 customer based allocation formulas (of which NJ would have received  
15 19.3%). The sheer number of transactions during these period, makes it  
16 administratively prohibitive to list the calculation of each and every  
17 transaction.  
18  
19

20 Based on this information, I recommend that the ITS Service expense allocation factor for  
21 NJAWC be based on the average of the actual allocation ratios experienced in the most  
22 recent three-year period 2009 through 2011. As shown under footnote (2) in Schedule  
23 RJH-28, this average ratio amounts to 18.39%.  
24

25 **Q. PLEASE EXPLAIN THE SECOND RECOMMENDED ITS SERVICES EXPENSE**  
26 **ADJUSTMENT.**

27 A. The Company has proposed to reflect a projected expense amount of \$3,449,000 for AWC  
28 ITS-related maintenance expenses. In response to RCR-A-272(a)(5), the Company

1       conceded that this originally projected expense amount of \$3,449,000 should be reduced to  
2       \$2,862,823 as a result of the required removal of certain “out-of-period” expense  
3       components that do not fall within the period for known and measurable changes. I have  
4       reflected this required expense correction on Schedule RJH-28, line 4a.

5  
6       **Q. PLEASE EXPLAIN THE FINAL RECOMMENDED ITS SERVICES EXPENSE**  
7       **ADJUSTMENT.**

8       A. While not reflected in its original filing, in the 9+3 update filing, the Company introduced  
9       an additional ITS Services expense of \$4,816,400 for projected ERP – Software Support  
10       Costs. This newly projected expense of \$4,816,400 consists of \$476,000 for projected SAP  
11       Post Go Live expenses and \$4,340,400 for projected Application Development and  
12       Configuration Management and Desk Help expenses.<sup>26</sup> As confirmed in its response to  
13       RCR-A-273, a contract has apparently been signed recently with SAP Max Attention with  
14       regard to the projected \$476,000 expenses for the SAP Post Go Live project. However,  
15       there appears to be no contract in place at this time regarding the projected \$4,340,000 for  
16       the Application Development and Configuration Management and Desk Help project. As  
17       indicated in the response to RCR-A-273, the projected \$4,340,000 expense amount is  
18       purely based on an estimate of “various types (e.g. configuration changes, enhancements,  
19       break-fix repairs, support, and development) and levels (speed of turnaround time of  
20       requests) of support that would be required.” Based on this information, I have concluded  
21       that this projected expense amount -- for which there is no underlying contract at this time  
22       and for which there is no information available as to what extent this expense will fall

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<sup>26</sup> See SIR-33, Revised – 11/11/2011.

1 within the period for known and measurable changes – cannot be considered an appropriate  
2 known and measurable expense deserving rate recognition in this case. I therefore  
3 recommend that this proposed projected expense be rejected for ratemaking purposes.

4  
5 - **Laboratory Services Expense**

6  
7 **Q. PLEASE EXPLAIN THE RECOMMENDED ADJUSTMENTS TO THE**  
8 **COMPANY’S PROPOSED LABORATORY SERVICE EXPENSES SHOWN ON**  
9 **SCHEDULE RJH-29.**

10 A. In the 9+3 update filing, NJAWC revised its originally proposed allocated Laboratory  
11 Services expenses of \$997,958 to the higher allocated expense level of \$1,431,455. The  
12 9+3 SIR-34 workpaper shows that the reason for this large increase is that the total pro  
13 forma Belleville Lab expenses of \$5,011,041, which in the original filing were allocated to  
14 NJAWC based on an allocation factor of 19.23%, are allocated to NJAWC in the 9+3  
15 update based on a new so-called Direct Charge allocation method that produced an  
16 allocation factor of 27.58%. For reasons described on page 9 of the supplemental  
17 testimony of Frank Simpson, the Company believes that the new, Direct Charge allocation  
18 method for Lab charges to NJAWC is preferable over the original allocation method. The  
19 Company’s proposed new Direct Charge allocation factor of 27.58% is based on the  
20 average Direct Charge allocation factors for 2009 and 2010 Lab activities. While I have  
21 accepted the use of the new Direct Charge allocation method, I recommend the use of the  
22 actual Direct Charge allocation factor of 22.54% for the more recent 12-month period  
23 ended October 31, 2011. Thus, as shown on Schedule RJH-29, lines 1-3, the use of the

1 recommended allocation factor of 22.54% versus the Company’s proposed allocation factor  
2 of 27.58% reduces NJAWC’s proposed allocated Laboratory Services expenses by  
3 \$252,716.

4  
5 **Q. HAVE YOU MADE ANOTHER ADJUSTMENT TO THE COMPANY’S**  
6 **PROPOSED ALLOCATED LABORATORY SERVICES EXPENSES?**

7 A. Yes. As shown on P-2, Schedule 27, the Company has claimed a total 9+3 Laboratory  
8 Services expense amount of \$1,431,455. Yet, the 9+3 SIR-34 workpaper in support of this  
9 claim shows a total NJAWC allocated Laboratory Services expense amount of \$1,382,205.  
10 This leaves an unexplained expense amount of \$49,250. Until the Company can explain  
11 what this additional expense amount represents, I have eliminated it from the test year  
12 expense.

13  
14 In summary, the two previously described recommended adjustments reduce the  
15 Company’s proposed Laboratory Services expenses by a total amount of \$301,966, as  
16 shown on Schedule RJH-29, line 5.

17  
18 **Q. DO YOU HAVE ANY FURTHER COMMENTS REGARDING SERVICE**  
19 **COMPANY CHARGES?**

20 A. Yes. I note that 96.7% of actual 2010 Service Company charges to NJAWC were allocated  
21 charges rather than direct charges.<sup>27</sup> As NJAWC acknowledges on p. 9 of Mr. Simpson’s  
22 supplemental testimony, direct charging is the preferred method of billing for services as

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<sup>27</sup> RCR-AFF-10.



1 set forth in the Service Company agreement. NJAWC’s level of allocated charges, at  
2 almost 97%, is much too high. Rate Counsel believes the Company should work to reduce  
3 this number, and would like to see a downward trend in allocated charges in future rate  
4 cases.

5  
6  
7 **- Regional Services Expense**

8  
9 **Q. PLEASE COMPARE THE REGIONAL SERVICES EXPENSES PROJECTED BY**  
10 **NJAWC IN ITS PRIOR 2010 RATE CASE TO THE ACTUAL EQUIVALENT**  
11 **REGIONAL SERVICES EXPENSES BOOKED BY NJAWC IN 2011.**

12 A. In the prior rate case, the Company projected its pro forma Regional Service expenses to be  
13 \$771,310. By contrast, the Company’s actual equivalent Regional Services expenses  
14 booked for 2011 (the first rate effective year of the prior rate case) amount to \$390,897, or  
15 approximately 51% lower than the Company’s projection in the prior case.

16  
17 **Q. WHAT PROJECTED REGIONAL SERVICES EXPENSES HAS THE COMPANY**  
18 **REFLECTED IN THE CURRENT CASE 9+3 UPDATE FILING OF NOVEMBER**  
19 **11, 2011?**

20 A. The Company’s 9+3 update filing in the current case reflects projected 2012 Regional  
21 Services expenses of \$639,765. Again, this projected regional services expense amount is  
22 substantially higher than the equivalent actual 2011 expense of \$390,897.

23

1 **Q. WHAT IS YOUR RECOMMENDATION BASED ON THE AFOREMENTIONED**  
2 **FACTS?**

3 A. Since history has shown that the Company's Regional Services expense projections are  
4 unreliable, I recommend that the most recent available actual 2011 expense of \$390,897,  
5 increased by the Company's proposed April 2012 wage increase of 3.5%<sup>28</sup> be reflected for  
6 ratemaking purposes in this case. As shown on Schedule RJH-30, the resulting Regional  
7 Services expense is \$404,578 which I then rounded up to arrive at the recommended  
8 expense level of \$405,000.

9

10 **- Shared Service Center Expense**

11

12 **Q. PLEASE COMPARE THE SHARED SERVICE CENTER EXPENSES**  
13 **PROJECTED BY NJAWC IN ITS PRIOR 2010 RATE CASE TO THE ACTUAL**  
14 **EQUIVALENT SHARED SERVICE CENTER EXPENSES BOOKED BY NJAWC**  
15 **IN 2011.**

16 A. In the prior rate case, the Company projected its pro forma Shared Service Center expenses  
17 to be \$2,975,887. By contrast, the Company's actual equivalent Shared Service Center  
18 expenses booked for 2011 (the first rate effective year of the prior rate case) amount to  
19 \$2,512,433, or approximately 16% lower than the Company's projection in the prior case.

20

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<sup>28</sup> It should be noted that this approach is conservative because a portion of the total Regional Services expenses consists of non-labor charges.

1 **Q. WHAT PROJECTED REGIONAL SERVICES EXPENSES HAS THE COMPANY**  
2 **REFLECTED IN THE CURRENT CASE 9+3 UPDATE FILING OF NOVEMBER**  
3 **11, 2011?**

4 A. The Company's 9+3 update filing in the current case reflects projected 2012 Regional  
5 Services expenses of \$3,017,306. Again, this projected Shared Service Center amount is  
6 substantially higher than the equivalent actual 2011 expense of \$2,512,433.

7  
8 **Q. WHAT IS YOUR RECOMMENDATION BASED ON THE AFOREMENTIONED**  
9 **FACTS?**

10 A. Since history has shown that the Company's Regional Shared Service Center expense  
11 projections are unreliable, I recommend that the most recent available actual 2011 expense  
12 of \$2,512,433, increased by the Company's proposed April 2012 wage increase of 3.5%<sup>29</sup>  
13 be reflected for ratemaking purposes in this case. As shown on Schedule RJH-31, the  
14 resulting Shared Service Center expense is a rounded amount of \$2.6 million.

15

16 - **Uncollectible Expense**

17

18 **Q. PLEASE EXPLAIN THE DERIVATION OF YOUR RECOMMENDED**  
19 **UNCOLLECTIBLE EXPENSES THAT ARE SHOWN ON SCHEDULE RJH-16,**  
20 **LINE 31.**

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<sup>29</sup> It should be noted that this approach is conservative because a portion of the total Regional Services expenses consists of non-labor charges.

1 A. My recommended uncollectible expenses for NJAWC were calculated by applying the  
2 updated and corrected uncollectible ratio of .53% (see response to RCR-A-231a) to the  
3 recommended operating revenues on Schedule RJH-8, line 1.

4

5 - **Audit Fees**

6

7 **Q. PLEASE EXPLAIN THE RECOMMENDED ADJUSTMENT TO THE**  
8 **COMPANY'S PROPOSED AUDIT FEES SHOWN ON SCHEDULE RJH-32.**

9 A. I recommend that one adjustment be made to the Company's proposed pro forma  
10 PricewaterhouseCoopers (PWC) audit fees. Specifically, I have removed the Company's  
11 proposed inflationary increase shown on Schedule RJH-32, line 6. The Company has  
12 assumed that the PWC audit fees of \$2.97 million currently in effect will experience an  
13 inflationary increase in the year 2012. This does not represent a known and measurable  
14 event. In fact, the PWC audit fees charged to American Water have been decreasing during  
15 the last two years from \$3.6 million in 2010 to \$2.97 million currently.

16

17 - **Property Sales**

18

19 **Q. PLEASE DESCRIBE THE COMPANY'S PROPOSED POSITION IN THIS CASE**  
20 **REGARDING PROPERTY SALES.**

21 A. As shown on P-2, Schedule 41 and the SIR workpaper supporting this schedule, in  
22 accordance with Board ratemaking policy, the Company has proposed to share with the

1           ratepayers 50% of the pre-tax gains on the sales of various properties that occurred in 2011.  
2           This is reflected as an expense credit of \$59,963.

3

4   **Q. DO YOU AGREE WITH THIS PROPOSED EXPENSE CREDIT?**

5   A. Yes, I do.

6

7   **Q. HAS THE COMPANY MADE ANOTHER ADJUSTMENT IN THIS CASE WITH**  
8   **REGARD TO AN EXPENSE CREDIT FOR PROPERTY SALES IN PRIOR**  
9   **YEARS?**

10 A. Yes. The Company's proposed test year also includes (as expense credits) the \$182,168  
11 amortization of property sales gains that were approved by the Board in NJAWC's prior  
12 2008 base rate case. As this property sales gain amortization expired in the 2010 base year,  
13 the Company has removed this expense credit from the pro forma test year results. This  
14 adjustment, which increases the pro forma test year expenses by \$182,168, is shown on P-  
15 2, Schedule 46, line 24(e).

16

17 **Q. DO YOU ALSO AGREE WITH THIS PROPOSED ADJUSTMENT?**

18 A. Yes, I do.

19

20 **Q. IS THERE ANOTHER ISSUE WITH REGARD TO GAINS ON PROPERTY**  
21 **SALES THAT THE COMPANY HAS NOT ADDRESSED OR REFLECTED IN**  
22 **THIS CASE?**

1 A. Yes. As shown in the Amortization Table in paragraph 7 of NJAWC’s prior (2010) case  
2 Stipulation, the Company is required to book as an expense credit an annual amortization  
3 of \$81,305 from 1/1/11 through 12/31/12 for gains on the sale of property identified in the  
4 2010 rate case. This gain amortization is not reflected in the 2010 base year. While the  
5 Company has proposed to increase its pro forma test year expenses by \$182,168 to reflect  
6 the 2010 expiration of the amortization of the gains on property sales established in the  
7 2008 rate case, the Company has not similarly reflected a pro forma test year expense  
8 credit of \$81,305 to reflect the ongoing amortization of the gains on property sales  
9 approved by the Board in the 2010 rate case that will continue to be in effect through the  
10 end of 2012. This is inconsistent and inappropriate.

11  
12 **Q. IS THERE ANOTHER GLARING INCONSISTENCY WITH REGARD TO THE**  
13 **COMPANY’S POSITION TO NOT RECOGNIZE THIS EXPENSE CREDIT FOR**  
14 **RATEMAKING PURPOSES IN THIS CASE?**

15 A. Yes. The Company is not reflecting this gain on property sales amortization of \$81,305  
16 because this item will expire on December 31, 2012. Yet, at the same time, the Company  
17 has reflected an expense of \$126,963 for its OPEB Stub Period amortization and another  
18 expense of \$740,457 for its OPEB Regulatory Asset amortization, both of which expense  
19 amortizations will expire one month later in January 2013.<sup>30</sup> This clearly shows that the  
20 Company wants its cake and eat it too.

21

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<sup>30</sup> See Schedule RJH-20, lines 4 and 9 as well as the response to RCR-A-127(g)(h).

1 **Q. WHAT IS YOUR RECOMMENDED POSITION ON THESE THREE**  
2 **AMORTIZATION ITEMS?**

3 **A.** My position on these matters is that you either remove or reflect each of these amortization  
4 items for ratemaking purpose. I have chosen to reflect all three of these amortization items  
5 in the case. Specifically, as described earlier in this testimony regarding the subject of  
6 OPEB expenses, I have recommended that the two OPEB related amortization expenses be  
7 amortized over a 2-year period, consistent with what NJAWC and Rate Counsel have  
8 reflected for the rate case expenses in this case. I am making the same recommendation for  
9 the \$81,305 gain on property sales amortization. In other words, I recommend that one-  
10 half of the annual gain on property sales amortization, or \$40,653, be reflected for  
11 ratemaking purposes in this case.

12

13 **Q. WHERE HAVE YOU REFLECTED THESE RECOMMENDATIONS?**

14 **A.** My recommendation with regard to the gain on property sales expense credit of \$40,653 is  
15 shown on Schedule RJH-16, line 33. My recommendations with regard to the OPEB Stub  
16 Period amortization and the OPEB Regulatory Asset amortization is shown on Schedule  
17 RJH-20, lines 4 and 9.

18

19 - **Management Audit Expense**

20

21 **Q. WHAT IS THE COMPANY'S POSITION WITH REGARD TO THE EXPENSES**  
22 **INCURRED FOR THE MANAGEMENT AUDIT THAT WAS COMPLETED IN**  
23 **DECEMBER 2010?**

1 A. The total expenses for this management audit amount to \$1,177,035. The Company is  
2 proposing to amortize this expense over a 5-year period for an annual amortization amount  
3 of \$235,407.

4

5 **Q. WAS THE COMPANY ALLOWED TO RECOVER A MONTHLY**  
6 **AMORTIZATION AMOUNT OF \$25,000 IN THE PRIOR 2010 RATE CASE?**

7 A. Yes. As shown in the Amortization Table in paragraph 7 of NJAWC's prior (2010) case  
8 Stipulation, the Company was allowed to recover in rates a monthly amortization amount  
9 of \$25,000 (\$300,000 annual amortization) for this same management audit. This monthly  
10 rate recovery of \$25,000 became effective on 1/1/2011. Therefore, by 1/31/12, the end of  
11 the test year in this case, the Company will have already recovered in its current rates a  
12 total amount of \$325,000.<sup>31</sup>

13

14 **Q. WHAT IS YOUR RECOMMENDATION BASED ON THE AFOREMENTIONED**  
15 **FACTS?**

16 A. The aforementioned facts indicate that the unamortized management audit balance that will  
17 not have been recovered in rates at the end of the test year amounts to \$1,177,035 -  
18 \$325,000, or \$852,035. Using the same 5-year amortization period as proposed by  
19 NJAWC results in an annual amortization expense of \$170,407. I recommend that this  
20 annual amortization amount be reflected for ratemaking purposes in this case. My  
21 recommendation is summarized on Schedule RJH-16, line 34 and shown in more detail on  
22 Schedule RJH-33.

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<sup>31</sup> Calculation: \$25,000 x 13 months (from 1/1/11 – 1/31/12) = \$325,000.



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- **Lobbying and Promotional Expense Removal**

**Q. HAVE YOU IDENTIFIED CERTAIN EXPENSES ASSOCIATED WITH LOBBYING AND PROMOTIONAL/INSTITUTIONAL ACTIVITIES THAT ARE INCLUDED IN THE COMPANY’S PROPOSED 9+3 PRO FORMA TEST YEAR OPERATING EXPENSES?**

A. Yes. Based my review of the Attachments to the response to RCR-A-140, I have concluded that an estimated 80% of the expenses incurred by employees in the Government Affairs Department are associated with lobbying, promotional and institutional activities.

**Q HOW DID YOU COME TO THIS CONCLUSION?**

A. Attachment 1 to RCR-A-140 shows that the highest level employee in the Government Affairs Department, who is required to be certified as a registered lobbyist,<sup>32</sup> spends the following percentages of time on the following extract of activities:

**35% of time**

“Proactively meets with state and local government officials on a regular basis to create strong relationships, mitigate emerging or potential problems, and establish a level of trust between American Water, mayors and other appointed and elected officials.”

“Is poised as the lead state lobbyist for the company charged with helping to change or support key legislation on water, wastewater or utility/business issues that may have an adverse or positive affect on the company.”

“Manages local contract lobbyists and maximizes effectiveness. Holds regular meetings with the contract lobbyists to ensure that they are kept abreast of services needed and that they understand that they are not just “bill trackers”, but rather are additional eyes and ears for the company...”

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<sup>32</sup> See RCR-A-140 Attachment 1, page 5.

1  
2 “Establishes and maintains an effective bill tracking program .... Builds effective  
3 alliances and coalitions to advance the company’s position on legislative initiatives.”

4  
5 “Helps identify business development opportunities through established relationships  
6 and through relationships that the company’s contract lobbyist and other employees  
7 may have.”

8  
9 **30% of time**

10 “Represents the company at mayoral, municipal and regulatory trade show events” ...

11  
12 “...sustain key relationships with community leaders, government and regulatory  
13 authorities, as well as elected and appointed officials...”

14  
15 **15% of time**

16 “Implements and manages timely processes to track all pertinent legislation that has the  
17 potential to impact the company and/or its state and local operations. Coordinates with  
18 various functional colleagues to determine types of legislation/regulation that would  
19 facilitate our business agenda and collaborates with key stakeholders to drive  
20 promulgation of such legislation/regulation.”

21  
22 “Implements and directs lobbying activities on behalf of the company. Prepares and  
23 manages the development of legislative testimony. Testifies on behalf of the company  
24 and /or prepares the state president or other members of the state senior management  
25 team to provide legislative testimony, as appropriate.”

26  
27 “Creates and manages a state-focuses PAC and ensures all Election Law Enforcement  
28 rules, regulations and other reporting requirements are met. Ensures the senior  
29 management team is aware of PAC-related opportunities to derive maximum benefit  
30 from PAC-related expenditures.”

31  
32 **10% of time**

33 “Is active and visible at various state and national conferences to ensure American  
34 Water is properly and effectively positioned. Represents the company at key business  
35 organization functions, political fundraisers, etc. and ensures senior management is  
36 poised to participate.

37  
38 While the above described activities add to 90%, I have conservatively reduced this to my  
39 conclusion that approximately 80% of this top Government Affairs Department employee’s  
40 time is related to lobbying, promotional and institutional activities.

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RCR-A-140 Attachment 3, page 1 indicates that the primary function of the second highest employee of NJAWC’s Government Affairs Department, i.e., the Manager Governmental and Regulatory affairs, is to:

Improve business climate for the Company through positive interactions with legislators and regulators and external opinion formers. Influence at state level to promote initiatives that support Company and other stakeholder goals and objectives.

Among the Key Accountabilities of this employee are:

To shape and influence legislative programs and other critical business issues in alignment with Company goals and objectives.

Establish constructive relationships with elected and appointed officials on a federal, state and local level and invest considerable time and energy in prioritized networking activity.

In summary, since I believe that these lobbying, and promotional/institutional related expenses should be funded by the Company’s stockholders rather than by the captive ratepayers, I recommend that 80% of the annual salaries and employee benefits of the Company’s Government Affairs Department be treated below-the-line for ratemaking purposes in this case. As I have calculated on Schedule RJH-34, footnote (2), this recommendation reduces the Company’s pro forma 9+3 O&M expenses by \$204,844.

1 **Q. HAVE YOU MADE ANOTHER ADJUSTMENT TO REMOVE LOBBYING**  
2 **EXPENSES THAT ARE STILL INCLUDED IN THE COMPANY’S 9+3 TEST**  
3 **YEAR OPERATING EXPENSES?**

4 A. Yes. The unadjusted base year expenses include \$140,000 for expenses paid by NJAWC to  
5 the New Jersey lobbying firm Salmon Ventures. For pro forma purposes, NJAWC has  
6 removed \$110,000 of these expenses, thereby leaving \$30,000 worth of Salmon Ventures  
7 expenses in the pro forma adjusted 9+3 test year.<sup>33</sup> The Company claims that this \$30,000  
8 expense represent “consulting fees” rather than “lobbying fees.” There is nothing in the  
9 record of this case showing what the specific activities are underlying the specific amount  
10 of \$30,000. Until the Company can prove through convincing evidence and actual source  
11 documentation that the specific Salmon Ventures expense of \$30,000 is a legitimate  
12 business expense properly chargeable to the ratepayers, I recommend that these expenses  
13 be treated below-the-line for ratemaking purposes in this case. My recommendation is  
14 shown on Schedule RJH-34, line 1.

15  
16  
17

- **Other O&M Expense**

18

19 **Q. PLEASE DESCRIBE THE OTHER O&M EXPENSE ADJUSTMENTS SHOWN ON**  
20 **SCHEDULE RJH-35.**

21 A. The expense adjustment shown on line 2 of Schedule RJH-35 represents a required  
22 correction to the Pottersville Credit to O&M expenses that was pointed out by NJAWC in

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<sup>33</sup> See response to RCR-A-235.

1 its response to RCR-A-227. This correction increases the Company’s proposed 9+3 test  
2 year Other O&M expenses by \$59,285.

3  
4 The expense adjustment on line 3 represents my adoption of Mr. Woods’ recommendation  
5 that NJAWC’s proposed projected Public Education expenses of \$1.1 million be  
6 disallowed for ratemaking purposes in this case.

7  
8 The expense adjustment on line 4 concerns my recommended adjustment to the Company’s  
9 proposed normalized outside legal expenses in this case. In determining its proposed  
10 normalized outside legal expenses, NJAWC used the actual 2010 outside legal expenses of  
11 \$525,759<sup>34</sup> and then added a projected additional legal expense of \$315,000 associated  
12 with certain ongoing litigation costs involving Woodland Park, MCMUA and D&D. Thus,  
13 the Company’s total proposed normalized test year outside legal expense amount is  
14 \$840,759. I believe the Company’s proposed approach to determine its pro forma  
15 normalized outside legal expenses is inappropriate and could result in unreasonably high  
16 outside legal expenses. Historically, the Company has used outside counsel for numerous  
17 litigation and other legal proceedings. None of these specific legal cases will last forever.  
18 Rather, all of them will be completed at some point and then other, new legal matters will  
19 take their place, as can clearly be seen in RCR-165 Attachment. It would therefore be  
20 wrong to assume that all of the legal matters and associated legal expenses in the 2010 base  
21 year will be recurring forever and then add the expenses of new legal matters, rather than  
22 assuming that the new legal expenses will simply replace base year legal expenses that will

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<sup>34</sup> This actual legal expense excludes actual legal expenses incurred for the aborted Trenton acquisition.

1 expire. Thus, a more reasonable and appropriate way of projecting the Company's  
2 normalized outside legal expense in the near future would be to consider the average  
3 outside legal expenses incurred by NJAWC during a recent historic period. On Schedule  
4 RJH-35A, I show that the Company's average outside legal expenses during the 5-year  
5 period 2007 – 2011 amounts to \$491,729. Since this average includes the rather low  
6 expense level in 2007, I believe it more reasonable to consider the average outside legal  
7 expenses for the most recent 3-year period 2009 – 2011. This recommended normalized  
8 outside legal expense level amounts to \$549,175 and is \$23,416 higher than the 2010 base  
9 year expense of \$525,759. In summary, while NJAWC has proposed to increase its 2010  
10 base year outside legal expenses by \$315,000, I recommend that the 2010 base year outside  
11 legal expenses be increased by \$23,416.

12  
13 The expense adjustment shown on line 5 represents my recommendation that all temporary  
14 employment agency expenses be disallowed for ratemaking purposes in this case. The  
15 2010 base year includes total temporary employment agency expenses of \$287,062. While  
16 the Company has proposed to remove \$168,153 of this total expense for ratemaking  
17 purposes, I recommend that the remaining temporary employment agency expense balance  
18 of \$118,909 similarly be excluded for ratemaking purposes. In its prior base rate case, the  
19 Company agreed with Rate Counsel in its response to RCR-A-149(c), that all temporary  
20 employment agency expenses should be withdrawn from the case if the full complement of  
21 employees requested by the Company in that case were allowed for ratemaking purposes.  
22 Since I have not made any adjustments to the Company's proposed projected number of

1 employees in this case, I recommend the removal of all temporary employment agency  
2 expenses from the Other O&M expenses.

3  
4 The Other O&M expense adjustment on line 6 represents my adjustment to the Company's  
5 proposed normalization adjustments for a variety of Other O&M expenses. As shown on  
6 Schedule RJH-35B, the Company's proposed normalized expense amount for these Other  
7 O&M expenses was determined by first taking the actual Other O&M expenses for the 12-  
8 month period ended 9/30/11, than adding a general inflation factor of 3.9%, and finally  
9 removing a small expense associated with the Voorhees Office. I recommend that the  
10 expense impact of the 3.9% inflation adjustment be rejected by the Board. This blanket  
11 inflation adjustment is not known and measurable at this time and the Company has  
12 provided no information showing why it would be appropriate to assume that the specific  
13 expenses included in this Other O&M expense category would increase by the specific  
14 factor of 3.9%. I also believe that the Board has a ratemaking policy of not allowing a  
15 blanket overall inflation factor for ratemaking purposes. As shown on Schedules RJH-34,  
16 line 6 and RJH-35B, my recommendation reduces the Company's proposed other O&M  
17 expenses by \$778,410.

18  
19 The expense adjustment on line 7 concerns the removal of an "out-of-period" expense.  
20 Specifically, NJAWC has included in its 9+3 pro forma test year an expense amount of  
21 \$318,043 for post-in service BT Maintenance Direct Charges. As shown in the response to  
22 RCR-A-281, \$124,995 of this total expense of \$318,043 is not scheduled to occur until  
23 February 2013. Since this concerns an expense adjustment that is not expected to occur

1       until 13 months after the end of the 1/31/2012 test year, it would be in violation of the  
2       Board’s post-test year ratemaking policy established in *In Re Elizabethtown Water Co.*,  
3       BPU Docket No. WR8504330, Order dated 5/23/85, that post-test year expense  
4       adjustments can only be made for events occurring within a time period extending not more  
5       than 9 months after the end of the test year used in a base rate proceeding.

6  
7       The expense adjustment shown on line 8 represents my recommendation that expenses  
8       associated with corporate sponsorships and donations should be disallowed for ratemaking  
9       purposes. These expenses have nothing to do with the provision of safe, adequate and  
10      reliable water and sewer service. For that reason, they should be removed in accordance  
11      with previously established Board ratemaking policy. The specific sources for this  
12      recommended miscellaneous expense adjustment are referenced in footnote (5) of Schedule  
13      RJH-35. My recommendation reduces the Company’s proposed Other O&M expenses by a  
14      total amount of \$211,080.

15  
16               - **Incremental Sales Expense**

17  
18      **Q. PLEASE EXPLAIN THE RECOMMENDED INCREMENTAL SALES EXPENSE**  
19      **ADJUSTMENT SHOWN ON SCHEDULE RJH-36.**

20      A. This recommended adjustment represents the variable expense increases associated with  
21      the recommended thousand gallons sales increases for SA-1, SA-2, SA-3, Manville, SA-1A  
22      and SA-1B. As shown under footnote (1) of Schedule RJH-36, the recommended variable



1 expense unit rate of \$0.3820 was calculated by dividing NJAWC’s proposed 9+3 power,  
2 chemical and waste disposal costs by the Company’s proposed 9+3 system delivery.

3  
4 - **Depreciation Expense**

5  
6 **Q. PLEASE EXPLAIN THE DERIVATION OF THE RECOMMENDED PRO FORMA**  
7 **DEPRECIATION EXPENSE LEVEL SHOWN ON SCHEDULE RJH-37.**

8 A. The starting point of the recommended pro forma depreciation expense amount is  
9 NJAWC’s proposed 9+3 annualized depreciation expense of \$78,320,126 based on the  
10 projected depreciable plant as of the end of the test year, 1/31/12. I then made two  
11 adjustments to this starting point expense. My first recommended adjustment is to reflect  
12 the \$17,144,967 difference between the 9+3 annualized test year depreciation expense of  
13 \$61,175,159 recommended by Rate Counsel witness Michael Majoros and the Company’s  
14 proposed 9+3 annualized test year depreciation expense of \$78,320,126. My second  
15 recommended adjustment is the addition of the annualized depreciation expense associated  
16 with the recommended post-test year plant additions for the Canoe Brook Treatment Plant  
17 and Business Transformation ERP project. As calculated under footnote (2) of Schedule  
18 RJH-37, the annualized depreciation expense for these two post-test year plant additions  
19 totals \$4,047,759.

20  
21 As shown on Schedule RJH-37, line 4, the resulting total recommended annualized  
22 depreciation expense amounts to \$65,222,918.

1                   - **Property Taxes**

2

3   **Q. PLEASE EXPLAIN YOUR RECOMMENDED ADJUSTMENT TO NJAWC’S**  
4   **PROPOSED PROPERTY TAXES SHOWN ON SCHEDULE RJH-8, LINE 5A.**

5   A. The recommended property tax adjustment reflects a correction to the Company’s proposed  
6   pro forma 9+3 payroll tax amount. In its response to RCR-A-213(c), the Company agrees  
7   that this correction needs to be made.

8

9                   - **Payroll Taxes**

10

11 **Q. PLEASE EXPLAIN YOUR RECOMMENDED ADJUSTMENT TO NJAWC’S**  
12 **PROPOSED PAYROLL TAXES SHOWN ON SCHEDULE RJH-8, LINE 5B.**

13 A. This recommended payroll tax adjustment reflects the payroll tax impact of my  
14 recommended payroll expense adjustment. I have calculated this payroll tax adjustment by  
15 applying the composite payroll tax ratio of approximately 8% to my recommended payroll  
16 operation and maintenance expense adjustment shown on Schedule RJH-16, line 1.

17

18                   - **Gross Receipts and Franchise Taxes**

19

20 **Q. PLEASE EXPLAIN YOUR RECOMMENDED ADJUSTMENT TO NJAWC’S**  
21 **PROPOSED GROSS RECEIPTS AND FRANCHISE TAXES (“GRAFT”) SHOWN**  
22 **ON SCHEDULE RJH-8, LINE 5C.**

1 A. This recommended adjustment reflects the GRAFT impact of my recommended operating  
2 revenue adjustments. I have calculated this GRAFT adjustment by applying the  
3 appropriate GRAFT ratio of 13.75% to the recommended operating revenue adjustment  
4 shown on Schedule RJH-8, line 1.

5

6 - **BPU/RC Assessments**

7

8 **Q. PLEASE EXPLAIN YOUR RECOMMENDED ADJUSTMENT TO NJAWC'S**  
9 **PROPOSED BPU AND RATE COUNSEL ("RC") ASSESSMENTS SHOWN ON**  
10 **SCHEDULE RJH-8, LINE 5D.**

11 A. This recommended adjustment reflects the BPU/RC assessment impact of my  
12 recommended operating revenue adjustments. I have calculated these BPU/RC assessment  
13 adjustments by applying the appropriate assessment ratio of .1827% to the recommended  
14 operating revenue adjustment shown on Schedule RJH-8, line 1.

15

16 - **Income Taxes**

17

18 **Q. ARE THERE ANY ISSUES WITH REGARD TO NJAWC'S PROPOSED PRO**  
19 **FORMA INCOME TAX CALCULATIONS SHOWN ON SCHEDULE RJH-38?**

20 A. No. As shown on the above-referenced schedule, I have used the same calculation method  
21 and calculation components as used by NJAWC to determine the recommended pro forma  
22 income tax amounts for NJAWC in this case. The difference between the recommended  
23 pro forma income taxes and NJAWC's proposed pro forma income taxes is merely caused

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1           by the “flow-through” effect of the recommended adjustments made by me to NJAWC’s  
2           proposed pre-tax operating income and pro forma interest deduction.

3

4

5   **Q.   MR. HENKES, DOES THIS COMPLETE YOUR TESTIMONY?**

6   A.   Yes, it does.