BEFORE THE
STATE OF NEW JERSEY
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 RATES AND CHARGES FOR WATER AND SEWER SERVICE; CHANGE IN DEPRECIATION RATES; AND OTHER TARIFF MODIFICATIONS	**BPU Docket No. WR11070460** **OAL Docket No. PUC09799-2011N**

DIRECT TESTIMONY OF

ANDREA C. CRANE

ON BEHALF OF THE
NEW JERSEY
DIVISION OF RATE COUNSEL

*****REDACTED VERSION*****

STEFANIE A. BRAND, ESQ.
DIRECTOR, DIVISION OF RATE COUNSEL

DIVISION OF RATE COUNSEL
31 CLINTON STREET, 11th FLOOR
P.O. BOX 46005
NEWARK, NEW JERSEY 07101

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I. STATEMENT OF QUALIFICATIONS

Q. Please state your name and business address.

A. My name is Andrea C. Crane and my business address is 90 Grove Street, Suite 211, Ridgefield, Connecticut 06877. (Mailing address: PO Box 810, Georgetown, Connecticut 06829)

Q. By whom are you employed and in what capacity?

A. I am President of The Columbia Group, Inc., a financial consulting firm that specializes in utility regulation. In this capacity, I analyze rate filings, prepare expert testimony, and undertake various studies relating to utility rates and regulatory policy. I have held several positions of increasing responsibility since I joined The Columbia Group, Inc. in January 1989. I became President of the firm in 2008.

Q. Please summarize your professional experience in the utility industry.

A. Prior to my association with The Columbia Group, Inc., I held the position of Economic Policy and Analysis Staff Manager for GTE Service Corporation, from December 1987 to January 1989. From June 1982 to September 1987, I was employed by various Bell Atlantic (now Verizon) subsidiaries. While at Bell Atlantic, I held assignments in the Product Management, Treasury, and Regulatory Departments.

Q. Have you previously testified in regulatory proceedings?

A. Yes, since joining The Columbia Group, Inc., I have testified in over 350 regulatory proceedings in the states of Arizona, Arkansas, Connecticut, Delaware, Hawaii, Kansas, Kentucky, Maryland, New Jersey, New Mexico, New York, Oklahoma, Pennsylvania, Rhode Island, South Carolina, Vermont, Washington, West Virginia and the District of Columbia. These proceedings involved water, wastewater, gas, electric, telephone, solid waste, cable television, and navigation utilities. A list of dockets in which I have filed testimony since January 2008 is included in Appendix A.

Q. What is your educational background?

A. I received a Master of Business Administration degree, with a concentration in Finance, from Temple University in Philadelphia, Pennsylvania. My undergraduate degree is a B.A. in Chemistry from Temple University.

II. PURPOSE OF TESTIMONY

Q. What is the purpose of your testimony?

A. On or about July 29, 2011, the New Jersey American Water Company, Inc. ("NJAWC" or "Company") filed a Petition with the New Jersey Board of Public Utilities ("BPU" or "Board") requesting an increase in its rates for water and sewer service. The Company filed for a revenue increase of $95.5 million or approximately 15.5% over pro forma revenues at present rates. On November 11, 2011, the Company filed supplemental testimony which purports to demonstrate a revenue deficiency of $99.3 million.

The Columbia Group, Inc. was engaged by The State of New Jersey, Division of Rate Counsel ("Rate Counsel") to review NJAWC's filing and to provide recommendations to the BPU with regard to the issues of consolidated income taxes and cash working capital.

III. SUMMARY OF CONCLUSIONS

Q. Please summarize your conclusions and recommendations.

A. Based on my analysis of the Company's filing and other documentation in this case, my conclusions and recommendations are as follows:

1. The members of the consolidated income tax group, including NJAWC, benefit from the filing of a consolidated income tax return.
2. The Board should continue to recognize the benefits accruing to the group members as a result of the filing of a consolidated income tax return.
3. The benefits of filing a consolidated income tax return should be appropriately allocated to the member companies.
4. NJAWC's share should be reflected as a consolidated income tax adjustment to its revenue requirement.
5. Based on the methodology previously approved by the Board, the Board should adopt a rate base reduction of $197,578,040 for NJAWC, representing accumulated consolidated income tax savings through December 31, 2010, the most recent period for which actual tax data is available (see Schedule ACC-1).
6. The consolidated income tax adjustment should be updated with 2011 tax

information if such information becomes available during the litigation phase of this case.

7. NJAWC has overstated the cash working capital requirement included in its rate base claim.

8. The Board should make adjustments to the Company's cash working capital claim to eliminate uncollectible costs, depreciation expense, deferred tax expense, and return on equity. In addition, the Board should revise the expense lag days for payments to the Management Service Company, to reflect the lag for NJAWC's internal labor costs. The Board should also make adjustments to include the impact of cash working capital provided by the lag on the payment of interest expense and preferred stock dividends.

9. Based on the Company's update of November 11, 2011, the Company has a cash working capital requirement of $14,500,000 (see Schedule ACC-2, page 1). The actual cash working capital requirement should be updated at the end of this case to reflect the level of costs found reasonable by the Board.

IV. DISCUSSION OF THE ISSUES

A. Consolidated Income Taxes

Q. How did the Company calculate its income tax expense claim in this case?

A. NJAWC calculated its pro forma income tax expense on a "stand-alone" basis. The Company's filing ignores the fact that NJAWC does not file its federal income taxes on a stand-alone basis, but rather files as part of a consolidated income tax group. By filing as part of a consolidated return, NJAWC can take advantage of tax losses experienced by other member companies. The tax loss benefits generated by one group member can be shared by the other consolidated group members, resulting in a reduction in the effective federal income tax rate. These tax savings should be flowed through to the benefit of New Jersey ratepayers. According to the response to RCR-CIT-17, NJAWC has been a member of a consolidated income tax group for at least 20 years. Over this period, the specific members in the consolidated income tax group have varied due to "acquisitions, dispositions, mergers, liquidations, and various other restructuring transactions" as noted on page 4, lines 24-27 of Mr. Warren's testimony.

Q. Why should consolidated income tax benefits be flowed through to NJAWC ratepayers?

A. These tax benefits should be flowed through to ratepayers because these benefits reflect the actual taxes paid. Establishing a revenue requirement based on a stand-alone federal income tax methodology would overstate the Company's expense, result in a windfall to shareholders, and result in rates that are higher than necessary.

Q. Has this issue been addressed previously by the BPU?

A. Yes, the issue of consolidated income tax adjustments has been thoroughly reviewed by both the Board and the New Jersey courts, both of which have found that a consolidated income tax adjustment is appropriate.[1] In its Decision in the 1991 Jersey Central Power and Light Company ("JCP&L") base rate case (BPU Docket No. ER91121820J), dated February 25, 1993, at pages 7-8, the BPU held that:

> The Board believes that it is appropriate to reflect a consolidated tax savings adjustment where, as here, there has been a tax savings as a result of filing a consolidated tax return. Income from utility operations provides the ability to produce tax savings for the entire GPU system because utility income is offset by the annual losses of the other subsidiaries. Therefore, the ratepayers who produce the income that provides the tax benefits should share in those benefits. The Appellate Division has repeatedly affirmed the Board's policy of requiring utility rates to reflect consolidated tax savings and the IRS has acknowledged that consolidated tax adjustments can be made and there are no regulations which prohibit such an adjustment.

In the Board's Final Order, dated July 25, 2003, in the 2002 JCP&L base rate case, Docket No. ER02080506, page 45, it stated:

> As a result of making a consolidated tax filing during the years 1991-1999, GPU, JCP&L's parent company during that time period, as a whole paid less federal income taxes than it would have if each subsidiary filed separately, thus producing a tax

1 I am not an attorney and therefore my comments are limited to the ratemaking implications of these findings. I am not testifying on any underlying legal issues associated with consolidated income tax adjustments.

> savings. The law and Board policy are well-settled that consolidated tax savings are to be shared with customers.

Unregulated subsidiaries are free to manage their activities as they see fit. The reality is that American Water Works Company, Inc. ("AWW"), NJAWC's parent company, has elected to file a consolidated income tax return for its subsidiaries, including NJAWC. Moreover, NJAWC has been a member of a consolidated income tax group since the Board first adopted consolidated income tax adjustments. Apparently the filing of a consolidated tax return still offers advantages to NJAWC and members of the consolidated income tax group. Because AWW has elected to file a consolidated tax return for its member companies, including NJAWC, I believe it is a settled matter that the tax savings should be shared with utility ratepayers.

Q. Does the Company's filing reflect the established BPU policy requiring a rate base deduction for tax savings arising from the utility's participation in a consolidated income tax filing?

A. No, NJAWC has not complied with accepted BPU policy and has instead requested rate recognition for federal income tax expense on a stand-alone basis.

Q. Do you believe the Company has provided any new or compelling reason to justify a change in Board policy on the issue of consolidated tax savings?

A. No, I do not. The Company's position is described in the testimony of James I. Warren. Mr. Warren discusses why he believes consolidated income tax adjustments are inappropriate. I understand that NJAWC would prefer not to share tax benefits with its customers but the Company has not introduced any compelling new argument to support a departure from Board policy.

Q. Is there anything in Mr. Warren's testimony that would distinguish NJAWC from the other utilities for which the BPU has adopted consolidated income tax adjustments?

A. No, there is not. There is nothing in Mr. Warren's testimony to distinguish NJAWC from the other companies for which the BPU has ordered consolidated income tax adjustments. The arguments raised by Mr. Warren in his testimony are not new or unique to NJAWC. Accordingly, Mr. Warren has not justified any change from well-established BPU policy on this issue.

Q. How does AWW determine the actual amount of taxes paid by NJAWC to its parent each year?

A. The payment of taxes is governed by a Tax Sharing Agreement among the members of the consolidated income tax group. Pursuant to the agreement, NJAWC, and other subsidiaries with positive taxable income, pay the amount of their stand-alone tax liability to AWW. The parent company then pays the amount of taxes due by the consolidated group to the IRS. Any excess funds are then allocated by AWW to the members of the consolidated income tax group with tax losses, resulting in a contractual means to have the regulated and profitable subsidiaries subsidize unregulated and unprofitable ventures. These procedures transfer the excess amounts collected from ratepayers for income tax expense from the utility to the affiliates that generated the income tax losses, effectively resulting in a subsidization of the unregulated affiliates by New Jersey ratepayers. In contrast, the consolidated income tax adjustment adopted by the BPU partially compensates ratepayers for this subsidization, by crediting ratepayers with carrying costs on these funds.

The existence of a Tax Sharing Agreement does not negate the validity of a consolidated income tax adjustment. The Tax Sharing Agreement was not approved by the BPU and is nothing more than a contractual means to have the regulated and profitable subsidiaries subsidize unregulated ventures with ratepayer funds. According to the responses to RCR-CIT-14 and RCR-CIT-15, from 1991 to 2010, NJAWC paid almost ***BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL*** of the total taxes that its parent paid to the Internal Revenue Service ("IRS"). However, even more compelling is the fact that from 2002 to 2010 (the last year for which data was provided in these responses), NJAWC paid ***BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL*** to its parent, even though AWW paid <u>no</u> taxes to the IRS over this period. In addition, during this period, AWW collected additional amounts from other companies with positive taxable income that were also reallocated by the parent to subsidiaries with tax losses.

Moreover, given the significant net operating tax loss carry-forwards of AWW, it may be quite some time before any taxes will actually be paid to the IRS. At December 31, 2010, the parent company reported federal net operating tax loss carry-forwards of $1.185 billion and these carry-forwards do not begin to expire until 2024.[2]

Q. How did you quantify your adjustment?

A. There are two principal methods of calculating consolidated income tax adjustments, the operating income method and the rate base method. With the rate base method, a utility's rate base is reduced by the accumulated tax benefits allocated to each entity that has positive taxable income. This method does not directly reduce the income tax expense included in a utility's revenue requirement, but rather provides for the treatment of these accumulated benefits as cost-free capital. This is the method adopted by the BPU.

The second method, the operating income or actual taxes paid method, provides for a direct reduction to pro forma income taxes to reflect the utility's allocable share of tax benefits resulting from tax losses of affiliates.

In RCR-CIT-21, I asked the Company to quantify the consolidated income tax benefit, based on the methodology approved by the Board in its Order in the base rate case proceeding involving Rockland Electric Company, BPU Docket No. ER02100724. It is my understanding that this is the last litigated case where the BPU addressed the methodology to be used for consolidated income tax

2 American Water Works Company 10-K Filing, filed February 28, 2011, page 31. In addition, the Company reported state net operating tax loss carry-forwards of $714.7 million expiring between 2011 and 2030.

adjustments. It is also the method that I used in testimony filed in the most recent base rate proceedings involving Atlantic City Electric Company, Public Service Electric and Gas Company, New Jersey Natural Gas Company, and the New Jersey-American Water Company. Unfortunately, the Company responded that "The Company does not possess such information. It has not prepared, nor attempted to prepare, such a calculation because it has no need for one in the normal course of its business." NJAWC went on to state in that response that it did not find the BPU's order in that case "...sufficiently specific to enable it to replicate whatever the methodology was without significant speculation." However, NJAWC did provide underlying tax data in response to RCR-CIT-11 and I utilized that data to quantify my consolidated income tax adjustment.

Q. How were consolidated income taxes calculated in the referenced proceeding involving Rockland Electric Company?

A. In that proceeding, the BPU ordered that the taxable income or loss for each company be aggregated from 1991 to the most recent data available. For each year, the taxable income or loss for each company that had an aggregated (1991-present) taxable loss was then multiplied by that year's annual federal income tax rate, in order to determine the annual income or loss for the year. Adjustments were then made for any alternative minimum tax ("AMT") payments made by the group. The annual tax loss benefit for those companies that had aggregated net losses was then itself aggregated from 1991 to the present. The resulting aggregated tax benefit, net of AMT, was then allocated among all the companies that had cumulative positive taxable income for the period from 1991-present, based on each entity's share of the aggregated positive taxable income. This is the methodology that I have used to calculate my consolidated income tax adjustment.

Q. What is the result of your adjustment?

A. Based on the rate base methodology that has been adopted by the BPU, I am recommending a rate base reduction of $197,578,040.

Q. Do you have any comment regarding the magnitude of this consolidated income tax adjustment?

A. While this adjustment is quite large, the magnitude is not unexpected, given the cumulative rate base methodology that has been adopted by the BPU and the magnitude of the tax losses incurred by the consolidated group. I note that the consolidated income tax adjustment results in a revenue requirement adjustment of approximately $24.37 million, assuming the cost of capital being recommended by Rate Counsel in this case. This adjustment is less than 36.5% of the total amount of federal income taxes included in NJAWC's revenue requirement. The Company's 9+3 Update includes a federal income tax claim of $66.82 million, even though the consolidated income tax group has not paid any federal income taxes since 2001 and is unlikely to pay any federal income taxes in the foreseeable future.

Q. Please comment on Mr. Warren's contention on page 8 of his testimony that most regulatory jurisdictions do not impose a consolidated income tax adjustment.

A. I agree with Mr. Warren that the majority of state regulatory commissions do not currently impose a CIT. However, in spite of this fact, the New Jersey BPU does impose a consolidated income tax adjustment and has done so for at least twenty years. Moreover, consolidated income tax adjustments are also well-established regulatory policy in the neighboring state of Pennsylvania, where the largest regulated AWW subsidiary is located. In fact, four of the five states that have adopted consolidated income tax adjustments, as mentioned on page 8, line 18 of Mr. Warren's testimony, have AWW operations and in many cases those operations are substantial. If customers in other states are getting the benefit of a consolidated income tax adjustment, there is no reason to deny that benefit to the ratepayers of New Jersey.

Q. Please comment on Mr. Warren's recommendation on page 14, lines 19-20 of his testimony that the Board should reconsider its policy on consolidated tax adjustments.

A. I find it ironic that Mr. Warren is seeking a change in the BPU's long-standing policy in this case, given the fact that the consolidated income tax group has not paid any federal income taxes since 2001 and is not expected to pay any federal income taxes in the foreseeable future. While Mr. Warren argues that a consolidated income tax adjustment should not apply in this case, I believe that the current case is exactly the type of situation where a consolidated tax adjustment is most necessary, i.e., a case where ratepayers are being asked to pay $66.82 million in federal income taxes that in fact will never actually be paid to the IRS.

Q. Please comment on Mr. Warren's contention on page 15 of his testimony that a consolidated income tax adjustment is analogous to having a home mortgage deduction "assigned to some third party who bore no part of the underlying expenditures nor any risk associated with ownership of the property."

A. Mr. Warren is incorrect. In the case of consolidated income tax adjustments, it is not an underlying expense that is being assigned to the regulated entity. Instead, the tax savings enjoyed by the consolidated group, including the regulated entity, is being allocated among the companies with positive taxable income. Mr. Warren ignores the fact that the net operating losses have value only because they can be used to offset positive taxable income of other group members. Thus, it is the positive taxable income of NJAWC, and other consolidated group members, that give the net operating losses their value and result in the consolidated income tax savings. The consolidated income tax adjustment does not attempt to transfer to ratepayers the tax benefit of any unregulated entity; it simply recognizes that the filing of a consolidated tax return results in a collective benefit to all members of the consolidated income tax group, and that a portion of that benefit should be allocated to NJAWC and its ratepayers.

Once the parent company decided that a consolidated income tax return would be filed, all members of the consolidated group became individually responsible for the entire annual tax liability. Therefore, it is entirely reasonable for the Board to recognize that the consolidated group results in a lower effective tax rate for NJAWC.

If, on the other hand, the parent company wanted to retain the independence of each entity for income tax purposes, it should not have elected to file a consolidated income tax return. In that case, each entity would individually retain the benefit of any tax losses. Moreover, in that case, each entity would only be responsible to the IRS for the taxes resulting from its own individual financial results.

Q. Do consolidated income tax adjustments violate the principle of cost responsibility, as alleged at pages 15-20 of Mr. Warren's testimony?

A. No, they do not. Mr. Warren states that such adjustments violate the principle of cost responsibility because they attempt to incorporate transactions that would not otherwise be reflected in the ratemaking process. I disagree. Consolidated tax adjustments do not attempt to impute non-regulated transactions or disallowed utility transactions to a utility's revenue requirement. Such adjustments simply recognize the benefits accruing to each group member as a result of participating in a consolidated return. Moreover, it is abundantly clear from the Board Orders that consolidated income tax adjustments do not distinguish between losses generated by regulated or unregulated entities. The overriding fact is that the net operating losses of members of a consolidated tax group are of little value without the income generated by the positive taxable income of other group members. In the case of NJAWC, that taxable income is provided by ratepayers and it is well accepted that New Jersey ratepayers will share in any benefits generated by a consolidated tax filing. NJAWC's parent company could have chosen to file stand-alone returns, thereby retaining any benefits associated with net operating losses for the companies giving rise to those losses. It chose not to do so. Therefore it is appropriate to continue to calculate the consolidated income tax adjustment in accordance with Board precedent.

There is no benefit to allocate to shareholders that does not arise, at least in part, from ratepayer-supplied utility income. There is no tax benefit without income to offset losses and that income is provided primarily by regulated utility income. Moreover, the methodology adopted in New Jersey, i.e., calculating a rate base offset for the cost-free capital provided by the consolidated income tax filing, means that ratepayers are only benefiting by earning a carrying charge on the excess taxes reflected in rates. Even under the BPU-approved methodology, ratepayers are not compensated for the actual excess of income taxes that they pay in rates relative to the Company's allocated share of the actual taxes paid. Moreover, New Jersey ratepayers do not benefit from costs incurred by the parent company or unregulated affiliates that would otherwise have been disallowed if incurred by the utility. Instead, New Jersey ratepayers are benefiting only from the recognition that the Company's allocated share of the federal income liability is less than the amount collected in rates. Hence a rate base adjustment can be viewed as the ratepayers "loaning" the Company a sum equal to the difference between the statutory tax expense and the lower taxes actually paid by NJAWC in its consolidated tax return. The interest rate applied to this loan is the Company's allowed return on rate base. It really does not matter what the nature or source of the net operating losses are, only what the impact is on the effective tax rate. In this case, the Company simply does not have the tax expense that they have included in rates and ratepayers are entitled to a rate base credit to reflect that fact. Likewise it is not material to the consolidated income tax adjustment whether or not the tax benefit arose from a disallowed cost or was simply incurred by a non-regulated entity pursuing any other line of business. In New Jersey, it is well-established policy that a tax benefit arising from the filing of a consolidated income tax filing is to be shared with ratepayers.

Q. Please comment on Mr. Warren's discussion at page 21, lines 3-16 of his testimony that the consolidated income tax adjustment depends on a completely fallacious premise – the "but for" premise.

A. Mr. Warren's argument ignores two important points. First, the CTA does not presume, as suggested by Mr. Warren, that a company would not have been able to use their tax losses but for consolidation. In fact, the methodology adopted by the BPU for consolidated income tax adjustments only utilizes tax losses from companies that have cumulative tax losses since 1991. Therefore, if a company has tax losses in several years, but has sufficient income to offset these losses in other years, that company's tax losses are not allocated to other members of the group. Therefore, the first step in the Board's methodology is to ensure that a company with tax losses could not have utilized those losses over the period in question.

Second, the "but for" argument ignores the economic reality that the utility does file a consolidated return and that companies with positive taxable income do take advantage of tax losses generated by other members of the group. A better analogy would be to argue that the tax losses could not be utilized at all "but for" the filing of a consolidated return that includes companies with positive taxable income.

Mr. Warren goes on to present a hypothetical of a married couple that would make different financial decisions if they filed separate tax returns. That may be, but the fact is the couple in his example do file a consolidated return and make their financial decisions accordingly. In this case, NJAWC and its other member companies also filed a consolidated return and make their financial decisions accordingly. Moreover, the BPU has a long history of consolidated income tax adjustments, as does the Pennsylvania Public Utility Commission, which regulates AWW's largest subsidiary, Pennsylvania American Water Company. Therefore, the imposition of a consolidated income tax adjustment should not come as a surprise to NJAWC.

Q. Please comment on Mr. Warren's contention on page 22, lines 4-19 of his testimony that companies would have structured differently if they knew that a consolidated income tax adjustment would be proposed.

A. The BPU approved a consolidated income tax adjustment approximately 20 years ago. Since a consolidated income tax adjustment was first approved, AWW has gone through several corporate restructurings. During this time, it knew, or should have known, that the BPU would be likely to impose a consolidated income tax adjustment. Nevertheless, AWW has continued to file a consolidated income tax return for the group. Moreover, AWW has also been aware that a consolidated income tax adjustment is standard ratemaking policy in Pennsylvania, yet it has continued to include Pennsylvania American Water Company in its consolidated income tax group along with NJAWC. Thus, Mr. Warren's argument that AWW would have structured differently if it had known that NJAWC would be subject to a consolidated income tax adjustment is without merit.

Q. Please comment on Mr. Warren's testimony on page 23, line 14-21, where he discusses the ability of a company to manage its own tax losses.

A. Mr. Warren ignores the fact that the methodology imposed by the BPU with regard to consolidated income tax adjustments only utilizes losses from companies that had aggregated losses over the period in question. Thus, if over time, a company had utilized its own taxable losses to offset taxable income, then those losses are not included in the consolidated income tax adjustment.

Q. Please comment on Mr. Warren's statement that consolidated income tax adjustments are based on the assumption of a fictional loan, as discussed on page 24, lines 10-23 of his testimony.

A. Under the Company's tax sharing agreement, NJAWC pays taxes to its parent company that are never paid to the IRS. In fact, from 2002-2010, the parent company collected ***BEGIN CONFIDENTIAL [redacted] END CONFIDENTIAL*** in tax payments that were not paid to the IRS. Instead, these funds were redistributed to companies with taxable losses. The BPU generously viewed these payments as a "loan", and only requires the Company to provide a consolidated income tax adjustment based on the time value of these loans, hence, the cumulative loans are deducted from rate base. The BPU could have taken a broader range view and actually imposed a consolidated income tax adjustment based on the methodology used in Pennsylvania, which results in a reduction to the pro forma income tax expense that utilities are permitted to recover from ratepayers in their revenue requirement.

Q. Please comment on Mr. Warren's contention at page 25, lines 1-8, that there is no loan involved among the members of the consolidated group, since taxes being charged to ratepayers are not "excess".

A. I disagree. I don't know how Mr. Warren would define "excess". However, since the Company is requesting recovery from ratepayers of $66.82 million in federal income tax expense that the consolidated group will never pay to the IRS. I definitely consider their tax claim to represent an "excess" that will accrue to the benefit of shareholders.

Q. Please comment on Mr. Warren's statement on page 25, line 19 that "there is no volume discount when it comes to federal tax returns".

A. Mr. Warren is correct that the consolidated income tax adjustment does not necessarily change the tax rate that will be applied to AWW's consolidated taxable income. However, he ignores the fact that this rate is applied to a significantly smaller base amount because of the filing of a consolidated return. AWW clearly does receive a discount relative to what it would pay if the IRS required each subsidiary with positive taxable income to pay 35% of its income to the IRS. As stated earlier, NJAWC paid *****BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL***** to AWW during the 2002-2010 period while AWW paid $0 to the IRS during this time. I would classify this differential as a substantial volume discount.

Q. Is a consolidated income tax adjustment similar to a gift card with a furniture store, as suggested by Mr. Warren on page 26, lines 3-16?

A. No, it is not. A gift card has value on its own. It can be used by anyone, or could be sold by its holder. This is a far different situation than a federal income tax loss, which can only be used by the generator of the loss or by the consolidated income tax group if the generator of the loss files a consolidated return. In and of itself, the tax loss has no value unless it is combined with positive taxable income.

While Mr. Warren keeps changing the examples he uses in his various testimonies on this issue, he still has not found an analogy that successfully rebuts the rationale for consolidated income tax adjustments.

Q. Please comment on the discussion on pages 27-31 of Mr. Warren's testimony that it is reasonable to pay the tax loss affiliate for the loss when the loss is produced.

A. Paying the loss companies results in the transfer of millions of dollars from New Jersey ratepayers to other subsidiaries of American Water Works. Since 1991, AWW has paid *****BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL***** was contributed by NJAWC. These amounts were collected from ratepayers in order to pay federal income taxes, and not to pay affiliates for tax losses. Moreover, since 2000, the loss companies have been paid *****BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL***** while over this same period no payments were made to the IRS by the consolidated group.

Q. Please comment on Mr. Warren's statement on page 31 of his testimony that consolidated income tax adjustments breach the separation between regulated and non-regulated operations.

A. Mr. Warren is incorrect. By making a consolidated income tax adjustment, the Board is not attempting to reach out and import non-regulated transactions. As previously noted in my discussion of cost responsibility, the consolidated income tax adjustment simply recognizes the impact on NJAWC of filing a consolidated income tax return. By filing a consolidated return, NJAWC is asking ratepayers to pay millions of dollars in tax expenses that are never paid to the IRS.

Q. Please comment on Mr. Warren's discussion on page 30 of his testimony that the activities of the loss affiliates entitle them to the benefits of the tax losses they create.

A. Mr. Warren's argument is based on his premise that "no member of the consolidated group producing positive taxable income, including the Company, contributed anything whatsoever to the creation of any tax loss allocated to it by virtue of the CTA mechanism."[3] While the companies with positive taxable income may not have produced the tax loss, they are responsible for giving it value. As previously noted, the tax loss only has value when it can be used to offset positive taxable income. In the absence of such income, the tax loss would have no value and there would be no reason for the parent company to pay the losing entity for the value of its tax loss benefits.

Moreover, it is ultimately the utility's ratepayers that are the source of the tax payments made by NJAWC to its parent company. Therefore, any payments made to the tax loss companies are funded, at least in part, by ratepayers. The fact that these funds may be funneled through the parent company does not change the fact that ratepayers are the ultimate source of the funds provided by NJAWC. Consolidated income tax adjustments recognize that cost-free capital is

3 Testimony of Mr. Warren, page 30, lines 4-6.

provided by ratepayers, because they provide the utility income that generates the tax benefits. This point is addressed in the 1993 JCP&L decision quoted above. It should be apparent that requiring ratepayers to pay a statutory federal tax rate that exceeds the actual taxes paid, provides a cost-free source of capital to the Company, and ultimately to the consolidated group. It is undisputed that a consolidated tax filing for the group members results in an overall tax expense that is less than the sum of the tax expenses resulting from the application of a statutory tax rate.

Q. Please comment on Mr. Warren's testimony on page 30, lines 6-12 where he states that the tax loss companies take risks that contribute to the tax losses.

A. Mr. Warren ignores the risks being taken by NJAWC for participating in a consolidated income tax return with other entities, some of which produce tax losses. As a member of a consolidated income tax return, NJAWC, along with other members of the group, are held responsible by the IRS for the entire group's tax liability. Thus, NJAWC itself faces risks by participating in a consolidated income tax return.

In addition, the implications of filing a consolidated income tax return are well known to AWW and its subsidiaries, including the tax loss subsidiaries. Consolidated income tax adjustments are well-established policy in the two states that account for approximately 50% of AWW's regulated operations – Pennsylvania and New Jersey. Tax decisions made at the corporate level about the filing of consolidated returns are made with this knowledge. The fact is that

AWW has chosen to file consolidated income taxes and that such a filing creates benefits – these benefits need to be shared with New Jersey ratepayers.

Q. Please comment on Mr. Warren's statement at pages 34-36 of his testimony that the BPU's consolidated income tax adjustment should be limited to an aggregate tax loss over a 15 year period.

A. I am not aware of any limitation placed by the BPU on such tax losses. Moreover, Mr. Warren did not provide any support for his claim. While the IRS may limit the period of time over which tax losses can be carried forward or back if a company files a stand-alone return, it is my understanding that the BPU has stated that all tax losses from 1991 onwards should be utilized, unless and until such time that the company generating the tax loss has aggregate positive taxable income. According to the BPU's formula, tax losses are only eliminated from the consolidated income tax calculation if an individual company moves from a tax loss company to a taxable income company, at which time the losses are no longer considered in the calculation. The BPU's approach is based on continuation of the adjustment until such time as the utility is compensated for providing cash working capital to the tax loss company.

Moreover, on page 35 of his testimony at lines 3-4, Mr. Warren states "Bear in mind that the loss carry-forwards (i.e., the otherwise unusable losses) employed in the CTA calculation are complete fictions. They do not, in fact, exist. They were actually used in consolidation." However, in spite of this "fiction", Mr. Warren attempts to limit the CTA to 15 years, based solely on the

IRS regulations regarding the fictitious loss carry-forwards. If the loss carry-forwards do not currently exist, and I agree with Mr. Warren that they have been used in consolidation, then the current IRS limitation is meaningless and irrelevant.

Q. Please comment on Mr. Warren's statement on page 34, lines 19-20 that if the "loan" has not been reversed within the tax law carryforward period, it never can be reversed.

A. Mr. Warren's statement may be correct with regard to the IRS's application, but it is not correct with regard to the ratemaking treatment for a consolidated income taxes. The BPU's methodology examines the cumulative tax losses or taxable income over the entire time horizon under review, in this case from 1991 to 2010. Pursuant to the BPU's methodology, a company can "use" its own tax loss at any time over the time horizon under review. It is only losses that have not been used during that time by the company generating the losses that are used in the consolidated income tax adjustment.

Q. Please comment on Mr. Warren's statement that CTAs are a "one way street", as stated on page 37, line 12 of his testimony?

A. I disagree with Mr. Warren's characterization. First, the formula used by the Board to determine consolidated income tax adjustments treats regulated and non-regulated companies in the same way. Cumulative losses of both regulated and non-regulated losses are allocated to all companies with cumulative taxable income, regulated and non-regulated. Moreover, there is no "incremental charge" being imposed on anyone through consolidated income tax adjustment, as alleged by Mr. Warren on page 37 at line 16. The consolidated income tax adjustment simply allocates a reasonable and proportionate share of a cumulative tax benefit to each company with cumulative positive taxable income.

Q **Are consolidated income tax adjustments a violation of the normalization requirements of the IRS, as discussed on pages 38-39 of Mr. Warren's testimony?**

A. No, they are not. Prior to 1990, there was some question as to whether or not consolidated income tax adjustments violated the normalization provisions of the IRS. However, around that time, the IRS determined that such adjustments do not violate the normalization rules. The BPU subsequently adopted consolidated income tax adjustments for New Jersey utilities. In the past 20 years, the IRS has never ruled that the consolidated income tax methodology used by the BPU violated the normalization requirements of the tax code. Mr. Warren acknowledged as much in the response to RCR-CIT-39, where he stated that he "knows of no IRS ruling denying a utility the use of accelerated depreciation based on a consolidated tax adjustment since the IRS changed its view of these adjustments in this regard in or about 1991." When the BPU issued its policy on consolidated income taxes, New Jersey utilities had the opportunity to seek a ruling from the IRS as to whether this methodology violated the normalization requirements of the tax code. As stated in the response to RCR-CIT-40, "Mr.

Warren knows of no request to the IRS that it rule on whether any 'rate base method' for consolidated income taxes violates any IRS requirements."

Q. Please comment on Mr. Warren's recommendation that tax losses associated with members that have transferred outside of the group should not be included in a consolidated income tax adjustment, as discussed on page 40 of his testimony.

A. The Board's consolidated income tax adjustment is based on the premise that the companies with positive taxable income contributed working capital by making tax payments to the parent company that were well in excess of the payments made by the parent to the IRS. Whether a specific company is still part of the consolidated income tax group is irrelevant to this analysis. Unless and until a company with positive taxable income is fully compensated for these excessive tax payments, the consolidated income tax adjustment is appropriate. For the same reason, the Board should reject Mr. Warren's argument on page 42 of his testimony that tax losses associated with merged or liquidated companies should be excluded.

Q. Do you agree with Mr. Warren that the consolidated income tax adjustment should be reduced by the amount of tax losses that have not yet been used by the consolidated group, as discussed on pages 40-42 of his testimony?

A. No, I do not. Whether the tax loss has been used or not by the parent is not the issue. The issue is whether or not the utility has paid the parent the excess tax expense. Otherwise, ratepayers could be asked to pay for millions of dollars in income tax expense which is not being paid at all to the IRS. As noted previously, from 2002-2010, NJAWC has paid its parent company ***BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL***** while its parent company has paid $0 to the IRS. Moreover, the Board's current methodology reflects the inclusion of pro forma income tax expense in the Company's revenue requirement. The Company has included $66.82 million of federal income tax expense in its revenue requirement claim, pro forma taxes that are unlikely to be paid to the IRS in the near future, if at all.

The Board's current methodology does not reduce the consolidated income tax rate base adjustment for tax loss carry-forwards. If the Board determines that tax loss carry-forwards should be considered, then it should also consider excluding all federal income tax expense from the Company's revenue requirement.

Q. Please discuss Mr. Warren's testimony on pages 43-44 where he states that "[t]he rule in New Jersey is that the tax benefit of a cost that is disallowed by the Board cannot be factored into the setting of rates."

A. Once again, Mr. Warren is confusing the issue of disallowances with the issue of consolidated income taxes. As discussed earlier in my testimony, consolidated income tax adjustments do not attempt to reach into a non-regulated entity's business transactions or to impute disallowed expenses back into the ratemaking process. The consolidated income tax adjustment simply recognizes that there is an impact on the regulated utility resulting from membership in a consolidated tax return. Moreover, Mr. Warren states that this supposed rule conflicts with the New Jersey Supreme Court decision in Hackensack Water Company v. BPU.[4] While I am not an attorney, I would like to point out that none of the transactions involving other AWW entities are passed through to New Jersey ratepayers, and we are not attempting to do so here. The fact that the New Jersey courts have already ruled on the legality of consolidated income tax adjustments suggests to me that the issue is settled.

Q. Please comment on Mr. Warren's testimony at pages 44-46 where he states that a portion of the tax loss benefit should be allocated to the companies with taxable losses.

A. Mr. Warren's testimony is completely at odds with well-established Board policy. Mr. Warren previously argued that tax loss benefits should be allocated primarily to unregulated companies with positive taxable income. Both arguments directly conflict with Board policy, which is that cumulative tax loss benefits be allocated to companies with cumulative positive taxable income. Moreover, since it is these companies who are bearing the entire income tax burden for the group, the Board's policy is appropriate.

Q. Will it be necessary to update your recommendation later in this proceeding?

4 See page 11 of Mr. Warren's testimony.

A. Yes, it will. I recommend that my consolidated income tax adjustment be updated to include 2011 tax information, if that data becomes available during the hearing phase of this case.

Q. Please summarize your recommendation with regard to consolidated income taxes.

A. The BPU has a long-standing policy on consolidated income tax adjustments, and on how such adjustments should be quantified. The Company has not provided any rationale for why the BPU should deviate from its policy or why the BPU should treat NJAWC differently from the other utilities in New Jersey. Accordingly, the BPU should adopt the consolidated income tax adjustment that I have quantified at Schedule ACC-1. While this is a large adjustment, the BPU should keep in mind the amount of taxes paid by NJAWC to its parent company, relative to the actual tax liability incurred by AWW. "Excess" funds have been redistributed to other subsidiaries. Ratepayers should continue to be compensated through a consolidated income tax adjustment for these payments to the parent company that exceed NJAWC's share of actual taxes paid to the IRS.

B. Cash Working Capital

Q. What is cash working capital?

A. Cash working capital is the amount of cash that is required by a utility in order to cover cash outflows between the time that revenues are received from customers and the time that expenses must be paid. For example, assume that a utility bills its customers monthly and that it receives monthly revenues approximately 30 days after the midpoint of the date that service is provided. If the Company pays its employees weekly, it will have a need for cash prior to receiving the monthly revenue stream. If, on the other hand, the Company pays its interest expense semi-annually, it will receive these revenues well in advance of needing the funds to pay interest expense.

Q. Do utilities always have a positive cash working capital requirement?

A. No, they do not. The actual amount and timing of cash flows dictate whether or not a utility requires a cash working capital allowance. Therefore, one should examine actual cash flows through a lead/lag study in order to accurately measure a utility's need for cash working capital.

Q. Please describe the Company's claim for cash working capital.

A. The Company has based its cash working capital claim on three lead/lag studies performed by its witness, Howard Walker, III. The expense lag days were generally developed by analyzing invoices for the twelve months ending December 30, 2010. Mr. Walker initially calculated his expense lags on an aggregated basis, i.e., he did not attempt to determine separate expense lags for each Service Area but rather determined an aggregate lag for each expense category. He then applied the aggregated lag for each expense category to each Service Area's expense levels to determine the expense lags for each area. Mr. Walker included all sewer operations in Service Area 1. Mr. Walker similarly calculated an aggregate revenue lag that he applied to all three Service Areas.

Mr. Walker rounded the results of his analysis, resulting in an original cash working capital claim of $66.0 million, including $40.7 million for Service Area 1, $23.8 million for Service Area 2, and $1.5 million for Service Area 3. The Company did not revise its claim for cash working capital when it filed its 9+3 Update on November 11, 2011. However, in response to RCR-CWC-12, NJAWC did provide updated schedules that reflect the 9+3 Updates. I have utilized these updated schedules to develop the recommendations contained in my testimony.

Q. Are you recommending any adjustments to the Company's cash working capital claim?

A. Yes, I am recommending that NJAWC's cash working capital claim be revised to eliminate cash working capital associated with non-cash items, such as depreciation and amortization expense, deferred tax expense, and uncollectible expense. I recommend that non-contractual costs, such as utility operating income, be excluded from the lead/lag study. I am recommending an adjustment to the expense lag associated with Management Service Company costs. I recommend that the lead/lag study be revised to include the lag on interest expense. This adjustment reflects the fact that revenues are collected in rates for interest expense on a monthly basis but debt payments are made semi-annually to the bondholders. Finally, I am making a similar recommendation with regard to the lag on the payment of preferred stock dividends, which are typically paid quarterly.

Q. Please explain how NJAWC has treated the non-cash items you have eliminated in your adjustment to cash working capital.

A. NJAWC has included depreciation and amortization expenses, deferred tax expense, uncollectible expense, and utility operating income in the lead/lag calculation as expenses with zero-lag days. The inclusion of these items with a zero lag actually has a very significant impact on the cash working capital requirement because it reduces the average number of expense lag days. The reduction in the average expense lag results in an increase in the overall cash working capital requirement because the net lag, i.e., the revenue lag – the expense lag, increases as the expense lag decreases. Thus, the Company's inclusion of non-cash items in a lead/lag study generally results in a significant increase to cash working capital.

Q. Why does NJAWC seek to include these items at a zero lag?

A. Mr. Walker argues at page 9, lines 13-20 of his testimony that depreciation, in the form of accumulated depreciation, is subtracted from rate base before the expense has been fully collected from customers, due to the lag in revenues. At pages 12-13 10 of his testimony, he argues that deferred taxes are also subtracted from rate base before they are fully collected in rates. Mr. Walker does not expressly address uncollectible expense in his testimony, but he has included uncollectible costs in "Other Expenses" to which he applied a 45 day lag. Finally, on page 13, lines 6-12 of his testimony, he states that operating income becomes the property of investors as it is earned, but it is not realized until revenues are collected.

Q. What is the basis for your recommendation to exclude depreciation and amortization expense from the lead/lag study?

A. It is inappropriate to include depreciation and amortization expense in a utility's cash working capital claim because these costs do not result in cash outflows by the utility. NJAWC does not make cash payments for depreciation expense on a specified date. The purpose of a lead/lag study is to match cash inflows, or revenues, with cash outflows, or expenses. Cash working capital reflects the need for investor-supplied funds to meet the day-to-day expenses of operations that arise from the timing differences between when NJAWC had to expend money to pay the expenses of operation and when revenues for utility service are received by the utility. Only items for which actual out-of-pocket cash expenditures must be made should be included in a cash working capital allowance. At Schedule ACC-2, I have made an adjustment to eliminate the cash working capital claims associated with depreciation and amortization expense from NJAWC's lead/lag studies. My adjustments for Service Area 1, Service Area 2, and Service Area 3 are shown on pages 2, 3 and 4 respectively of this schedule, while a summary of my recommendations is shown on page 1 of Schedule ACC-2.

Q. Please comment on Mr. Walker's argument that depreciation expense should be included in a lead/lag study at zero lag because it is deducted from rate base prior to being recovered from ratepayers.

A. The argument that these expenses must be reflected in the lead/lag study because of their rate base impact ignores how utility rates are established. The amount of revenues to be collected is determined in a base rate case that includes pro forma depreciation expense and a rate base valued at a given point in time. Although accumulated depreciation at a point in time is deducted from rate base, that does not change the fact that depreciation is a non-cash expense. It does not matter in the slightest that the books of account include accrued depreciation that is subtracted from rate base at a point in time. Moreover, the rate base that is used to set rates is known and measurable, and it does not change on a monthly basis. Therefore to claim a cash working capital requirement based on booking a non-cash item such as accumulated depreciation during the year, is unwarranted. It is immaterial how much depreciation is actually booked or when it is booked because the revenue per unit of consumption is established for the rate effective period, regardless of any changes that may occur between rate cases. Utility rates are not reset every month to reflect the actual changes in rate base that occur between rate cases. Moreover, the calculated revenue lag already reflects the lag in the collection of all expenses, including depreciation. The rate base has been determined in a manner that allows NJAWC an opportunity to earn its authorized return on investor supplied capital and that process already reflects the regulatory treatment for accrued depreciation. NJAWC's method effectively double-counts the revenue lag for depreciation expense and its claim should be rejected.

Q. Why do you also reject the use of zero lag days for deferred tax expense?

A. This item is similar to depreciation in that the amount allowed in rates for its recovery is established by the BPU and does not change during the rate-effective period based on fluctuations in actual results. Therefore the lag in revenues already reflects the lag in the collection of deferred tax expense. The Company is fully compensated in rates for deferred taxes and the entire balance of deferred taxes is a rate base offset because it represents a source of non-investor supplied funds. Thus all the regulatory allowances, including all rate base effects, for this item are considered and determined in the rate setting process. The Company is not paying deferred taxes to another party. It pays only current taxes, and therefore deferred tax expense is not properly includable in any form in the calculation of cash working capital.

Q. What expense lag did the Company utilize for Management Service Company costs?

A. Mr. Walker utilized an expense lead (negative expense lag) of (11.5) days. This assumes that, on average, the Company pays its Management Service Company charges 11.5 days before the date when service is provided by the Service Company to NJAWC. Essentially, NJAWC has reflected a prepayment of these costs in its lead/lag study.

Q. Do you believe that it is appropriate to reflect a prepayment for Management Service Company costs in the lead/lag study?

A. No, I do not. The Management Service Company Agreement, which covers the majority of the services billed to NJAWC through Management Service Company fees, provides for each company to be billed "as soon as practicable after the last day of each month, Service Company shall render a bill to Water Company for all amounts due from Water Company for services and expenses for such month plus an amount equal to the estimated cost of such services and expenses for the current month,..."[5] While the Agreement provides for a prepayment each month based on estimated costs, it does not necessarily follow that this prepayment should be reflected in utility rates through the Company's cash working capital claim.

The provisions of the Management Services Company agreement result in a cash working capital requirement. However, if NJAWC provided these services internally, or obtained these services from a third party, there would be a lag between receipt of service and payment for service, resulting in a source of cash working capital. Ratepayers should not have to pay for higher cash working capital requirements because of AWW's decision to centralize certain services in the Management Services Company.

Q. What do you recommend?

A. I recommend that a 10.4 day expense lag be used for Management Service Company costs in the development of the Company's cash working capital claim. This is the lag used by NJAWC for its internal labor costs. If the services provided

5 Agreement provided in response to RCR-CWC-7, Attachment B, page 11.

by Management Service Company personnel were instead provided internally by NJAWC, there would be a 10.4 day labor expense lag. Since labor-related costs generally comprise the majority of centralized service company costs for a utility, it is reasonable to utilize an expense lag equal to the lag that would be result if the services were provided internally by the utility. Accordingly, I am recommending that a 10.4 day expense lag be used for Management Service Company costs in the lead lag study.

Q. Why should uncollectible costs be excluded from a utility's cash working capital requirement?

A. Uncollectible costs are non-cash expenses and therefore they should not impact the cash working capital calculation. Moreover, the Company is already fully compensated for the cash working capital impact of its cash expenses through the lead/lag study. For example, assume that the Company's revenue requirement consists of only two expenses, payroll costs of $100 and uncollectible costs of $5. The result would be a total revenue requirement of $105, $100 of which the Company would actually collect from customers. That $100 in revenues would match the actual cash outflows required to be made by this hypothetical company. Therefore, the uncollectible expense does not generate an additional cash working capital impact for the Company. Accordingly, at Schedule ACC-2, I have made adjustments to eliminate uncollectible expense from the Other Expenses included in the Company's claim at a 45 day expense lag.

Q. Please explain why you have rejected the Company's claim for zero lag days for utility operating income.

A. Utility operating income includes components for cost of equity, cost of debt, and cost of preferred stock. The latter two components, i.e., interest expense and preferred stock dividends, are addressed below.

With regard to the cost of equity, this component does not represent a contractual obligation of NJAWC. The Company is under no obligation to make payments to their stockholders. While NJAWC may make common dividend payments, they are not contractually obligated to do so. Moreover, even if dividend payments are made, they are generally made no more frequently than quarterly. They are certainly not made on a daily basis, which is the assumption inherent in the use of a zero lag. In addition, companies generally retain a portion of their earnings rather than paying out all earnings as dividends, another fact not taken into account in NJAWC's lead/lag study.

Q. Has NJAWC reflected a reduction in cash working capital related to the lag in its payment of interest expense?

A. No, it has not. NJAWC failed to reflect the fact that the revenue requirement includes a component for interest expense, which is a contractual obligation of the utility, and that this obligation is typically paid semi-annually.

Q. How is working capital generated by NJAWC's lag in the payment of its interest expense?

A. NJAWC collects revenues from ratepayers for interest expense on a monthly basis but it pays its bondholders for interest only twice a year. Therefore, on average, the accrued interest funds are available to NJAWC, at no cost, to finance its operations between the time the Company collects the interest from customers and the time that interest payments are made to bondholders.

Q. How should this cost-free source of funds be reflected for ratemaking purposes?

A. The lag in the payment of interest expense must be reflected in the cash working capital calculation so that ratepayers are compensated for providing a cost-free source of capital to NJAWC. In developing my adjustment, I included the interest expense at a lag of 91.25 days, which reflects semi-annual payments of interest.[6]

Q. Are you making a similar recommendation with regard to the dividend payments on preferred stock?

A. Yes, I am. However, since dividend payments on preferred stock are generally made quarterly, I used an expense lag of 45.625 days.

Q. Are you recommending any adjustments to the expense lag days reflected in the cash working capital study?

A. No, I have not made any adjustment to any of the lead/lag days reflected in the Company's lead/lag study other than the adjustment to the Management Service

6 Reflects the lag from the midpoint of the 182.5 day service period (365 / 2 / 2).

Company charges discussed above. My other adjustments relate solely to the components to which these lead/lag days should be applied.

Q. What are the results of your cash working capital adjustments?

A. I have eliminated the zero lag days used by the Company for depreciation, amortization, deferred tax expense, uncollectible expense, and utility operating income. I have used a 10.4 day expense lag for charges from the Management Service Company. In addition, I have reflected the lag in the payment of interest expense and preferred dividends. As shown in Schedule ACC-2, page 1, my adjustments result in a cash working capital allowance $9,700,000 million for Service Area 1, $4,900,000 million for Service Area 2, and ($100,000) for Service Area 3. Therefore, I recommend that the Board include a cash working capital allowance of $14,500,000 in the Company's pro forma rate base.

Q. Do you have additional comments regarding cash working capital?

A. Yes. I have based my recommendation on the level of expenses included in the response to RCR-CWC-12, which the Company indicated corresponds with NJAWC's 9+3 Update of November 11, 2011. However, I recommend that the cash working capital requirement be updated to reflect the actual level of expenses, including interest expense and preferred dividends, found by the BPU to be appropriate.

Q. Does this conclude your testimony?

A. Yes, it does.