

**COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION**

IN THE MATTER OF:)
)
NOTICE OF ADJUSTMENT OF THE RATES OF) **CASE NO. 2004-00103**
KENTUCKY AMERICAN WATER COMPANY)
EFFECTIVE ON AND AFTER MAY 30, 2004)

**DIRECT TESTIMONY OF
SHEILA A. VALENTINE**

April 30, 2004

KENTUCKY AMERICAN WATER COMPANY
CASE NO. 2004-00103
Direct Testimony
Sheila A. Valentine

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28
29

1. Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS FOR THE RECORD.

A. My name is Sheila A. Valentine and my business address is 1600 Pennsylvania Avenue, Charleston, West Virginia 25302.

2. Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am employed by the American Water Service Company, Inc. ("Service Company") as Senior Financial Analyst for the Southeastern Regional Service Company Office.

3. Q. PLEASE ELABORATE UPON YOUR DUTIES AS SENIOR FINANCIAL ANALYST FOR THE SOUTHEASTERN REGIONAL SERVICE COMPANY.

A. My responsibilities include the preparation and presentation of rate filings requested by five operating companies comprising the Southeastern Region of American Water. I am also responsible for various accounting duties including budget preparation, account reconciliation, and financial statement analysis.

4. Q. HAVE YOU PREVIOUSLY PARTICIPATED IN REGULATORY MATTERS?

A. Yes, I have prepared rate cases and presented testimony before the Tennessee Regulatory Authority and the State Corporation Commission of Virginia. I have also worked on the preparation of exhibits and data requests for West Virginia American.

5. Q. WOULD YOU PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND BUSINESS EXPERIENCE?

A. Yes. In 1983, I graduated Summa Cum Laude with a Bachelor of Arts degree from Glenville State College with a major in Accounting and Management, and a minor in Economics. In 1988, I received my Certified Public Accountant license.

1
2 I have worked with the American System for 19 years and began my career in
3 December 1984, as a Junior Accountant. In that capacity I worked in the
4 Construction Accounting Department for the Service Company.
5

6 I assisted with the system-wide acquisition integration of Citizens Water by
7 serving on the Acquisition Team. I also participated in the set up of the system-
8 wide conversion process for the Shared Services Center by assisting
9 Information Services with reporting processes.
10

11 Throughout the years, I have moved through the ranks of the financial side of
12 the business from Accountant in 1985, Construction Accounting Supervisor for
13 the Southeast Region in 1988, Construction Accounting Superintendent for
14 West Virginia American Water Company in 1992, Assistant Director of
15 Accounting for West Virginia American in 1995, Director of Accounting for West
16 Virginia American in 1997, Director of Accounting for the Southeast Region in
17 2000, and due to the reorganization of the Shared Services Center, I was
18 transferred to Senior Financial Analyst for the Southeast Region in 2002. I have
19 significant knowledge and expertise in accounting and other financial aspects of
20 American Water, including Kentucky American Water.
21

22 **6. Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS CASE?**

23 The purpose of my testimony is to support the Company's adjustments to
24 forecasted Purchased Water, Fuel & Power, Chemicals, Waste Disposal,
25 Group Insurance, Pensions, Regulatory Expense, Insurance Other than Group,
26 Customer Accounting, Rents, General Office Expense, Miscellaneous Expense,
27 Maintenance Expense, and General Taxes. I will also address the Filing
28 Requirements and the General Rate Case Structure.
29

30 **7. Q. WHAT IS THE AMOUNT OF THE REVENUE INCREASE THAT THE**
31 **COMPANY IS REQUESTING?**

32 A. The Company is requesting an overall revenue increase of \$7,297,443 or
33 16.82%, including activation fees. Central Division is seeking a revenue
34 increase of \$6,919,910 or 16.29%, Tri Village is seeking an increase of

1 \$338,208 or 40.99%, and Elk Lake is seeking an increase of \$39,325 or
2 42.17%.

3
4 **8. Q. WHAT IS THE TEST PERIOD REFLECTED IN THIS CASE?**

5 A. The Company has used a forecasted test period of the twelve months ending
6 November 30, 2005 and a base period of twelve months ended July 31, 2004.
7 The base period data reflects six months of actual data and six months of
8 forecasted data.

9
10 **9. Q. MS. VALENTINE, WHAT GUIDELINES HAS THE COMPANY FOLLOWED IN
11 ADJUSTING THE BASE PERIOD DATA?**

12 A. The Company has adjusted its base period revenues, expenses, rate base and
13 capitalization to reflect these items based on a forecasted test period ending
14 November 30, 2005. The Company has utilized the same guidelines in
15 developing its forecasted test period as it uses in its budgeting process. These
16 guidelines are designed to reflect, as accurately as possible, the Company's
17 needs to operate and maintain its assets, provide quality service to its
18 customers and provide a reasonable return to its stockholder.

19
20 **10. Q. MS. VALENTINE, WOULD YOU PLEASE SUMMARIZE COMPANY'S RATE
21 FILING?**

22 A. Yes. As noted earlier, the Company is filing this application for an increase in
23 rates based upon a fully forecasted test period of 12 months ending November
24 30, 2005 as currently allowed by 807 KAR 5:001 Section 10b the Commission
25 has outlined various filing requirements concerning a forecasted test period.
26 The Company's filing is supported by a series of 37 exhibits. We have
27 segregated the filing into three districts including the Central Division which
28 includes Bourbon, Clark, Fayette, Harrison, Jessamine, Scott, and Woodford
29 Counties, Tri Village, and Elk Lake. The allocation of some direct and indirect
30 costs between these divisions will be discussed in the testimony of Mr. Coleman
31 Bush.

32
33 **11. Q. MS. VALENTINE, ARE THERE ANY EXHIBITS YOU WISH TO COMMENT ON
34 BEFORE YOU CONTINUE?**

1 A. Yes. I would like to briefly discuss Exhibit 37. Exhibit 37 represents the
2 standard schedules required by the Commission when a utility files a general
3 adjustment in rates supported by a forecasted test period. This exhibit contains
4 14 schedules identified as Schedules A through N. I would like to identify each
5 schedule.

6
7 **Schedule A** is a jurisdictional financial summary for both the base period and
8 the forecasted period, which details how the utility derived the amount of the
9 requested revenue increase.

10
11 **Schedule B** is a jurisdictional rate base summary for the base period and the
12 forecasted period with the supporting schedules, which include detailed analysis
13 of each component of rate base.

14
15 **Schedule C** is a jurisdictional operating income summary for the base period
16 and the forecasted period with supporting schedules that are broken-down by
17 major account group and by individual account.

18
19 **Schedule D** is a summary of jurisdictional adjustments to operating income by
20 major account with supporting schedules for individual adjustments and
21 jurisdictional factors.

22
23 **Schedule E** is the jurisdictional federal and state income tax summary for the
24 base period and the forecasted period with supporting schedules of the various
25 components of jurisdictional income taxes.

26
27 **Schedule F** contains summary schedules for the base period and the
28 forecasted period of organization membership dues, initiation fees, expenditures
29 at country clubs, charitable contributions, marketing, sales, and advertising
30 expenditures; professional service expenses; civic and political expenses;
31 expenditures for employee awards functions and outings; employee gift
32 expenses; and rate case expenses.

1 **Schedule G** is an analysis of payroll costs including schedules for wages and
2 salaries, employee benefits, payroll taxes, straight time and overtime hours, and
3 executive compensation.

4
5 **Schedule H** is a computation of the gross revenue conversion factor for the
6 forecasted period.

7
8 **Schedule I** provides comparative income statements, revenue statistics and
9 sales statistics for the five most recent calendar years from the application filing
10 date, the base period, the forecasted period, and two calendar years beyond the
11 forecast period.

12
13 **Schedule J** provides a cost of capital summary for both the base period and
14 forecasted period and supporting schedules providing detail on each component
15 of the capital structure.

16
17 **Schedule K** provides comparative financial data and earnings measures with
18 the 10 most recent calendar years, the base period and the forecasted period.

19
20 **Schedule L** provides a narrative explanation of all proposed tariff changes.

21
22 **Schedule M** provides a revenue summary for both the base period and
23 forecasted period with supporting schedules, which provide detailed billing
24 analyses for all customer classes.

25
26 **Schedule N** provides a typical bill comparison of the present and proposed
27 rates for all customer classes.

28
29 **12. Q. MS. VALENTINE, WHAT IS THE SOURCE OF THE INFORMATION**
30 **CONTAINED ON THE EXHIBITS 1 THROUGH 37 AND SCHEDULES**
31 **MARKED A THROUGH N UNDER EXHIBIT 37?**

32 A. The information utilized in all exhibits and schedules was taken from the books
33 and records of the Company or from information provided to me and other

1 Company witnesses and by management of the Company; Dr. James H. Vander
2 Weide, who is the Company's rate of return consultant; Dr. Edward Spitznagel,
3 who is the Company's weather normalization consultant, Mr. James Salsler, who
4 is the Company's working capital consultant, and will also cover revenues and
5 income taxes, Dr. Ken Rubin, who is the Company's expert on security matters.
6 Each schedule is keyed to a schedule or work paper, where appropriate, which
7 was used to develop the schedule. Each schedule also identifies a witness or
8 witnesses will be responsible for responding to questions concerning
9 information on the schedule.

10
11 **13. Q. PLEASE EXPLAIN THE CALCULATIONS OF THE FORECASTED LEVEL OF**
12 **PURCHASED WATER EXPENSE.**

13 The Company purchases water from Winchester Municipal Utilities (WMU) for
14 Central Division customers in Clark County. The Company has an agreement
15 with WMU to purchase water that expires October 13, 2021. The Company also
16 purchases water from Georgetown Municipal Water and Sewer System
17 (GMWSS) for water sold in Owen County and from the City of Owenton for
18 customers in the Tri Village and Elk Lake Districts of the Northern Division. The
19 forecasted Purchased Water Expense was estimated based on the actual usage
20 during 2003 and applying the appropriate cost rate per cubic feet.

21
22 **14. Q. HOW DID THE COMPANY CALCULATE THE FUEL/POWER AND**
23 **CHEMICAL EXPENSE?**

24 A. All three expenses are directly related to system delivery. The basis for
25 estimating system delivery is forecasted water sales. Non-revenue usage from
26 historical data and unaccounted for water are added to sales to produce total
27 system delivery. Total system delivery for the forecasted period is 14,463 MG.
28 Monthly system delivery is projected by considering a five-year monthly history
29 of pumpage. This may be adjusted based on judgment concerning future
30 events.

31
32 Fuel and power costs are projected using historical and currently known data.
33 Demand is projected using the most recent five-year data from both treatment
34 facilities. Power providers are consulted regarding any known changes. Using

1 historical data and information from Kentucky Utilities (KU), we then forecast
2 fuel and power by multiplying the forecasted pumpage by the historical fuel
3 demand per unit (KWH/MG), then by the current known unit costs. Any known
4 credits or adjustments such as the environmental surcharge and fuel adjustment
5 clause are factored into the calculations. The totals fuels and power expense
6 for the forecasted period is a \$1,922,641.

7
8 To project chemical expenses we generally use the most recent five-year
9 average of pounds per million gallons per chemical that have been required. If
10 we have been using a chemical for less than five years, or if there are changes
11 for other reasons, we use operational judgment for our forecast, by soliciting
12 input from our water quality associates and by relying on our operating
13 experience. All chemicals are purchased through a competitive bidding process
14 and current prices are in effect until December, 2004. The company has
15 forecasted a general price increase of 2.5% effective January 2005. The
16 chemical expense for the forecasted period is \$1,221,136.

17
18 **15. Q. PLEASE EXPLAIN HOW YOU WASTE DISPOSAL IS FORECASTED?**

19 A. The forecasted Waste disposal expense is based on third party bids for
20 cleaning. Cleanings are amortized over a 24-month period. Other waste
21 disposal expenses include electricity to operate sludge pumps and chemicals to
22 treat the residuals. The forecast for waste disposal expense is \$238,996. We
23 obtained a permit-by-rule from the Division of Waste Management in 1998 to
24 allow us to continue to utilize our residuals from the KRS and the RRS on-site
25 for an additional 10-20 years.

26
27 **16. Q. HOW DID THE COMPANY CALCULATE ITS GROUP INSURANCE
28 EXPENSE?**

29 A. The total group insurance expense for the forecasted test year is \$1,724,407
30 This expense is comprised of 1) current group insurance costs for current
31 associates and 2) post retirement employee benefits costs (OPEB's) for both its
32 current employees and its retired employees.

1 The current group insurance costs reflect the use of the Company's current
2 group insurance premium statement rates and adjusted to reflect an 8.94%
3 increase effective January 1, 2005. These rates were then applied to the
4 current coverage levels for the full time employees included in the Company's
5 case.

6
7 The Company provides its current associates with life insurance, group medical
8 insurance, prescription drug, accidental death, accident, sickness and disability
9 coverage. The current group insurance coverage rates were effective January
10 1, 2004.

11
12 **17. Q. HOW DID THE COMPANY CALCULATE ITS OPEB EXPENSE?**

13 A. Towers Perrin (TP), a nationally recognized actuarial firm (and the actuarial firm
14 that has been certifying the Company's pension liability for American Water
15 Works Company for a number of years), prepared an analysis in conjunction
16 with American Water Service Company personnel to estimate the Company's
17 expense for post-retirement health care and life insurance benefits on an
18 accrual basis. The analysis reflects the Company's total 2005 level of OPEB
19 cost using a 20-year amortization period for the transition obligation, in
20 accordance with provisions of FAS 106, to be \$809,063.

21
22 **18. Q. MS. VALENTINE, HOW DID THE COMPANY COMPUTE ITS PENSION COST
23 UNDER FAS 87 IN THIS CASE?**

24 A. Towers Perrin prepares an actuarial study each year for the American System
25 Companies. The pension cost is a ratio of Kentucky American Water's payroll to
26 the total system payroll. Towers Perrin estimates KAW's pension cost to be
27 \$904,848. The calculated ratio of total pension cost to total system payroll is
28 2.54%. The Company has calculated the total pension expense net of the
29 capitalized costs for the forecasted test year to be \$747,404.

30
31 **19. Q. WHAT ARE REGULATORY COMMISSION EXPENSES?**

32 A. Regulatory expenses are estimated costs incurred for preparing and litigating
33 this case, including studies and investigations. We are requesting a three-year
34 amortization of rate case expense.

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28
29
30
31
32
33

20. Q. HOW WAS KENTUCKY AMERICAN WATER'S LEVEL OF INSURANCE OTHER THAN GROUP EXPENSE CALCULATED?

A. KAW's level of insurance other than group is based on the most current annual premiums. Insurance other than group includes payments for insurance to cover such items as excess general liability, property liability, fiduciary liability, commercial crime coverage, flood liability and worker's compensation.

21. Q. PLEASE DISCUSS KENTUCKY AMERICAN WATER'S FORECASTED LEVEL OF CUSTOMER ACCOUNTING EXPENSE.

A. KAW's customer accounting expense includes costs for such items as postage, telephone, forms utilized for customer service and billings, uncollectible accounts and collection agencies. This is not a thorough listing but it does represent most of the larger dollar items in this expense. In comparison, our forecast is actually below the amount experienced in 2003 and slightly below the base period. The forecast reflects an expense of \$989,860 for customer accounting costs.

22. Q. CAN YOU PLEASE DESCRIBE WHAT ITEMS ARE INCLUDED IN RENT EXPENSE?

A. KAW's forecast for rent expense is based upon signed agreements and anticipated agreements. These agreements cover such items as copiers and a postage machine. These items were all included in KAW's previous rate case.

23. Q. PLEASE EXPLAIN WHAT ITEMS ARE INCLUDED IN THE GENERAL OFFICE CATEGORY.

A. Items in this category include dues and memberships, employee travel and meal expenses, office supplies, and general office utility costs. The Company's forecasted expense is \$348,606. This amount is below the base period expense amount and considerably less than the prior three years.

24. Q. WHAT IS INCLUDED IN THE CATEGORY OF MISCELLANEOUS EXPENSES?

1 A. Included in this category are various expense items that are incurred throughout
2 the year that are not just unique to the water industry. These items are a part of
3 the carrying out normal business functions. Included in this category are costs
4 for services such as janitorial, legal, advertising, employee training programs,
5 uniforms, telephone and some amortizations. Also included are expenditures
6 related to conservation, and since our last filing, security services.
7

8 **25. Q. WHAT IS THE REASON FOR THE INCREASE TO MAINTENANCE**
9 **EXPENSE?**

10 A. This increase represents increase costs associated with the upkeep on
11 Kentucky American Water's utility property that need to be performed that are
12 over and above the base year levels, including tank inspections and general
13 maintenance of plant.
14

15 **26. Q. MS. VALENTINE, PLEASE DISCUSS EACH COMPONENT OF THE**
16 **COMPANY'S FORECASTED LEVEL FOR GENERAL TAXES.**

17 A. The first component that I will discuss is property taxes. The Company's
18 forecasted level of property tax is \$2,223,671. It is based upon a ratio of the
19 actual 2003 tax payments to the applicable total tax base as of December 31,
20 2002. The rate of \$1.0322 per \$100 of property was applied to the actual tax
21 base of December 31, 2003 and to the projected tax base of December 31,
22 2004 to arrive at a forecasted property tax expense for the 12-months ended
23 November 30, 2005.
24

25 The second component of General Taxes is the Public Service Commission
26 Fee. The Company has forecasted its Public Service Commission (PSC) fee for
27 the forecasted test period by arriving at an average PSC fee rate of .1869%.
28 The percent was calculated by dividing the actual tax payments for 2001-2003
29 by their associated revenues and then calculating a three-year average PSC fee
30 rate. By applying this three-year average PSC fee rate to the total forecasted
31 revenues (less AFUDC of \$470,940), the Company's forecasted level of PSC
32 fee is \$78,499 at present rates.
33

1 The final component of General Taxes is payroll taxes. The Company has
2 forecasted its payroll tax expense based upon the forecasted level of labor
3 costs. For FICA taxes, the rate used was 6.2% on a base of \$76,200 and a
4 Medicare tax rate of 1.45% on all wages. Federal unemployment is calculated
5 based upon a tax rate of .8% and a base of \$7,000. State unemployment tax of
6 .5% is calculated on a base of \$8,000. These tax rates and bases were then
7 applied to the total forecasted level of labor cost with amounts being expensed
8 and capitalized. The Company's total forecasted level of payroll tax expense is
9 \$410,283.

10
11 Total forecasted General Taxes is \$2,712,458 at present rates.

12
13 **27. Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

14 A. Yes, it does.