
**Market Cost Comparison of Service Company Charges to
Long Island American Water Company
12-Months Ended December 31, 2010**



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Purpose of This Study

This study was undertaken to answer four questions concerning the services provided by American Water Works Service Company, Inc. (Service Company) to Long Island American Water Company (LIAW):

1. Are the Service Company's charges to LIAW during 2010 reasonable?
2. Was LIAW charged the lower of cost or market for managerial and professional services provided by the Service Company during 2010?
3. Were 2010 costs of the Service Company's customer accounts services, including those of the National Call Centers, comparable to those of other utilities?
4. Are the services LIAW receives from Service Company necessary?

Study Results

Concerning question 1, the following conclusion was reached:

- The Service Company's 2010 cost per LIAW customer was reasonable compared to cost per customer for electric and combination electric/gas service companies. During 2010, LIAW was charged \$55 per customer for administrative and general (A&G)-related services provided by the Service Company. This compares to an average of \$95 per customer for service companies reporting to the Federal Energy Regulatory Commission (FERC). Only 2 of the 24 comparison group utility service companies filed a FERC Form 60 for 2009 had a lower per customer A&G cost than LIAW's charges from the Service Company.

Concerning question 2, the following conclusions were drawn from this study:

- LIAW was charged the lower of cost or market for managerial and professional services during 2010.
- On average, the hourly rates for outside service providers are 54% higher than the Service Company's hourly rates.
- The managerial and professional services provided by the Service Company are vital and could not be procured externally by LIAW without careful supervision on the part of LIAW. If these services were contracted entirely to outside providers, LIAW would have to add at least one position to manage activities of outside firms. This position would be necessary to ensure the quality and timeliness of services provided.
- If all the managerial and professional services now provided by the Service Company had been outsourced during 2010, LIAW and its ratepayers would have incurred more than \$2,500,000 in additional expenses. This amount includes the higher cost of outside providers and the cost of one LIAW position needed to direct the outsourced work.
- This study's hourly rate comparison actually understates the cost advantages that accrue to LIAW from its use of the Service Company. Outside service providers generally bill for every hour worked. Service Company exempt personnel, on the other hand, charge a maximum of 8 hours per day even when they work more hours. If all overtime hours of Service Company personnel were factored into the hourly rate calculation, the Service

I – Introduction

Company would have had an even greater annual dollar advantage than the \$2,500,000 cited above.

- It would be difficult for LIAW to find local service providers with the same specialized water industry expertise as that possessed by the Service Company staff. Service Company personnel spend substantially all their time serving operating water companies. This specialization brings with it a unique knowledge of water utility operations and regulation that is most likely unavailable from local service providers.
- Service Company fees do not include any profit markup. Only its actual cost of service is being recovered from LIAW ratepayers.

Concerning question 3, the following conclusion was reached:

- The cost of the Service Company's customer accounts services, including those provided by the National Call Center, is below the range of the average of the neighboring electric utility comparison group. As will be explained further herein, this group of companies provides a reasonable proxy group for comparison to a regulated utility of the size and scope of the Service Company and LIAW. During 2010, the customer accounts cost for LIAW customers was \$24.96 compared to the 2009 average of \$45.57 for neighboring electric utilities. The highest comparison group per customer cost was \$94.95 and the lowest \$12.90.

Concerning question 4, the following conclusions were drawn:

- The services that the Service Company provides are necessary and would be required even if LIAW were a stand-alone water utility.
- Furthermore, there is no redundancy or overlap in the services provided by the Service Company to LIAW. For all of the services listed in Exhibit 12, there was only one entity primarily responsible for the service.

II – Background

Overview of American Water Works Service Company

American Water's Service Company exists to provide certain shared services to American Water subsidiaries. It follows a service company model used by many utility holding companies that own multiple regulated utilities. By consolidating executive and professional services into a single service company, utility holding companies are able to realize the following benefits for ratepayers:

- **Purchasing Economies** – Common expenses (e.g., insurance, chemicals, piping) can be procured on a much larger scale thereby providing greater bargaining power for the combined entity compared to individual utility operating companies. A service company facilitates corporate-wide purchasing programs through its procurement and contract administration functions.
- **Operating Economies of Scale** – A service company is able to deliver services more efficiently because workloads can be balanced across more persons and facilities. For instance, American Water's Service Company is able to maintain one principal data center for the entire corporation. This is much more cost-efficient than each operating utility funding their own data center with its large fixed hardware, software and staffing costs.
- **Continuity of Service** – Centralizing service company personnel who perform similar services facilitates job cross-training and sharing of knowledge and expertise. This makes it easier to deal with staff turnover and absences and to sustain high levels of service to operating utilities. An individual operating utility might experience considerable disruption if a key professional left and it was necessary to hire outside to fill the vacancy.
- **Maintenance of Corporate-Wide Standards** – Personnel in American Water's Service Company establish standards for many functions (e.g., engineering designs, operating procedures and maintenance practices). It is easier to ensure these standards are followed by every operating utility because their implementation is overseen by the Service Company.
- **Improved Governance** – American Water's Service Company provides another dimension of management and financial oversight that supplements local operating utility management. The Service Company facilitates standard planning and reporting that help ensure operating utilities meet the requirements of their customers in a cost effective manner.
- **Retention of Personnel** – A service company organization provides operating utility personnel with another career path beyond what may be available on a local level. These opportunities tend to improve employee retention.

American Water follows the model for other utility service companies in another important regard. Its services are provided to affiliate operating utilities, like LIAW, at cost. American Water's Service Company is not a profit-making entity. It assigns only its actual expenses to the American Water subsidiaries it services.

The Service Company provides services to American Water operating companies from the following locations:

- **Corporate Office** – Includes American Water's executive management and personnel from the various corporate support services. American Water's corporate office is located in Voorhees, New Jersey.



II – Background

- National Call Centers – Perform customer service functions, including: customer call processing, service order processing, correspondence processing, credit and collections. American Water maintains two call centers. One in Alton, Illinois that went into operation in 2001 and a second in Pensacola, Florida that went into operation in 2005. Prior to the establishment of these national call centers, customer service functions were performed by employees of LIAW, which incurred the expense on its books.
- National Shared Services Center – The Shared Services Center, located in Cherry Hill, New Jersey, provides various financial, accounting and treasury functions that had been performed by individual operating companies. This arrangement has improved and streamlined the Company's financial processes and allowed operating companies to focus on providing utility service.
- Divisional Offices – Divisional offices provide operating companies with certain support services that can be performed more effectively on a divisional basis because individual operating company/center workloads are not sufficient to warrant a full-time staff for these activities. At the same time, these services require closer proximity to operating companies served so they are not provided by the National Shared Services Center. Examples of divisional office services include rates and revenues, engineering, operations and field resource coordination.
- Belleville Lab – The national trace substance laboratory is located in Belleville, Illinois and performs testing for all American Water operating companies.
- Information Technology Service Centers – American Water's principal data center, located in Hershey, Pennsylvania, supports the IT infrastructure required to run corporate and operating company business applications and the communications systems. IT personnel rotate, as needed, throughout the divisional offices and operating companies.

Service Company Expense Categories

The Service Company renders a monthly bill to operating companies. Charges are broken down into the following expense categories:

- Labor – base pay (salaries) of managerial and professional employees
- Labor-Related Overheads - employee benefit costs (payroll taxes, medical coverage, pensions, disability insurance) and other general expenses
- Support - wages and salaries of office support personnel, including secretaries, clerical personnel, telephone operators and mail clerks
- Office Expenses - office rent, equipment leases, telephone, electric, office supplies, property taxes, office maintenance
- Vouchers/Journal Entries – (1) travel expenses incurred by Service Company personnel, (2) other items submitted for reimbursement by employees, including professional association dues, (3) outside service contracts for such things as actuarial services, and (4) various other expenditures, including data center expenses for software licenses and hardware maintenance.

Service Company expenses are either assigned directly or allocated to operating companies, as shown in the table below.

II – Background

Expense Category	Direct Charged	Allocated	Comments
Labor	X	X	Professional personnel working for one or several operating companies
Labor-Related Overheads	X	X	These are primarily employee benefit costs that relate directly to labor
Support		X	Administrative personnel support the professional staff, thus support costs are allocated on the basis of professional labor
Office Expense		X	Are all allocated on the basis of professional labor
Vouchers/Journals	X	X	May be either directly in support of one operating company (e.g., an engineer traveling from the Corporate Office to the operating company) or allocated to several operating companies

A direct charge occurs when Service Company work or expenses are incurred in support of only one operating company. Direct charge examples include work in support of an operating company's rate case, engineering design work on an operating company's project and the preparation of an operating company's financial statements.

Service Company expenses are allocated when more than one operating company benefits from the underlying work. Examples include assessments of new Federal water quality regulations, development of the company-wide materials procurement contracts and creation of company-wide engineering design standards.

Charging and Assignment Of Service Company Time and Expenses

Service Company transactions are assigned with the following information so there is a proper accounting and eventual charging to an operating company:

- Operating company
- Formula number
- Work order (where applicable)
- Authorization number (where applicable)

Charges can originate from the following systems:

- Payroll System
- RVI System (outside vendor payments)
- PCard System (credit card payments)
- Internal Purchase Order System
- Journal entries

II – Background

The Service Company's time reporting process enables labor and support charges to be assigned to the proper operating company. Labor charges are based on the time reported by managerial and professional Service Company employees. Every week, Service Company professional employees complete an electronic time sheet that shows:

- Formula number (this is linked to operating company within American Water's financial system)
- Employee hours worked
- Account number for non-labor charges

At month-end, time report information is processed and direct and allocated professional labor hours tabulated for each operating company. Dollar charges are then calculated using the hourly rate of each Service Company professional employee based upon their base salary (i.e., an employee's hours times his/her hourly rate of pay).

Support (administrative) personnel charge their time to the activity "General Admin." As described in the table on page 4, their labor charges are allocated to operating companies based upon how their office's professional personnel labor charges are assigned. For instance, if 20% of American Water's Eastern Division's professional labor is assigned to LIAW during a month, then 20% of that office's monthly administrative labor charges also are assigned to the operating company.

The overhead cost category is next assigned based on professional and administrative labor costs. Thus, if 20% of the Eastern Division's accumulated professional and support labor is charged to LIAW during the month, then 20% of that month's overhead expenses will be assigned to LIAW.

Each Service Company location's office expenses are allocated to operating companies based on how professional labor charges for that office have been assigned. For instance, if 2% of professional labor from one Service Company office is assigned to LIAW, then 2% of that office's office expenses would be assigned to LIAW. Thus, office expenses are allocated in the very same way as administrative labor.

Vouchers/journal entries may be charged directly or allocated, depending on who benefits from the expenditure. For instance, the cost of a continuing professional education course taken by a professional in a divisional office is allocated to the operating companies served by that office. Travel expenses by that same professional to a rate case proceeding are charged directly to the operating company whose case is being heard.

III – Service Company Cost Comparison Approach

During 2010, the Service Company billed LIAW \$4,590,695 in O&M-related charges and \$864,628 in capital-related charges. These total charges of \$5,455,323 were subjected to a market cost comparison.

	12 Months Ended Dec 30, 2010	
Mgmt Fee Expense - O&M	\$	4,590,695
Mgmt Fees - Capital	\$	864,628
Total Testable AWWSC Charges	\$	5,455,323

For purposes of comparing these charges to certain outside benchmarks, Service Company services were placed into two categories:

- Managerial and Professional Services – Includes such services as management, accounting, legal, human resources, information technology and engineering.
- Customer Accounts Services – Includes customer-related services, such as call center, credit, billing, collection and payment processing.

Total test period Service Company charges break down between management/professional services, customer account services and field resource coordination as follows:

	12 Months Ended December 31, 2010	
	Amount	Hours
Management and Professional Services	\$ 4,407,221	31,982
Customer Account Services	\$ 1,048,102	20,646
Total Service Company Charges	\$ 5,455,323	52,628

This study's first question—whether Service Company 2010 charges are reasonable—was determined by comparing LIAW's A&G-related Service Company charges per customer to the same charges for utility companies that must file the FERC Form 60 – Annual Report of Service Companies.

The second question—whether Service Company charges during 2010 were at the lower of cost or market—was evaluated by comparing the cost per hour for managerial and professional services provided by Service Company personnel to hourly billing rates that would be charged by outside providers of equivalent services. Service Company costs per hour were based on actual charges to LIAW during 2010. Outside providers' billing rates came from surveys or other information from professionals that could perform the services now provided by the Service Company.

III – Service Company Cost Comparison Approach

The third question—whether Service Company’s 2010 customer account services charges, including those of the National Call Center costs, were comparable to other utilities—was addressed by comparing LIAW’s customer accounts services expenses to those of neighboring electric utilities. This approach was selected because the costs of outside providers of call center services are not publicly available. However, electric utility customer account services expenses can be obtained from the FERC Form 1. The availability and transparency of FERC data adds to the validity of its use in this comparison.

The fourth question—the necessity of Service Company services—was investigated by defining the services provided to LIAW and determining if these services would be required if LIAW were a stand-alone utility.

IV – Question 1 – Reasonableness of Service Company Charges

LIAW's Service Company Cost per Customer

During 2010, LIAW was charged \$55 per customer by the Service Company for A&G-related services. The calculation of this amount, shown in the table below, starts with total net testable Service Company charges and adjusts for capital and non-A&G functions (engineering, operations and water quality) charges. These adjustments are necessary to develop a per customer cost that is comparable to cost of utility service companies.

	2010 AWWSC Charges
Total Service Company charges	\$ 5,455,323
Less: Capital charges	\$ (864,628)
Less: Non-A&G function O&M charges	
Engineering	\$ (5,548)
Operations	\$ (402,414)
Water Quality	\$ (144,595)
Net A&G/O&M-related charges	\$ 4,038,138
LIAW customers	74,007
LIAW Cost Per Customer	\$ 55

Comparison Group Cost Per Customer

Every centralized service company in a holding company system must file a Form 60 in accordance with the Public Utility Holding Company Act of 2005, Section 1270, Section 390 of the Federal Power Act and 18 C.F.R. paragraph 366.23. This report is designed to collect financial information from service companies that are subject to regulation by the FERC.

For 2009, a Form 60 was filed by service companies that are part of 25 utility holding companies that own utilities providing regulated electric and, in some cases, gas service to retail customers. In order to make a valid comparison of these service companies' costs to those of American Water Works Service Company, it was necessary to isolate expenses that they have in common. These include A&G-related charges recorded in the following FERC accounts:

901 – Supervision	921 – Office supplies and expenses
903 – Customer records and collection expenses	923 – Outside services employed
905 – Miscellaneous customer accounts expenses	928 – Regulatory commission expenses
907 – Supervision	930.2 – Miscellaneous general expenses
910 – Misc customer service and info expenses	931 – Rents
911 – Supervision	935 – Maintenance of structures and equipment
920 - Administrative and general salaries	

Charges to utility affiliates for the comparison group service companies were obtained from Schedule XVI – Analysis of Charges for Service Associate and Non-Associate Companies (p. 303 to 306) of each entity's FERC Form 60. This schedule shows charges by FERC Account.

Comparison group service company 2009 expenses were also adjusted to remove charges to non-regulated affiliates from the cost pool used to calculate the cost per regulated service customer. This determination was made using information from the FERC Form 60 schedule: Account 457 – Analysis of Billing – Associate Companies.

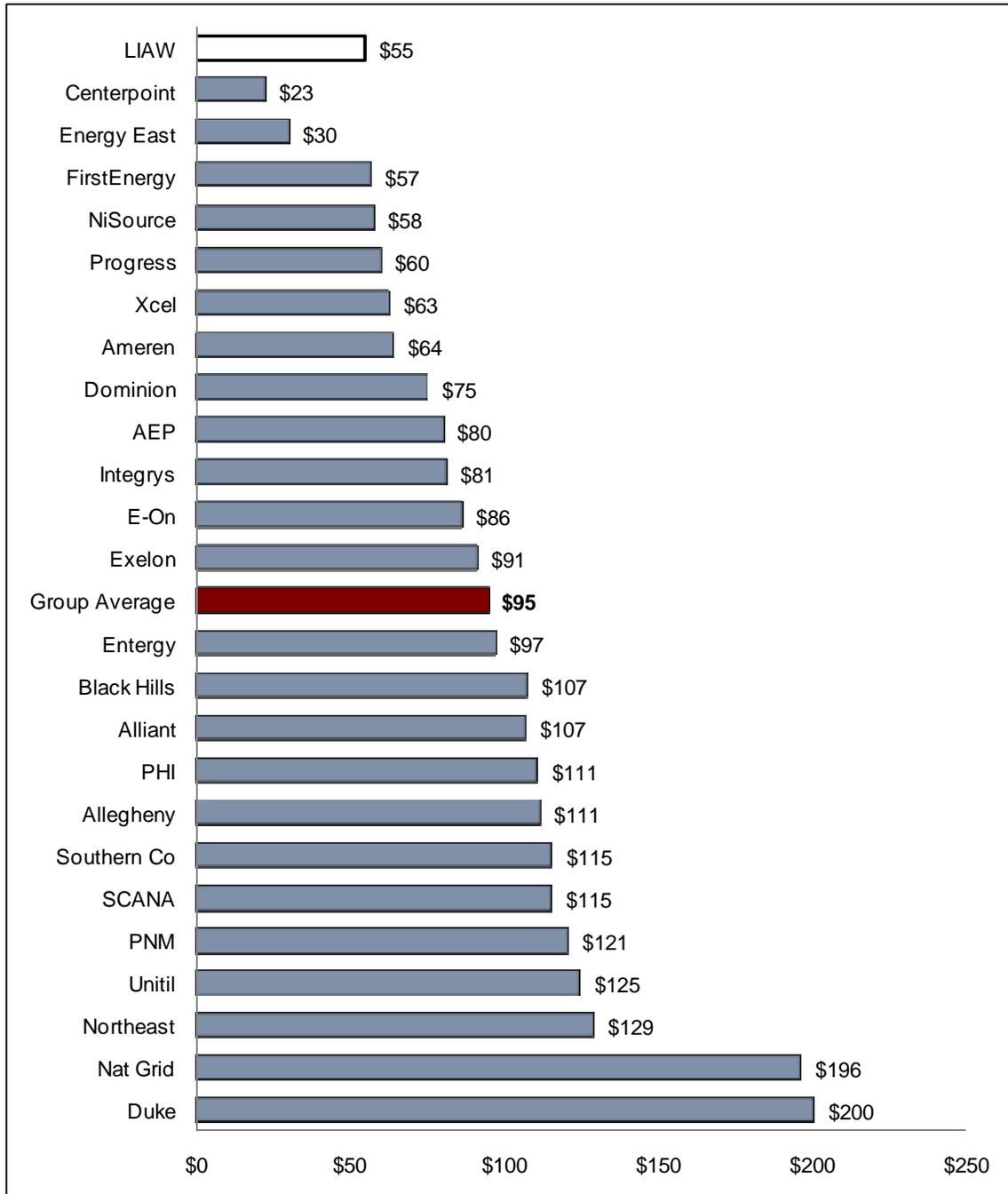
IV – Question 1 – Reasonableness of Service Company Charges

One service company that filed a Form 60 was excluded from the comparison group because its Form 60 contained no data for 2009. That service company, Great Plains Energy Services Incorporated, became inactive in 2009 and had no charges to its regulated utility affiliate. The A&G expenses per regulated utility customer for the other 24 utility companies that filed a Form 60 for 2009 are calculated below.

Utility Company	2009 Regulated Retail Service Company A&G Expenses	Regulated Retail Customers	Cost per Customer
AEP	\$418,484,117	5,213,000	\$ 80
Allegheny	\$176,685,245	1,585,700	\$ 111
Alliant	\$149,116,475	1,395,189	\$ 107
Ameren	\$212,036,412	3,300,000	\$ 64
Black Hills	\$81,484,333	759,400	\$ 107
Centerpoint	\$119,304,604	5,300,000	\$ 23
Dominion	\$279,128,940	3,700,000	\$ 75
Duke	\$901,762,388	4,500,000	\$ 200
Energy East	\$89,580,962	2,973,000	\$ 30
Entergy	\$262,596,172	2,700,000	\$ 97
E-On	\$105,893,093	1,226,000	\$ 86
Exelon	\$537,633,122	5,886,000	\$ 91
FirstEnergy	\$255,874,712	4,500,000	\$ 57
Integrus	\$175,423,352	2,157,700	\$ 81
Nat Grid	\$1,314,902,105	6,700,000	\$ 196
NiSource	\$216,480,637	3,750,000	\$ 58
Northeast	\$269,948,801	2,095,000	\$ 129
PHI	\$215,465,623	1,946,000	\$ 111
Progress	\$186,256,921	3,100,000	\$ 60
PNM	\$87,998,259	729,700	\$ 121
SCANA	\$166,555,883	1,445,000	\$ 115
Southern Co	\$508,130,523	4,402,000	\$ 115
Unitil	\$21,115,280	169,600	\$ 125
Xcel	\$333,389,459	5,300,000	\$ 63
Group Total	\$7,085,247,416	74,833,289	\$ 95

Exhibit 1 (page 11) shows LIAW's 2010 Service Company cost per customer of \$55 to be considerably lower than the average of \$95 per customer for the comparison group service companies. Only 2 of 24 comparison group service companies had a lower cost per customer than LIAW. Based on this result, it is possible to conclude that the Service Company's 2010 charges to LIAW were reasonable.

**Long Island American Water Company
Comparison of Service Company Annual Costs Per Customer**



V – Question 2 – Provision of Services at the Lower of Cost or Market

Methodology

The lower-of-cost-or-market comparison is accomplished by comparing the cost per hour for Service Company managerial and professional services to those of outside service providers to whom these duties could be assigned. Based on the nature of the Service Company services it was determined that the following outside providers could perform the categories of services indicated below:

- Management Consultants – executive and administrative management, risk management, human resources and communications services
- Attorneys – legal services
- Certified Public Accountants – accounting, financial and rates and revenues services
- IT Professionals – information technology services
- Professional Engineers – engineering, operations and water quality services.

The services provided by the Belleville lab are assumed to be transferable to professional engineers for purposes of this cost comparison. This was done for two reasons. First, there is no readily available survey of hourly billing rates for testing services such as those performed by Belleville. Second, Belleville personnel have similar, scientific educational backgrounds as Service Company engineering personnel. Thus, it is valid to compare the hourly rates of Belleville services to those of outside engineering firms.

Service Company's hourly rate were calculated for each of the five outside service provider categories, based on the dollars and hours charged to LIAW during 2010. Hourly billing rates for outside service providers were developed using third party surveys or directly from information furnished by outside providers themselves.

It should be noted that by using the Service Company's hours charged LIAW during 2010, its hourly rates are actually overstated because some Service Company personnel charge a maximum 8 per day even when they work more. Outside service providers generally bill for every hour worked. If all overtime hours of Service Company personnel had been factored into the hourly rate calculation, Service Company hourly rates would have been lower.

The last step in the market cost comparison was to compare the Service Company's average cost per hour to the average cost per hour for outside providers.

Service Company Hourly Rates

Exhibit 2 (page 14) details the assignment of 2010 management and professional Service Company charges by outsider provider category. Exhibit 3 (page 15) shows the same assignment for Service Company management and professional hours charged to LIAW during 2010.

Certain adjustments to these dollar amounts were necessary to calculate Service Company hourly rates that are directly comparable to those of outside providers. Adjustments were made to the following 2010 test period non-labor Service Company charges:

- Contract Services – 2010 Service Company charges to LIAW include expenses associated with the use of outside professional firms to perform certain corporate-wide services (e.g., legal, financial audit, actuarial services). These professional fees are

V – Question 2 – Provision of Services at the Lower of Cost or Market

excluded from the Service Company hourly rate calculation because the related services have effectively been out-sourced already.

- Travel Expenses – In general, client-related travel expenses are not recovered by outside service providers through their hourly billing rate. Rather, actual out-of-pocket travel expenses are billed to clients in addition to fees for professional services. Thus, it is appropriate to remove these Service Company charges from the hourly rate calculation.
- Information Technology Infrastructure Expenses – Included in 2010 Service Company charges to LIAW are leases, maintenance fees and depreciation related to American Water's enterprise mainframe, server and network infrastructure and corporate business applications. An outside provider that would take over operation of this infrastructure would recover these expenses over and above the labor necessary to operate the data center.

Exhibit 4 (page 16) shows how contract services, travel expenses and computer hardware/software-related Service Company charges are assigned among the five outside provider categories.

Based on the assignment of expenses and hours shown in Exhibits 2 and 3 and the excludable items shown in Exhibit 4, the Service Company's equivalent costs per hour for 2010 are calculated below.

	Attorney	Management Consultant	Certified Public Accountant	IT Professional	Professional Engineer	Total
Total management, professional & technical services charges	\$ 128,600	\$ 1,453,755	\$ 1,122,849	\$ 1,158,727	\$ 543,287	\$ 4,407,218
Less:						
Contract services	\$ 10,780	\$ 272,958	\$ 108,025	\$ 124,493	\$ (5,892)	\$ 510,364
Travel expenses	\$ 2,277	\$ 26,643	\$ 14,262	\$ 15,045	\$ 17,159	\$ 75,386
IT infrastructure expenses	\$ 3,248	\$ 430,185	\$ 10,674	\$ 214,432	\$ 21,038	\$ 679,577
Net Service Charges (A)	\$ 112,295	\$ 723,969	\$ 989,888	\$ 804,757	\$ 510,982	\$ 3,141,891
Total Hours (B)	511	4,765	13,276	5,480	7,949	31,982
Average Hourly Rate (A / B)	\$ 220	\$ 152	\$ 75	\$ 147	\$ 64	

Long Island American Water Company
Analysis of 2010 Service Company Charges By Location And Function

		12 Months Ended December 31, 2009 Service Company Charges					
Location	Function	Attorney	Management Consultant	Certified Public Accountant	IT Professional	Professional Engineer	Total
Belleville Lab	Water Quality					\$ 118,814	\$ 118,814
Call Center	Human Resources		\$ 26,036				\$ 26,036
Corporate	Accounting			\$ 290,163			\$ 290,163
	Administration		\$ 284,643				\$ 284,643
	Audit			\$ 36,489			\$ 36,489
	Communications		\$ 69,385				\$ 69,385
	Finance		\$ 531,407	\$ 205,647			\$ 737,054
	Human Resources		\$ 213,544				\$ 213,544
	Information Technology				\$ 39,529		\$ 39,529
	Legal	\$ 77,599					\$ 77,599
	Operations		\$ 113,979			\$ 384,416	\$ 498,395
	Rates & Revenue			\$ 51,353			\$ 51,353
	Risk Management		\$ 26,803				\$ 26,803
	Water Quality					\$ 1,962	\$ 1,962
Regional Offices	Accounting			\$ 12,288			\$ 12,288
	Administration		\$ 40,362				\$ 40,362
	Communications		\$ 48,202				\$ 48,202
	Engineering					\$ 5,761	\$ 5,761
	Finance			\$ 79,130			\$ 79,130
	Human Resources		\$ -				\$ -
	Legal	\$ 51,001					\$ 51,001
	Operations		\$ 4,266			\$ 31,863	\$ 36,129
	Risk Management		\$ 37,015				\$ 37,015
	Water Quality					\$ 471	\$ 471
Information Technology	Information Technology				\$ 1,119,198		\$ 1,119,198
Shared Services	Accounting			\$ 320,121			\$ 320,121
	Administration		\$ 58,113				\$ 58,113
	Finance			\$ 1,480			\$ 1,480
	Rates & Revenue			\$ 126,178			\$ 126,178
Total Dollars Charged		\$ 128,600	\$ 1,453,755	\$ 1,122,849	\$ 1,158,727	\$ 543,287	\$ 4,407,218

Long Island American Water Company
Analysis of 2010 Service Company Hours By Location And Function

		12 Months Ended December 31, 2009 Service Company Hours					
Location	Function	Attorney	Management Consultant	Certified Public Accountant	IT Professional	Professional Engineer	Total
Belleville Lab	Water Quality					1,149	1,149
Call Center	Human Resources		287				287
Corporate	Accounting			2,536			2,536
	Administration		518				518
	Audit			252			252
	Communications		282				282
	Finance		505	1,611			2,115
	Human Resources		1,317				1,317
	Information Technology				307		307
	Legal	255					255
	Operations		263			6,629	6,893
	Rates & Revenue			277			277
	Risk Management		163				163
	Water Quality					-	-
Regional Offices	Accounting			126			126
	Administration		-				-
	Communications		349				349
	Engineering					-	-
	Finance			417			417
	Human Resources		(1)				(1)
	Legal	256					256
	Operations		6			170	176
	Risk Management		821				821
	Water Quality					-	-
Information Technology	Information Technology				5,173		5,173
Shared Services	Accounting			5,879			5,879
	Administration		255				255
	Finance						-
	Rates & Revenue			2,179			2,179
Total Hours Charged		511	4,765	13,276	5,480	7,949	31,982

Long Island American Water Company
2010 Service Company Charges Excludable From The Hourly Rate Calculation

Charges By Function	Exclusions From Hourly Rate Calculation			
	Contract Services	Travel Expenses	IT HW/SW	Total
Accounting	\$ 86,634	\$ 5,630	\$ 4,126	\$ 96,390
Administration	\$ 21,984	\$ 3,604	\$ 152,015	\$ 177,603
Audit	\$ 4,241	\$ 431	\$ 710	\$ 5,382
Communications	\$ 11,182	\$ 5,449	\$ 1,346	\$ 17,977
Engineering		\$ (4)	\$ 105	\$ 101
Finance	\$ 204,857	\$ 11,153	\$ 272,911	\$ 488,921
Human Resources	\$ 38,936	\$ 8,166	\$ 3,312	\$ 50,414
Information Technology	\$ 124,493	\$ 15,045	\$ 214,432	\$ 353,970
Legal	\$ 10,780	\$ 2,277	\$ 3,248	\$ 16,305
Operations	\$ 3,373	\$ 18,908	\$ 8,705	\$ 30,986
Rates & Revenue	\$ 11,928	\$ 2,698	\$ 1,404	\$ 16,030
Risk Management	\$ 986	\$ 1,655	\$ 1,411	\$ 4,052
Water Quality	\$ (9,030)	\$ 370	\$ 15,957	\$ 7,297
Total	\$ 510,364	\$ 75,382	\$ 679,682	\$ 1,265,428

Outside Service Provider Category
Certified Public Accountant
Management Consultant
Certified Public Accountant
Management Consultant
Professional Engineer
Management Consultant
Certified Public Accountant
Management Consultant
IT Professional
Attorney
Management Consultant,
Professional Engineer
Certified Public Accountant
Management Consultant
Professional Engineer

Recap By Outside Provider	Exclusions From Hourly Rate Calculation			
	Contract Services	Travel Expenses	IT HW/SW	Total
Attorney	\$ 10,780	\$ 2,277	\$ 3,248	\$ 16,305
Management Consultant	\$ 272,958	\$ 26,643	\$ 430,185	\$ 729,786
Certified Public Accountant	\$ 108,025	\$ 14,262	\$ 10,674	\$ 132,961
IT Professional	\$ 124,493	\$ 15,045	\$ 214,432	\$ 353,970
Professional Engineer	\$ (5,892)	\$ 17,159	\$ 21,038	\$ 32,305
Total	\$ 510,364	\$ 75,386	\$ 679,577	\$ 1,265,327

Outside Service Provider Hourly Rates

The next step in the cost comparison was to obtain the average billing rates for each outside service provider. The source of this information and the determination of the average rates are described in the paragraphs that follow.

It should be noted that professionals working for three of the five outside provider categories may be licensed to practice by state regulatory bodies. However, not every professional working for these firms is licensed. For instance, among New York certified public accounting firms, only more experienced staff are predominantly CPAs (see table below). Some Service Company employees also have professional licenses. Thus, it is valid to compare the Service Company's hourly rates to those of the outside professional service providers included in this study.

Position	New York Average
Partners/Owners	94%
Directors (11+ years experience)	87%
Managers (6-10 years experience)	80%
Sr Associates (4-5 years experience)	39%
Associates (1-3 years experience)	13%
New Professionals	0%

Source: AICPA's National PCPS/TSCPA Management of an Accounting Practice Survey (2010)

Attorneys

The New York State Bar does not survey its members as to their hourly billing rates. As a result, an estimate of New York hourly rates was developed from two surveys conducted by Lawyers Weekly in the states of Michigan and Massachusetts. As presented in Exhibit 5 (page 19), the average rate for each firm in these surveys was adjusted for the cost of living differential between their locations and Lynbrook, New York. The cost of living indices utilized in this analysis were obtained from the Council for Community and Economic Research, a membership organization created in 1961 to develop high quality regional economic data and analytical methods. The Lawyers Weekly surveys included rates in effect at December 31, 2009. Thus, the 2009 average rate was escalated to June 30, 2010—the midpoint of 2010.

Management Consultants

The cost per hour for management consultants was developed from a 2010 survey performed by the Association of Management Consulting Firms—an industry trade organization. The survey includes rates that were in effect during 2009 for firms throughout the United States. Consultants typically do not limit their practice to any one region and must travel to a client's location. Thus, the U.S. national average is appropriate for comparison.

The first step in the calculation, presented in Exhibit 6 (page 20), was to determine an average rate by consultant position level. From these rates, a single weighted average hourly rate was calculated based upon the percent of time that is typically applied to a consulting assignment by each consultant position level. The 2009 average rate was escalated to June 30, 2010—the midpoint of 2010.

V – Question 2 – Provision of Services at the Lower of Cost or Market

Certified Public Accountants

The average hourly rate for New York CPAs was developed from a 2010 survey performed by the American Institute of Certified Public Accountants (AICPA). The New York version of this survey was used to develop hourly rates for member firms in New York.

As shown in Exhibit 7 (page 21), a weighted average hourly rate was developed based on a set of accountant positions and a percent of time that is typically applied to an accounting assignment. This survey includes rate information in effect during 2009. Thus, the data had to be escalated to June 30, 2010—the midpoint of 2010.

Information Technology Professionals

The average hourly rate for information technology consultants and contractors was developed from Baryenbruch & Company, LLC IT industry hourly billing rate data. As shown in Exhibit 8 (page 22), that data was compiled and a weighted average was calculated based on a percent of time that is typically applied to an IT consulting assignment based on Baryenbruch & Company, LLC's experience.

Professional Engineers

The Company provided hourly rate information for outside engineering firms that could have been used by LIAW in 2010. As presented in Exhibit 9 (page 23), an average rate was developed for each engineering position level. Then, using a typical percentage mix of project time by engineering position, a weighted average cost per hour was calculated.

Long Island American Water Company
Estimated Billing Rates For New York Attorneys Based On
Michigan and Massachusetts Attorney Billing Rates

Billing rates during 2009		Billing Rate Range (A)					Average	Cost of Living Adjust (B)	Adjusted Rate
Firm	Location	Associate		Partner					
		Low	High	Low	High				
Dickinson Wright	Detroit, Mi	\$ 195	\$ 275	\$ 355	\$ 575	\$ 350	87%	\$ 400	
Dykema	Detroit, Mi	\$ 185	\$ 425	\$ 295	\$ 615	\$ 380	87%	\$ 435	
Butzel Long	Detroit, Mi	\$ 175	\$ 325	\$ 260	\$ 600	\$ 340	87%	\$ 389	
Jaffe Raitt Heuer & Weiss	Southfield, Mi	\$ 175	\$ 250	\$ 225	\$ 550	\$ 300	87%	\$ 343	
Brooks Kushman	Southfield, Mi	\$ 180	\$ 275	\$ 300	\$ 425	\$ 295	87%	\$ 338	
Kemp, Klein, Umphrey, Edelman	Troy, Mi	\$ 145	\$ 260	\$ 200	\$ 350	\$ 239	87%	\$ 273	
Rader, Fishman & Grauer	Bloomfield Hills, Mi	\$ 130	\$ 250	\$ 275	\$ 550	\$ 301	87%	\$ 345	
Williams, Williams, Rattner & Plunket	Birmingham, Mi	\$ 150	\$ 250	\$ 275	\$ 450	\$ 281	87%	\$ 322	
Abbott, Nicholson, Quilter, Esshaki,	Detroit, Mi	\$ 150	\$ 220	\$ 300	\$ 375	\$ 261	87%	\$ 299	
Parmenter O'Toole	Muskegon, Mi			\$ 125	\$ 275	\$ 200	79%	\$ 254	
Lipson, Neilson, Cole, Seltzer & Garir	Bloomfield Hills, Mi	\$ 185	\$ 235	\$ 225	\$ 300	\$ 236	87%	\$ 270	
Burns & Levinson	Boston, Ma	\$ 210	\$ 350	\$ 375	\$ 525	\$ 365	112%	\$ 327	
Sullivan & Worcester	Boston, Ma	\$ 290	\$ 535	\$ 475	\$ 830	\$ 533	112%	\$ 477	
Holland & Knight	Boston, Ma	\$ 215	\$ 450	\$ 445	\$ 800	\$ 478	112%	\$ 428	
Seyfarth Shaw	Boston, Ma	\$ 327	\$ 327	\$ 511	\$ 511	\$ 419	112%	\$ 375	
Bowditch & Dewey	Worcester, Ma	\$ 125	\$ 220	\$ 250	\$ 550	\$ 286	112%	\$ 256	
Prince Lobel	Boston, Ma	\$ 195	\$ 325	\$ 325	\$ 525	\$ 343	112%	\$ 307	
Hinckley, Allen & Snyder	Boston, Ma	\$ 205	\$ 395	\$ 360	\$ 645	\$ 401	112%	\$ 359	
Mirick O'Connell	Worcester, Ma	\$ 220	\$ 220	\$ 350	\$ 350	\$ 285	112%	\$ 255	
Lawson & Weitzen	Boston, Ma	\$ 125	\$ 225	\$ 225	\$ 450	\$ 256	112%	\$ 229	
Sunstein Kann Murphy Timbers	Boston, Ma	\$ 285	\$ 535	\$ 575	\$ 825	\$ 555	112%	\$ 497	
Keegan Werlin	Boston, Ma	\$ 200	\$ 300	\$ 300	\$ 475	\$ 319	112%	\$ 285	
Rich May	Boston, Ma	\$ 150	\$ 325	\$ 295	\$ 400	\$ 293	112%	\$ 262	
Anderson Kreiger	Cambridge, Ma	\$ 285	\$ 285	\$ 450	\$ 450	\$ 368	112%	\$ 329	
Bernkopf Goodman	Boston, Ma	\$ 205	\$ 395	\$ 375	\$ 550	\$ 381	112%	\$ 341	
Tarlow Breed Hart & Rodgers	Boston, Ma	\$ 225	\$ 365	\$ 375	\$ 495	\$ 365	112%	\$ 327	
Donoghue Barrett & Singal	Boston, Ma	\$ 225	\$ 390	\$ 350	\$ 450	\$ 354	112%	\$ 317	
Cesari and McKenna	Boston, Ma	\$ 150	\$ 400	\$ 425	\$ 525	\$ 375	112%	\$ 336	
Overall Average 2009 Billing Rate								\$ 335	
<u>Escalation to Test Period Midpoint (June 30, 2010) (Note B)</u>									
CPI at December 31, 2009								216.0	
CPI at June 30, 2010								218.0	
Inflation/Escalation								0.9%	
Average Hourly Billing Rate For Attorneys At June 30, 2010								\$ 338	

Note A: Source is Michigan Lawyers Weekly and Massachusetts Lawyers Weekly

Note B: Source is Council for Community and Economic Research. This percentage represents the cost of living difference between the Michigan and Massachusetts cities and Lynbrook, New York. A number over 100% indicates the Michigan or Massachusetts city's cost of living is higher than Lynbrook. A number less than 100% indicates Lynbrook's cost of living is higher.

**Long Island American Water Company
Billing Rates of U.S. Management Consultants**

Survey billing rates in effect in 2009 (Note A)						
A. Calculation of Average Hourly Billing Rate by Consultant Position						
Average	Average Hourly Rates (Note A)					
	Entry-Level Consultant	Associate Consultant	Senior Consultant	Junior Partner	Senior Partner	
	\$ 155	\$ 215	\$ 279	\$ 328	\$ 413	
B. Calculation of Overall Average Hourly Billing Rate Based on a Typical Distribution of Time on an Engagement						
Average Hourly Billing Rate (from above)	Entry-Level Consultant	Associate Consultant	Senior Consultant	Junior Partner	Senior Partner	
	\$ 155	\$215	\$279	\$328	\$413	
	30%	30%	20%	10%	10%	Weighted Average
Percent of Consulting Assignment	\$ 46	\$ 64	\$ 56	\$ 33	\$ 41	\$ 240
<u>Escalation to Test Period Midpoint (June 30, 2010) (Note B)</u>						
					CPI at December 31, 2009	216.0
					CPI at June 30, 2010	218.0
					Inflation/Escalation	0.9%
Average Hourly Billing Rate For CPAs At June 30, 2010						\$ 243

Note A: Source is "Operating Ratios For Management Consulting Firms, 2010 Edition," Association of Management Consulting Firms

Note B: Source is U.S. Bureau of Labor Statistics (<ftp://ftp.bls.gov/pub/special.requests/cpi/cpi.ai.txt>)

**Long Island American Water Company
Billing Rates Of New York Certified Public Accountants**

Survey billing rates were those in effect in 2009 (Note A)					
Average Hourly Billing Rate (Note A)					
	Staff Accountant	Senior Accountant	Manager	Partner	
Type of Firm					
Average Hourly Rate	\$ 101	\$ 151	\$ 220	\$ 275	
B. Calculation of Overall Average Accountant Billing Rate Based Upon Typical Distribution of Time on an Engagement					
Average Hourly Billing Rate (From Above)					
	Staff Accountant	Senior Accountant	Manager	Partner	
Average Hourly Billing Rate (From Above)	\$ 101	\$ 151	\$ 220	\$ 275	
Typical Percent of Time Spent on an Accounting Assignment	30%	30%	20%	20%	Weighted Average
	\$ 30	\$ 45	\$ 44	\$ 55	\$ 175
<u>Escalation to Test Period Midpoint (June 30, 2010) (Note B)</u>					
				CPI at December 31, 2009	216.0
				CPI at June 30, 2010	218.0
				Inflation/Escalation	0.9%
				Average Hourly Billing Rate For CPAs At June 30, 2010	\$ 176

Note A: Source is AICPA's 2010 National PCPS/TSCPA Management of an Accounting Practice Survey (New York edition)

Note B: Source is US Bureau of Labor Statistics (<ftp://ftp.bls.gov/pub/special.requests/cpi/cpiat.txt>)

**Long Island American Water Company
Billing Rates of Information Technology Professionals**

IT Resource Level	2010 Hourly Rate (A)
Consultant Positions	
Senior Manager/Partner Consultant	\$ 350
Staff/Manager Consultant	\$ 245
Contractor Positions	
Senior Contractor	\$ 145
Contractor	\$ 63

Overall Average	2010 Rate	% of Project/Assignment	
Senior Manager/Partner Consultant	\$ 350	10%	\$ 35
Staff/Manager Consultant	\$ 245	30%	\$ 73
Senior Contractor	\$ 145	30%	\$ 44
Contractor	\$ 63	30%	\$ 19
Weighted Average			\$ 171

Note A: Source is Baryenbruch & Company, LLC

Long Island American Water Company Billing Rates Of New York Engineers

A. Calculation of Average Hourly Rate by Engineer Position				
Name of Firm	Average Hourly Billing Rates			
	Technician	Engineer	Project Manager	Officer
	Senior Technician	Design Engineer Project Engineer	Sr. Mgr. Engineer	Principal Engineer
Firm #1	\$73	\$101	\$130	\$155
Firm #2	\$67	\$81	\$127	\$162
Firm #3	\$78	\$100	\$123	\$163
Firm #4	\$73	\$72	\$127	\$165
Firm #5	\$58	\$73	\$132	\$171
Firm #6	\$68	\$95	\$136	\$173
Firm #7	\$80	\$98	\$149	\$182
Firm #8	\$94	\$87	\$141	\$184
Firm #9	\$73	\$70	\$141	\$185
Firm #10	\$87	\$112	\$168	\$190
Firm #11	\$78	\$97	\$148	\$199
Firm #12	\$85	\$90	\$144	\$200
Firm #13	\$93	\$109	\$144	\$200
Firm #14	\$77	\$109	\$146	\$205
Firm #15	\$108	\$126	\$168	\$208
Firm #16	\$68	\$96	\$153	\$208
Firm #17	\$76	\$118	\$167	\$209
Firm #18	\$95	\$115	\$176	\$210
Firm #19	\$91	\$126	\$184	\$217
Firm #20	\$114	\$154	\$203	\$225
Firm #21	\$85	\$122	\$193	\$225
Firm #22	\$60	\$83	\$95	NA
Firm #23	\$78	\$95	\$165	NA
Firm #24	\$91	\$119	\$177	\$195

B. Calculation of Overall Average Engineering Hourly Billing Rate					
	Technician	Engineer	Project Manager	Officer	
	Senior Technician	Design Engineer Project Engineer	Sr. Mgr. Engineer	Principal Engineer	
Average Hourly Billing Rate (From Above)	\$81	\$102	\$151	\$192	
Typical Percent of Time on an Engineering Assignment	30%	35%	25%	10%	Weighted Average
	\$24	\$36	\$38	\$19	\$117

Source: Information provided by American Water Works Service Company

V – Question 2 – Provision of Services at the Lower of Cost or Market

Service Company versus Outside Provider Cost Comparison

As shown in the table below, Service Company costs per hour are considerably lower than those of outside providers.

12 Months Ended December 31, 2010			
Service Provider	Service Company	Outside Provider	Difference-- Service Co. Greater(Less) Than Outside
Attorney	\$ 220	\$ 338	\$ (118)
Management Consultant	\$ 152	\$ 243	\$ (91)
Certified Public Accountant	\$ 75	\$ 176	\$ (102)
IT Professional	\$ 147	\$ 171	\$ (24)
Professional Engineer	\$ 64	\$ 117	\$ (53)

Based on these cost per hour differentials and the number of managerial and professional services hours billed to LIAW during 2010, outside service providers would have cost \$2,391,733 more than the Service Company (see table below). Thus, on average, outside provider's hourly rates are 54% higher than those of the Service Company (\$2,391,733 / \$4,407,221).

12 Months Ended December 31, 2010			
Service Provider	Hourly Rate Difference-- Service Co. Greater(Less) Than Outside	Service Company Hours Charged	Dollar Difference
Attorney	\$ (118)	511	\$ (60,256)
Management Consultant	\$ (91)	4,765	\$ (432,764)
Certified Public Accountant	\$ (102)	13,276	\$ (1,348,508)
IT Professional	\$ (24)	5,480	\$ (130,667)
Professional Engineer	\$ (53)	7,949	\$ (419,538)
Service Company Less Than Outside Providers			\$ (2,391,733)

It should be noted that the cost differential associated with using outside providers is even greater because exempt Service Company personnel do not charge more than 8 hours per day even when they work more. Outside providers generally charge clients for all hours worked. Thus, LIAW would have been charged by outside providers for overtime worked by Service Company personnel who are not paid for that time.

If LIAW were to use outside service providers rather than the Service Company for managerial and professional services, it would incur other additional expenses besides those associated with higher hourly rates. Managing outside firms who would perform almost 32,000 hours of work (more than 21 full-time equivalents at 1,500 "billable" hours per FTE per year) would add a significant workload to the existing LIAW management team. Thus, it would be necessary for LIAW to add at least one position to supervise the outside firms and ensure they delivered quality and timely services. The individuals that would fill this position would need a good understanding of each profession being managed. They must also have management experience and the authority necessary to give them credibility with the outside firms. As calculated in the table below, this position would add almost \$165,000 per year to LIAW's personnel expenses.

V – Question 2 – Provision of Services at the Lower of Cost or Market

<u>Cost of Adding 1 Professional Position To LIAW's S</u>	
	<u>Total</u>
New Positions' Salary	\$ 100,000
Benefits (at 49.4%)	\$ 49,400
Office Expenses (15.2%)	\$ 15,200
Total Cost of One Position	\$ 164,600

Thus, the total effect on the ratepayers of LIAW of contracting all services now provided by Service Company would be an increase in their costs of \$2,556,333 (\$2,391,733 + \$164,600). Based on the results of this comparison, it is possible to conclude that the Service Company charged LIAW at the lower of cost or market for services provided during 2010.

VI - Question 3 - Reasonableness of Customer Accounts Services Costs

Background

Customer Accounts Services covers the following utility functions:

- Customer Call Center – customer calls/contact, credit, order taking/disposition, bill collection efforts, outage calls
- Call Center IT – maintenance of phone banks, voice recognition units, call center software applications, telecommunications
- Customer billing – bill printing, stuffing, and mailing
- Remittance processing – processing customer payments received in the mail
- Bill payment centers – locations where customers can pay their bills in person

It is difficult to compare the cost of the Service Company's customer accounts services-related charges to LIAW with outside providers of the same services because survey data is proprietary and expensive to obtain. For this reason, LIAW's charges from the Service Company for customer accounts services are compared to those of neighboring electric utilities because the data necessary to make such comparison is available to the public.

Neighboring electric utility cost information comes from the 2009 FERC Form 1 that each utility must file. FERC's chart of accounts is defined in Chapter 18, Part 101 of the Code of Federal Regulations. FERC accounts that contain customer accounts services-related expenses are Account 903 Customer Accounts Expense – Records and Collection Expense and Account 905 Customer Accounts Expense – Miscellaneous Customer Accounts Expense. Exhibit 10 (pages 27-28) provides FERC's definition of the type of expenses that should be recorded in these accounts.

In addition to the charges in these FERC accounts, labor-related overheads charged to the following FERC accounts must be added to the labor components of Accounts 903 and 905:

- Account 926 Employee Pension and Benefits
- Account 408 Taxes Other Than Income (employer's portion of FICA)

Comparison Group

Electric utilities included in the comparison group are shown in the table below. These are companies whose FERC Form 1 show amounts for accounts 903 and 905.

New York	<ul style="list-style-type: none"> • Central Hudson Gas & Elect • Consolidated Edison • New York State Gas & Elect 	<ul style="list-style-type: none"> • Niagra Mohawk Power • Orange & Rockland Utilities • Rochester Gas & Elect
Pennsylvania	<ul style="list-style-type: none"> • Duquesne Light • Metropolitan Edison • PECO Energy • Pennsylvania Electric 	<ul style="list-style-type: none"> • Pennsylvania Power • PPL Electric Utilities • West Penn Power
New Jersey	<ul style="list-style-type: none"> • Atlantic City Electric • Jersey Central Power 	<ul style="list-style-type: none"> • Public Service Elect & Gas
Connecticut	<ul style="list-style-type: none"> • Connecticut Light & Power 	<ul style="list-style-type: none"> • United Illuminating
Massachusetts	<ul style="list-style-type: none"> • Fitchburg Gas & Electric • Massachusetts Electric 	<ul style="list-style-type: none"> • Western Mass Electric
Vermont	<ul style="list-style-type: none"> • Central Vermont Pub Svc 	<ul style="list-style-type: none"> • Green Mountain Power

Long Island American Water Company FERC Account Descriptions

903 – Customer Records and Collection Expenses

This account shall include the cost of labor, materials used and expenses incurred in work on customer applications, contracts, orders, credit investigations, billing and accounting, collections and complaints.

Labor

1. Receiving, preparing, recording and handling routine orders for service, disconnections, transfers or meter tests initiated by the customer, excluding the cost of carrying out such orders, which is chargeable to the account appropriate for the work called for by such orders.
2. Investigations of customers' credit and keeping of records pertaining thereto, including records of uncollectible accounts written off.
3. Receiving, refunding or applying customer deposits and maintaining customer deposit, line extension, and other miscellaneous records.
4. Checking consumption shown by meter readers' reports where incidental to preparation of billing data.
5. Preparing address plates and addressing bills and delinquent notices.
6. Preparing billing data.
7. Operating billing and bookkeeping machines.
8. Verifying billing records with contracts or rate schedules.
9. Preparing bills for delivery, and mailing or delivering bills.
10. Collecting revenues, including collection from prepayment meters unless incidental to meter reading operations.
11. Balancing collections, preparing collections for deposit, and preparing cash reports.
12. Posting collections and other credits or charges to customer accounts and extending unpaid balances.
13. Balancing customer accounts and controls.
14. Preparing, mailing, or delivering delinquent notices and preparing reports of delinquent accounts.
15. Final meter reading of delinquent accounts when done by collectors incidental to regular activities.
16. Disconnecting and reconnecting services because of nonpayment of bills.
17. Receiving, recording, and handling of inquiries, complaints, and requests for investigations from customers, including preparation of necessary orders, but excluding the cost of carrying out such orders, which is chargeable to the account appropriate for the work called for by such orders.
18. Statistical and tabulating work on customer accounts and revenues, but not including special analyses for sales department, rate department, or other general purposes, unless incidental to regular customer accounting routines.
19. Preparing and periodically rewriting meter reading sheets.
20. Determining consumption and computing estimated or average consumption when performed by employees other than those engaged in reading meters.

Materials and expenses

21. Address plates and supplies.
22. Cash overages and shortages.
23. Commissions or fees to others for collecting.
24. Payments to credit organizations for investigations and reports.
25. Postage.
26. Transportation expenses, including transportation of customer bills and meter books under centralized billing procedure.
27. Transportation, meals, and incidental expenses.
28. Bank charges, exchange, and other fees for cashing and depositing customers' checks.
29. Forms for recording orders for services, removals, etc.
30. Rent of mechanical equipment.

**Long Island American Water Company
FERC Account Descriptions**

905 – Miscellaneous Customer Accounts Expenses

This account shall include the cost of labor, materials used and expenses incurred not provided for in other accounts.

Labor

1. General clerical and stenographic work.
2. Miscellaneous labor.

Materials and expenses

3. Communication service.
4. Miscellaneous office supplies and expenses and stationery and printing other than those specifically provided for in accounts 902 and 903.

VI - Question 3 - Reasonableness of Customer Accounts Services Costs

LIAW Cost per Customer

As calculated below, LIAW's 2010 customer account services expense per customer was \$24.96. The cost pool used to calculate this average includes charges for Service Company services (e.g., call center, billing, payment processing) and postage and forms expenses, which are incurred directly by LIAW. It was necessary to adjust the National Call Center charges because electric utilities experience an average of 2.50 calls per customer compared to American Water's 1.54 calls per customer. Thus, National Call Center expenses had to be increased, for comparison purposes, to reflect its costs at a 2.50 calls per customer level.

Long Island American Cost Per Customer		Year Ended 12/31/2010	Adjustment Fewer Service Co Calls For	Water Cos. (A)	Adjusted
Service Company					
Call Centers	Call processing, order processing, credit, bill collection	\$ 1,041,448	\$ 280,193		\$ 1,321,642
Regional Offices		\$ 6,653			\$ 6,653
Operating Company	Customer payment processing				\$ 95,025 Note B
Operating Company	Postage & forms				\$ 423,805
		Cost Pool Total			\$ 1,847,125
		Total Customers			74,007
12 Months Ended December 31, 2010 Cost Per LIAW Customer					<u>\$ 24.96</u>

Note A: Adjustment for American Water's fewer calls per customer

This adjustment is necessary because water utilities experience fewer calls per customer than do electric utilities

Call handling expenses	\$ 450,139
Electric utility industry's avg calls/customer	2.50
American Water's avg calls/customer	1.54
Percent different	62%
Total Adjustment	\$ 280,193

Note B: Estimated customer payment processing expenses

Number of customers	74,007
Number of payments/customer/year	12
Total payments processed/year	888,084
Bank charge per item	\$ 0.1070
Total estimated annual expense	\$ 95,025

Electric Utility Group Cost per Customer

Exhibit 11 (pages 31-34) shows the actual 2009 customer accounts expense per customer calculation for the electric utility comparison group. All of the underlying data was obtained from the utilities' FERC Form 1.

VI - Question 3 - Reasonableness of Customer Accounts Services Costs

Summary of Results

As shown in the table below, LIAW's cost per customer is below the average cost of the neighboring electric utility comparison group. It can therefore be concluded that LIAW's 2010 customer accounts-related expenses, including those of the Alton and Pensacola Call Centers, assigned by the Service Company to LIAW were comparable to those of other utilities.

Average Customer Accounts Expense Per Customer	
West Penn Power	\$ 12.90
Pennsylvania Electric	\$ 15.59
Pennsylvania Power	\$ 16.65
Duquesne Light	\$ 16.83
Metropolitan Edison	\$ 16.98
Jersey Central Power	\$ 17.66
Central Vermont Pub Service	\$ 18.54
Green Mountain Power	\$ 22.76
Long Island American Water	\$ 24.96
PPL Electric Utilities	\$ 29.30
Rochester Gas & Electric	\$ 31.61
Niagra Mohawk Power	\$ 32.06
Western Mass Electric	\$ 33.67
Connecticut Light & Power	\$ 38.08
New York State Electric & Gas	\$ 40.86
Massachusetts Electric	\$ 41.63
Comparison Group Average	\$ 45.57
Fitchburg Gas & Electric	\$ 46.25
Central Hudson Gas & Electric	\$ 49.98
United Illuminating	\$ 52.78
Consolidated Edison	\$ 54.53
Orange & Rockland Utilities	\$ 58.04
PECO Energy	\$ 60.99
Atlantic City Electric	\$ 73.00
Public Service Electric & Gas	\$ 94.95

Long Island American Water Company Comparison Group 2009 Customer Accounts Expense Per Customer

New York						
	Central Hudson Gas & Electric	Consolidated Edison	New York State Electric & Gas	Niagra Mohaw k Pow er	Orange & Rockland Utilities	Rochester Gas & Electric
Customer Account Management Cost Pool						
FERC Account Balances:						
Account 903 - Customer Records & Collection (page 322, line 161)	\$ 7,473,794	\$ 116,295,568	\$ 33,086,419	\$ 39,838,790	\$ 8,445,381	\$ 11,789,265
Account 905 - Misc Customer Accounts (page 322, line 163)	\$ 2,442,189	\$ 355,012	\$ 389,911	\$ 1,069,573	\$ 88,789	\$ 83,465
Subtotal	\$ 9,915,983	\$ 116,650,580	\$ 33,476,330	\$ 40,908,363	\$ 8,534,170	\$ 11,872,730
Add: Employee Benefits & Employer FICA (not included in above amounts)						
Account 926 - Employee Pension & Benefits Note A	\$ 3,628,517	\$ 54,133,608	\$ 248,623	\$ 2,224,149	\$ 3,785,341	\$ (1,131,464)
Account 408 - Taxes Other Than Income (Employer's Portion of FICA) Note B	\$ 553,629	\$ 7,968,797	\$ 2,037,841	\$ 360,402	\$ 642,347	\$ 717,653
Total Cost Pool	\$ 14,098,128	\$ 178,752,985	\$ 35,762,794	\$ 43,492,914	\$ 12,961,858	\$ 11,458,919
Total Customers (page 304, line 43)	282,069	3,277,855	875,290	1,356,403	223,336	362,510
Customer Account Services Expense per Customer	\$ 49.98	\$ 54.53	\$ 40.86	\$ 32.06	\$ 58.04	\$ 31.61
Note A: Calculation of Pension & Benefits Pertaining to Customer Account Mgmt						
Account 926 - Employee Pension & Benefits (page 323, line 187)	\$ 28,917,048	\$ 309,686,425	\$ 1,320,903	\$ 94,953,663	\$ 28,030,935	\$ (6,292,595)
Total O&M Payroll (page 355, line 65)	\$ 57,674,266	\$ 595,918,020	\$ 141,526,577	\$ 201,128,526	\$ 62,178,617	\$ 52,172,554
Benefits as Percent of Payroll	50.1%	52.0%	0.9%	47.2%	45.1%	-12.1%
Payroll Applicable to Customer Account Services						
Total Payroll Charged to Customer Accounts Function						
Electric (page 354, line 7)	\$ 7,822,289	\$ 108,428,498	\$ 27,562,426	\$ -	\$ 7,755,378	\$ 6,783,478
Gas (page 354, line 37)	\$ 1,384,435	\$ 23,801,394	\$ 5,087,185	\$ 5,241,609	\$ 3,468,065	\$ 4,569,391
Total Payroll Charged to Customer Accounts	\$ 9,206,724	\$ 132,229,892	\$ 32,649,611	\$ 5,241,609	\$ 11,223,443	\$ 11,352,869
Percent Applicable to Customer Accounts Services (903 and 905):						
Account 903 - Customer Records & Collection (page 322, line 161)	\$ 7,473,794	\$ 116,295,568	\$ 33,086,419	\$ 39,838,790	\$ 8,445,381	\$ 11,789,265
Account 905 - Misc Customer Accounts (page 322, line 163)	\$ 2,442,189	\$ 355,012	\$ 389,911	\$ 1,069,573	\$ 88,789	\$ 83,465
Subtotal - Total Charges Applicable to Customer Accounts Services	\$ 9,915,983	\$ 116,650,580	\$ 33,476,330	\$ 40,908,363	\$ 8,534,170	\$ 11,872,730
Account 902 - Meter Reading Expenses (page 322, line 160)	\$ 2,698,913	\$ 31,425,607	\$ 7,554,188	\$ 4,606,263	\$ 2,873,026	\$ 2,495,495
Total Charges Applicable to Customer Accounts Svcs & Meter Reading	\$ 12,614,896	\$ 148,076,187	\$ 41,030,518	\$ 45,514,626	\$ 11,407,196	\$ 14,368,225
Percent Applicable to Customer Accounts Services (903 and 905)	78.6%	78.8%	81.6%	89.9%	74.8%	82.6%
Customer Account Services Portion of Total Payroll	\$ 7,236,978	\$ 104,167,280	\$ 26,638,444	\$ 4,711,137	\$ 8,396,697	\$ 9,381,086
Pension & Benefits Pertaining to Customer Accounts Services	\$ 3,628,517	\$ 54,133,608	\$ 248,623	\$ 2,224,149	\$ 3,785,341	\$ (1,131,464)
Note B: Calculation of Employer's FICA Pertaining to Customer Accounts Services						
Customer Account Services Portion of Total Payroll	\$ 7,236,978	\$ 104,167,280	\$ 26,638,444	\$ 4,711,137	\$ 8,396,697	\$ 9,381,086
Employer's Portion of FICA (6.20%) and Medicare (1.45%)	7.65%	7.65%	7.65%	7.65%	7.65%	7.65%
Estimated Employer's Portion of FICA	\$ 553,629	\$ 7,968,797	\$ 2,037,841	\$ 360,402	\$ 642,347	\$ 717,653

Long Island American Water Company Comparison Group 2009 Customer Accounts Expense Per Customer

Pennsylvania							
	Duquesne Light	Metropolitan Edison	PECO Energy	Pennsylvania Electric	Pennsylvania Power	PPL Electric Utilities	West Penn Power
Customer Account Management Cost Pool							
FERC Account Balances:							
Account 903 - Customer Records & Collection (page 322, line 161)	\$ 7,251,333	\$ 8,147,866	\$ 54,108,164	\$ 8,285,931	\$ 2,345,167	\$ 29,834,173	\$ 7,062,895
Account 905 - Misc Customer Accounts (page 322, line 163)	\$ -	\$ 190,699	\$ 31,454,063	\$ 318,212	\$ 62,195	\$ 1,237,553	\$ -
Subtotal	\$ 7,251,333	\$ 8,338,565	\$ 85,562,227	\$ 8,604,143	\$ 2,407,362	\$ 31,071,726	\$ 7,062,895
Add: Employee Benefits & Employer FICA (not included in above amounts)							
Account 926 - Employee Pension & Benefits Note A	\$ 2,344,537	\$ 760,872	\$ 7,908,524	\$ 306,665	\$ 180,088	\$ 8,438,577	\$ 1,791,804
Account 408 - Taxes Other Than Income (Employer's Portion of FICA) Note B	\$ 484,798	\$ 234,290	\$ 1,945,506	\$ 276,430	\$ 69,299	\$ 1,445,946	\$ 369,311
Total Cost Pool	\$ 10,080,668	\$ 9,333,728	\$ 95,416,257	\$ 9,187,238	\$ 2,656,750	\$ 40,956,249	\$ 9,224,010
Total Customers (page 304, line 43)	598,969	549,818	1,564,433	589,201	159,558	1,397,730	714,966
Customer Account Services Expense per Customer	\$ 16.83	\$ 16.98	\$ 60.99	\$ 15.59	\$ 16.65	\$ 29.30	\$ 12.90
Note A: Calculation of Pension & Benefits Pertaining to Customer Account Mgmt							
Account 926 - Employee Pension & Benefits (page 323, line 187)	\$ 19,609,439	\$ 7,369,188	\$ 43,788,734	\$ 2,761,682	\$ 1,285,130	\$ 40,413,365	\$ 17,716,168
Total O&M Payroll (page 355, line 65)	\$ 53,003,877	\$ 29,662,034	\$ 140,811,506	\$ 32,541,096	\$ 6,464,412	\$ 90,520,382	\$ 47,732,099
Benefits as Percent of Payroll	37.0%	24.8%	31.1%	8.5%	19.9%	44.6%	37.1%
Payroll Applicable to Customer Account Services							
Total Payroll Charged to Customer Accounts Function							
Electric (page 354, line 7)	\$ 9,501,076	\$ 5,050,243	\$ 24,534,887	\$ 6,047,880	\$ 1,444,650	\$ 20,125,865	\$ 8,201,891
Gas (page 354, line 37)	\$ -	\$ -	\$ 5,390,281	\$ -	\$ -	\$ -	\$ -
Total Payroll Charged to Customer Accounts	\$ 9,501,076	\$ 5,050,243	\$ 29,925,168	\$ 6,047,880	\$ 1,444,650	\$ 20,125,865	\$ 8,201,891
Percent Applicable to Customer Accounts Services (903 and 905):							
Account 903 - Customer Records & Collection (page 322, line 161)	\$ 7,251,333	\$ 8,147,866	\$ 54,108,164	\$ 8,285,931	\$ 2,345,167	\$ 29,834,173	\$ 7,062,895
Account 905 - Misc Customer Accounts (page 322, line 163)	\$ -	\$ 190,699	\$ 31,454,063	\$ 318,212	\$ 62,195	\$ 1,237,553	\$ -
Subtotal - Total Charges Applicable to Customer Accounts Services	\$ 7,251,333	\$ 8,338,565	\$ 85,562,227	\$ 8,604,143	\$ 2,407,362	\$ 31,071,726	\$ 7,062,895
Account 902 - Meter Reading Expenses (page 322, line 160)	\$ 3,620,208	\$ 5,411,680	\$ 15,118,763	\$ 5,796,694	\$ 1,431,801	\$ 2,013,136	\$ 4,936,672
Total Charges Applicable to Customer Accounts Svcs & Meter Reading	\$ 10,871,541	\$ 13,750,245	\$ 100,680,990	\$ 14,400,837	\$ 3,839,163	\$ 33,084,862	\$ 11,999,567
Percent Applicable to Customer Accounts Services (903 and 905)	66.7%	60.6%	85.0%	59.7%	62.7%	93.9%	58.9%
Customer Account Services Portion of Total Payroll	\$ 6,337,231	\$ 3,062,620	\$ 25,431,455	\$ 3,613,458	\$ 905,873	\$ 18,901,253	\$ 4,827,599
Pension & Benefits Pertaining to Customer Accounts Services	\$ 2,344,537	\$ 760,872	\$ 7,908,524	\$ 306,665	\$ 180,088	\$ 8,438,577	\$ 1,791,804
Note B: Calculation of Employer's FICA Pertaining to Customer Accounts Services							
Customer Account Services Portion of Total Payroll	\$ 6,337,231	\$ 3,062,620	\$ 25,431,455	\$ 3,613,458	\$ 905,873	\$ 18,901,253	\$ 4,827,599
Employer's Portion of FICA (6.20%) and Medicare (1.45%)	7.65%	7.65%	7.65%	7.65%	7.65%	7.65%	7.65%
Estimated Employer's Portion of FICA	\$ 484,798	\$ 234,290	\$ 1,945,506	\$ 276,430	\$ 69,299	\$ 1,445,946	\$ 369,311

Long Island American Water Company Comparison Group 2009 Customer Accounts Expense Per Customer

	New Jersey			Connecticut		
	Atlantic City Electric	Jersey Central Power	Public Service Electric & Gas	Rockland Electric	Connecticut Light & Power	United Illuminating
Customer Account Management Cost Pool						
FERC Account Balances:						
Account 903 - Customer Records & Collection (page 322, line 161)	\$ 38,294,686	\$ 15,780,845	\$ 59,788,911	\$ 38,399,035	\$ 13,961,033	
Account 905 - Misc Customer Accounts (page 322, line 163)	\$ 34,267	\$ 439,305	\$ 111,203,742	\$ 7,027,977	\$ -	
Subtotal	\$ 38,328,953	\$ 16,220,150	\$ 170,992,653	\$ 45,427,012	\$ 13,961,033	
Add: Employee Benefits & Employer FICA (not included in above amounts)						
Account 926 - Employee Pension & Benefits Note A	\$ 1,358,237	\$ 2,528,439	\$ 28,017,852	\$ 290,623	\$ 2,698,280	
Account 408 - Taxes Other Than Income (Employer's Portion of FICA) Note B	\$ 189,708	\$ 572,212	\$ 6,309,076	\$ 118,428	\$ 486,853	
Total Cost Pool	\$ 39,876,898	\$ 19,320,801	\$ 205,319,581	\$ 45,836,064	\$ 17,146,166	
Total Customers (page 304, line 43)	546,236	1,093,885	2,162,345	1,203,701	324,865	
Customer Account Services Expense per Customer	\$ 73.00	\$ 17.66	\$ 94.95	See New York	\$ 38.08	\$ 52.78
Note A: Calculation of Pension & Benefits Pertaining to Customer Account Mgmt						
Account 926 - Employee Pension & Benefits (page 323, line 187)	\$ 12,246,672	\$ 21,925,388	\$ 113,984,286	\$ 18,329,558	\$ 31,896,803	
Total O&M Payroll (page 355, line 65)	\$ 22,359,783	\$ 64,861,990	\$ 335,516,951	\$ 97,637,292	\$ 75,230,872	
Benefits as Percent of Payroll	54.8%	33.8%	34.0%	18.8%	42.4%	
Payroll Applicable to Customer Account Services						
Total Payroll Charged to Customer Accounts Function						
Electric (page 354, line 7)	\$ 2,772,357	\$ 12,317,288	\$ 49,701,550	\$ 1,653,342	\$ 8,955,597	
Gas (page 354, line 37)	\$ -	\$ -	\$ 41,062,287	\$ -	\$ -	
Total Payroll Charged to Customer Accounts	\$ 2,772,357	\$ 12,317,288	\$ 90,763,837	\$ 1,653,342	\$ 8,955,597	
Percent Applicable to Customer Accounts Services (903 and 905):						
Account 903 - Customer Records & Collection (page 322, line 161)	\$ 38,294,686	\$ 15,780,845	\$ 59,788,911	\$ 38,399,035	\$ 13,961,033	
Account 905 - Misc Customer Accounts (page 322, line 163)	\$ 34,267	\$ 439,305	\$ 111,203,742	\$ 7,027,977	\$ -	
Subtotal - Total Charges Applicable to Customer Accounts Services	\$ 38,328,953	\$ 16,220,150	\$ 170,992,653	\$ 45,427,012	\$ 13,961,033	
Account 902 - Meter Reading Expenses (page 322, line 160)	\$ 4,521,071	\$ 10,489,885	\$ 17,192,771	\$ 3,088,717	\$ 5,685,056	
Total Charges Applicable to Customer Accounts Svcs & Meter Reading	\$ 42,850,024	\$ 26,710,035	\$ 188,185,424	\$ 48,515,729	\$ 19,646,089	
Percent Applicable to Customer Accounts Services (903 and 905)	89.4%	60.7%	90.9%	93.6%	71.1%	
Customer Account Services Portion of Total Payroll	\$ 2,479,848	\$ 7,479,895	\$ 82,471,580	\$ 1,548,083	\$ 6,364,085	
Pension & Benefits Pertaining to Customer Accounts Services	\$ 1,358,237	\$ 2,528,439	\$ 28,017,852	\$ 290,623	\$ 2,698,280	
Note B: Calculation of Employer's FICA Pertaining to Customer Accounts Services						
Customer Account Services Portion of Total Payroll	\$ 2,479,848	\$ 7,479,895	\$ 82,471,580	\$ 1,548,083	\$ 6,364,085	
Employer's Portion of FICA (6.20%) and Medicare (1.45%)	7.65%	7.65%	7.65%	7.65%	7.65%	
Estimated Employer's Portion of FICA	\$ 189,708	\$ 572,212	\$ 6,309,076	\$ 118,428	\$ 486,853	

Long Island American Water Company Comparison Group 2009 Customer Accounts Expense Per Customer

	Massachusetts			Vermont	
	Fitchburg Gas & Electric	Massachusetts Electric	Western Mass Electric	Central Vermont Pub Service	Green Mountain Power
Customer Account Management Cost Pool					
FERC Account Balances:					
Account 903 - Customer Records & Collection (page 322, line 161)	\$ 1,204,356	\$ 34,482,297	\$ 6,374,384	\$ 2,620,312	\$ 1,701,897
Account 905 - Misc Customer Accounts (page 322, line 163)	\$ -	\$ 1,447,984	\$ 366,238	\$ 98,578	\$ 348,693
Subtotal	\$ 1,204,356	\$ 35,930,281	\$ 6,740,622	\$ 2,718,890	\$ 2,050,590
Add: Employee Benefits & Employer FICA (not included in above amounts)					
Account 926 - Employee Pension & Benefits Note A	\$ 100,571	\$ 3,850,028	\$ 46,817	\$ 470,634	\$ 111,738
Account 408 - Taxes Other Than Income (Employer's Portion of FICA) Note B	\$ 11,943	\$ 327,365	\$ 88,741	\$ 132,178	\$ 72,528
Total Cost Pool	\$ 1,316,870	\$ 40,107,674	\$ 6,876,179	\$ 3,321,702	\$ 2,234,856
Total Customers (page 304, line 43)	28,472	963,390	204,220	179,140	98,190
Customer Account Services Expense per Customer	\$ 46.25	\$ 41.63	\$ 33.67	\$ 18.54	\$ 22.76
Note A: Calculation of Pension & Benefits Pertaining to Customer Account Mgmt					
Account 926 - Employee Pension & Benefits (page 323, line 187)	\$ 1,578,312	\$ 54,012,798	\$ 712,100	\$ 10,033,014	\$ 1,368,699
Total O&M Payroll (page 355, line 65)	\$ 2,450,086	\$ 60,034,828	\$ 17,644,084	\$ 36,833,880	\$ 11,613,281
Benefits as Percent of Payroll	64.4%	90.0%	4.0%	27.2%	11.8%
Payroll Applicable to Customer Account Services					
Total Payroll Charged to Customer Accounts Function					
Electric (page 354, line 7)	\$ 97,713	\$ 4,783,315	\$ 1,307,170	\$ 3,467,597	\$ 1,254,212
Gas (page 354, line 37)	\$ 63,138	\$ -	\$ -	\$ -	\$ -
Total Payroll Charged to Customer Accounts	\$ 160,851	\$ 4,783,315	\$ 1,307,170	\$ 3,467,597	\$ 1,254,212
Percent Applicable to Customer Accounts Services (903 and 905):					
Account 903 - Customer Records & Collection (page 322, line 161)	\$ 1,204,356	\$ 34,482,297	\$ 6,374,384	\$ 2,620,312	\$ 1,701,897
Account 905 - Misc Customer Accounts (page 322, line 163)	\$ -	\$ 1,447,984	\$ 366,238	\$ 98,578	\$ 348,693
Subtotal - Total Charges Applicable to Customer Accounts Services	\$ 1,204,356	\$ 35,930,281	\$ 6,740,622	\$ 2,718,890	\$ 2,050,590
Account 902 - Meter Reading Expenses (page 322, line 160)	\$ 36,488	\$ 4,232,067	\$ 855,140	\$ 2,737,697	\$ 662,122
Total Charges Applicable to Customer Accounts Svcs & Meter Reading	\$ 1,240,844	\$ 40,162,348	\$ 7,595,762	\$ 5,456,587	\$ 2,712,712
Percent Applicable to Customer Accounts Services (903 and 905)	97.1%	89.5%	88.7%	49.8%	75.6%
Customer Account Services Portion of Total Payroll	\$ 156,121	\$ 4,279,278	\$ 1,160,007	\$ 1,727,823	\$ 948,082
Pension & Benefits Pertaining to Customer Accounts Services	\$ 100,571	\$ 3,850,028	\$ 46,817	\$ 470,634	\$ 111,738
Note B: Calculation of Employer's FICA Pertaining to Customer Accounts Services					
Customer Account Services Portion of Total Payroll	\$ 156,121	\$ 4,279,278	\$ 1,160,007	\$ 1,727,823	\$ 948,082
Employer's Portion of FICA (6.20%) and Medicare (1.45%)	7.65%	7.65%	7.65%	7.65%	7.65%
Estimated Employer's Portion of FICA	\$ 11,943	\$ 327,365	\$ 88,741	\$ 132,178	\$ 72,528

Group Average
\$ 854,739,290
18,756,582
\$ 45.57

VI - Question 4 – Need for Service Company Services

Analysis of Services

The final aspect of this study was an assessment of whether the services that are provided to LIAW by the Service Company would be necessary if LIAW were a stand-alone water utility. The first step in this evaluation was to determine specifically what the Service Company does for LIAW. Based on discussions with Service Company personnel, the matrix in Exhibit 12 (pages 36-38) was created showing which entity—LIAW or a Service Company location—is responsible for each of the functions LIAW requires to ultimately provide service to its customers. This matrix was reviewed to determine: (1) if there was redundancy or overlap in the services being provided by the Service Company and (2) if Service Company services are typical of those needed by a stand-alone water utility.

Upon review of Exhibit 12, the following conclusions can be drawn:

- The services that the Service Company provides are necessary and would be required even if LIAW were a stand-alone water utility.
- There is no redundancy or overlap in the services provided by the Service Company to LIAW. For all of the services listed in Exhibit 12, there was only one entity that was primarily responsible for the service.

Long Island American Water Company Designation Of Responsibility For Water Utility Functions

P - Primarily Responsible S - Provides Support	Performed By:						
	LIAW	American Water Service Company					
		Customer Call Center	Eastern Division	Shared Services	Central Services	IT Service Centers	Supply Chain
Water Company Function							
Engineering and Construction Management							
CPS Preparation	S			P			
Five-Year System Planning	P		S				
Engineering Standards & Policies Development				P			
Project Design							
Major Projects (e.g., new treatment plant)	P			S			
Special Projects	P		S	S			
Minor Projects (e.g., pipelines)	P						
Construction Project Management							
Major Projects	P		S				
Special Projects	P		S				
Minor Projects	P						
Hydraulics Review	P		S				
Developers Extensions	P						
Tank Painting	P		S				
Water Quality and Purification							
Water Quality Standards Development			S	P			S
Research Studies	S		S	P			S
Water Quality Program Implementation	P		S	S			
Water Treatment Operations & Maintenance	P		S				
Compliance Sampling	P		S				S
Testing/Other Sampling	S		S				P
Transmission and Distribution							
Preventive Maintenance Program Development	P						
System Maintenance	P						
Leak Detection	S		P				
Customer Service							
Community Relations	P		S	S			
Customer Contact	S	P					
Call Processing		P					
Service Order Processing	S	P					
Customer Credit		P					
Meter Reading	P						
Customer Bill Preparation					P		
Bill Collection	S	P					
Customer Payment Processing	S			P			
Meter Standards Development			S		P		
Meter Testing, Maintenance & Replacement	P						

Long Island American Water Company Designation Of Responsibility For Water Utility Functions

P - Primarily Responsible S - Provides Support	Performed By:						
	LIAW	American Water Service Company					
		Customer Call Center	Eastern Division	Shared Services	Central Services	IT Service Centers	Supply Chain
Financial Management							
Financial Planning	P	S		S			
Financings--Equity	S			S			
Financings--Long Term Debt & Preferred (Note A)	S	S					
Short Term Lines of Credit Arrangements(Note A)	S	S					
Investor Relations					P		
Insurance Program Administration		S			P		
Loss Control/Safety Program Administration	S	P			S		
Pension Fund Asset Management					P		
Cash Management/Disbursements			P				
Internal Auditing					P		
Budgeting and Variance Reporting							
Corporate Guidelines & Instructions					P		
Regional Guidelines & Instructions		P					
Budget Preparation							
Revenue and O&M	P						
Depreciation and Interest Expense	P		S	S			
Budget Preparation--Service Company Charges		S	S	S	S	S	S
Capital Budget Preparation—Projects	P		S				
Capital Budget Preparation—Non-Project Work	P		S				
Prepare Monthly Budget Variance Report (“Budget/Plan Analysis”)	P		S				
Prepare Capital Project Budget Status Report	P		S				
Year-End Projections	P		S				
Accounting and Taxes							
Accounts Payable Accounting	S			P			
Payroll Accounting	S			P			
Work Order Accounting	S		S	P			
Fixed Asset Accounting	S		S	P			
Journal Entry Preparations--Billing Corrections	S		S	P			
Journal Entry Preparation--All Others	S		S	P			
Financial Statement Preparation	S		S	P			
State Commission Reporting	S		S	P			
Income Taxes--State				P			
Income Taxes--Federal				P			
Property Taxes			S	P			
Gross Receipts (Town) Taxes	S		S	P			

Note A: Lines of credit are the responsibility of American Water Capital Corporation (“AWCC”). AWCC is also responsible for Corporate financings which may be distributed to the regulated subsidiaries.

Long Island American Water Company Designation Of Responsibility For Water Utility Functions

P - Primarily Responsible S - Provides Support	Performed By:							
	LIAW	American Water Service Company						
		Customer Call Center	Eastern Division	Shared Services	Central Services	IT Service Centers	Supply Chain	Belleville Lab
Rates								
Rate Studies & Tariff Change Administration	S	P	S					
Rate Case Planning and Preparation	S	P	S					
Rate Case Administration	S	P						
Commission Inquiry Response	S	P						
Legal		P		S				
Purchasing and Materials Management – National (pipe, chemicals, meters, etc.)								
Specification Development	S	S		P		S		
Bid Solicitation	S					P		
Contract Administration	S					P		
Purchasing and Materials Management – State (state supplier service agreements)								
Specification Development	P	S						
Bid Solicitation	P							
Contract Administration	P							
Ordering	P							
Inventory Management	P							
Human Resources Management								
Benefit Program Development		S		P				
Benefits Program Administration		P	S					
Management Compensation Administration		P		S				
Wage & Salary Program Design		S		P				
Wage & Salary Administration		P		S				
Labor Negotiations--Wages	P	S						
Labor Negotiations--Benefits	P	S		S				
Labor Negotiations-- Work Rules	P	S						
Training Program Development		P		S				
Training--Course Delivery		P						
Affirmative Action/EEO--Plan Development		P						
Affirmative Action/EEO--Implementation		P						
Information Systems Services								
Service Company Data Centers								
System Operations & Maintenance					P			
Software Maintenance					P			
Network Administration					P			
PC Acquisition & Support	S				P			
Help Desk					P			

VI - Question 4 – Need for Service Company Services

Governance Practices Associated With Service Company Charges

There are several ways by which LIAW exercises control over Service Company services and charges. The most important of these are described below.

- **LIAW Company Board Oversight** – The LIAW board of directors includes the Senior Vice President of Eastern Division, the Vice President of Finance for the Eastern Division, a member of the LIAW management team and an external business and community leader. This diverse board ensures that LIAW's needs are a factor in the delivery of Service Company services. The LIAW Board meets at a minimum of four times each year and at every meeting financial and operational reports and issues are discussed at length.
- **LIAW President Oversight** – The LIAW President is responsible for the overall performance of LIAW, including services and charges received from the American Water Service Company. The President of LIAW has previously served as a board member on the service company's board of directors (see the section for Service Company Board Oversight below for further discussion). In addition, as part of the overall management team of American Water through the President of Regulated Operations and the Senior Vice President of Eastern Division, LIAW's President has a significant voice in major business decisions of American Water and has the ability to monitor Service Company performance quality and spending as LIAW's President is one of seven direct reports to the Senior Vice President of Eastern Division.
- **LIAW Vice President and Treasurer** – The Vice President and Treasurer is responsible for the financial reporting, performance and regulatory matters of the LIAW. The Vice President and Treasurer monitors the performance, expense and reporting from the Service Company and verifies and validates the cost of services received. In addition, the Vice President and Treasurer through the Financial Planning and Analysis staff reviews the monthly charges and investigates whenever the amount, quality and/or services are appropriate.
- **Service Company Board Oversight** – The Service Company Board of Directors is comprised of 16 members, of which the President of the Eastern Division is on it. They typically meet four times a year to provide governance on the activities and bylaws of Service Company. Their primary responsibilities include:
 - Approve the Business Plan and Operating Budget
 - Review Financial Performance of the Service Center
 - Review performance metrics of certain functional groups
 - Approve policy, procedures and practices of AW as it relates to Service Company.
- **Service Company Budget Review/Approval** – Several state regulated water utility presidents serve on the Service Company board of directors and that board must formally approve the budget for Service Company charges for the next year. State presidents serve on a rotational basis and LIAW president served as a board member in 2009. These budgeted charges are consolidated with the operating company's own spending into an overall budget which must be approved by the individual operating company's board of directors (e.g., LIAW).
- **Major Project Review And Approval** – Major non-capital projects undertaken by the Service Company must first be reviewed by American Water's Executive Leadership Team, which includes the President of Regulated Operations. The President of Regulated Operations, with significant input from his direct reports (including the Senior Vice President of Eastern Division), has the ability to impact all new initiatives and projects before they are authorized. Major non-capital projects and initiatives for the Service Company are approved through the Business Plan. All significant business

VI - Question 4 – Need for Service Company Services

initiatives (capital or non-capital) are required to be submitted to the “BATT” (Business and Technology Team) committee for final approval. The “BATT” team is comprised of C-level executive members (CEO, CFO, etc.).

- **Capital Investment Management (CIM)** – CIM covers capital and asset planning and is employed throughout American Water, including the Service Company. CIM provides a full range of governance practices, including a formal protocol for assessing system needs, prioritizing expenditures, managing the capital program, approving project spending, delivering projects and measuring outputs. CIM ensures that:
 - Capital expenditure plans are aligned with the strategic intent of the business
 - The impact of capital expenditure and income plans are fully reflected in operating expense plans
 - The impacts of these plans are understood and affordable
 - Effective controls are in place over budgets (through business plans) and individual capital projects (through appropriate authorization thresholds, management and reporting processes).

The CIM process was designed to optimize the effectiveness of asset investment.

- **Accounting and Financial Reporting** – Similar to the states, the Service Company follows the same accounting and financial reporting processes. During the month accounting transactions are recorded. At month end, the SSC and Service Company Finance teams review all transactions. Variance analyses are performed based on month to month actual as well as actual to budget to ensure accuracy. Once completed, the service company bill is run and the actuals are “pushed down” based on direct charges and allocations to the states based on predetermined formulas. A conference call is scheduled before the operating companies close their books each month to discuss Service Company performance. This is based at a functional level with explanation reported for those expense variances that meet or exceed certain thresholds. At this time, the operating companies may question expenses and spending for better understanding of results. LIAW Financial Performance and Analysis (FP&A) personnel review the monthly Service Company bill for accuracy and reasonableness on a monthly basis. Any mistakes or overcharges are credited on a subsequent billing.
- **LIAW Company Budget Variance Reporting** – The “Budget/Plan Analysis,” produced monthly by each operating company, has line items for Management Fees and Shared Service Expense (i.e., IT, Call Center, etc.). In this way, Service Company budget versus actual charges as charged to the operating company can be monitored and reviewed for the month and year-to-date as compared to prior year, plan and reforecast.

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

CASE 11-W-_____

PROCEEDING ON THE MOTION OF THE COMMISSION AS TO THE
RATES, CHARGES, RULES AND REGULATIONS OF
LONG ISLAND WATER CORPORATION D/B/A
LONG ISLAND AMERICAN WATER FOR WATER SERVICE

Testimony of Patrick L. Baryenbruch

April 29, 2011

PATRICK L. BARYENBRUCH - DIRECT TESTIMONY

1 **1. Q. Please state your name and business address.**

2 A. Patrick L. Baryenbruch, 2832 Claremont Road, Raleigh, North Carolina 27608.

3 **2. Q. Please describe your educational and professional background.**

4 A. I received a Bachelors degree in accounting from the University of Wisconsin-
5 Oshkosh in 1974 and a Masters in Business Administration degree from the
6 University of Michigan in 1979.

7 I am a financial consultant and a certified public accountant. I am a member of the
8 American Institute of Certified Public Accountants and the North Carolina
9 Association of Certified Public Accountants.

10 I began my career as a staff accountant with Arthur Andersen & Company where I
11 performed financial audits of utilities, banks and finance companies. After three
12 years I left to pursue an M.B.A. degree. Upon graduation from business school, I
13 worked with the consulting firms of Theodore Barry & Associates and Scott,
14 Madden & Associates.

15 During my consulting career, I have performed consulting assignments for
16 approximately 50 utilities and 10 public service commissions. I have participated
17 as project manager, lead or staff consultant for 24 commission-ordered management
18 and prudence audits of public utilities. Of these, I have been responsible for
19 evaluating the area of affiliate charges and allocation of corporate expenses in the

PATRICK L. BARYENBRUCH - DIRECT TESTIMONY

1 Commission-ordered audits of Connecticut Light and Power, Connecticut Natural
2 Gas, General Water Corporation (Pennsylvania Operations), Philadelphia Suburban
3 Water Company (now Aqua America) and Pacific Gas & Electric Company.

4 My firm has performed the commission-ordered audit of Southern California
5 Edison's 2002, 2003, 2004 and 2005 transactions with its non-regulated affiliate
6 companies.

7 **3. Q. What are your duties and responsibilities in your current position?**

8 A. I am the President of my own consulting practice, Baryenbruch & Company, LLC,
9 which was established in 1985. In that capacity, I provide consulting services to
10 utilities and their regulators.

11 **4. Q. Please describe the reason for your testimony in this case.**

12 A. I am presenting the results of my study which evaluated the services provided by
13 American Water Service Company ("Service Company") during the 12 months
14 ended December 31, 2010 to Long Island Water Corporation d/b/a Long Island
15 American Water ("LIAW" or the "Company"). This study was undertaken in
16 conjunction with LIAW's rate case and is true to the best of my knowledge and
17 belief. The study is attached as Exhibit PLB-1.

18 **5. Q. What were the objectives of your study?**

19 A. This study was undertaken to answer four questions concerning the services
20 provided by the Service Company to LIAW, each of which bears on the

PATRICK L. BARYENBRUCH - DIRECT TESTIMONY

1 reasonableness of those charges as incurred during 2010. First, were the Service
2 Company's charges to LIAW during the 2010 reasonable? Second, was LIAW
3 charged the lower of cost or market for managerial and professional services
4 provided by the Service Company during 2010? Third, were 2010 costs of the
5 Service Company's customer accounts services, including those of the National Call
6 Centers, comparable to those of other utilities? Fourth, are the services LIAW
7 receives from Service Company necessary?

8 **6. Q. What conclusions were you able to draw concerning question number 1,**
9 **whether the Service Company charges to LIAW were reasonable?**

10 A. The Service Company's 2010 cost per LIAW customer was reasonable compared to
11 cost per customer for electric and combination electric/gas service companies.
12 During 2010, LIAW was charged \$55 per customer for administrative and general
13 (A&G)-related services provided by the Service Company. This compares to an
14 average of \$95 per customer for service companies reporting to the Federal Energy
15 Regulatory Commission (FERC). Only 2 of the 24 comparison group utility service
16 companies filed a FERC Form 60 for 2009 had a lower per customer A&G cost
17 than LIAW's charges from the Service Company.

18 **7. Q. What conclusions were you able to draw concerning question number 2,**
19 **whether LIAW was charged the lower of cost or market services provided by**
20 **the Service Company?**

21 A. I was able to draw the following conclusions:

PATRICK L. BARYENBRUCH - DIRECT TESTIMONY

- 1 (1) LIAW was charged the lower of cost or market for managerial and
2 professional services during 2010.
- 3 (2) On average, the hourly rates for outside service providers are 54% higher than
4 the Service Company's hourly rates.
- 5 (3) The managerial and professional services provided by the Service Company
6 are vital and could not be procured externally by LIAW without careful
7 supervision on the part of LIAW. If these services were contracted entirely to
8 outside providers, LIAW would have to add at least one position to manage
9 activities of outside firms. This position would be necessary to ensure the
10 quality and timeliness of services provided.
- 11 (4) If all the managerial and professional services now provided by the Service
12 Company had been outsourced during 2010, LIAW and its ratepayers would
13 have incurred more than \$2,500,000 in additional expenses. This amount
14 includes the higher cost of outside providers and the cost of one LIAW
15 position needed to direct the outsourced work.
- 16 (5) This study's hourly rate comparison actually understates the cost advantages
17 that accrue to LIAW from its use of the Service Company. Outside service
18 providers generally bill for every hour worked. Service Company exempt
19 personnel, on the other hand, charge a maximum of 8 hours per day even
20 when they work more hours. If all overtime hours of Service Company
21 personnel were factored into the hourly rate calculation, the Service Company
22 would have had an even greater annual dollar advantage than the \$2,500,000
23 cited above.
- 24 (6) It would be difficult for LIAW to find local service providers with the same
25 specialized water industry expertise as that possessed by the Service Company
26 staff. Service Company personnel spend substantially all their time serving

PATRICK L. BARYENBRUCH - DIRECT TESTIMONY

1 operating water companies. This specialization brings with it a unique
2 knowledge of water utility operations and regulation that is most likely
3 unavailable from local service providers.

4 (7) Service Company fees do not include any profit markup. Only its actual cost
5 of service is being recovered from LIAW ratepayers.

6 **8. Q. What conclusions were you able to draw concerning question number 3,**
7 **whether 2010 costs of the Service Company's customer account services,**
8 **including those of the National Call Centers, were reasonable?**

9 A. The cost of the Service Company's customer accounts services, including those
10 provided by the National Call Center, is below the range of the average of the
11 neighboring electric utility comparison group. As explained further in the Market
12 Cost Comparison study, Exhibit PLB-1, this group of companies provides a
13 reasonable proxy group for comparison to a regulated utility of the size and scope of
14 the Service Company and LIAW. During 2010, the customer accounts cost for
15 LIAW customers was \$24.96 compared to the 2009 average of \$45.57 for
16 neighboring electric utilities. The highest comparison group per customer cost was
17 \$94.95 and the lowest \$12.90.

18 **9. Q. What conclusions were you able to draw concerning question number 4,**
19 **whether the services LIAW receives from the Service Company are necessary?**

20 A. I was able to draw the following conclusions:

21 (1) The services that the Service Company provides are necessary and would be
22 required even if LIAW were a stand-alone water utility.

PATRICK L. BARYENBRUCH - DIRECT TESTIMONY

1 (2) Furthermore, there is no redundancy or overlap in the services provided by the
2 Service Company to LIAW.
3

PATRICK L. BARYENBRUCH - DIRECT TESTIMONY

1 **10. Q. Does this complete your testimony?**

2 A. Yes.



STATE OF NEW JERSEY
Board of Public Utilities
Two Gateway Center, Suite 801
Newark, NJ 07102
www.nj.gov/bpu

WATER

IN THE MATTER OF THE PETITION OF) ORDER ADOPTING INITIAL
NEW JERSEY AMERICAN WATER COMPANY,) DECISION / STIPULATION
INC. FOR APPROVAL OF INCREASED TARIFF) OF SETTLEMENT
RATES AND CHARGES FOR WATER AND)
WASTEWATER SERVICE AND OTHER TARIFF) BPU DOCKET NO. WR10040260
REVISIONS) OAL DOCKET NO. PUC 5064-10N

Ira G. Megdal, Esq., Cozen O'Connor, 457 Haddonfield Road, P.O. Box 5459, Cherry Hill, N.J. 08002 for Petitioner

BY THE BOARD:

On April 9, 2010, pursuant to N.J.S.A. 48:2-18, 48:2-21, and 48:2-21.1¹, and N.J.A.C. 14:1-5.7 and 14:1-5.12, Petitioner, New Jersey American Water Company, Inc. ("Company" or "NJAW"), a public utility of the State of New Jersey subject to the jurisdiction of the Board of Public Utilities ("Board"), filed a petition seeking to increase its rates for water service and wastewater service amounting to an overall increase in revenue requirement in the amount of \$84,725,112 or 13.61% over current rate revenues.

By this Order, the Board considers the Initial Decision recommending adoption of the Stipulation of Settlement ("Stipulation") executed by the Company; the Division of Rate Counsel ("Rate Counsel"); Board Staff; Middlesex Water Company; Aqua New Jersey, Inc.; Lawrenceville Water Company; and Aqua New Jersey, Inc. (collectively, the "Signatory Parties"), agreeing to an overall increase in revenues in the amount of \$39,900,000 representing a 7.45% increase over Company revenues. The increase will result in Company revenues of \$575,250,496. Present rate revenues including PWAC/PSTAC are \$584,287,578. The rate increase is 6.83% and total revenues are \$624,187,578 including PWAC/PSTAC. The Parties propose that these rates will be effective on January 1, 2011.

BACKGROUND/PROCEDURAL HISTORY

NJAW serves approximately 633,000 water customers and 34,000 wastewater customers in certain portions of Atlantic, Burlington, Camden, Cape May, Essex, Gloucester, Hunterdon, Mercer, Middlesex, Monmouth, Morris, Ocean, Passaic, Salem, Somerset, Union and Warren Counties, New Jersey.

¹ The Board notes that although the petition cites N.J.S.A. 48:2-21, the petition does not include a request for an adjustment of rates during the pendency of the hearing.

The increase in rates was proposed to become effective on May 11, 2010.² The petition did not seek interim rate relief pending final determination on the petition. On May 12, 2010, the Board issued an Initial Suspension Order suspending the proposed rates to September 12, 2010. On August 18, 2010, the Board issued a second Suspension Order suspending the proposed rates to January 12, 2011.

The matter was transmitted to the Office of Administrative Law ("OAL") as a contested case pursuant to N.J.S.A. 52:14B-1 et seq. and N.J.S.A. 52:14F-1 et seq., where it was assigned to Administrative Law Judge ("ALJ") Irene Jones. On June 8, 2010, ALJ Jones held a pre-hearing conference in which counsel for the Company and the statutory parties to the case, the Division of Rate Counsel ("Rate Counsel") and Board Staff participated. A pre-hearing Order was issued on June 23, 2010, setting forth, among other things, the issues to be litigated and the schedule going forward.

By Orders dated June 16, 2010, June 23, 2010, and September 1, 2010 the following parties were granted Intervenor status: Rutgers University, Johanna Foods, Inc., Princeton University, ConocoPhillips, Cogen Technologies Linden Venture, L.P. (collectively the "OIW Group"); Bulk Purchaser Coalition ("BPC")³; Middlesex Water Company; Aqua New Jersey, Inc.; and Lawrenceville Water Company. Public Service Electric and Gas Company filed a motion to intervene and, in the alternative, was granted participant status in this proceeding. On July 2, 2010, the Utility Workers Union of America ("UWUA"), Locals #391, #395 and #423 and individuals Noel Christmas and Thomas DiFranco ("Individuals") jointly filed a Motion to Intervene. The UWUA Locals were granted participant status. The motion of the Individuals was denied by Order dated October 6, 2010.

On August 10, 2010, public hearings were held in Ocean City at 2:00 p.m. and in Westampton at 7:00 p.m. On August 18, 2010, public hearings were held in Howell at 2:00 p.m. and in Westfield at 7:00 p.m. Numerous members of the public spoke at each public hearing. The comments centered on the magnitude of the proposed rate increase, the impact the proposed rate increase would have on citizens with fixed incomes, billing concerns, customer service, and the impact the proposed rates would have on fire districts.

Subsequent to the public hearing and prior to evidentiary hearings in this matter, the Parties engaged in settlement negotiations. As the result of those negotiations, the Parties reached a settlement on all issues and entered into a Stipulation. A copy of the Stipulation is attached.

As a result of settlement negotiations, the Signatory Parties reached a settlement on all issues and entered into a Stipulation that, among other things, provides for an overall increase of \$39,900,000, representing approximately a 7.45% increase above current operating revenues. The following Interveners submitted letters not opposing the proposed Settlement: the OIW Group, and the BPC.

On November 19, 2010, ALJ Jones issued her Initial Decision recommending adoption of the Stipulation executed by the Signatory Parties, finding that the Signatory Parties had voluntarily agreed to the Settlement and that the Settlement fully disposes of all issues and was consistent with the law. No exceptions to the Initial Decision have been filed.

² On April 14, 2010, the Company filed a letter with the Board stating that it will not implement the proposed rates pending Board action to suspend the proposed rates at its May 12, 2010 meeting.

³ The BPC includes: Mount Laurel Township Municipal Utilities Authority; Evesham Municipal Utilities Authority; Monroe Township Water Municipal Utilities Authority; Merchantville - Pennsauken Water Commission; and the Township of Moorestown.

DISCUSSIONS AND FINDINGS

Among the provisions of the Stipulation⁴, the Parties recommend a rate base of \$1,771,009,511 and that the Company be authorized a return on equity of 10.30%, for an overall rate of return of 8.3248%. Pursuant to the Stipulation, the average bills for a NJAW residential water customer with a 5/8" meter using on average 84,000 gallons of water per year (7,000 per month) will increase from a range of \$3.24 (or an increase of 6.54%) per month to \$5.99 (or an increase of 19.02%) per month depending on the rate class, as outlined in the attached Stipulation of Settlement. The average bills for a NJAW sewer customer will increase from a range of \$0 per month to \$80.17 per month (100.00%).

Water Service Revenue Increases:

The rates for a typical GMS residential customer using 7,000 gallons per month for Service Area-1 ("SA-1") shall increase by \$3.24 per month; for SA-2 and SA-3 Main by \$4.31 per month; for SA-2 Manville by \$4.31 per month; for SA-3 Southampton by \$4.53; for SA-3 Homestead by \$3.24; for SA-1A Harrison by \$4.31; for SA-1B Pennsgrrove by \$4.31. For a Jensen's Deep Run customer ("SA-3 Main") using 5,000 gallons per month the rate shall increase by \$5.99 per month.

The rates of commodity-demand and off peak service customers shall increase 0.30% overall and by 0.35% overall, respectively. Rates of the OIW customers shall increase 7.66% overall. Rates of the SOS customers shall increase 9.22% overall. For private fire protection service, rates shall increase for each group overall as follows: for SA-1, 11.2%; for SA-1A, 11.89%, for SA-1B, 2.0%; for SA-1 Rate Schedule L-2, 11.8%; for SA-2, 0.3%; and for SA-3, 11.2%. For public fire protection service, rates shall increase overall as follows: for SA-1, 4.7%; for SA-1A, 6.9%; for SA-1B, 8.9%; for SA-2, 0.2%; for SA-3, 4.7%; for SA-1 Rate Schedule M-2, 8.7%; and SA-1 Rate Schedule M-3, 6.0%.

The rates of the former water customers of Applied Wastewater Management reflect no change over the rates approved by the Board's Order dated May 21, 2009 in Docket No. WR08080550.

The Monthly Customer Charges (Fixed Service Charges) for all service areas except SA-1B shall be set at \$10.00 per month (non-exempt) for a 5/8 inch meter. The customer charge for SA-1B shall be set at \$7.75 per month (non-exempt) for a 5/8 inch meter. Meter capacity ratios are utilized to establish rates for larger size meters.

Sewer Service Revenue Increases:

Sewer service revenues shall increase for the Company's Ocean City Service Area by 2.0% and for the Adelpia Service Area by 5.5%. Within these service areas, these increases shall be spread to rates on an across-the-board basis. The Pottersville rates for a typical residential customer using 6,000 gallons per month shall increase \$78.79 per month or 98.28%, while a Pottersville-Flat Rate, residential customer shall increase \$80.17 per month or 100%, Jensen's Deep Run wastewater service customers shall be charged a flat rate of \$52.50 per month. The rates of Lakewood sewer customers will reflect no change in sewer rates.

⁴ Although described in this Order at some length, should there be any conflict between this summary and the Stipulation, the terms of the Stipulation control, subject to the findings and conclusions in this Order.

The rates of the former wastewater customers of Applied Wastewater Management reflect no change over the rates approved by the Board's Order dated May 21, 2009 in Docket No. WR08080550.

Having reviewed the record in this matter, including ALJ Jones' Initial Decision, the Stipulation, and letters from the non-signatory Parties indicating that they do not oppose the Stipulation, the Board FINDS that the Parties have voluntarily agreed to the Stipulation and that the Stipulation fully disposes of all the issues in this proceeding and is consistent with the law. The Board HEREBY ADOPTS the ALJ's Initial Decision and the Stipulation, attached hereto, including all attachments and schedules, as its own, incorporating by reference the terms and conditions of the Stipulation, as if they were fully set forth at length herein, subject to the following:

- a. The tariff sheets attached to the Stipulation containing rates and charges conforming to the Stipulation and designed to produce the additional revenues to which the Parties have stipulated herein are HEREBY ACCEPTED; and
- b. The stipulated increase and the tariff design allocations for each customer classification are HEREBY ACCEPTED.

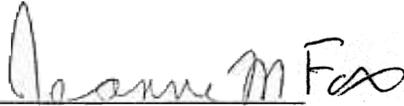
Based upon the foregoing, the Board HEREBY APPROVES an overall increase in revenues in the amount of \$39,900,000 representing a 7.45% increase over current operating revenues.

The Board HEREBY DIRECTS the Company to submit complete revised tariffs conforming to the terms and conditions of the Stipulation and this Order within ten (10) days from the date of this Order.

DATED: 12/6/10

BOARD OF PUBLIC UTILITIES
BY:


LEE A. SOLOMON
PRESIDENT


JEANNE M. FOX
COMMISSIONER


JOSEPH L. FIORDALISO
COMMISSIONER

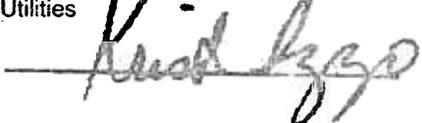

NICHOLAS ASSELTA
COMMISSIONER


ELIZABETH RANDALL
COMMISSIONER

ATTEST:


KRISTI IZZO
SECRETARY

HEREBY CERTIFY that the within document is a true copy of the original in the files of the Board of Public Utilities



I/M/O New Jersey American Water Company, Inc.,
For Approval of Increased Tariff Rates and Charges
For Water and Wastewater Service and Other Tariff Revisions
BPU Docket No. WR10040260
OAL Docket No. PUC 5064-10

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November 22, 2010

VIA E-MAIL
VIA HAND DELIVERY
Hon. Irene Jones, ALJ
Office of Administrative Law
33 Washington Street
Newark, NJ 07102

**Re: In The Matter of the Petition of New Jersey American Water Company, Inc.
For an Increase In Rates For Water And Sewer Service and Other Tariff
Modifications; BPU Docket No. WR10040260; OAL Docket No. PUC 5064-
10N**

Dear Judge Jones:

Enclosed please find an executed Stipulation in the above-referenced matter.

Thank you in advance for your cooperation.

Respectfully,

COZEN O'CONNOR

A handwritten signature in blue ink that reads "Ira G. Megdal".
By: Ira G. Megdal

IGM/bab
Enclosure

cc: See Attached List (*via email only*)

**IN THE MATTER OF THE PETITION OF NEW JERSEY AMERICAN WATER
COMPANY, INC. FOR AN INCREASE IN RATES FOR WATER AND SEWER
SERVICE AND OTHER TARIFF MODIFICATIONS
BPU DOCKET NO. WR10040260
OAL DOCKET NO. PUC 5064-10N**

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Each member of this Service List will only receive an electronic copy of all documents delivered, unless otherwise noted.

* = Electronic and Paper Copies

C/T = Confidential and Trade Secret discovery

Conf. = Confidential discovery only (NO TRADE SECRET)

**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
WASTEWATER SERVICE AND OTHER
TARIFF REVISIONS

BPU DOCKET NO. WR10040260
OAL DOCKET NO. PUC5064-10N

STIPULATION OF SETTLEMENT

APPEARANCES:

Ira G. Megdal, Esq., Cozen O'Connor, and Suzana Duby, Esq., Corporate Counsel, Counsel for Petitioner, New Jersey American Water Company, Inc.;

Debra F. Robinson, Esq., Deputy Rate Counsel, and Christine Juarez Assistant Deputy Rate Counsel, for the New Jersey Division of Rate Counsel (Stefanie A. Brand, Esq., Director);

Alex Moreau, Deputy Attorney General, and Cynthia Holland, Deputy Attorney General, for the Staff of the New Jersey Board of Public Utilities (Paula T. Dow, Attorney General of New Jersey);

Kevin A. Conti, Esq., DeCotiis, Fitzpatrick & Cole, LLP Counsel for Intervenors, Aqua New Jersey, Inc. and Lawrenceville Water Company;

Martin C. Rothfelder, Esq., and Bradford M. Stern, Esq., Rothfelder Stern, LLC, Counsel for Intervenors Cogen Technologies Linden Venture, L.P., ConocoPhillips Company, Johanna Foods, Inc., Princeton University, and Rutgers, the State University of New Jersey;

Anthony R. Francioso, Esq., Fornaro Francioso, Counsel for Intervenor Bulk Purchaser Coalition; and

Kenneth J. Quinn, Esq., Middlesex Water Company, Counsel for Intervenor Middlesex Water Company

TO: THE HONORABLE IRENE JONES, ALJ

BACKGROUND

On April 9, 2010, New Jersey American Water Company ("NJAWC", "Petitioner", or "Company") filed with the New Jersey Board of Public Utilities ("Board") a Petition, Testimony

and Exhibits (the "Petition") requesting an increase in operating revenues of approximately \$84.7 million or 13.61% over projected test year operating revenues.

In the Petition, NJAWC proposed a test-year ending September 30, 2010. The Petition as originally filed was based upon five (5) months of actual and seven (7) months of estimated data. As the case progressed, the estimated data were replaced by actual data, and on July 21, 2010, the Company filed its update consisting of nine months of actual data. The Company filed its 12 and 0 update on October 20, 2010.

On May 12, 2010, this proceeding was transmitted by the Board to the Office of Administrative Law ("OAL") as a contested case. The matter was assigned to Administrative Law Judge Irene Jones. On June 8, 2010, a prehearing conference was conducted by Judge Jones and on June 23, 2010, Judge Jones issued a prehearing order establishing procedures and hearing dates for the conduct of this case. The prehearing order was subsequently modified on several occasions.

The signatory parties to this case include Petitioner, the Division of Rate Counsel ("Rate Counsel"), and the Staff of the Board ("Staff"). Motions to intervene were filed by the following parties, were unopposed, and were granted: Bulk Purchaser Coalition; Rutgers, the State University of New Jersey; Princeton University; ConocoPhillips Company; Johanna Foods, Inc.; Cogen Technologies Linden Venture, L.P.; Middlesex Water Company; Aqua New Jersey, Inc.; and Lawrenceville Water Company by Orders dated September 1, 2010, June 16, 2010, and June 23, 2010. Public Service Electric and Gas Company filed a motion for intervention but agreed to accept Participant status. On July 2, 2010, the Utility Workers Union of America ("UWUA"), Locals 391, 395 and 423 (the "Locals") and individuals Noel Christmas and Thomas DiFranco (the "Individuals") jointly filed a Motion to Intervene, or in the alternative to Participate in this proceeding. The motion was opposed by NJAWC. The motion of the Individuals was denied by

Order dated October 6, 2010. The motion of the Locals, in the alternative, was granted, and the Locals were provided with Participant status.

Pursuant to appropriate notice in newspapers of general circulation within the Company's service territory, and the serving of notice upon affected municipalities and counties within the Company's service area, four public hearings were held in Ocean City, New Jersey, Westampton, New Jersey, Howell, New Jersey and Westfield, New Jersey on August 10, 2010, and August 18, 2010. Numerous members of the public spoke at the public hearings, and the comments generally involved opposition to rate increases.

Discovery involving over 700 requests, many with multiple parts, was answered by the Company.

The Company filed initial direct and supplemental direct testimony. Prior to the filing of testimony by other parties, settlement discussions ensued and this Stipulation of Settlement resulted.

Evidentiary hearings were scheduled for October and November, 2010. Prior to the commencement of such hearings, the parties conducted meetings to discuss settlement, and as a result, this Stipulation of Settlement was agreed upon by the parties. As a result of those settlement conferences, the undersigned parties **AGREE AND STIPULATE AS FOLLOWS:**

REVENUE REQUIREMENTS

The parties agree that Petitioner's revenues from base rates should be increased by \$39.9 million, effective for service rendered on and after January 1, 2011, or on such other date as the Board deems appropriate.

2. The parties stipulate that the 12-month period ending September 30, 2010, as adjusted for known and measurable changes, shall be the test year in this case.

3. The parties stipulate that pro forma present rate revenues are \$535,350,496. The parties stipulate to a rate increase of \$39.9 million or 7.45%, as shown on attached Schedule B. As a result, rates emanating from this proceeding will be designed to yield total revenues of \$575,250,496. Present rate revenues including PWAC/PSTAC are \$584,287,578. The rate increase is 6.83% and total revenues are \$624,187,578 including PWAC/PSTAC.

4. The parties stipulate that the Company's rate base for use in this proceeding is set at \$1,771,009,51

5. The parties to this Stipulation agree that the revenue increase set forth earlier in this Stipulation of Settlement reflects an adjustment to rate base due to the filing of a consolidated federal income tax return.

6. Rate of Return. The parties agree to the following rate of return for use in this case.

	<u>Ratios</u>	<u>Cost Rates</u>	<u>Weighted Cost Rates</u>
1. Long-Term Debt	48.94%	6.2684%	3.0678%
2. Preferred Stock	0.04%	4.8000%	0.0019%
3. Common Equity	51.02%	10.3000%	5.2551%
4. Total	<u>100.00%</u>		<u>8.3248%</u>

Amortizations. The parties agree that the rate increase set forth earlier in this Stipulation reflects an amortization of unamortized balance sheet accounts, in accordance with the following schedule:

<u>Account</u>	<u>Balance at 9/30/2010</u>	<u>Monthly Amortization</u>	<u>Amortization Start Date</u>	<u>Amortization Ending Date</u>
Deferred Pension Expense	\$6,341,812.07	\$39,390.14	3/1/2004	2/28/2024
FAS 106 (SA-1)	\$1,442,397.60	\$51,514.20	2/1/1998	1/31/2013
FAS 106 (SA-2/SA-3)	\$560,812.95	\$20,770.85	11/1/1998	12/31/2012
FAS 109 (SA-1)	\$12,023,979.00	\$48,878.00	*	3/31/2031
FAS 109 (SA-2)	\$7,887,714.96	\$38,105.00	*	12/31/2027
FAS 109 (SA-3)	\$50,945.00	\$346.00	*	12/31/2022
FAS 112	\$204,255.50	\$2,084.25	12/1/2008	11/30/2018
Gain on Land Sales	(162,609.07)	(\$6,775.38)	1/1/2011	12/31/2012
Acquisition Adjustments	\$4,832,667.31	\$23,886.68	Various	Various
South Jersey Services	\$4,510,223.70	\$9,847.65	12/1/2008	11/30/2048
Mt Ephraim	\$56,324.84	\$122.98	12/1/2008	11/30/2048
Pelican Island	\$7,094.42	\$15.49	12/1/2008	11/30/2048
Sick Bank Amortization - 2008	\$1,814,963.92	\$18,520.04	12/1/2008	11/30/2018
Sick Bank Amortization - 2010	\$228,633.60	\$1,905.28	1/1/2011	12/31/2020
BPU Management Audit Amort	\$1,500,000.00	\$25,000.00	1/1/2011	12/31/2015
Concentric Study Amortization	\$249,000.00	\$4,150.00	1/1/2011	12/31/2015
Pre 1971 Investment Credit	(\$541,426.60)	(\$2,987.52)	Various	Various
Regulatory Liability/Asset for Excess/Deficit Deferred Income Taxes	(\$3,679,226.00)	(\$13,321.00)	Various	Various
MTBE	(\$7,050,614.04)	(\$14,688.78)	1/1/2011	12/31/2050
Pottersville Operating Deferral	\$188,744.53	3,145.75	1/1/2011	12/31/2015

8. Normalization of Regulatory Commission Expense. The parties stipulate that the Company incurred rate case expenses of \$1.20 million for this proceeding. This amount will be shared 50/50 between the Company and ratepayers, and normalized over two years at \$300,000 per year.

9. The settlement reflects that the treatment of MTBE litigation proceeds is consistent with the treatment afforded by the Board in IM/O The Petition of United Water New Jersey, Inc., and United Water Toms River, Inc. for an Order Authorizing Special Accounting Treatment of Litigation Proceeds, Docket No. WO08100886 (January 28, 2009). That is, 85% of the net of tax settlement proceeds (\$7,050,614) has been utilized as a rate base deduction, and it is agreed that such rate base deduction will continue until fully amortized. Amortization will be over a 40-year period and will be treated as an expense credit for book and ratemaking purposes.

Moreover, it is agreed that this treatment of MTBE litigation proceeds is to be used for this proceeding only, and is not to be viewed as precedential in nature. Accounting of the Company's MTBE litigation proceeds should be booked in conjunction with the rates-effective date that is approved by the Board within this proceeding.

10. It is agreed that the Company will withdraw its petition In the Matter of the Petition of New Jersey-American Water Company, Inc. for Authorization to Defer Certain Charges to the Company's Financial Statements Related to Pension and OPEB Costs Resulting from the Impact of Recent Adverse Economic Events, Docket No. WR09110938, upon the issuance of a Board Order approving this executed Stipulation within this proceeding.

11. One Call Markout Expenses. It is agreed that the expenses associated with the incremental One Call markouts may be deferred by NJAWC if such expenses arise. The Company may recover same with interest at the rate shown in the Federal Reserve statistical release closest to January 1 of each year for seven (7) year constant maturity treasuries plus sixty (60) basis points. The interest rate shall remain in effect for a one-year period. At such time as the Company seeks recovery of these expenses, any party may challenge the prudence of the level of such costs.

12. The Company agrees to implement a Low Income Conservation Program as it was initially proposed in the Company's petition. See program summary attached hereto as Schedule "1". The Company will provide an annual report to Rate Counsel and Staff relative to the levels of its expenditures as to a low income conservation program. The report will be provided on a form to be agreed upon by the parties. The Company will not at this time implement any other aspect of the conservation program proposed in its Petition, nor at this time will the Company implement the associated Conservation Plan Tracker or Water Efficiency Tracker.

TARIFF AND RATE DESIGN ISSUES

13. The parties stipulate and agree that the rate design shown in Schedule A is appropriate.

14. The parties agree that within ten (10) business days of an order accepting this Stipulation, the Company will submit to the Board a Compliance Filing, consisting of tariffs implementing the rate design agreed to in this Stipulation, and shall simultaneously provide electronic copy of such filing to the parties.

15. Lakewood Wastewater Service Sewer Usage Minimum Charge. The Company proposed imposition of a Winter Quarter Sewer Usage Monthly Use Constant minimum charge to be applied to Lakewood wastewater service customers, which the parties stipulate to herein. It is based upon a minimum usage of 2,000 gallons per month.

16. Reconnection Charge. The charge during normal working hours will be set at \$28.

17. Bad Check Charge. The charge will be set at \$15.

18. Class Revenue Increases. The parties stipulate that GMS rates for a typical residential customer using 7,000 gallons per month for Service Area-1 ("SA-1") shall increase by \$3.24 per month; for SA-2 and SA-3 Main by \$4.31 per month; for SA-2 Manville by \$4.31 per month; for SA-3 Southampton by \$4.53; for SA-3 Homestead by \$3.24; for SA-1A Harrison by \$4.31; for SA-1B Pennsgrove by \$4.31; and for Jensen's Deep Run by \$5.99. Rates of commodity-demand and off peak service customers shall increase 0.30% overall and by 0.35% overall, respectively. Rates of the OIW customers will increase 7.66% overall. Rates of the SOS customers will increase 9.22% overall. For private fire protection service, rates will increase for each group overall as follows: for SA-1, 11.2%; for SA-1A, 11.89%, for SA-1B, 2.0%; for SA-

Rate Schedule L-2, .8%; for SA-2, 0.3%; and for SA-3, 11.2%. For public fire protection service, rates will increase overall as follows: for SA-1, 4.7%; for SA-1A, 6.9%; for SA-1B, 8.9%; for SA-2, 0.2%; for SA-3, 4.7%; for SA-1 Rate Schedule M-2, 8.7%; and SA-1 Rate Schedule M-3, 6.0%. The rates of the former water customers of Applied Wastewater Management reflect no change over the rates approved by the Board's Order dated May 21, 2009 in Docket No. WR08080550.

19. Customer Charges (Fixed Service Charges). The monthly customer charges for all service areas except SA-1B will be set at \$10.00 per month (non-exempt) for a ½ inch meter. The customer charge for SA-1B will be set at \$7.75 per month (non-exempt) for a ½ inch meter. Meter capacity ratios are utilized to establish rates for larger size meters.

20. Sewer Service Revenue Increases. The Parties stipulate that sewer service revenues will increase for the Company's Ocean City Service Area by 2.0% and for the Adelpia Service Area by 5.5%. Within these service areas, these increases will be spread to rates on an across-the-board basis. The parties stipulate that Pottersville rates for a typical residential customer using 6,000 gallons per month will increase \$78.79 per month or 98.28%, while a Pottersville-Flat Rate, residential customer will increase \$80.17 per month or 100%, Jensen's Deep Run wastewater service customers will be charged a flat rate of \$52.50 per month. The rates of the former wastewater customers of Applied Wastewater Management reflect no change over the rates approved by the Board's Order dated May 21, 2009 in Docket No. WR08080550.

21. Low Income Payment Program (LIPP) customer discounts will equate to one hundred percent (100%) of the water fixed service charge.

22. The undersigned parties hereby agree that this Settlement has been made exclusively for the purpose of this proceeding and that this Settlement, in total or by specific item, is in no way binding upon them in any other proceeding, except to enforce the terms of the Settlement

23. The undersigned parties agree that this Settlement contains a mutual balancing of interests, contains interdependent provisions and, therefore, is intended to be accepted and approved in its entirety. In any event any particular aspect of this Settlement is not accepted and approved in its entirety by the Board, or modified by the Board, each party that is adversely affected by the modification can either accept the modification or declare this Settlement to be null and void, and the parties shall be placed in the same position that they were in immediately prior to its execution.

24. It is the intent of the undersigned parties that the provisions hereof be approved by the Board as being in the public interest. The undersigned parties further agree that they consider the Settlement to be binding on them for all purposes herein.

25. It is specifically understood and agreed that this Settlement represents a negotiated agreement and has been made exclusively for the purpose of this proceeding. Except as expressly provided herein, the undersigned parties shall not be deemed to have approved, agreed to, or consented to any principle or methodology underlying or supposed to underlie any agreement provided herein and, in total or by specific item. The undersigned parties further agree that this Settlement is in no way binding upon them in any other proceeding, except to enforce the terms of this Settlement.

26. **WHEREFORE**, the undersigned parties respectfully submit this Settlement to the Presiding Administrative Law Judge and Board of Public Utilities and request (1) the Presiding

Administrative Law Judge to issue an Initial Decision approving this Stipulation of Settlement in its entirety in accordance with the terms contained herein, and (2) the Board approve this Stipulation of Settlement in its entirety in accordance with the terms contained herein.

**NEW JERSEY AMERICAN WATER
COMPANY, INC.**

By: Ira G. Megdal
Ira G. Megdal, Esq.

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Attorney for the Staff of the Board of Public
Utilities

By: _____
Alex Moreau, DAG

**Aqua New Jersey
Lawrenceville Water Company**

By: _____
Kevin A. Conti, Esq.

Middlesex Water Company

By: _____
Kenneth J. Quinn, Esq.

Dated: November 16, 2010

Administrative Law Judge to issue an Initial Decision approving this Stipulation of Settlement in its entirety in accordance with the terms contained herein, and (2) the Board approve this Stipulation of Settlement in its entirety in accordance with the terms contained herein.

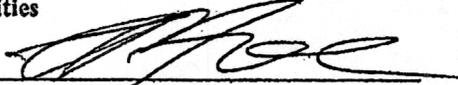
**NEW JERSEY AMERICAN WATER
COMPANY, INC.**

By: _____
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Dated: November 16, 2010

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**NEW JERSEY AMERICAN WATER
COMPANY, INC.**

By: Ira G. Megdal
Ira G. Megdal, Esq.

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Kenneth J. Quinn, Esq.

Dated: November 16, 2010



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Of Counsel
KATHLEEN A. FRANCIOSO*

*MEMBERS OF THE NEW JERSEY & PENNSYLVANIA BAR

November 16, 2010

The Honorable Irene Jones
Administrative Law Judge
Office of Administrative Law
33 Washington Street
Newark, New Jersey 07102

RE: In the Matter of the Petition of New Jersey American Water Company, Inc., for an Increase in Rates for Water and Sewer Service and Other Tariff Modifications
BPU Docket No. WR10040260
OAL Docket No. PUC 5064-10N

Dear Judge Jones:

FORNARO FRANCIOSO LLC represents the ad hoc group of Municipalities and Municipal Utility Authorities intervenors known as the Bulk Purchaser Coalition in the above referenced public utility rate matter. As special counsel for the Bulk Purchaser Coalition, I am able to advise the Court that while the Bulk Purchaser Coalition will not be executing the proposed Stipulation, the Bulk Purchaser Coalition will not be filing an opposition to same.

Thank you for Your Honor's consideration to the foregoing.

Respectfully submitted,
FORNARO FRANCIOSO LLC

Anthony R. Francioso, Esq.

ARF/id

c: Service List

H:\Clients\Bulk Purchaser Coalition\2010 NJAWC Rate Petition\Correspondence\ALJ Jones Stipulation Letter 001 1110.wpd

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November 16, 2010

Via E-Mail and First Class Mail

Hon. Irene Jones, ALJ
Office of Administrative Law
33 Washington Street
Newark, NJ 07102

**Re: In The Matter of the Petition of New Jersey American Water
Company, Inc. For an Increase In Rates For Water And Sewer Service
and Other Tariff Modifications
BPU Docket No. WR10040260; OAL Docket No. PUC 5064-10N**

Dear Judge Jones:

This letter is transmitted on behalf of intervenors Cogen Technologies Linden Venture, L.P., ConocoPhillips Company, Johanna Foods, Inc., Princeton University, and Rutgers, the State University of New Jersey (collectively, the "OIW Customer Coalition"). The OIW Customer Coalition has reviewed the Stipulation of Settlement, and Schedules A and B attached thereto, in this case, dated today and received from Petitioner by e-mail at 4:26 p.m. EST. The OIW Customer Coalition will not be a signatory to said Stipulation, but will not oppose it, with the understanding that the schedule of Customer Charges for exempt customers shown on Page 1 of Schedule A shall be applicable to exempt customers in the OIW customer class.

Very truly yours,

Rothfelder Stern, LLC

By: 
Martin C. Rothfelder

cc: Alex Moreau, DAG
Cynthia Holland, DAG
Ira G. Megdal, Esq.
Suzana Duby, Esq.
Kenneth J. Quinn, Esq.

Debra F. Robinson, Esq.
Christine Juarez, Esq.
Kevin A. Conti, Esq.
Anthony R. Francioso, Esq.

by
RMA

Schedule

LIPP Conservation Plan

The purpose of the proposed LIPP Conservation Plan is to augment the Company's current rate discount program to include physical conservation programs. See PT-2, pg. 22, line 25. This will enable customers who otherwise could not afford to participate in conservation programs to enjoy the benefits of increasing water efficiency/reducing water demand while reducing their monthly water bill. See PT-20, pg. 31, lines 6-9. Upon their acceptance into the LIPP program, all eligible customers will be notified that an added benefit available to them is a free audit and retrofit kit which will include instructions to perform a home water audit (e.g. leak detection, fixture retrofit, steps to conserve water) and certain fixtures (i.e., faucet aerator, toilet tank "bladder", and either a low-flow showerhead or a low flow shower wand for those customers who do not have a shower). See PT-2, pg. 23, lines 5-9; PT-20, pg. 32, lines 14-19. In addition, those customers who are identified as potentially benefitting from additional support will be contacted by phone to discuss water conservation and to help the customers perform their home water audits. See PT-2, pg. 23, lines 9-11. If, based upon that call, it is determined that the customer requires in-home support, a technician or plumber, as appropriate, will be scheduled to go to the customer's home and provide any of the following services, as needed:

Water audit;

Installation of audit kit fixtures and devices; and

Leak repair of fixtures for which the customer is responsible.

See PT-2, pg. 23, lines 11-20.

Please see PT-20, Schedule JJR-9 for a description of the proposed annual budget for the LIPP Conservation Plan.

The foregoing is the Company's proposal. Should circumstances require the Company to modify the LIPP Conservation Plan, the Company will seek appropriate Board review.

SCHEDULE A

NEW JERSEY-AMERICAN WATER COMPANY
BASE RATES – BPU Docket No. WR10040260
COMPARATIVE SCHEDULE OF PRESENT AND SETTLEMENT RATES
SERVICE AREA 1 (SA-1)

Customer Charges, per Month:

Meter Size	Present Rates		Settlement Rates	
	Non-Exempt	Exempt	Non-Exempt	Exempt
.5/8	\$ 9.00	\$ 7.80	\$ 10.00	\$ 8.62
3/4	13.50	11.70	15.00	12.94
1	22.50	19.51	25.00	21.56
1-1/2	45.00	39.02	50.00	43.12
2	72.00	62.42	80.00	68.99
3	135.00	117.05	150.00	129.36
4	225.00	195.08	250.00	215.60
6	450.00	390.15	500.00	431.20
8	720.00	624.24	800.00	689.92
10	900.00	780.30	1,000.00	862.40
12	1,125.00	975.38	1,250.00	1,078.00
16	1,800.00	1,552.44	2,000.00	1,724.80

Consumption Charges,
per Thousand Gallons:

All Usage - GMS	\$ 5.3825	\$ 4.6666	\$ 5.7025	\$ 4.9178
All Usage - Regular SFR	5.3325	4.6233	5.6525	4.8747
All Usage - Peaking Rate SFR	\$ 7.8084	\$ 6.7681	\$ 8.1264	\$ 7.0082

Private Fire Connections (Monthly):

Size	Present Monthly Rates		Settlement State-Wide
	Schedule L-1	Schedule L-2	
2-inch	\$ 18.38		\$ 18.21
3-inch	36.85		40.97
4-inch	65.50		72.83
6-inch	147.38		163.87
8-inch	262.02		291.34
10-inch	409.40		455.21
12-inch	589.54		655.51
16-inch	1,048.32		1,165.83
Sprinkler Heads		\$0.76	0.85
Private Hydrant		18.80	22.02

NEW JERSEY-AMERICAN WATER COMPANY
 BASE RATES – BPU Docket No. WR10040260
 COMPARATIVE SCHEDULE OF PRESENT AND SETTLEMENT RATES
 SERVICE AREA 1 (SA-1)

<u>Public Fire Hydrant (Annually):</u>		<u>Present</u>	<u>Settlement</u>
State-Wide	M-1	\$ 494.78	\$ 518.04
Logan/Ortley	M-2	300.00	326.16
Adolphia	M-3	438.36	464.88

Sales for Resale

<u>Present Rates</u>		<u>Settlement Rates</u>	
<u>Non-Exempt</u>	<u>Exempt</u>	<u>Non-Exempt</u>	<u>Exempt</u>

Rates Applicable to Commodity-Demand Tariff:

Customer Charges, per Month:					
By Meter Size		Same as GMS		Same as GMS	
Consumption Charges, per Thousand:					
All Usage	\$ 0.5082	\$ 0.4383	\$ 0.5138	\$ 0.4431	
Demand Charge per Month:					
Per Thousand Gallons of					
Maximum Day Nomination	\$ 62.49	\$ 53.90	\$ 62.49	\$ 53.90	
Off-Peak Demand Charge per Month:					
Per Thousand Gallons of					
Maximum Day Nomination	\$ 57.47	\$ 49.57	\$ 57.47	\$ 49.57	

Rates Applicable to Manasquan:

Customer Charges, per Month:					
By Meter Size		Same as GMS		Same as GMS	
Consumption Charges, per Thousand:					
Uninterruptible Sales	\$ 1.7749	\$ 1.5309	\$ 1.7840	\$ 1.5385	
Regular Sales	5.3325	4.6233	5.6525	4.8747	

NEW JERSEY-AMERICAN WATER COMPANY
BASE RATES – BPU Docket No. WR10040260
COMPARATIVE SCHEDULE OF PRESENT AND SETTLEMENT RATES
SERVICE AREA 2 (SA-2)

Customer Charges, per Month:

Meter Size	Present Rates		Settlement Rates	
	Non-Exempt		Non-Exempt	
5/8	\$	9.00	\$	10.00
3/4		13.50		15.00
1		22.50		25.00
1-1/2		45.00		50.00
2		72.00		80.00
3		135.00		150.00
		225.00		250.00
		450.00		500.00
8		720.00		800.00
10		900.00		1,000.00
12		1,125.00		1,250.00
16		1,800.00		2,000.00

Consumption Charges, per Thousand Gallons:

	Present Rates		Settlement Rates	
	Non-Exempt	Exempt	Non-Exempt	Exempt
All Usage - GMS	\$	4.6214	\$	4.0068
All Usage - GMS, Manville		4.0607		3.5208
All Usage - OIW		2.9514		2.5589
All Usage - SOS		2.2730		1.9707
All Usage - GMS-SOS		4.5785		3.9698

Private Fire Connections (Monthly):

Size	Present Rates		Settlement Rates	
2-inch	\$	40.47	\$	40.47
3-inch		79.48		79.48
4-inch		128.18		128.18
6-inch		237.75		237.75
8-inch		406.07		406.07
10-inch		482.88		482.88
12-inch		704.93		704.93
16-inch		1,500.17		1,500.17
20-inch		2,733.96		2,733.96
Private Hydrant		25.17		27.99

Public Fire Hydrant (Annually):

Fire Hydrants Zone 2A	\$	430.08	\$	450.36
Fire Hydrants Zone 2C		499.92		523.44
Fire Hydrants Zone 2D		537.48		549.96
Fire Hydrants Zone 2E		591.12		591.12
Fire Hydrants Zone 2F		645.00		645.00
Fire Hydrants Zone 2G		698.76		698.76
Fire Hydrants Zone 2H		750.00		750.00
Fire Hydrants Zone 2I		800.04		800.04
Fire Hydrants Zone 2J		850.08		850.08
Fire Hydrants Zone 2K		900.00		900.00
Fire Hydrants Zone 2L		949.92		949.92

NEW JERSEY-AMERICAN WATER COMPANY
BASE RATES -- BPU Docket No. WR10040260
COMPARATIVE SCHEDULE OF PRESENT AND SETTLEMENT RATES
SERVICE AREA 3 (SA-3)

Customer Charges, per Month:

Meter Size	Present Rates	Settlement
	Non-Exempt	Rates Non-Exempt
5/8	\$ 9.00	\$ 10.00
3/4	13.50	15.00
1	22.50	25.00
1-1/2	45.00	50.00
2	72.00	80.00
3	135.00	150.00
4	225.00	250.00
8	450.00	500.00
8	720.00	800.00
10	900.00	1,000.00
12	1,125.00	1,250.00
18	1,800.00	2,000.00

Consumption Charges,
per Thousand Gallons:

All Usage - Mount Holly	\$ 4.6214	\$ 5.0936
All Usage - Southampton	3.5402	4.0444

Private Fire Connections (Monthly):

Size	Present Rates	Settlement
	Rates	Rates
2-inch	\$ 16.38	\$ 18.21
3-inch	36.85	40.97
4-inch	65.50	72.83
6-inch	147.38	163.87
8-inch	262.02	291.34
10-inch	409.40	455.21
12-inch	589.54	655.51
18-inch	1,048.32	1,185.63
Private Hydrant	7.08	7.87

Public Fire Hydrant (Annually):

Fire Hydrants Zone 3A	\$ 250.08	\$ 261.84
Fire Hydrants Zone 3B	300.00	314.16
Fire Hydrants Zone 3C	350.04	366.48
Fire Hydrants Zone 3D	400.08	418.92
Fire Hydrants Zone 3G	475.08	497.40

NEW JERSEY-AMERICAN WATER COMPANY
BASE RATES -- BPU Docket No. WR10040260
COMPARATIVE SCHEDULE OF PRESENT AND SETTLEMENT RATES
SERVICE AREA 1A (SA-1A)

Customer Charges, per Month:

<u>Meter Size</u>	<u>Present Rates Non-Exempt</u>	<u>Settlement Rates Non-Exempt</u>
5/8	\$ 9.00	\$ 10.00
3/4	13.50	15.00
1	22.50	25.00
1-1/2	45.00	50.00
2	72.00	80.00
3	135.00	150.00
4	225.00	250.00
6	450.00	500.00
8	720.00	800.00
10	900.00	1,000.00
12	1,125.00	1,250.00

Consumption Charges,
per Thousand Gallons:

All Usage	\$ 4.6214	\$ 5.0938
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Private Fire Connections (Monthly):

<u>Size</u>	<u>Present Rates</u>	<u>Settlement Rates</u>
2-inch	\$ 19.95	\$ 19.95
3-inch	44.90	44.90
4-inch	119.67	119.67
6-inch	179.61	179.61
8-inch	319.19	319.19
Private Hydrant	2.27	4.54

<u>Public Fire Hydrant (Annually):</u>	339.84	363.12
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NEW JERSEY-AMERICAN WATER COMPANY
BASE RATES -- BPU Docket No. WR10040260
COMPARATIVE SCHEDULE OF PRESENT AND SETTLEMENT RATES
SERVICE AREA 1B (SA-1B)

Customer Charges, per Month:

<u>Meter Size</u>	<u>Present Rates Non-Exempl</u>	<u>Settlement Rates Non-Exempl</u>
	\$ 8.40	\$ 7.75
	9.80	11.63
	16.00	19.38
	32.00	38.75
	51.20	62.00
	96.00	116.25
	180.00	193.75
	320.00	387.50
	512.00	620.00
	640.00	\$775.00
	800.00	\$988.75

Consumption Charges,
per Thousand Gallons:

All Usage	\$ 3.3295	\$ 3.7522
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Private Fire Connections (Monthly):

<u>Size</u>	<u>Present Rates</u>	<u>Settlement Rates</u>
2-inch	\$ 27.51	\$ 27.51
3-inch	61.89	61.89
4-inch	110.03	110.03
6-inch	247.64	247.64
8-inch	440.12	440.12
10-inch	687.69	687.69
12-inch	990.28	990.28
Private Hydrant	19.87	22.02

Public Fire Hydrant (Annually):

	262.32	285.60
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NEW JERSEY-AMERICAN WATER COMPANY
 BASE RATES – BPU Docket No. WR10040260
 COMPARATIVE SCHEDULE OF PRESENT AND SETTLEMENT RATES
 SERVICE AREA 1D (SA-1D)

Customer Charges, per Month:

<u>Meter Size</u>	<u>Present Rates Non-Exempt</u>	<u>Settlement Rates Non-Exempt</u>
5/8	\$ 9.00	\$ 9.00
3/4	13.50	13.50
1	22.50	22.50
1-1/2	45.00	45.00
2	72.00	72.00

Consumption Charges,
per Thousand Gallons:

All Usage	\$ 4.9889	\$ 4.9889
All Usage - Irrigation	\$ 6.8034	\$ 6.8034

Private Fire Connections (Annually):

<u>Size</u>	<u>Present Rates</u>	<u>Settlement Rates</u>
Private Hydrant	\$ 231.92	\$ 231.92

Public Fire Hydrant (Annually):

	\$ 231.92	\$ 231.92
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NEW JERSEY-AMERICAN WATER COMPANY
BASE RATES – BPU Docket No. WR10040280
COMPARATIVE SCHEDULE OF PRESENT AND SETTLEMENT RATES
SEWER SERVICE

ADELPHIA

Customer Charges, per Month:

Meter Size	Present Rates	Settlement
	Non-Exempt	Rates Non-Exempt
5/8	\$5.39	\$5.89
3/4	8.09	8.54
1	13.48	14.23
1-1/2	26.95	28.45
2	43.12	45.52
3	80.85	85.35
4	134.75	142.25
6	289.50	284.50
8	431.20	455.20
10	539.00	569.00
12	673.75	711.25
Sewer Usage Charge, per Thousand Gallons:	\$5.2214	\$5.5060

LAKEWOOD

Customer Charges, per Month: All meter sizes	Present Rates	Settlement
	Non-Exempt	Rates Non-Exempt
	\$15.06	\$15.06
Sewer Usage Charge, per Thousand Gallons:	\$3.4102	\$3.4102

OCEAN CITY

Minimum Service Charge per Thousand Gallons:	Present Rates	Settlement
	Non-Exempt	Rates Non-Exempt
	\$10.5630	\$10.7750
Sewer Usage Charge, per Thousand Gallons:	\$1.7788	\$1.8144

POTTERSVILLE

Flat Rate Billed Customers Flat Rate Fixed Service Charge, per Month	Present Rates	Settlement
	Non-Exempt	Rates Non-Exempt
	\$80.17	\$160.34
<u>General Metered Service Customers</u> Fixed Service Charge, per Month	\$80.17	\$110.96
Sewer Usage Charge, per Thousand Gallons:	n/a	\$8.0000

NEW JERSEY-AMERICAN WATER COMPANY
BASE RATES – BPU Docket No. WR10040260
COMPARATIVE SCHEDULE OF PRESENT AND SETTLEMENT RATES
SEWER SERVICE

<u>STATEWIDE</u>	Present Rates	Settlement
	Non-Exempt	Rates Non-Exempt
<u>Flat Rate Charges - Rate Schedule 5-A (Cows):</u>		
Detached Single Family - Monthly	\$107.58	\$107.58
2 Bedroom Age Restricted - Monthly	92.04	92.04
3 Bedroom Age Restricted - Monthly	94.80	94.80
4 Bedroom Age Restricted - Monthly	94.80	94.80
1 Bedroom Townhouse - Monthly	90.38	90.38
2 Bedroom Townhouse - Monthly	94.80	94.80
3 Bedroom Townhouse - Monthly	107.58	107.58
3 Bedroom Townhouse Age Restricted - Monthly	94.80	94.80
<u>Flat Rate Charges - Rate Schedule 6-A (Homestead):</u>		
Detached Single Family - Monthly	71.03	71.03
2 Bedroom Age Restricted - Monthly	71.03	71.03
<u>Non-Residential Sewer Custs. - Rate Schedule 7-A (All)</u>		
<u>Customer Charges, per Month:</u>		
5/8" Meter	\$30.08	\$30.08
3/4" Meter	45.11	45.11
1" Meter	75.19	75.19
1 1/2" Meter	150.38	150.38
2" Meter	240.60	240.60
Sewer Usage Charge, per Thousand Gallons:	\$9.8260	\$9.8260
<u>Other Contracts - Rate Schedule 8-A</u>		
Schools (per formula)	\$341.56	\$341.56
Other (per Equivalent Dwelling Unit)	\$341.56	\$341.56
<hr/>		
<u>JENSEN's</u>	Present Rates	Settlement
	Non-Exempt	Rates Non-Exempt
<u>Flat Rate Billed Customers</u>		
Flat Rate Fixed Service Charge, per Month	n/a	\$52.50

NEW JERSEY-AMERICAN WATER COMPANY
BASE RATES -- BPU Docket No. WR10040260
COMPARATIVE SCHEDULE OF PRESENT AND SETTLEMENT RATES
MISCELLANEOUS CHARGES (only those changed in this Rate Case)

	<u>Present Rates</u>	<u>Settlement Rates</u>
Reconnection of Service Charge:		
Normal Working Hours	\$22.00	\$28.00
Bad Check Charge	\$9.00	\$15.00

SCHEDULE B

New Jersey American Water Company
Calculation of Revenue Deficiency

	<u>Per Stipulation</u>
Rate Base	\$1,771,009,511
Rate of Return	<u>8.3248%</u>
Operating Income Requirement	147,433,000
Pro Forma Operating Income	<u>125,174,115</u>
Income Deficiency	22,258,885
Revenue Conversion Factor	<u>1.798531</u>
Revenue Deficiency	40,033,294
Remove Revenue Requirement For Morris Chase Sewer System	<u>(133,294)</u>
Net Revenue Deficiency	<u><u>39,900,000</u></u>



State of New Jersey

OFFICE OF ADMINISTRATIVE LAW

INITIAL DECISION

SETTLEMENT

OAL DKT. NO. PUC 05064-10

AGENCY DKT. NO. WR10040260

**IN THE MATTER OF THE PETITION OF
NEW JERSEY AMERICAN WATER COMPANY,
INC FOR AN INCREASE IN RATES FOR WATER
AND SEWER SERVICES AND OTHER TARIFF
MODIFICATIONS**

Ira G. Megdal, Esq., Cozen O'Connor, and **Suzana Duby**, Esq., Corporate Counsel, Counsel for Petitioner, New Jersey American Water Company, Inc.;

Debra F. Robinson, Esq., Deputy Rate Counsel, and **Christine Juarez** Assistant Deputy Rate Counsel, for the New Jersey Division of Rate Counsel (Stefanie A. Brand, Esq., Director);

Alex Moreau, Deputy Attorney General, and **Cynthia Holland**, Deputy Attorney General, for the Staff of the New Jersey Board of Public Utilities (Paula T. Dow, Attorney General of New Jersey);

Kevin A. Conti, Esq., DeCotiis, Fitzpatrick & Cole, LLP Counsel for Intervenors, Aqua New Jersey, Inc. and Lawrenceville Water Company;

Martin C. Rothfelder, Esq., and **Bradford M. Stern**, Esq., (Rothfelder Stern, LLC, Counsel for Intervenors Cogen Technologies Linden Venture, L.P., Conoco Phillips Company, Johanna Foods, Inc., Princeton University, and Rutgers, the State University of New Jersey);

Anthony R. Francioso, Esq., Fornaro Francioso, Counsel for Intervenor Bulk Purchaser Coalition; and

Kenneth J. Quinn, Esq., Middlesex Water Company, Counsel for Intervenor Middlesex Water Company

Record Closed: November 22, 2010

Decided: November 22, 2010

BEFORE IRENE JONES, ALJ:

On April 9, 2010, New Jersey American Water Company, "Petitioner" or "Company") filed with the New Jersey Board of Public Utilities ("Board") a Petition requesting an increase in operating revenues of approximately \$84.7 million or a 13.61% increase in its rates.

On May 12, 2010, the Board transmitted the matter to the Office of Administrative Law ("OAL") for hearing as a contested case pursuant to N.J.S.A. 52:14B-1 through 15 and N.J.S.A. 52:14F-1 through 13. On June 8, 2010, a prehearing conference was held and a prehearing order was issued on June 23, 2010.

The parties to this matter are the Petitioner, The Division of Rate Counsel ("Rate Counsel"), and the Staff of the Board ("Staff"). Motions to Intervene were filed and granted to: Bulk Purchaser Coalition; Rutgers, the State University of New Jersey; Princeton University; ConocoPhillips Company; Johanna Foods, Inc.; Cogen Technologies Linden Venture, L.P.; Middlesex Water Company; Aqua New Jersey, Inc.; and Lawrenceville Water Company by Orders dated September 1, 2010, June 16, 2010, and June 23, 2010.

Additionally, Public Service Electric and Gas Company filed a Motion for Intervention but agreed to accept Participant status. On July 2, 2010, the Utility Workers Union of America ("UWUA"), Locals 391, 395 and 423 (the "Locals") and Individuals Noel Christmas and Thomas DiFranco (the "Individuals") jointly filed a Motion to Intervene, or in the alternative to Participate in this proceeding. The motion was opposed by NJAWC. The motion of the Individuals was denied by Order dated October 6, 2010. The motion of the Locals was granted and they were provided Participant status.

Pursuant to statute, Petitioner published in newspapers of general circulation within its service territory a notice of the public hearings which were held in Ocean City,

Westampton, Howell Township, and Westfield on August 10, 2010 and August 18, 2010.

As part of the case, the parties exchanged discovery consisting of over 700 discovery requests, attended numerous meetings and settlement conferences.

Evidentiary hearings were scheduled for October and November, 2010. Prior to the commencement of such hearings, the parties entered into a Stipulation of Settlement which is appended to this Initial Decision.

have reviewed the record and the terms of the settlement and **FIND:**

1. The parties to the Stipulation have voluntarily agreed to a settlement evidenced by their signatures.
2. The Stipulation of Settlement has been executed by all parties of record, excluding the Interveners and Participants. The Interveners to this case have submitted letters stating they do not object to the Stipulation.

I **CONCLUDE** that this agreement meets the requirements of N.J.A.C. 1:1-19 and accordingly, I approve the Stipulation of Settlement.

ORDER

It is therefore, **ORDERED** that the parties to comply with the terms of the settlement and this proceeding is now concluded.

hereby **FILE** my Initial Decision with the **BOARD OF PUBLIC UTILITIES** for consideration.

This recommended decision may be adopted, modified or rejected by the **BOARD OF PUBLIC UTILITIES**, which by law is authorized to make a final decision in this matter. If the Board of Public Utilities does not adopt, modify or reject this decision within forty-five days and unless such time limit is otherwise extended, this recommended decision shall become a final decision in accordance with N.J.S.A. 52:14B-10.



November 19, 2010

DATE

IRENE JONES, ALJ

Date Received at Agency:

Date Mailed to Parties:

sei

**Market Cost Comparison of Service Company Charges to
New Jersey American Water Company
12-Months Ended December 31, 2010**



**New Jersey American Water Company
Market Cost Comparison of Service Company Charges
12-Months Ended December 31, 2010**

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Purpose of This Study

This study was undertaken to answer four questions concerning the services provided by American Water Works Service Company, Inc. (Service Company) to New Jersey American Water Company (NJAWC):

1. Were the Service Company's charges to NJAWC during the 2010 reasonable?
2. Was NJAWC charged the lower of cost or market for managerial and professional services provided by the Service Company during the 2010?
3. Were the 2010 costs of the Service Company's customer accounts services, including those of the National Call Centers, comparable to those of other utilities?
4. Are the services NJAWC receives from Service Company necessary?

Study Results

Concerning question 1, the following conclusion was reached:

- The Service Company's 2010 cost per NJAWC customer is reasonable compared to cost per customer for electric and combination electric/gas service companies. During the 2010, NJAWC was charged \$48 per customer for administrative and general (A&G)-related services provided by the Service Company. This compares to an average of \$111 per customer for service companies reporting to the Federal Energy Regulatory Commission (FERC). Only 2 of the 24 utility service companies that filed a FERC Form 60 for 2010 had a lower per customer A&G cost than NJAWC's charges from the Service Company.

Concerning question 2, the following conclusions were drawn from this study:

- NJAWC was charged the lower of cost or market for managerial and professional services during the 2010.
- On average, the hourly rates for outside service providers are 45% higher than the Service Company's hourly rates.
- The managerial and professional services provided by the Service Company are vital and could not be procured externally by NJAWC without careful supervision on the part of NJAWC. If these services were contracted entirely to outside providers, NJAWC would have to add at least two positions to manage activities of outside firms. These positions would be necessary to ensure the quality and timeliness of services provided.
- If all the managerial and professional services now provided by the Service Company had been outsourced during the 2010, NJAWC and its ratepayers would have incurred more than \$14.3 million in additional expenses. This amount includes the higher cost of outside providers and the cost of two NJAWC positions needed to direct the outsourced work.
- This study's hourly rate comparison actually understates the cost advantages that accrue to NJAWC from its use of the Service Company. Outside service providers generally bill for every hour worked. Service Company exempt personnel, on the other hand, charge a maximum of 8 hours per day even when they work more hours. If all overtime hours of



I – Introduction

Service Company personnel were factored into the hourly rate calculation, the Service Company would have had an even greater annual dollar advantage than the \$14.3 cited above.

- It would be difficult for NJAWC to find local service providers with the same specialized water industry expertise as that possessed by the Service Company staff. Service Company personnel spend substantially all their time serving operating water companies. This specialization brings with it a unique knowledge of water utility operations and regulation that is most likely unavailable from local service providers.
- Service Company fees do not include any profit markup. Only its actual cost of service is being recovered from NJAWC ratepayers.

Concerning question 3, the following conclusion was reached:

- The cost of the Service Company's customer accounts services, including those provided by the National Call Centers, is well below the average of the neighboring electric utility comparison group. As will be explained further herein, this group of companies provides a reasonable proxy group for comparison to a regulated utility of the size and scope of the Service Company and NJAWC. During 2010, the customer accounts cost for NJAWC customers was \$24.32 compared to the 2010 average of \$50.51 for neighboring electric utilities. The highest comparison group per customer cost was \$97.07 and the lowest \$13.30.

Concerning question 4, the following conclusions was drawn:

- The services that the Service Company provides are necessary and would be required even if NJAWC were a stand-alone water utility.
- Furthermore, there is no redundancy or overlap in the services provided by the Service Company to NJAWC. For all of the services listed in Exhibit 12, there was only one entity primarily responsible for the service.



II – Background

Overview of American Water Works Service Company

American Water's Service Company exists to provide certain shared services to American Water subsidiaries. It follows a service company model used by many utility holding companies that own multiple regulated utilities. By consolidating executive and professional services into a single service company, utility holding companies are able to realize the following benefits for ratepayers:

- **Purchasing Economies** – Common expenses (e.g., insurance, chemicals, piping) can be procured on a much larger scale thereby providing greater bargaining power for the combined entity compared to individual utility operating companies. A service company facilitates corporate-wide purchasing programs through its procurement and contract administration functions.
- **Operating Economies of Scale** – A service company is able to deliver services more efficiently because workloads can be balanced across more persons and facilities. For instance, American Water's Service Company is able to maintain one principal data center for the entire corporation. This is much more cost-efficient than each operating utility funding their own data center with its large fixed hardware, software and staffing costs.
- **Continuity of Service** – Centralizing service company personnel who perform similar services facilitates job cross-training and sharing of knowledge and expertise. This makes it easier to deal with staff turnover and absences and to sustain high levels of service to operating utilities. An individual operating utility might experience considerable disruption if a key professional left and it was necessary to hire outside to fill the vacancy.
- **Maintenance of Corporate-Wide Standards** – Personnel in American Water's Service Company establish standards for many functions (e.g., engineering designs, operating procedures and maintenance practices). It is easier to ensure these standards are followed by every operating utility because their implementation is overseen by the Service Company.
- **Improved Governance** – American Water's Service Company provides another dimension of management and financial oversight that supplements local operating utility management. The Service Company facilitates standard planning and reporting that help ensure operating utilities meet the requirements of their customers in a cost effective manner.
- **Retention of Personnel** – A service company organization provides operating utility personnel with another career path beyond what may be available on a local level. These opportunities tend to improve employee retention.

American Water follows the model for other utility service companies in another important regard. Its services are provided to affiliate operating utilities, like NJAWC, at cost. American Water's Service Company is not a profit-making entity. It assigns only its actual expenses to the American Water subsidiaries it services.

The Service Company provides services to American Water operating companies from the following locations:

II – Background

- Corporate Office – Includes American Water's executive management and personnel from the various corporate support services. American Water's corporate office is located in Voorhees, New Jersey.
- National Call Centers – Perform customer service functions, including: customer call processing, service order processing, correspondence processing, credit and collections. American Water maintains two call centers. One in Alton, Illinois that went into operation in 2001 and a second in Pensacola, Florida that went into operation in 2005. Prior to the establishment of these national call centers, customer service functions were performed by employees of NJAWC, which incurred the expense on its books.
- National Shared Services Center – The Shared Services Center, located in Cherry Hill, New Jersey, provides various financial, accounting and treasury functions that had been performed by individual operating companies. This arrangement has improved and streamlined the Company's financial processes and allowed operating companies to focus on providing utility service.
- Regional Offices – Regional offices provide operating companies with certain support services that can be performed more effectively on a regional basis because individual operating company/center workloads are not sufficient to warrant a full-time staff for these activities. At the same time, these services require closer proximity to operating companies served so they are not provided by the National Shared Services Center. Examples of regional office services include legal, communication, human resources and maintenance.
- Belleville Lab – The national trace substance laboratory is located in Belleville, Illinois and performs testing for all American Water operating companies.
- Information Technology Service Centers – American Water's principal data center, located in Hershey, Pennsylvania, supports the IT infrastructure required to run corporate and operating company business applications and the communications systems. IT personnel rotate, as needed, throughout the regional offices and operating companies.

Service Company Expense Categories

The Service Company renders a monthly bill to operating companies. Charges are broken down into the following expense categories:

- Labor – base pay (salaries) of managerial and professional employees
- Labor-Related Overheads - employee benefit costs (payroll taxes, medical coverage, pensions, disability insurance) and other general expenses
- Support - wages and salaries of office support personnel, including secretaries, clerical personnel, telephone operators and mail clerks
- Office Expenses - office rent, equipment leases, telephone, electric, office supplies, property taxes, office maintenance
- Vouchers/Journal Entries – (1) travel expenses incurred by Service Company personnel, (2) other items submitted for reimbursement by employees, including professional association dues, (3) outside service contracts for such things as actuarial

II – Background

services, and (4) various other expenditures, including data center expenses for software licenses and hardware maintenance.

Service Company expenses are either assigned directly or allocated to operating companies, as shown in the table below.

Expense Category	Direct Charged	Allocated	Comments
Labor	X	X	Professional personnel working for one or several operating companies
Labor-Related Overheads	X	X	These are primarily employee benefit costs that relate directly to labor
Support		X	Administrative personnel support the professional staff, thus support costs are allocated on the basis of professional labor
Office Expense		X	Are all allocated on the basis of professional labor
Vouchers/Journals	X	X	May be either directly in support of one operating company (e.g., an engineer traveling from the Corporate Office to the operating company) or allocated to several operating companies

A direct charge occurs when Service Company work or expenses are incurred in support of only one operating company. Direct charge examples include work in support of an operating company's rate case, engineering design work on an operating company's project and the preparation of an operating company's financial statements.

Service Company expenses are allocated when more than one operating company benefits from the underlying work. Examples include assessments of new Federal water quality regulations, development of the company-wide materials procurement contracts and creation of company-wide engineering design standards.

Charging and Assignment Of Service Company Time and Expenses

Service Company transactions are assigned with the following information so there is a proper accounting and eventual charging to an operating company:

- Operating company
- Formula number
- Work order (where applicable)
- Authorization number (where applicable)

Charges can originate from the following systems:

- Payroll System
- RVI System (outside vendor payments)
- PCard System (credit card payments)
- Internal Purchase Order System
- Journal entries

II – Background

The Service Company's time reporting process enables labor and support charges to be assigned to the proper operating company. Labor charges are based on the time reported by managerial and professional Service Company employees. Every week, Service Company professional employees complete an electronic time sheet that shows:

- Formula number (this is linked to operating company within American Water's financial system)
- Employee hours worked
- Account number for non-labor charges

At month-end, time report information is processed and direct and allocated professional labor hours tabulated for each operating company. Dollar charges are then calculated using the hourly rate of each Service Company professional employee based upon their base salary (i.e., an employee's hours times their hourly rate of pay).

Support (administrative) personnel charge their time to the activity "General Admin." As described in the table on page 4, their labor charges are allocated to operating companies based upon how their office's professional personnel labor charges are assigned. For instance, if 10% of American Water's Shared Services' professional labor is assigned to NJAWC during a month, then 10% of that office's monthly administrative labor charges also are assigned to the operating company.

The overhead cost category is next assigned based on professional and administrative labor costs. Thus, if 10% of the Shared Services' accumulated professional and support labor is charged to NJAWC during the month, then 10% of that month's overhead expenses will be assigned to NJAWC.

Each Service Company location's office expenses are allocated to operating companies based on how professional labor charges for that office have been assigned. For instance, if 2% of professional labor from one Service Company office is assigned to NJAWC, then 2% of that office's office expenses would be assigned to NJAWC. Thus, office expenses are allocated in the very same way as administrative labor.

Vouchers/journal entries may be charged directly or allocated, depending on who benefits from the expenditure. For instance, the cost of a continuing professional education course taken by a professional in a regional office is allocated to the operating companies served by that office. Travel expenses by that same professional to a rate case proceeding are charged directly to the operating company whose case is being heard.

III – Service Company Cost Comparison Approach

During the 2010, the Service Company billed NJAWC a total of \$40.8 million, as shown in the table below. These charges were subjected to a market cost comparison.

	2010
Management Fees - O&M	\$ 33,228,943
Management Fees - Capital	\$ 7,583,315
Total AWSC Charges	\$ 40,812,258

For purposes of comparing these charges to certain outside benchmarks, Service Company services were placed into two categories:

- Managerial and Professional Services – Includes such services as management, accounting, legal, human resources, information technology, and engineering.
- Customer Accounts Services – Includes customer-related services, such as call center, credit, billing, collection and payment processing.

Total 2010 Service Company charges break down between management/professional services and customer account services as follows:

	2010	
	Amount	Hours
Management and Professional Services	\$ 31,703,175	191,382
Customer Account Services	\$ 9,109,084	177,965
Total Service Company Charges	\$ 40,812,258	369,347

This study's first question—whether Service Company 2010 charges were reasonable—was determined by comparing NJAWC's A&G-related Service Company charges per customer to the same charges for utility companies that must file the FERC Form 60 – Annual Report of Service Companies.

The second question—whether Service Company charges during the 2010 were at the lower of cost or market—was evaluated by comparing the cost per hour for managerial and professional services provided by Service Company personnel to hourly billing rates that would be charged by outside providers of equivalent services. Service Company costs per hour were based on actual charges to NJAWC during the 2010. Outside providers' billing rates came from surveys or other information from professionals that could perform the services now provided by the Service Company.

III – Service Company Cost Comparison Approach

The third question—whether Service Company’s 2010 customer account services charges, including National Call Center costs, were comparable to other utilities—was addressed by comparing NJAWC’s customer accounts services expenses to those of neighboring investor owned electric utilities. This utility comparison group was selected because the cost of outside providers of customer accounts services is proprietary and not publicly available. Comparison to electric utilities is appropriate because all utilities, regardless of service type, must perform customer account services activities, including updating customer records for meter reads, printing and mailing bills, and the collection and processing of customer payments. Electric utility costs are available from the Federal Energy Regulatory Commission (FERC) Form 1, thus there is appropriate data transparency. The selection of electric utilities from New Jersey and neighboring states provides a sufficiently sized comparison group.

The fourth question—the necessity of Service Company services—was investigated by defining the services provided to NJAWC and determining if these services would be required if NJAWC were a stand-alone utility.



IV – Question 1 – Reasonableness of Service Company Charges

NJAWC’s Service Company Cost per Customer

During the 2010, NJAWC was charged \$48 per customer by the Service Company for A&G-related services. The calculation of this amount, shown in the table below, starts with total net testable Service Company charges and adjusts for capital and non-A&G functions (engineering, operations and water quality) charges. These adjustments are necessary to develop a per customer cost that is comparable to cost of utility service companies.

	2010
Testable Service Company charges	\$ 40,812,258
Less: Capital charges	\$ (7,583,315)
Less: Non-A&G function charges	
Engineering	\$ (15,785)
Operations	\$ (1,555,590)
Water Quality	\$ (1,295,307)
Net A&G-related charges	\$ 30,362,261
NJAWC customers	638,458
NJAWC Cost Per Customer	\$ 48

Comparison Group Cost Per Customer

Every centralized service company in a holding company system subject to regulation by the FERC must file a Form 60 in accordance with the Public Utility Holding Company Act of 2005, Section 1270, Section 390 of the Federal Power Act and 18 C.F.R. paragraph 366.23. This report is designed to collect financial information from service companies that are subject to regulation by the FERC.

For 2010, a Form 60 was filed by 25 utility service companies, all of which serve utilities that provide regulated electric and, in some cases, gas service to retail customers. In order to make a valid comparison of this group’s costs to those of American Water Works Service Company, it was necessary to isolate expenses that they have in common. These include A&G-related charges associated with the following FERC accounts:

901 – Supervision	921 – Office supplies and expenses
903 – Customer records and collection expenses	923 – Outside services employed
905 – Miscellaneous customer accounts expenses	926 – Employee pensions and benefits
907 – Supervision	928 – Regulatory commission expenses
910 – Misc customer service and info expenses	930.2 – Miscellaneous general expenses
911 – Supervision	931 – Rents
920 - Administrative and general salaries	935 – Maintenance of structures and equipment

Charges to utility affiliates for the comparison group service companies were obtained from Schedule XVI – Analysis of Charges for Service Associate and Non-Associate Companies (p. 303 to 306) of each entity’s FERC Form 60. This schedule shows charges by FERC Account.

Comparison group service company 2010 expenses were also adjusted to remove charges to non-regulated affiliates from the cost pool used to calculate the cost per regulated service customer. This determination was made using information from the FERC Form 60 schedule: Account 457 – Analysis of Billing – Associate Companies.

One service company that filed a Form 60 was excluded from the comparison group because its Form 60 contained no data for 2010. That service company, Great Plains Energy Services Incorporated, became inactive in 2010 and had no charges to its regulated utility affiliate. The

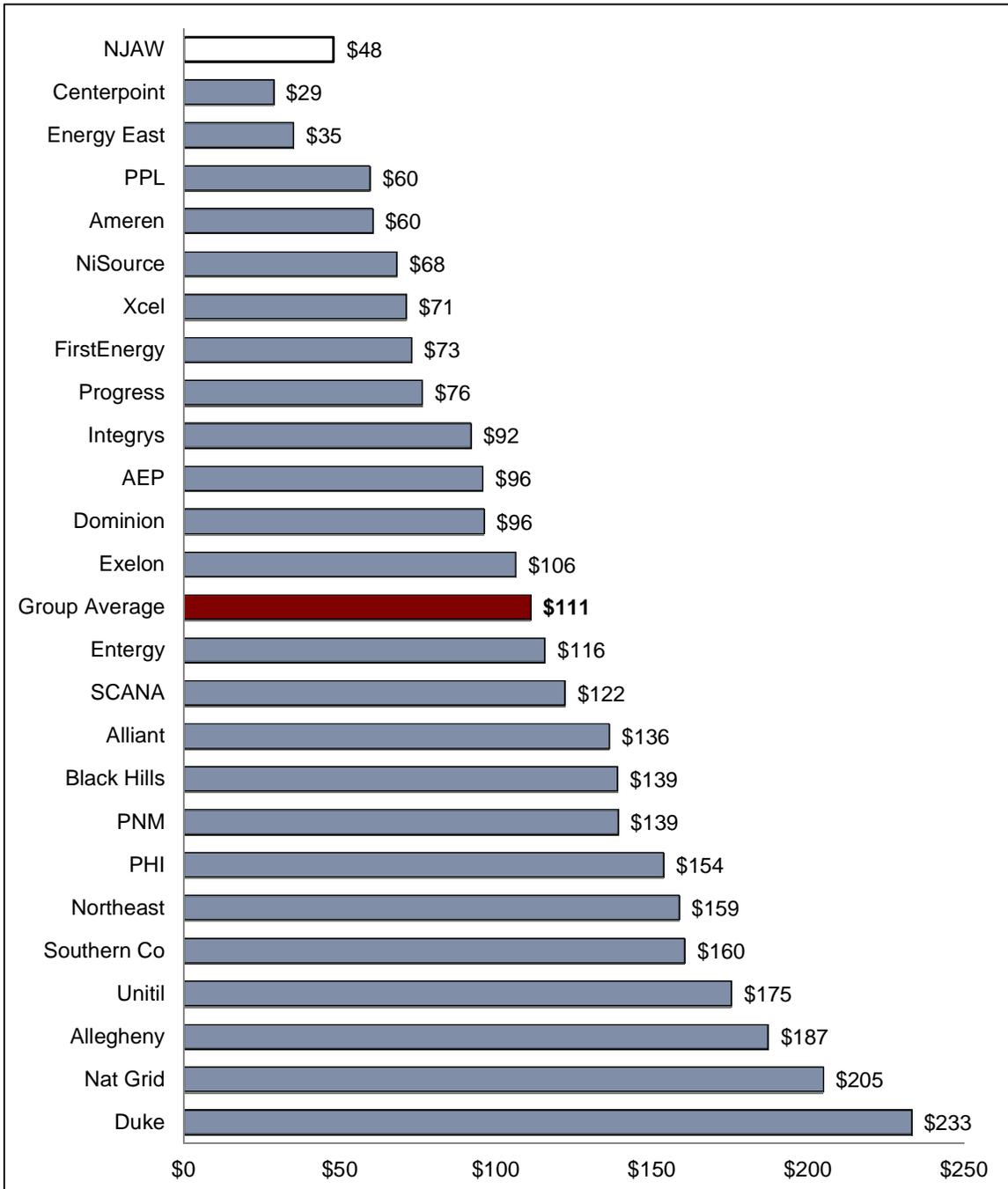
IV – Question 1 – Reasonableness of Service Company Charges

A&G expenses per regulated utility customer for the other 24 utility companies that filed a Form 60 for 2010 are calculated below.

Utility Company	2010 Regulated Retail Service Company A&G Expenses	Regulated Retail Customers	Cost per Customer
AEP	\$504,470,290	5,270,000	\$ 96
Allegheny	\$280,648,832	1,500,000	\$ 187
Alliant	\$190,279,242	1,397,000	\$ 136
Ameren	\$199,214,264	3,300,000	\$ 60
Black Hills	\$101,069,342	728,000	\$ 139
Centerpoint	\$154,637,102	5,400,000	\$ 29
Dominion	\$355,526,659	3,700,000	\$ 96
Duke	\$1,050,793,575	4,510,000	\$ 233
Energy East	\$104,272,025	2,973,000	\$ 35
Entergy	\$312,275,947	2,700,000	\$ 116
Exelon	\$625,208,791	5,890,000	\$ 106
FirstEnergy	\$328,067,979	4,500,000	\$ 73
Integrus	\$201,979,742	2,200,000	\$ 92
Nat Grid	\$1,412,608,875	6,900,000	\$ 205
NiSource	\$255,900,005	3,755,000	\$ 68
Northeast	\$332,151,577	2,095,000	\$ 159
PHI	\$298,918,585	1,946,000	\$ 154
Progress	\$236,500,882	3,100,000	\$ 76
PNM	\$101,288,510	728,700	\$ 139
PPL	\$158,366,212	2,659,000	\$ 60
SCANA	\$177,720,204	1,457,000	\$ 122
Southern Co	\$708,564,089	4,417,000	\$ 160
Unitil	\$30,113,132	171,700	\$ 175
Xcel	\$376,977,165	5,300,000	\$ 71
Group Total	\$8,497,553,025	76,597,400	\$ 111

Exhibit 1 (page 11) shows NJAWC's 2010 Service Company cost per customer of \$48 to be considerably lower than the average of \$111 per customer for the comparison group service companies. Only 2 of 24 comparison group service companies had a lower cost per customer than NJAWC. Based on this result, it is possible to conclude that the Service Company's 2010 charges to NJAWC were reasonable.

**New Jersey American Water Company
Comparison of Service Company Annual Costs Per Customer**



Methodology

The lower-of-cost-or-market comparison is accomplished by comparing the cost per hour for Service Company managerial and professional services to those of outside service providers to whom these duties could be assigned. Based on the nature of the Service Company services it was determined that the following outside providers could perform the categories of services indicated below:

- Management Consultants – executive and administrative management, risk management, human resources and communications services
- Attorneys – legal services
- Certified Public Accountants – accounting, financial and rates and revenues services
- IT Professionals – information technology services
- Professional Engineers – engineering, operations and water quality services.

The services provided by the Belleville lab are assumed to be transferable to professional engineers for purposes of this cost comparison. This was done for two reasons. First, there is no readily available survey of hourly billing rates for testing services such as those performed by Belleville. Second, Belleville personnel have similar, scientific educational backgrounds as Service Company engineering personnel. Thus, it is valid to compare the hourly rates of Belleville services to those of outside engineering firms.

Service Company's hourly rate were calculated for each of the five outside service provider categories, based on the dollars and hours charged to NJAWC during the 2010. Hourly billing rates for outside service providers were developed using third party surveys or directly from information furnished by outside providers themselves.

It should be noted that by using the Service Company's hours charged NJAWC during 2010, its hourly rates are actually overstated because some Service Company personnel charge a maximum 8 per day even when they work more. Outside service providers generally bill for every hour worked. If all overtime hours of Service Company personnel had been factored into the hourly rate calculation, Service Company hourly rates would have been lower.

The last step in the market cost comparison was to compare the Service Company's average cost per hour to the average cost per hour for outside providers.

Service Company Hourly Rates

Exhibit 2 (page 14) details the assignment of 2010 management and professional Service Company charges by outsider provider category. Exhibit 3 (page 15) shows the same assignment for Service Company management and professional hours charged to NJAWC during the 2010.

Certain adjustments to these dollar amounts were necessary to calculate Service Company hourly rates that are directly comparable to those of outside providers. Adjustments were made to the following the 2010 test period non-labor Service Company charges:

- Contract Services – 2010 Service Company charges to NJAWC include expenses associated with the use of outside professional firms to perform certain corporate-wide

V – Question 2 – Provision of Services at the Lower of Cost or Market

services (e.g., legal, financial audit, actuarial services). These professional fees are excluded from the Service Company hourly rate calculation because the related services have effectively been out-sourced already.

- Travel Expenses – In general, client-related travel expenses are not recovered by outside service providers through their hourly billing rate. Rather, actual out-of-pocket travel expenses are billed to clients in addition to fees for professional services. Thus, it is appropriate to remove these Service Company charges from the hourly rate calculation.
- Information Technology Infrastructure Expenses – Included in the 2010 Service Company charges to NJAWC are leases, maintenance fees and depreciation related to American Water's enterprise mainframe, server and network infrastructure and corporate business applications. An outside provider that would take over operation of this infrastructure would recover these expenses over and above the labor necessary to operate the data center.

Exhibit 4 (page 16) shows how contract services, travel expenses and computer hardware/software-related Service Company charges are assigned among the four outside provider categories.

Based on the assignment of expenses and hours shown in Exhibits 2 and 3 and the excludable items shown in Exhibit 4, the Service Company's equivalent costs per hour for the 2010 are calculated below.

	Attorney	Management Consultant	Certified Public Accountant	IT Professional	Professional Engineer	Total
Total management, professional & technical services charges	\$ 962,056	\$ 9,665,151	\$ 7,119,857	\$ 10,080,984	\$ 3,875,127	\$ 31,703,175
Less:						
Contract services	\$ 91,664	\$ 2,232,640	\$ 805,626	\$ 1,077,821	\$ 416,537	\$ 4,624,289
Travel expenses	\$ 18,636	\$ 176,334	\$ 53,903	\$ 124,852	\$ 62,389	\$ 436,114
IT infrastructure expenses	\$ 22,375	\$ 3,444,466	\$ 42,925	\$ 2,107,067	\$ 205,063	\$ 5,821,896
Net Service Charges (A)	\$ 829,382	\$ 3,811,711	\$ 6,217,403	\$ 6,771,243	\$ 3,191,138	\$ 20,820,876
Total Hours (B)	4,031	29,032	76,795	48,078	33,446	191,382
Average Hourly Rate (A / B)	\$ 206	\$ 131	\$ 81	\$ 141	\$ 95	

New Jersey American Water Company
Analysis of 2010 Service Company Charges By Location And Function

		12 Months Ended December 31, 2010 Service Company Charges					
Location	Function	Attorney	Management Consultant	Certified Public Accountant	IT Professional	Professional Engineer	Total
Belleville Lab	Water Quality					\$ 999,007	\$ 999,007
Call Center	Human Resources		\$ 227,134				\$ 227,134
Corporate	Accounting			\$ 2,216,971			\$ 2,216,971
	Administration		\$ 1,065,502				\$ 1,065,502
	Audit			\$ 324,283			\$ 324,283
	Communications		\$ 536,069				\$ 536,069
	Finance		\$ 4,601,241	\$ 1,499,826			\$ 6,101,067
	Human Resources		\$ 1,408,031				\$ 1,408,031
	Information Technology				\$ 342,472		\$ 342,472
	Legal		\$ 600,727				\$ 600,727
	Operations			\$ 774,707			\$ 2,928,251
	Rates & Revenue				\$ 406,814		\$ 406,814
	Risk Management			\$ 288,781			\$ 288,781
	Water Quality					\$ 503,006	\$ 503,006
Regional Offices	Accounting			\$ 21,949			\$ 21,949
	Administration		\$ 70,436				\$ 70,436
	Communications		\$ 214,358				\$ 214,358
	Engineering					\$ 17,100	\$ 17,100
	Finance			\$ 328,154			\$ 328,154
	Human Resources			\$ 0			\$ 0
	Legal		\$ 361,328				\$ 361,328
	Operations			\$ 5,259		\$ 200,125	\$ 205,384
	Risk Management			\$ 12,640			\$ 12,640
	Water Quality					\$ 2,345	\$ 2,345
	Information Technology	Information Technology				\$ 9,738,511	\$ 9,738,511
	Shared Services	Accounting			\$ 2,052,418		
Administration			\$ 460,994				\$ 460,994
Finance				\$ 16,930			\$ 16,930
Rates & Revenue				\$ 252,513			\$ 252,513
Total Dollars Charged		\$ 962,056	\$ 9,665,151	\$ 7,119,857	\$ 10,080,984	\$ 3,875,127	\$ 31,703,175

New Jersey American Water Company
Analysis of 2010 Service Company Hours By Location And Function

Location	Function	12 Months Ended December 31, 2010 Service Company Hours					Total	
		Attorney	Management Consultant	Certified Public Accountant	IT Professional	Professional Engineer		
Belleville Lab	Water Quality					9,487	9,487	
Call Center	Human Resources		2,480				2,480	
Corporate	Accounting			17,857			17,857	
	Administration		601				601	
	Audit			2,507			2,507	
	Communications		2,159				2,159	
	Finance		4,370	12,804			17,175	
	Human Resources		10,060				10,060	
	Information Technology				2,662		2,662	
	Legal	2,335					2,335	
	Operations		2,254			18,053	20,308	
	Rates & Revenue			2,400			2,400	
	Risk Management		3,098				3,098	
	Water Quality					4,795	4,795	
	Regional Offices	Accounting			232			232
		Administration		-				-
Communications			1,790				1,790	
Engineering						-	-	
Finance				3,845			3,845	
Human Resources			(7)				(7)	
Legal		1,696					1,696	
Operations			-			1,111	1,111	
Risk Management			-				-	
Water Quality						-	-	
Information Technology	Information Technology				45,417		45,417	
Shared Services	Accounting			34,662			34,662	
	Administration		2,226				2,226	
	Finance						-	
	Rates & Revenue			2,487			2,487	
Total Hours Charged		4,031	29,032	76,795	48,078	33,446	191,382	

**New Jersey American Water Company
2010 Service Company Charges Excludable From The Hourly Rate Calculation**

Charges By Function	Exclusions From Hourly Rate Calculation			
	Contract Services	Travel Expenses	IT HW/SW	Total
Accounting	\$ 665,652	\$ 31,874	\$ 29,451	\$ 726,977
Administration	\$ 33,560	\$ 12,817	\$ 1,025,594	\$ 1,071,970
Audit	\$ 36,703	\$ 3,755	\$ 4,915	\$ 45,373
Communications	\$ 96,563	\$ 19,412	\$ 9,086	\$ 125,062
Engineering			\$ 366	\$ 366
Finance	\$ 1,779,093	\$ 69,251	\$ 2,347,589	\$ 4,195,934
Human Resources	\$ 312,852	\$ 44,300	\$ 26,018	\$ 383,170
Information Technology	\$ 1,077,821	\$ 124,852	\$ 2,107,067	\$ 3,309,740
Legal	\$ 91,664	\$ 18,636	\$ 22,375	\$ 132,674
Operations	\$ 425,392	\$ 57,939	\$ 69,170	\$ 552,500
Rates & Revenue	\$ 103,271	\$ 18,274	\$ 8,559	\$ 130,104
Risk Management	\$ 8,534	\$ 13,625	\$ 10,089	\$ 32,248
Water Quality	\$ (6,817)	\$ 21,380	\$ 161,616	\$ 176,179
Total	\$ 4,624,289	\$ 436,114	\$ 5,821,896	\$ 10,882,299

Outside Service Provider Category
Certified Public Accountant
Management Consultant
Certified Public Accountant
Management Consultant
Professional Engineer
Management Consultant
Certified Public Accountant
Management Consultant
IT Professional
Attorney
Management Consultant,
Professional Engineer
Certified Public Accountant
Management Consultant
Professional Engineer

Recap By Outside Provider	Exclusions From Hourly Rate Calculation			
	Contract Services	Travel Expenses	IT HW/SW	Total
Attorney	\$ 91,664	\$ 18,636	\$ 22,375	\$ 132,674
Management Consultant	\$ 2,232,640	\$ 176,334	\$ 3,444,466	\$ 5,853,441
Certified Public Accountant	\$ 805,626	\$ 53,903	\$ 42,925	\$ 902,454
IT Professional	\$ 1,077,821	\$ 124,852	\$ 2,107,067	\$ 3,309,740
Professional Engineer	\$ 416,537	\$ 62,389	\$ 205,063	\$ 683,989
Total	\$ 4,624,289	\$ 436,114	\$ 5,821,896	\$ 10,882,299

Outside Service Provider Hourly Rates

The next step in the cost comparison was to obtain the average billing rates for each outside service provider. The source of this information and the determination of the average rates are described in the paragraphs that follow.

It should be noted that professionals working for three of the five outside provider categories may be licensed to practice by state regulatory bodies. However, not every professional working for these firms is licensed. For instance, among New Jersey certified public accounting firms, only more experienced staff are predominantly CPAs (see table below). Some Service Company employees also have professional licenses. Thus, it is valid to compare the Service Company's hourly rates to those of the outside professional service providers included in this study.

Position	New Jersey Average
Partners/Owners	100%
Directors (11+ years experience)	82%
Managers (6-10 years experience)	70%
Sr Associates (4-5 years experience)	36%
Associates (1-3 years experience)	9%
New Professionals	7%

Source: AICPA's National PCPS/TSCPA Management of an Accounting Practice Survey (2010)

Attorneys

The New Jersey State Bar does not survey its members as to their hourly billing rates. In addition, publicly available billing rate information could not be found for New Jersey attorneys. Therefore, an estimate of New Jersey attorney rates was developed from two surveys conducted by Lawyers Weekly in the states of Michigan and Massachusetts. As presented in Exhibit 5 (page 19), the average rate for each firm was adjusted for the cost of living differential between its location and Trenton, New Jersey. The Lawyers Weekly surveys included rates in effect at December 31, 2009. Thus, the 2009 average rate was escalated to June 30, 2010—the midpoint of the test year ended December 31, 2010.

Management Consultants

The cost per hour for management consultants was developed from a 2010 survey performed by the Association of Management Consulting Firms—an industry trade organization. The survey includes rates that were in effect during 2009 for firms throughout the United States. Consultants typically do not limit their practice to any one region and must travel to a client's location. Thus, the U.S. national average is appropriate for comparison.

The first step in the calculation, presented in Exhibit 6 (page 20), was to determine an average rate by consultant position level. From these rates, a single weighted average hourly rate was calculated based upon the percent of time that is typically applied to a consulting assignment by each consultant position level.

V – Question 2 – Provision of Services at the Lower of Cost or Market

Certified Public Accountants

The average hourly rate for New Jersey CPAs was developed from a 2010 survey performed by the American Institute of Certified Public Accountants (AICPA). The New Jersey version of this survey was used to develop hourly rates for member firms in New Jersey.

As shown in Exhibit 7 (page 21), a weighted average hourly rate was developed based on a set of accountant positions and a percent of time that is typically applied to an accounting assignment. This survey includes rate information in effect during 2009. Thus, the data had to be escalated to June 30, 2010—the midpoint of the test year ended December 31, 2010.

Information Technology Professionals

The average hourly rate for information technology consultants and contractors was developed from Baryenbruch & Company, LLC IT industry hourly billing rate data. As shown in Exhibit 8 (page 22), that data was compiled and a weighted average was calculated based on a percent of time that is typically applied to an IT consulting assignment based on Baryenbruch & Company, LLC's experience.

Professional Engineers

The Company provided hourly rate information for outside engineering firms that could have been used by NJAWC in 2010. As presented in Exhibit 9 (page 23), an average rate was developed for each engineering position level. Then, using a typical percentage mix of project time by engineering position, a weighted average cost per hour was calculated.



**New Jersey American Water Company
Estimated Billing Rates For New Jersey Attorneys Based On
Michigan and Massachusetts Attorney Billing Rates**

Billing rates during 2009		Billing Rate Range (A)					Average	Cost of Living Adjust (B)	Adjusted Rate
Firm	Location	Associate		Partner					
		Low	High	Low	High				
Dickinson Wright	Detroit, Mi	\$ 195	\$ 275	\$ 355	\$ 575	\$ 350	83%	\$ 423	
Dykema	Detroit, Mi	\$ 185	\$ 425	\$ 295	\$ 615	\$ 380	83%	\$ 460	
Butzel Long	Detroit, Mi	\$ 175	\$ 325	\$ 260	\$ 600	\$ 340	83%	\$ 411	
Jaffe Raitt Heuer & Weiss	Southfield, Mi	\$ 175	\$ 250	\$ 225	\$ 550	\$ 300	83%	\$ 363	
Brooks Kushman	Southfield, Mi	\$ 180	\$ 275	\$ 300	\$ 425	\$ 295	83%	\$ 357	
Kemp, Klein, Umphrey, Edelman	Troy, Mi	\$ 145	\$ 260	\$ 200	\$ 350	\$ 239	83%	\$ 289	
Rader, Fishman & Grauer	Bloomfield Hills, Mi	\$ 130	\$ 250	\$ 275	\$ 550	\$ 301	83%	\$ 364	
Williams, Williams, Rattner & Plunket	Birmingham, Mi	\$ 150	\$ 250	\$ 275	\$ 450	\$ 281	83%	\$ 340	
Abbott, Nicholson, Quilter, Eshaki,	Detroit, Mi	\$ 150	\$ 220	\$ 300	\$ 375	\$ 261	83%	\$ 316	
Parmenter O'Toole	Muskegon, Mi			\$ 125	\$ 275	\$ 200	75%	\$ 268	
Lipson, Neilson, Cole, Seltzer & Garir	Bloomfield Hills, Mi	\$ 185	\$ 235	\$ 225	\$ 300	\$ 236	83%	\$ 286	
Burns & Levinson	Boston, Ma	\$ 210	\$ 350	\$ 375	\$ 525	\$ 365	106%	\$ 346	
Sullivan & Worcester	Boston, Ma	\$ 290	\$ 535	\$ 475	\$ 830	\$ 533	106%	\$ 504	
Holland & Knight	Boston, Ma	\$ 215	\$ 450	\$ 445	\$ 800	\$ 478	106%	\$ 452	
Seyfarth Shaw	Boston, Ma	\$ 327	\$ 327	\$ 511	\$ 511	\$ 419	106%	\$ 397	
Bowditch & Dewey	Worcester, Ma	\$ 125	\$ 220	\$ 250	\$ 550	\$ 286	106%	\$ 271	
Prince Lobel	Boston, Ma	\$ 195	\$ 325	\$ 325	\$ 525	\$ 343	106%	\$ 324	
Hinckley, Allen & Snyder	Boston, Ma	\$ 205	\$ 395	\$ 360	\$ 645	\$ 401	106%	\$ 380	
Mirick O'Connell	Worcester, Ma	\$ 220	\$ 220	\$ 350	\$ 350	\$ 285	106%	\$ 270	
Lawson & Weitzen	Boston, Ma	\$ 125	\$ 225	\$ 225	\$ 450	\$ 256	106%	\$ 243	
Sunstein Kann Murphy Timbers	Boston, Ma	\$ 285	\$ 535	\$ 575	\$ 825	\$ 555	106%	\$ 525	
Keegan Werlin	Boston, Ma	\$ 200	\$ 300	\$ 300	\$ 475	\$ 319	106%	\$ 302	
Rich May	Boston, Ma	\$ 150	\$ 325	\$ 295	\$ 400	\$ 293	106%	\$ 277	
Anderson Kreiger	Cambridge, Ma	\$ 285	\$ 285	\$ 450	\$ 450	\$ 368	106%	\$ 348	
Bernkopf Goodman	Boston, Ma	\$ 205	\$ 395	\$ 375	\$ 550	\$ 381	106%	\$ 361	
Tarlow Breed Hart & Rodgers	Boston, Ma	\$ 225	\$ 365	\$ 375	\$ 495	\$ 365	106%	\$ 346	
Donoghue Barrett & Singal	Boston, Ma	\$ 225	\$ 390	\$ 350	\$ 450	\$ 354	106%	\$ 335	
Cesari and McKenna	Boston, Ma	\$ 150	\$ 400	\$ 425	\$ 525	\$ 375	106%	\$ 355	
Overall Average 2009 Billing Rate								\$ 354	
<u>Escalation to Test Period Midpoint (June 30, 2010) (Note B)</u>									
CPI at December 31, 2009								216.0	
CPI at June 30, 2010								218.0	
Inflation/Escalation								0.9%	
Average Hourly Billing Rate For Attorneys At June 30, 2010								\$ 357	

Note A: Source is Michigan Lawyers Weekly and Massachusetts Lawyers Weekly

Note B: Source is Council for Community and Economic Research. This percentage represents the cost of living difference between the Michigan and Massachusetts cities and Trenton, New Jersey. A number over 100% indicates the Michigan or Massachusetts city's cost of living is higher than New Jersey. A number less than 100% indicates Trenton's cost of living is higher.

**New Jersey American Water Company
Billing Rates of U.S. Management Consultants**

Survey billing rates in effect in 2009 (Note A)

A. Calculation of Average Hourly Billing Rate by Consultant Position

		Average Hourly Rates (Note A)				
		Entry-Level Consultant	Associate Consultant	Senior Consultant	Junior Partner	Senior Partner
Average		\$ 155	\$ 215	\$ 279	\$ 328	\$ 413

B. Calculation of Overall Average Hourly Billing Rate Based on a Typical Distribution of Time on an Engagement

		Entry-Level Consultant	Associate Consultant	Senior Consultant	Junior Partner	Senior Partner	
Average Hourly Billing Rate (from above)		\$ 155	\$215	\$279	\$328	\$413	
Percent of Consulting Assignment		30%	30%	20%	10%	10%	Weighted Average
		\$ 46	\$ 64	\$ 56	\$ 33	\$ 41	\$ 240

Escalation to Test Period Midpoint (June 30, 2010) (Note B)

CPI at December 31, 2009	216.0
CPI at June 30, 2010	218.0
Inflation/Escalation	0.9%
Average Hourly Billing Rate For CPAs At June 30, 2010	\$ 243

Note A: Source is "Operating Ratios For Management Consulting Firms, 2010 Edition," Association of Management Consulting Firms

Note B: Source is U.S. Bureau of Labor Statistics (<ftp://ftp.bls.gov/pub/special.requests/cpi/cpiiai.txt>)

**New Jersey American Water Company
Billing Rates Of New Jersey Certified Public Accountants**

Survey billing rates were those in effect in 2009 (Note A)

Average Hourly Billing Rate (Note A)				
Type of Firm	Staff Accountant	Senior Accountant	Manager	Partner
Average Hourly Rate	\$ 121	\$ 150	\$ 249	\$ 280

B. Calculation of Overall Average Accountant Billing Rate Based Upon Typical Distribution of Time on an Engagement

					Weighted Average
					Average
Type of Firm	Staff Accountant	Senior Accountant	Manager	Partner	
Average Hourly Billing Rate (From Above)	\$ 121	\$ 150	\$ 249	\$ 280	
Typical Percent of Time Spent on an Accounting Assignment	30%	30%	20%	20%	
	\$ 36	\$ 45	\$ 50	\$ 56	\$ 187

<u>Escalation to Test Period Midpoint (June 30, 2010) (Note B)</u>	
CPI at December 31, 2009	216.0
CPI at June 30, 2010	218.0
Inflation/Escalation	0.9%
Average Hourly Billing Rate For CPAs At June 30, 2010	\$ 189

Note A: Source is AICPA's 2010 National PCPS/TSCPA Management of an Accounting Practice Survey (New Jersey edition)

Note B: Source is US Bureau of Labor Statistics (<ftp://ftp.bls.gov/pub/special.requests/cpi/cpi.ai.txt>)



**New Jersey American Water Company
Billing Rates of Information Technology Professionals**

IT Resource Level	2010 Hourly Rate (A)
Consultant Positions	
Senior Manager/Partner Consultant	\$ 350
Staff/Manager Consultant	\$ 245
Contractor Positions	
Senior Contractor	\$ 145
Contractor	\$ 66

Overall Average	2010 Rate	% of Project/Assignment	
Senior Manager/Partner Consultant	\$ 350	10%	\$ 35
Staff/Manager Consultant	\$ 245	30%	\$ 73
Senior Contractor	\$ 145	30%	\$ 44
Contractor	\$ 66	30%	\$ 20
Weighted Average			\$ 172

Note A: Source is Baryenbruch & Company, LLC

New Jersey American Water Company Billing Rates Of New Jersey Engineers

A. Calculation of Average Hourly Rate by Engineer Position				
Name of Firm	Average Hourly Billing Rates			
	Technician	Engineer	Project Manager	Officer
	Senior Technician	Design Engineer Project Engineer	Sr. Mgr. Engineer	Principal Engineer
Firm #1	\$73	\$101	\$130	\$155
Firm #2	\$67	\$81	\$127	\$162
Firm #3	\$78	\$100	\$123	\$163
Firm #4	\$73	\$72	\$127	\$165
Firm #5	\$58	\$73	\$132	\$171
Firm #6	\$68	\$95	\$136	\$173
Firm #7	\$80	\$98	\$149	\$182
Firm #8	\$94	\$87	\$141	\$184
Firm #9	\$73	\$70	\$141	\$185
Firm #10	\$87	\$112	\$168	\$190
Firm #11	\$78	\$97	\$148	\$199
Firm #12	\$85	\$90	\$144	\$200
Firm #13	\$93	\$109	\$144	\$200
Firm #14	\$77	\$109	\$146	\$205
Firm #15	\$108	\$126	\$168	\$208
Firm #16	\$68	\$96	\$153	\$208
Firm #17	\$76	\$118	\$167	\$209
Firm #18	\$95	\$115	\$176	\$210
Firm #19	\$91	\$126	\$184	\$217
Firm #20	\$114	\$154	\$203	\$225
Firm #21	\$85	\$122	\$193	\$225
Firm #22	\$60	\$83	\$95	NA
Firm #23	\$78	\$95	\$165	NA
Firm #24	\$91	\$119	\$177	\$195

B. Calculation of Overall Average Engineering Hourly Billing Rate					
	Technician	Engineer	Project Manager	Officer	
	Senior Technician	Design Engineer Project Engineer	Sr. Mgr. Engineer	Principal Engineer	
Average Hourly Billing Rate (From Above)	\$81	\$102	\$151	\$192	
Typical Percent of Time on an Engineering Assignment	30%	35%	25%	10%	Weighted Average
	\$24	\$36	\$38	\$19	\$117

Source: Information provided by American Water Works Service Company

V – Question 2 – Provision of Services at the Lower of Cost or Market

Service Company versus Outside Provider Cost Comparison

As shown in the table below, Service Company costs per hour are considerably lower than those of outside providers.

Service Provider	12 Months Ended December 31, 2010		
	Service Company	Outside Provider	Difference-- Service Co. Greater(Less) Than Outside
Attorney	\$ 206	\$ 357	\$ (152)
Management Consultant	\$ 131	\$ 243	\$ (111)
Certified Public Accountant	\$ 81	\$ 189	\$ (108)
IT Professional	\$ 141	\$ 172	\$ (31)
Professional Engineer	\$ 95	\$ 117	\$ (22)

Based on these cost per hour differentials and the number of managerial and professional services hours billed to NJAWC during 2010, outside service providers would have cost \$14,337,415 more than the Service Company (see table below). Thus, on average, outside provider's hourly rates are 45% higher than those of the Service Company (\$14,337,415 / \$31,703,175).

Service Provider	12 Months Ended December 31, 2010		
	Hourly Rate Difference-- Service Co. Greater(Less) Than Outside	Service Company Hours Charged	Dollar Difference
Attorney	\$ (152)	4,031	\$ (610,703)
Management Consultant	\$ (111)	29,032	\$ (3,235,351)
Certified Public Accountant	\$ (108)	76,795	\$ (8,285,355)
IT Professional	\$ (31)	48,078	\$ (1,481,950)
Professional Engineer	\$ (22)	33,446	\$ (724,055)
Service Company Less Than Outside Providers			\$ (14,337,415)

It should be noted that the cost differential associated with using outside providers is even greater because exempt Service Company personnel do not charge more than 8 hours per day even when they work more. Outside providers generally charge clients for all hours worked. Thus, NJAWC would have been charged by outside providers for overtime worked by Service Company personnel who are not paid for that time.

If NJAWC were to use outside service providers rather than the Service Company for managerial and professional services, it would incur other additional expenses besides those associated with higher hourly rates. Managing outside firms who would perform over 191,300 hours of work (more than 128 full-time equivalents at 1,500 "billable" hours per FTE per year) would add a significant workload to the existing NJAWC management team. Thus, it would be necessary for NJAWC to add at least two positions to supervise the outside firms and ensure they delivered quality and timely services. The individuals that would fill these positions would need a good understanding of each profession being managed. They must also have management experience and the authority necessary to give them credibility with the outside firms. As

V – Question 2 – Provision of Services at the Lower of Cost or Market

calculated in the table below, this position would add more than \$300,000 per year to NJAWC's personnel expenses.

Cost of Adding 2 Professional Positions To NJAWC's Staff

	<u>Total</u>
New Positions' Salary	\$ 100,000
Benefits (at 49.4%)	\$ 49,400
Office Expenses (15.2%)	<u>\$ 15,200</u>
Cost per Position	\$ 164,600
Number of Positions	<u>2</u>
Total Cost of Two Positions	<u>\$ 329,200</u>

Thus, the total effect on the ratepayers of NJAWC of contracting all services now provided by Service Company would be an increase in their costs of \$14,337,415 (\$14,337,415 + \$329,200). Based on the results of this comparison, it is possible to conclude that the Service Company charged NJAWC at the lower of cost or market for services provided during the 2010.

VI - Question 3 - Reasonableness of Customer Accounts Services Costs

Background

Customer Accounts Services involve the processes that occur from the time meter read data is recorded in the customer information system through the printing and mailing of bills through the collection and processing of customer payments. Customer Accounts Services are accomplished by the following utility functions:

- Customer Call Center Operations – customer calls/contact, credit, order taking/disposition, bill collection efforts and outage calls
- Customer Call Center Maintenance – support of phone banks, voice recognition units, call center software applications and telecommunications
- Customer billing – bill printing, stuffing and mailing
- Remittance processing – processing customer payments received in the mail
- Bill payment centers – processing customer payments at locations where customers can pay their bills in person

Neighboring electric utility cost information comes from the FERC Form 1 that each utility that is subject to FERC regulation, must file. FERC’s chart of accounts is defined in Chapter 18, Part 101 of the Code of Federal Regulations. FERC accounts that contain customer accounts services-related expenses are Account 903 Customer Accounts Expense – Records and Collection Expense and Account 905 Customer Accounts Expense – Miscellaneous Customer Accounts Expense. Exhibit 9 provides FERC’s definition of the type of expenses that should be recorded in these accounts.

In addition to the charges in these FERC accounts, labor-related overheads charged to the following FERC accounts must be added to the labor components of Accounts 903 and 905:

- Account 926 Employee Pension and Benefits
- Account 408 Taxes Other Than Income (employer’s portion of FICA)

Comparison Group

Electric utilities included in the comparison group are shown in the table below. These are companies whose FERC Form 1 show amounts for accounts 903 and 905.

New York	<ul style="list-style-type: none"> • Central Hudson Gas & Elect • Consolidated Edison • New York State Elect & Gas 	<ul style="list-style-type: none"> • Niagra Mohawk Power • Orange & Rockland Utilities • Rochester Gas & Electric
Pennsylvania	<ul style="list-style-type: none"> • Duquesne Light • Metropolitan Edison • PECO Energy • Pennsylvania Electric 	<ul style="list-style-type: none"> • Pennsylvania Power • PPL Electric Utilities • West Penn Power
New Jersey	<ul style="list-style-type: none"> • Atlantic City Electric • Jersey Central Power 	<ul style="list-style-type: none"> • Public Svc Electric & Gas • Rockland Electric
Maryland	<ul style="list-style-type: none"> • Baltimore Gas & Electric • Delmarva Power & Light 	<ul style="list-style-type: none"> • Potomac Electric

New Jersey American Water Company FERC Account Descriptions

903 – Customer Records and Collection Expenses

This account shall include the cost of labor, materials used and expenses incurred in work on customer applications, contracts, orders, credit investigations, billing and accounting, collections and complaints.

Labor

1. Receiving, preparing, recording and handling routine orders for service, disconnections, transfers or meter tests initiated by the customer, excluding the cost of carrying out such orders, which is chargeable to the account appropriate for the work called for by such orders.
2. Investigations of customers' credit and keeping of records pertaining thereto, including records of uncollectible accounts written off.
3. Receiving, refunding or applying customer deposits and maintaining customer deposit, line extension, and other miscellaneous records.
4. Checking consumption shown by meter readers' reports where incidental to preparation of billing data.
5. Preparing address plates and addressing bills and delinquent notices.
6. Preparing billing data.
7. Operating billing and bookkeeping machines.
8. Verifying billing records with contracts or rate schedules.
9. Preparing bills for delivery, and mailing or delivering bills.
10. Collecting revenues, including collection from prepayment meters unless incidental to meter reading operations.
11. Balancing collections, preparing collections for deposit, and preparing cash reports.
12. Posting collections and other credits or charges to customer accounts and extending unpaid balances.
13. Balancing customer accounts and controls.
14. Preparing, mailing, or delivering delinquent notices and preparing reports of delinquent accounts.
15. Final meter reading of delinquent accounts when done by collectors incidental to regular activities.
16. Disconnecting and reconnecting services because of nonpayment of bills.
17. Receiving, recording, and handling of inquiries, complaints, and requests for investigations from customers, including preparation of necessary orders, but excluding the cost of carrying out such orders, which is chargeable to the account appropriate for the work called for by such orders.
18. Statistical and tabulating work on customer accounts and revenues, but not including special analyses for sales department, rate department, or other general purposes, unless incidental to regular customer accounting routines.
19. Preparing and periodically rewriting meter reading sheets.
20. Determining consumption and computing estimated or average consumption when performed by employees other than those engaged in reading meters.

Materials and expenses

21. Address plates and supplies.
22. Cash overages and shortages.
23. Commissions or fees to others for collecting.
24. Payments to credit organizations for investigations and reports.
25. Postage.
26. Transportation expenses, including transportation of customer bills and meter books under centralized billing procedure.
27. Transportation, meals, and incidental expenses.
28. Bank charges, exchange, and other fees for cashing and depositing customers' checks.
29. Forms for recording orders for services, removals, etc.
30. Rent of mechanical equipment.

**New Jersey American Water Company
FERC Account Descriptions**

905 – Miscellaneous Customer Accounts Expenses

This account shall include the cost of labor, materials used and expenses incurred not provided for in other accounts.

Labor

1. General clerical and stenographic work.
2. Miscellaneous labor.

Materials and expenses

3. Communication service.
4. Miscellaneous office supplies and expenses and stationery and printing other than those specifically provided for in accounts 902 and 903.



VI - Question 3 - Reasonableness of Customer Accounts Services Costs

NJAWC Cost per Customer

As calculated below, NJAWC's 2010 customer account services expense per customer was \$24.32. The cost pool used to calculate this average includes charges for Service Company services (e.g., call center, billing, payment processing) and postage and forms expenses, which are incurred directly by NJAWC. It was necessary to adjust the National Call Center charges because electric utilities experience an average of 2.50 calls per customer compared to American Water's 1.57 calls per customer. Thus, National Call Center expenses had to be increased, for comparison purposes, to reflect its costs at a 2.50 calls per customer level.

New Jersey American Water Company		Year Ended 12/31/2010	Adjustment Fewer Calls For	Adjusted
Cost Component	Service Co	Charges	Water Cos. (A)	Adjusted
Service Company				
Call Centers	Call processing, order processing, credit, bill collection	\$ 9,074,719	\$ 2,287,706	\$11,362,425
Regional Offices		\$ 34,364		\$ 34,364
Service Company	Customer payment processing			\$ 829,386 (B)
Operating Company	Postage & forms			\$ 3,483,087
Cost Pool Total				<u>\$15,709,262</u>
Total Customers				645,939
Year Ended 2010 Cost Per New Jersey American Customer				<u>\$ 24.32</u>

Note A: Adjustment for American Water's fewer calls per customer

This adjustment is necessary because water utilities experience fewer calls per customer than do electric utilities

Call handling expenses		\$ 3,892,201
Electric utility industry's avg calls/customer	2.50	
American Water's avg calls/customer	1.57	
Percent different	<u>59%</u>	59%
Total Adjustment		<u>\$ 2,287,706</u>

Note B: Estimated customer payment processing expenses

Number of customer bills	7,751,268
Bank charge per item	\$ 0.1070
Total estimated annual expense	<u>\$ 829,386</u>

Electric Utility Group Cost per Customer

Exhibit 11 (page 31) shows the actual 2010 customer accounts expense per customer calculation for the electric utility comparison group. All of the underlying data was taken from the utilities' FERC Form 1.

VI - Question 3 - Reasonableness of Customer Accounts Services Costs

Summary of Results

As shown in the table below, NJAWC's cost per customer is well below the average cost of the neighboring electric utility comparison group. It can therefore be concluded that NJAWC's 2010 customer accounts-related expenses, including those of the Alton and Pensacola Call Centers, assigned by the Service Company to NJAWC were comparable to those of other utilities.

Customer Account Services Expenses Per Customer	
Pennsylvania Power Company	\$ 13.30
Metropolitan Edison Company	\$ 13.75
Pennsylvania Electric Company	\$ 13.81
West Penn Power Company	\$ 16.01
Jersey Central Power & Light Company	\$ 16.51
Duquesne Light Company	\$ 17.08
New Jersey American Water	\$ 24.32
Rochester Gas & Electric Corporation	\$ 29.35
PPL Electric Utilities Corporation	\$ 32.92
New York State Electric & Gas Corporation	\$ 34.77
Baltimore Gas & Electric	\$ 36.73
Comparison Group Average	\$ 50.51
Central Hudson Gas & Electric Company	\$ 56.40
Consolidated Edison Company	\$ 57.77
Orange & Rockland Electric	\$ 61.68
PECO Energy Company	\$ 61.76
Atlantic City Electric Company	\$ 73.16
Rockland Electric	\$ 74.16
Delmarva Power & Light Company	\$ 74.83
Potomac Electric	\$ 75.43
Public Service Electric & Gas Company	\$ 97.07

New Jersey American Water Company
Comparison Group 2010 Actual Customer Accounts Expense Per Customer

	New Jersey				Maryland		
	Atlantic City Electric	Jersey Central Power	Public Service Electric & Gas	Rockland Electric	Baltimore Gas & Electric	Delmarva Power & Light	Potomac Electric
Customer Account Services Cost Pool							
FERC Account Balances:							
Acct 903 - Customer Records & Collection (page 322, line 161)	\$ 38,379,348	\$ 14,942,282	\$ 68,135,796	\$ 2,649,743	\$ 32,124,609	\$ 33,731,176	\$ 51,028,163
Acct 905 - Misc Customer Accounts (page 322, line 163)	\$ 9,340	\$ 476,375	\$ 107,541,888	\$ 612,165	\$ 3,467,467	\$ 2,228	\$ -
Subtotal	\$ 38,388,688	\$ 15,418,657	\$ 175,677,684	\$ 3,261,908	\$ 35,592,076	\$ 33,733,404	\$ 51,028,163
Add: Employee Benefits & Employer FICA (not included in above amounts)							
Account 926 - Employee Pension & Benefits Note A	\$ 1,469,412	\$ 2,130,763	\$ 28,557,338	\$ 1,971,077	\$ 7,175,643	\$ 3,138,929	\$ 7,139,118
Account 408 - Taxes Other Than Income (Employer's Portion of FICA) Note B	\$ 190,294	\$ 564,585	\$ 7,333,964	\$ 139,022	\$ 2,664,148	\$ 517,430	\$ 900,454
Total Cost Pool	\$ 40,048,394	\$ 18,114,005	\$ 211,568,986	\$ 5,372,007	\$ 45,431,866	\$ 37,389,763	\$ 59,067,735
Total Customers (page 304, line 43)	547,400	1,097,078	2,179,559	72,438	1,236,939	499,689	783,069
Customer Account Services Expense per Customer	\$ 73.16	\$ 16.51	\$ 97.07	\$ 74.16	\$ 36.73	\$ 74.83	\$ 75.43
Note A: Calculation of Pension & Benefits Pertaining to Customer Acct Mgmt							
Account 926 - Employee Pension & Benefits (page 323, line 187)	\$ 14,418,942	\$ 17,857,493	\$ 99,708,453	\$ 12,251,432	\$ 41,908,186	\$ 19,690,595	\$ 37,396,545
Total O&M Payroll (page 355, line 65)	\$ 24,409,204	\$ 61,851,963	\$ 334,727,675	\$ 11,295,502	\$ 203,392,492	\$ 42,429,484	\$ 61,657,632
Benefits as Percent of Payroll	59.1%	28.9%	29.8%	108.5%	20.6%	46.4%	60.7%
Payroll Applicable to Customer Account Services							
Total Payroll Charged to Customer Accounts Function							
Electric (page 354, line 7)	\$ 2,781,655	\$ 12,091,884	\$ 57,901,535	\$ 2,308,846	\$ 26,762,799	\$ 6,765,452	\$ 13,188,369
Gas (page 354, line 37)	\$ -	\$ -	\$ 47,299,045	\$ -	\$ 13,788,328	\$ 1,485,099	\$ -
Total Payroll Charged to Customer Accounts	\$ 2,781,655	\$ 12,091,884	\$ 105,200,580	\$ 2,308,846	\$ 40,551,127	\$ 8,250,551	\$ 13,188,369
Percent Applicable to Customer Accounts Services (903 and 905):							
Acct 903 - Customer Records & Collection (page 322, line 161)	\$ 38,379,348	\$ 14,942,282	\$ 68,135,796	\$ 2,649,743	\$ 32,124,609	\$ 33,731,176	\$ 51,028,163
Acct 905 - Misc Customer Accounts (page 322, line 163)	\$ 9,340	\$ 476,375	\$ 107,541,888	\$ 612,165	\$ 3,467,467	\$ 2,228	\$ -
Subtotal - Total Charges Applicable to Customer Accounts Services	\$ 38,388,688	\$ 15,418,657	\$ 175,677,684	\$ 3,261,908	\$ 35,592,076	\$ 33,733,404	\$ 51,028,163
Acct 902 - Meter Reading Expenses (page 322, line 160)	\$ 4,539,521	\$ 9,843,616	\$ 17,100,273	\$ 882,327	\$ 5,851,707	\$ 7,414,978	\$ 6,146,168
Total Charges Applicable to Customer Accounts Svcs & Meter Reading	\$ 42,928,209	\$ 25,262,273	\$ 192,777,957	\$ 4,144,235	\$ 41,443,783	\$ 41,148,382	\$ 57,174,331
Percent Applicable to Customer Accounts Services (903 and 905)	89.4%	61.0%	91.1%	78.7%	85.9%	82.0%	89.3%
Customer Account Services Portion of Total Payroll	\$ 2,487,504	\$ 7,380,199	\$ 95,868,815	\$ 1,817,282	\$ 34,825,460	\$ 6,763,794	\$ 11,770,636
Pension & Benefits Pertaining to Customer Accounts Services	\$ 1,469,412	\$ 2,130,763	\$ 28,557,338	\$ 1,971,077	\$ 7,175,643	\$ 3,138,929	\$ 7,139,118
Note B: Calculation of Employer's FICA Pertaining to Customer Accounts Services							
Customer Account Services Portion of Total Payroll	\$ 2,487,504	\$ 7,380,199	\$ 95,868,815	\$ 1,817,282	\$ 34,825,460	\$ 6,763,794	\$ 11,770,636
Employer's Portion of FICA (6.20%) and Medicare (1.45%)	7.65%	7.65%	7.65%	7.65%	7.65%	7.65%	7.65%
Estimated Employer's Portion of FICA	\$ 190,294	\$ 564,585	\$ 7,333,964	\$ 139,022	\$ 2,664,148	\$ 517,430	\$ 900,454

New Jersey American Water Company
Comparison Group 2010 Actual Customer Accounts Expense Per Customer

	Pennsylvania						
	Duquesne Light	Metropolitan Edison	PECO Energy	Pennsylvania Electric	Pennsylvania Power	PPL Electric Utilities	West Penn Power
Customer Account Services Cost Pool							
FERC Account Balances:							
Acct 903 - Customer Records & Collection (page 322, line 161)	\$ 7,573,095	\$ 7,151,817	\$ 54,585,949	\$ 7,379,259	\$ 2,069,405	\$ 36,293,334	\$ 9,088,387
Acct 905 - Misc Customer Accounts (page 322, line 163)	\$ -	\$ 171,941	\$ 32,815,230	\$ 331,883	\$ 62,212	\$ 1,211,692	\$ -
Subtotal	\$ 7,573,095	\$ 7,323,758	\$ 87,401,179	\$ 7,711,142	\$ 2,131,617	\$ 37,505,026	\$ 9,088,387
Add: Employee Benefits & Employer FICA (not included in above amounts)							
Account 926 - Employee Pension & Benefits Note A	\$ 2,220,422	\$ 44,640	\$ 7,355,053	\$ 176,097	\$ (70,362)	\$ 7,060,753	\$ 1,949,474
Account 408 - Taxes Other Than Income (Employer's Portion of FICA) Note B	\$ 440,355	\$ 218,171	\$ 2,016,685	\$ 258,047	\$ 64,852	\$ 1,576,323	\$ 426,864
Total Cost Pool	\$ 10,233,872	\$ 7,586,569	\$ 96,772,917	\$ 8,145,286	\$ 2,126,107	\$ 46,142,102	\$ 11,464,725
Total Customers (page 304, line 43)	599,126	551,776	1,566,871	589,851	159,886	1,401,657	716,108
Customer Account Services Expense per Customer	\$ 17.08	\$ 13.75	\$ 61.76	\$ 13.81	\$ 13.30	\$ 32.92	\$ 16.01
Note A: Calculation of Pension & Benefits Pertaining to Customer Acct Mgmt							
Account 926 - Employee Pension & Benefits (page 323, line 187)	\$ 19,532,432	\$ 446,289	\$ 44,685,357	\$ 1,284,530	\$ (406,870)	\$ 33,435,335	\$ 19,719,782
Total O&M Payroll (page 355, line 65)	\$ 50,636,301	\$ 28,512,169	\$ 160,160,748	\$ 24,605,376	\$ 4,902,070	\$ 97,574,951	\$ 56,443,368
Benefits as Percent of Payroll	38.6%	1.6%	27.9%	5.2%	-8.3%	34.3%	34.9%
Payroll Applicable to Customer Account Services							
Total Payroll Charged to Customer Accounts Function							
Electric (page 354, line 7)	\$ 9,651,460	\$ 5,022,929	\$ 25,625,115	\$ 5,783,973	\$ 1,409,373	\$ 21,778,786	\$ 9,169,248
Gas (page 354, line 37)	\$ -	\$ -	\$ 5,480,638	\$ -	\$ -	\$ -	\$ -
Total Payroll Charged to Customer Accounts	\$ 9,651,460	\$ 5,022,929	\$ 31,105,753	\$ 5,783,973	\$ 1,409,373	\$ 21,778,786	\$ 9,169,248
Percent Applicable to Customer Accounts Services (903 and 905):							
Acct 903 - Customer Records & Collection (page 322, line 161)	\$ 7,573,095	\$ 7,151,817	\$ 54,585,949	\$ 7,379,259	\$ 2,069,405	\$ 36,293,334	\$ 9,088,387
Acct 905 - Misc Customer Accounts (page 322, line 163)	\$ -	\$ 171,941	\$ 32,815,230	\$ 331,883	\$ 62,212	\$ 1,211,692	\$ -
Subtotal - Total Charges Applicable to Customer Accounts Services	\$ 7,573,095	\$ 7,323,758	\$ 87,401,179	\$ 7,711,142	\$ 2,131,617	\$ 37,505,026	\$ 9,088,387
Acct 902 - Meter Reading Expenses (page 322, line 160)	\$ 5,124,608	\$ 5,575,227	\$ 15,727,956	\$ 5,511,174	\$ 1,412,193	\$ 2,135,502	\$ 5,846,168
Total Charges Applicable to Customer Accounts Svcs & Meter Reading	\$ 12,697,703	\$ 12,898,985	\$ 103,129,135	\$ 13,222,316	\$ 3,543,810	\$ 39,640,528	\$ 14,934,555
Percent Applicable to Customer Accounts Services (903 and 905)	59.6%	56.8%	84.7%	58.3%	60.2%	94.6%	60.9%
Customer Account Services Portion of Total Payroll	\$ 5,756,271	\$ 2,851,908	\$ 26,361,896	\$ 3,373,164	\$ 847,744	\$ 20,605,526	\$ 5,579,923
Pension & Benefits Pertaining to Customer Accounts Services	\$ 2,220,422	\$ 44,640	\$ 7,355,053	\$ 176,097	\$ (70,362)	\$ 7,060,753	\$ 1,949,474
Note B: Calculation of Employer's FICA Pertaining to Customer Accounts Services							
Customer Account Services Portion of Total Payroll	\$ 5,756,271	\$ 2,851,908	\$ 26,361,896	\$ 3,373,164	\$ 847,744	\$ 20,605,526	\$ 5,579,923
Employer's Portion of FICA (6.20%) and Medicare (1.45%)	7.65%	7.65%	7.65%	7.65%	7.65%	7.65%	7.65%
Estimated Employer's Portion of FICA	\$ 440,355	\$ 218,171	\$ 2,016,685	\$ 258,047	\$ 64,852	\$ 1,576,323	\$ 426,864

New Jersey American Water Company
Comparison Group 2010 Actual Customer Accounts Expense Per Customer

	New York				
	Central Hudson Gas & Electric	Consolidated Edison	New York State Electric & Gas	Orange & Rockland	Rochester Gas & Electric
Customer Account Services Cost Pool					
FERC Account Balances:					
Acct 903 - Customer Records & Collection (page 322, line 161)	\$ 9,500,596	\$ 120,832,854	\$ 27,185,242	\$ 9,083,492	\$ 10,316,521
Acct 905 - Misc Customer Accounts (page 322, line 163)	\$ 1,264,401	\$ 361,418	\$ 1,742,151	\$ 222,681	\$ 657,468
Subtotal	\$ 10,764,997	\$ 121,194,272	\$ 28,927,393	\$ 9,306,173	\$ 10,973,989
Add: Employee Benefits & Employer FICA (not included in above amounts)					
Account 926 - Employee Pension & Benefits Note A	\$ 4,301,254	\$ 61,671,899	\$ 102,455	\$ 4,466,313	\$ (848,630)
Account 408 - Taxes Other Than Income (Employer's Portion of FICA) Note B	\$ 611,415	\$ 8,255,557	\$ 1,491,928	\$ 655,974	\$ 602,616
Total Cost Pool	\$ 15,677,666	\$ 191,121,729	\$ 30,521,776	\$ 14,428,460	\$ 10,727,976
Total Customers (page 304, line 43)	277,980	3,308,063	877,739	233,908	365,466
Customer Account Services Expense per Customer	\$ 56.40	\$ 57.77	\$ 34.77	\$ 61.68	\$ 29.35
Note A: Calculation of Pension & Benefits Pertaining to Customer Acct Mgmt					
Account 926 - Employee Pension & Benefits (page 323, line 187)	\$ 34,365,838	\$ 347,425,002	\$ 650,152	\$ 34,853,649	\$ (5,189,013)
Total O&M Payroll (page 355, line 65)	\$ 63,856,664	\$ 607,937,187	\$ 123,756,812	\$ 66,915,101	\$ 48,166,598
Benefits as Percent of Payroll	53.8%	57.1%	0.5%	52.1%	-10.8%
Payroll Applicable to Customer Account Services					
Total Payroll Charged to Customer Accounts Function					
Electric (page 354, line 7)	\$ 8,458,797	\$ 111,519,584	\$ 21,319,789	\$ 7,894,041	\$ 5,700,192
Gas (page 354, line 37)	\$ 1,490,183	\$ 24,479,908	\$ 4,122,630	\$ 3,513,048	\$ 3,919,971
Total Payroll Charged to Customer Accounts	\$ 9,948,980	\$ 135,999,492	\$ 25,442,419	\$ 11,407,089	\$ 9,620,163
Percent Applicable to Customer Accounts Services (903 and 905):					
Acct 903 - Customer Records & Collection (page 322, line 161)	\$ 9,500,596	\$ 120,832,854	\$ 27,185,242	\$ 9,083,492	\$ 10,316,521
Acct 905 - Misc Customer Accounts (page 322, line 163)	\$ 1,264,401	\$ 361,418	\$ 1,742,151	\$ 222,681	\$ 657,468
Subtotal - Total Charges Applicable to Customer Accounts Services	\$ 10,764,997	\$ 121,194,272	\$ 28,927,393	\$ 9,306,173	\$ 10,973,989
Acct 902 - Meter Reading Expenses (page 322, line 160)	\$ 2,635,412	\$ 31,539,267	\$ 8,810,807	\$ 3,073,835	\$ 2,427,948
Total Charges Applicable to Customer Accounts Svcs & Meter Reading	\$ 13,400,409	\$ 152,733,539	\$ 37,738,200	\$ 12,380,008	\$ 13,401,937
Percent Applicable to Customer Accounts Services (903 and 905)	80.3%	79.4%	76.7%	75.2%	81.9%
Customer Account Services Portion of Total Payroll	\$ 7,992,349	\$ 107,915,783	\$ 19,502,331	\$ 8,574,820	\$ 7,877,336
Pension & Benefits Pertaining to Customer Accounts Services	\$ 4,301,254	\$ 61,671,899	\$ 102,455	\$ 4,466,313	\$ (848,630)
Note B: Calculation of Employer's FICA Pertaining to Customer Accounts Services					
Customer Account Services Portion of Total Payroll	\$ 7,992,349	\$ 107,915,783	\$ 19,502,331	\$ 8,574,820	\$ 7,877,336
Employer's Portion of FICA (6.20%) and Medicare (1.45%)	7.65%	7.65%	7.65%	7.65%	7.65%
Estimated Employer's Portion of FICA	\$ 611,415	\$ 8,255,557	\$ 1,491,928	\$ 655,974	\$ 602,616

Group Average
\$ 861,941,940
17,064,603
\$ 50.51

VI - Question 4 – Need for Service Company Services

Analysis of Services

The final aspect of this study was an assessment of whether the services that are provided to NJAWC by the Service Company would be necessary if NJAWC were a stand-alone water utility. The first step in this evaluation was to determine specifically what the Service Company does for NJAWC. Based on discussions with Service Company personnel, the matrix in Exhibit 12 (page 35) was created showing which entity—NJAWC or a Service Company location—is responsible for each of the functions NJAWC requires to ultimately provide service to its customers. This matrix was reviewed to determine: (1) if there was redundancy or overlap in the services being provided by the Service Company and (2) if Service Company services are typical of those needed by a stand-alone water utility.

Upon review of Exhibit 12, the following conclusions can be drawn:

- The services that the Service Company provides are necessary and would be required even if NJAWC were a stand-alone water utility.
- There is no redundancy or overlap in the services provided by the Service Company to NJAWC. For all of the services listed in Exhibit 12, there was only one entity that was primarily responsible for the service.



New Jersey American Water Company
Designation Of Responsibility For Water Utility Functions

P - Primarily Responsible S - Provides Support	Performed By:					
	NJAWC	American Water Service Company				
		Customer Call Center	Shared Services	Central Services	IT Service Centers	Supply Chain
Water Company Function						
Engineering and Construction Management						
CPS Preparation	P		S			
Five-Year System Planning	P					
Engineering Standards & Policies Development	S		P			
Project Design						
Major Projects (e.g., new treatment plant)	P		S			
Special Projects	P		S			
Minor Projects (e.g., pipelines)	P					
Construction Project Management						
Major Projects	P		S			
Special Projects	P		S			
Minor Projects	P					
Hydraulics Review	P					
Developers Extensions	P					
Tank Painting	P					
Water Quality and Purification						
Water Quality Standards Development	P		S			S
Research Studies	S		P			S
Water Quality Program Implementation	P		S			
Water Treatment Operations & Maintenance	P		S			
Compliance Sampling	P					S
Testing/Other Sampling	P(Note A)		S			P(Note A)
Transmission and Distribution						
Preventive Maintenance Program Development	P					
System Maintenance	P					
Leak Detection	P					
Customer Service						
Community Relations	P		S			
Customer Contact	S	P				
Call Processing		P				
Service Order Processing	P	S				
Customer Credit	S	P				
Meter Reading	P					
Customer Bill Preparation	S	P		S		
Bill Collection		P				
Customer Payment Processing	S		P			
Meter Standards Development	S		P			
Meter Testing, Maintenance & Replacement	P					

Note A: NJAWC and the Belleville Lab are primarily responsible for different studies

New Jersey American Water Company
Designation Of Responsibility For Water Utility Functions

Water Company Function	NJAWC	Performed By:					
		American Water Service Company					
		Customer Call Center	Shared Services	Central Services	IT Service Centers	Supply Chain	Belleville Lab
Financial Management							
Financial Planning	P			S			
Financings--Equity				S			
Financings--Long Term Debt & Preferred (Note A)	P						
Short Term Lines of Credit Arrangements(Note A)	P						
Investor Relations				P			
Insurance Program Administration				P			
Loss Control/Safety Program Administration	P			S			
Pension Fund Asset Management				P			
Cash Management/Disbursement Processing			P				
Internal Auditing				P			
SOX Compliance	P			S			
Budgeting and Variance Reporting							
Corporate Guidelines & Instructions				P			
Regional Guidelines & Instructions	P						
Budget Preparation							
Revenue and O&M	P						
Depreciation and Interest Expense	P		S	S			
Budget Preparation--Service Company Charges	S	S	S	P	S	S	S
Capital Budget Preparation—Projects	P						
Capital Budget Preparation—Non-Project Work	P						
Prepare Monthly Budget Variance Report	P						
("Budget/Plan Analysis")							
Prepare Capital Project Budget Status Report	P						
Year-End Projections	P						
Accounting and Taxes							
Accounts Payable Accounting	S		P				
Payroll Accounting	S		P				
Work Order Accounting	S		P				
Fixed Asset Accounting	S		P				
Journal Entry Preparations--Billing Corrections	S		P				
Journal Entry Preparation--All Others	S		P				
Financial Statement Preparation	S		P				
State Commission Reporting	S		P				
Income Taxes--State - N/A							
Income Taxes--Federal			P				
Property Taxes	S		P				
Gross Receipts (Tow n) Taxes	S		P				

Note A: Lines of credit are the responsibility of American Water Capital Corporation ("AWCC"). AWCC is also responsible for Corporate financings which may be distributed to the regulated subsidiaries. NJAWC has its own credit rating and has the ability to do its own financings, in 2009 NJAWC did two such financings.

New Jersey American Water Company
Designation Of Responsibility For Water Utility Functions

Water Company Function	NJAWC	Performed By:					
		American Water Service Company					
		Customer Call Center	Shared Services	Central Services	IT Service Centers	Supply Chain	Belleville Lab
Rates							
Rate Studies & Tariff Change Administration	P		S				
Rate Case Planning and Preparation	P		S				
Rate Case Administration	P						
Commission Inquiry Response	P						
Legal	P			S			
Purchasing and Materials Management – National (pipe, chemicals, meters, etc.)							
Specification Development	S		S	S		S	
Bid Solicitation	S		S			P	
Contract Administration	S		S			P	
Purchasing and Materials Management – State (state supplier service agreements)							
Specification Development	P		S				
Bid Solicitation	P		S				
Contract Administration	P		S				
Ordering	P						
Inventory Management	P		S				
Human Resources Management							
Benefit Program Development	S			P			
Benefits Program Administration	S		P				
Management Compensation Administration	S			P			
Wage & Salary Program Design	S			P			
Wage & Salary Administration	P			S			
Labor Negotiations--Wages	P						
Labor Negotiations--Benefits	S			P			
Labor Negotiations-- Work Rules	P						
Training Program Development	P			S			
Training--Course Delivery	P						
Affirmative Action/EEO--Plan Development	P						
Affirmative Action/EEO--Implementation	P						
Information Systems Services							
Service Company Data Centers							
System Operations & Maintenance					P		
Software Maintenance					P		
Network Administration					P		
PC Acquisition & Support	S				P		
Help Desk					P		

VI - Question 4 – Need for Service Company Services

Governance Practices Associated With Service Company Charges

There are several ways by which NJAWC exercises control over Service Company services and charges. The most important of these are described below.

- **NJAWC Company Board Oversight** – The NJAWC board of directors includes members of American Water’s Executive Management Team, members of the NJAWC management team and external business and community leaders. This diverse board ensures that NJAWC’s needs are a factor in the delivery of Service Company services. The NJAWC Board meets at a minimum of four times each year and at every meeting financial and operational reports and issues are discussed at length.
- **NJAWC President Oversight** – The NJAWC President is responsible for the overall performance of NJAWC, including services and charges received from the American Water Service Company. The President of NJAWC is also a board member on the Service Company’s Board of Directors (see below for further discussion). In addition, as part of the overall management team of American Water through the President of Regulated Operations, NJAWC’s President has a significant voice in major business decisions of American Water and has the ability to monitor Service Company performance quality and spending as NJAWC’s President is one of five direct reports to the President of Regulated Operations.
- **NJAWC Vice President and Treasurer** – The Vice President and Treasurer is responsible for the financial reporting and performance, as well as the internal control performance of the NJAWC. The Vice President and Treasurer monitors the performance, expense and reporting from the Service Company and verifies and validates the cost of services received. In addition, the Vice President and Treasurer through the Financial Planning and Analysis staff reviews the monthly charges and investigates whenever the amount, quality and/or services are appropriate.
- **Service Company Board Oversight** – The Service Company Board of Directors is comprised of 17 members, of which NJAWC President is one of the members. They typically meet four times a year to provide governance on the activities and bylaws of Service Company. Their primary responsibilities include:
 - Approve the Business Plan and Operating Budget
 - Review Financial Performance of the Service Center
 - Review performance metrics of certain functional groups
 - Approve policy, procedures and practices of AW as it relates to Service Company.
- **Service Company Budget Review/Approval** – the NJAWC president and several other state regulated water utility presidents serve on the Service Company board of directors and that board must formally approve the budget for Service Company charges for the next year. These budgeted charges are consolidated with the operating company’s own spending into an overall budget which must be approved by the individual operating company’s board of directors (e.g., NJAWC).
- **Major Project Review And Approval** – Major non-capital projects undertaken by the Service Company must first be reviewed by American Water’s Executive Management Team, which includes the President of Regulated Operations. The President of Regulated Operations, with significant input from his direct reports (including the NJAWC president), has the ability to impact all new initiatives and projects before they are authorized. Major non-capital projects and initiatives for the Service Company are approved through the Business Plan. All significant business initiatives (capital or non-capital) are required to be submitted to the “BATT” (Business and Technology Team) committee for final approval. The “BATT” team is comprised of C-level executive members (CEO, CFO, etc.).

VI - Question 4 – Need for Service Company Services

- **Capital Investment Management (CIM)** – CIM covers capital and asset planning and is employed throughout American Water, including the Service Company. CIM provides a full range of governance practices, including a formal protocol for assessing system needs, prioritizing expenditures, managing the capital program, approving project spending, delivering projects and measuring outputs. CIM ensures that:
 - Capital expenditure plans are aligned with the strategic intent of the business
 - The impact of capital expenditure and income plans are fully reflected in operating expense plans
 - The impacts of these plans are understood and affordable
 - Effective controls are in place over budgets (through business plans) and individual capital projects (through appropriate authorization thresholds, management and reporting processes).The CIM process was designed to optimize the effectiveness of asset investment.
- **Accounting and Financial Reporting** – Similar to the states, the Service Company follows the same accounting and financial reporting processes. During the month accounting transactions are recorded. At month end, the SSC and Service Company Finance teams review all transactions. Variance analyses are performed based on month to month actual as well as actual to budget to ensure accuracy. Once completed, the service company bill is run and the actuals are “pushed down” and allocated to the states based on predetermined formulas. A conference call is scheduled before the operating companies close their books each month to discuss Service Company performance. This is based at a functional level with explanation reported for those expense variances that meet or exceed certain thresholds. At this time, the operating companies may question expenses and spending for better understanding of results. NJAWC Financial Performance and Analysis (FP&A) personnel review the monthly Service Company bill for accuracy and reasonableness on a monthly basis. Any mistakes or overcharges are credited on a subsequent billing.
- **NJAWC Company Budget Variance Reporting** – The “Budget/Plan Analysis,” produced monthly by each operating company, has line items for Management Fees and Shared Service Expense (i.e., IT, Call Center, etc.). In this way, Service Company budget versus actual charges as charged to the operating company can be monitored and reviewed for the month and year-to-date as compared to prior year, plan and reforecast.

BEFORE THE
STATE OF NEW JERSEY
BOARD OF PUBLIC UTILITIES

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

B.P.U. Docket No. WR1107__

O.A.L. Docket No. PUC _____-2011N

DIRECT TESTIMONY OF
PATRICK L. BARYENBRUCH

NEW JERSEY AMERICAN WATER COMPANY, INC.

1 **1. Q. Please state your name and business address.**

2 A. Patrick L. Baryenbruch, 2832 Claremont Road, Raleigh, North Carolina 27608.

3 **2. Q. Please describe your educational and professional background.**

4 A. I received a Bachelors degree in accounting from the University of Wisconsin-
5 Oshkosh in 1974 and a Masters in Business Administration degree from the
6 University of Michigan in 1979.

7 I am a financial consultant and a certified public accountant. I am a member of the
8 American Institute of Certified Public Accountants and the North Carolina
9 Association of Certified Public Accountants.

10 I began my career as a staff accountant with Arthur Andersen & Company where I
11 performed financial audits of utilities, banks and finance companies. After three
12 years I left to pursue an M.B.A. degree. Upon graduation from business school, I
13 worked with the consulting firms of Theodore Barry & Associates and Scott,
14 Madden & Associates.

15 During my consulting career, I have performed consulting assignments for
16 approximately 50 utilities and 10 public service commissions. I have participated as
17 project manager, lead or staff consultant for 24 commission-ordered management
18 and prudence audits of public utilities. Of these, I have been responsible for
19 evaluating the area of affiliate charges and allocation of corporate expenses in the

NEW JERSEY AMERICAN WATER COMPANY, INC.

1 Commission-ordered audits of Connecticut Light and Power, Connecticut Natural
2 Gas, General Water Corporation (Pennsylvania Operations), Philadelphia Suburban
3 Water Company (now Aqua America) and Pacific Gas & Electric Company.

4 My firm has performed the commission-ordered audit of Southern California
5 Edison's 2002, 2003, 2004 and 2005 transactions with its non-regulated affiliate
6 companies.

7 **3. Q. What are your duties and responsibilities in your current position?**

8 A. I am the President of my own consulting practice, Baryenbruch & Company, LLC,
9 which was established in 1985. In that capacity, I provide consulting services to
10 utilities and their regulators.

11 **4. Q. Please describe the reason for your testimony in this case.**

12 A. I am presenting the results of my study which evaluated the services provided by
13 American Water Service Company ("Service Company") during the 12 months ended
14 December 31, 2010 to New Jersey American Water Company ("NJAWC"). This
15 study was undertaken in conjunction with NJAWC's rate case and is true to the best
16 of my knowledge and belief. The study is attached as Schedule PLB-1.

17 **5. Q. What were the objectives of your study?**

18 A. This study was undertaken to answer four questions concerning the services provided
19 by the Service Company to NJAWC, each of which bears on the reasonableness of
20 those charges as incurred during 2010. First, were the Service Company's charges to

NEW JERSEY AMERICAN WATER COMPANY, INC.

1 NJAWC during 2010 reasonable? Second, was NJAWC charged the lower of cost or
2 market for managerial and professional services provided by the Service Company
3 during 2010? Third, were 2010 costs of the Service Company's customer accounts
4 services, including those of the National Call Centers, comparable to those of other
5 utilities? Fourth, are the services NJAWC receives from Service Company necessary?

6 **6. Q. What conclusions were you able to draw concerning question number 1,**
7 **whether the Service Company charges to NJAWC were reasonable?**

8 A. The Service Company's 2010 cost per NJAWC customer is reasonable compared to
9 cost per customer for electric and combination electric/gas service companies. During
10 the 2010, NJAWC was charged \$48 per customer for administrative and general
11 (A&G)-related services provided by the Service Company. This compares to an
12 average of \$111 per customer for service companies reporting to the Federal Energy
13 Regulatory Commission ("FERC"). Only 2 of the 24 utility service companies that
14 filed a FERC Form 60 for 2010 had a lower per customer A&G cost than NJAWC's
15 charges from the Service Company.

16 **7. Q. What conclusions were you able to draw concerning question number 2,**
17 **whether NJAWC was charged the lower of cost or market services provided by**
18 **the Service Company?**

19 A. I was able to draw the following conclusions:

NEW JERSEY AMERICAN WATER COMPANY, INC.

- 1 (1) NJAWC was charged the lower of cost or market for managerial and
2 professional services during the 2010.
- 3 (2) On average, the hourly rates for outside service providers are 45% higher than
4 the Service Company's hourly rates.
- 5 (3) The managerial and professional services provided by the Service Company are
6 vital and could not be procured externally by NJAWC without careful
7 supervision on the part of NJAWC. If these services were contracted entirely to
8 outside providers, NJAWC would have to add at least two positions to manage
9 activities of outside firms. These positions would be necessary to ensure the
10 quality and timeliness of services provided.
- 11 (4) If all the managerial and professional services now provided by the Service
12 Company had been outsourced during the 2010, NJAWC and its ratepayers
13 would have incurred more than \$14.3 million in additional expenses. This
14 amount includes the higher cost of outside providers and the cost of two
15 NJAWC positions needed to direct the outsourced work.
- 16 (5) This study's hourly rate comparison actually understates the cost advantages that
17 accrue to NJAWC from its use of the Service Company. Outside service
18 providers generally bill for every hour worked. Service Company exempt
19 personnel, on the other hand, charge a maximum of 8 hours per day even when
20 they work more hours. If all overtime hours of Service Company personnel were

NEW JERSEY AMERICAN WATER COMPANY, INC.

1 factored into the hourly rate calculation, the Service Company would have had
2 an even greater annual dollar advantage than the \$14.3 cited above.

3 (6) It would be difficult for NJAWC to find local service providers with the same
4 specialized water industry expertise as that possessed by the Service Company
5 staff. Service Company personnel spend substantially all their time serving
6 operating water companies. This specialization brings with it a unique
7 knowledge of water utility operations and regulation that is most likely
8 unavailable from local service providers.

9 (7) Service Company fees do not include any profit markup. Only its actual cost of
10 service is being recovered from NJAWC ratepayers.

11 **8. Q. What conclusions were you able to draw concerning question number 3,**
12 **whether the 2010 costs of the Service Company's customer account services,**
13 **including those of the National Call Centers, were reasonable?**

14 A. I was able to determine that the cost of the Service Company's customer accounts
15 services, including those provided by the National Call Centers, is well below the
16 average of the neighboring electric utility comparison group. As will be explained
17 further herein, this group of companies provides a reasonable proxy group for
18 comparison to a regulated utility of the size and scope of the Service Company and
19 NJAWC. During 2010, the customer accounts cost for NJAWC customers was \$24.32

NEW JERSEY AMERICAN WATER COMPANY, INC.

1 compared to the 2010 average of \$50.51 for neighboring electric utilities. The highest
2 comparison group per customer cost was \$97.07 and the lowest \$13.30.

3 **9. Q. What conclusions were you able to draw concerning question number 4,**
4 **whether the services NJAWC receives from the Service Company are**
5 **necessary?**

6 A. I was able to draw the following conclusions:

7 (1) The services that the Service Company provides are necessary and would be
8 required even if NJAWC were a stand-alone water utility.

9 (2) There is no redundancy or overlap in the services provided by the Service
10 Company to NJAWC.

11 **10. Q. Does this complete your direct testimony?**

12 A. Yes.

**Market Cost Comparison of Service Company Charges to
Tennessee American Water Company
12-Months Ended March 31, 2010**



**Tennessee American Water Company
Market Cost Comparison of Service Company Charges
12-Months Ended March 31, 2010**

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Purpose of This Study

This study was undertaken to answer four questions concerning the services provided by American Water Works Service Company, Inc. (Service Company) to Tennessee American Water Company (TAWC):

1. Are the Service Company's charges to TAWC during the 12 months ended March 31, 2010 reasonable?
2. Was TAWC charged the lower of cost or market for managerial and professional services provided by the Service Company during the 12 months ended March 31, 2010?
3. Were the 12 months ended March 31, 2010 costs of the Service Company's customer accounts services, including those of the National Call Centers, comparable to those of other utilities?
4. Are the services TAWC receives from Service Company necessary?

Study Results

Concerning question 1, the following conclusion was reached:

- The Service Company's 12 months ended March 31, 2010 cost per TAWC customer was reasonable compared to cost per customer for electric and combination electric/gas service companies. During the 12 months ended March 31, 2010, TAWC was charged \$59 per customer for administrative and general (A&G)-related services provided by the Service Company. This compares to an average of \$95 per customer for service companies reporting to the Federal Energy Regulatory Commission (FERC). Only 4 of the 24 comparison group utility service companies filed a FERC Form 60 for 2009 had a lower per customer A&G cost than TAWC's charges from the Service Company.

Concerning question 2, the following conclusions were drawn from this study:

- TAWC was charged the lower of cost or market for managerial and professional services during the 12 months ended March 31, 2010.
- On average, the hourly rates for outside service providers are 45% higher than the Service Company's hourly rates.
- The managerial and professional services provided by the Service Company are vital and could not be procured externally by TAWC without careful supervision on the part of TAWC. If these services were contracted entirely to outside providers, TAWC would have to add at least one position to manage activities of outside firms. This position would be necessary to ensure the quality and timeliness of services provided.
- If all the managerial and professional services now provided by the Service Company had been outsourced during the 12 months ended March 31, 2010, TAWC and its ratepayers would have incurred \$2,000,000 in additional expenses. This amount includes the higher cost of outside providers and the cost of one TAWC position needed to direct the outsourced work.
- This study's hourly rate comparison actually understates the cost advantages that accrue to TAWC from its use of the Service Company. Outside service providers generally bill

I – Introduction

for every hour worked. Service Company exempt personnel, on the other hand, charge a maximum of 8 hours per day even when they work more hours. If the overtime hours of Service Company personnel were factored into the hourly rate calculation, the Service Company would have had an even greater annual dollar advantage than the \$2,000,000 cited above. For instance, if Service Company overtime is conservatively estimated at 5% (2 hours per week) then that work would have added more than \$92,000 in charges from outside providers.

- It would be difficult for TAWC to find local service providers with the same specialized water industry expertise as that possessed by the Service Company staff. Service Company personnel spend substantially all their time serving operating water companies. This specialization brings with it a unique knowledge of water utility operations and regulation that is most likely unavailable from local service providers.
- Service Company fees do not include any profit markup. Only its actual cost of service is being recovered from TAWC ratepayers.

Concerning question 3, the following conclusion was reached:

- The cost of the Service Company's customer accounts services, including those provided by the National Call Center, is below the range of the average of the neighboring electric utility comparison group. As will be explained further herein, this group of companies provides a reasonable proxy group for comparison to a regulated utility of the size and scope of the Service Company and TAWC. During the 12-months ended March 31, 2010, the customer accounts cost for TAWC customers was \$29.08 compared to the 2009 average of \$32.01 for neighboring electric utilities. The highest comparison group per customer cost was \$67.39 and the lowest \$17.53.

Concerning question 4, the following conclusions were drawn:

- The services that the Service Company provides are necessary and would be required even if TAWC were a stand-alone water utility.
- Furthermore, there is no redundancy or overlap in the services provided by the Service Company to TAWC. For all of the services listed in Exhibit 11, there was only one entity primarily responsible for the service.



II – Background

Overview of American Water Works Service Company

American Water's Service Company exists to provide certain shared services to American Water subsidiaries. It follows a service company model used by many utility holding companies that own multiple regulated utilities. By consolidating executive and professional services into a single service company, utility holding companies are able to realize the following benefits for ratepayers:

- **Purchasing Economies** – Common expenses (e.g., insurance, chemicals, piping) can be procured on a much larger scale thereby providing greater bargaining power for the combined entity compared to individual utility operating companies. A service company facilitates corporate-wide purchasing programs through its procurement and contract administration functions.
- **Operating Economies of Scale** – A service company is able to deliver services more efficiently because workloads can be balanced across more persons and facilities. For instance, American Water's Service Company is able to maintain one principal data center for the entire corporation. This is much more cost-efficient than each operating utility funding their own data center with its large fixed hardware, software and staffing costs.
- **Continuity of Service** – Centralizing service company personnel who perform similar services facilitates job cross-training and sharing of knowledge and expertise. This makes it easier to deal with staff turnover and absences and to sustain high levels of service to operating utilities. An individual operating utility might experience considerable disruption if a key professional left and it was necessary to hire outside to fill the vacancy.
- **Maintenance of Corporate-Wide Standards** – Personnel in American Water's Service Company establish standards for many functions (e.g., engineering designs, operating procedures and maintenance practices). It is easier to ensure these standards are followed by every operating utility because their implementation is overseen by the Service Company.
- **Improved Governance** – American Water's Service Company provides another dimension of management and financial oversight that supplements local operating utility management. The Service Company facilitates standard planning and reporting that help ensure operating utilities meet the requirements of their customers in a cost effective manner.
- **Retention of Personnel** – A service company organization provides operating utility personnel with another career path beyond what may be available on a local level. These opportunities tend to improve employee retention.

American Water follows the model for other utility service companies in another important regard. Its services are provided to affiliate operating utilities, like TAWC, at cost. American Water's Service Company is not a profit-making entity. It assigns only its actual expenses to the American Water subsidiaries it services.

The Service Company provides services to American Water operating companies from the following locations:

- **Corporate Office** – Includes American Water's executive management and personnel from the various corporate support services. American Water's corporate office is located in Voorhees, New Jersey.



II – Background

- National Call Centers – Perform customer service functions, including: customer call processing, service order processing, correspondence processing, credit and collections. American Water maintains two call centers. One in Alton, Illinois that went into operation in 2001 and a second in Pensacola, Florida that went into operation in 2005. Prior to the establishment of these national call centers, customer service functions were performed by employees of TAWC, which incurred the expense on its books.
- National Shared Services Center – The Shared Services Center, located in Cherry Hill, New Jersey, provides various financial, accounting and treasury functions that had been performed by individual operating companies. This arrangement has improved and streamlined the Company's financial processes and allowed operating companies to focus on providing utility service.
- Regional Offices – Regional offices provide operating companies with certain support services that can be performed more effectively on a regional basis because individual operating company/center workloads are not sufficient to warrant a full-time staff for these activities. At the same time, these services require closer proximity to operating companies served so they are not provided by the National Shared Services Center. Examples of regional office services include rates and revenues, engineering, operations and field resource coordination.
- Belleville Lab – The national trace substance laboratory is located in Belleville, Illinois and performs testing for all American Water operating companies.
- Information Technology Service Centers – American Water's principal data center, located in Hershey, Pennsylvania, supports the IT infrastructure required to run corporate and operating company business applications and the communications systems. IT personnel rotate, as needed, throughout the regional offices and operating companies.

Service Company Expense Categories

The Service Company renders a monthly bill to operating companies. Charges are broken down into the following expense categories:

- Labor – base pay (salaries) of managerial and professional employees
- Labor-Related Overheads - employee benefit costs (payroll taxes, medical coverage, pensions, disability insurance) and other general expenses
- Support - wages and salaries of office support personnel, including secretaries, clerical personnel, telephone operators and mail clerks
- Office Expenses - office rent, equipment leases, telephone, electric, office supplies, property taxes, office maintenance
- Vouchers/Journal Entries – (1) travel expenses incurred by Service Company personnel, (2) other items submitted for reimbursement by employees, including professional association dues, (3) outside service contracts for such things as actuarial services, and (4) various other expenditures, including data center expenses for software licenses and hardware maintenance.

Service Company expenses are either assigned directly or allocated to operating companies, as shown in the table below.



II – Background

Expense Category	Direct Charged	Allocated	Comments
Labor	X	X	Professional personnel working for one or several operating companies
Labor-Related Overheads	X	X	These are primarily employee benefit costs that relate directly to labor
Support		X	Administrative personnel support the professional staff, thus support costs are allocated on the basis of professional labor
Office Expense		X	Are all allocated on the basis of professional labor
Vouchers/Journals	X	X	May be either directly in support of one operating company (e.g., an engineer traveling from the Corporate Office to the operating company) or allocated to several operating companies

A direct charge occurs when Service Company work or expenses are incurred in support of only one operating company. Direct charge examples include work in support of an operating company's rate case, engineering design work on an operating company's project and the preparation of an operating company's financial statements.

Service Company expenses are allocated when more than one operating company benefits from the underlying work. Examples include assessments of new Federal water quality regulations, development of the company-wide materials procurement contracts and creation of company-wide engineering design standards.

Charging and Assignment Of Service Company Time and Expenses

Service Company transactions are assigned with the following information so there is a proper accounting and eventual charging to an operating company:

- Operating company
- Formula number
- Work order (where applicable)
- Authorization number (where applicable)

Charges can originate from the following systems:

- Payroll System
- RVI System (outside vendor payments)
- PCard System (credit card payments)
- Internal Purchase Order System
- Journal entries

II – Background

The Service Company's time reporting process enables labor and support charges to be assigned to the proper operating company. Labor charges are based on the time reported by managerial and professional Service Company employees. Every week, Service Company professional employees complete an electronic time sheet that shows:

- Formula number (this is linked to operating company within American Water's financial system)
- Employee hours worked
- Account number for non-labor charges

At month-end, time report information is processed and direct and allocated professional labor hours tabulated for each operating company. Dollar charges are then calculated using the hourly rate of each Service Company professional employee based upon their base salary (i.e., an employee's hours times his/her hourly rate of pay).

Support (administrative) personnel charge their time to the activity "General Admin." As described in the table on page 4, their labor charges are allocated to operating companies based upon how their office's professional personnel labor charges are assigned. For instance, if 20% of American Water's Southeast Region's professional labor is assigned to TAWC during a month, then 20% of that office's monthly administrative labor charges also are assigned to the operating company.

The overhead cost category is next assigned based on professional and administrative labor costs. Thus, if 20% of the Southeast Region's accumulated professional and support labor is charged to TAWC during the month, then 20% of that month's overhead expenses will be assigned to TAWC.

Each Service Company location's office expenses are allocated to operating companies based on how professional labor charges for that office have been assigned. For instance, if 2% of professional labor from one Service Company office is assigned to TAWC, then 2% of that office's office expenses would be assigned to TAWC. Thus, office expenses are allocated in the very same way as administrative labor.

Vouchers/journal entries may be charged directly or allocated, depending on who benefits from the expenditure. For instance, the cost of a continuing professional education course taken by a professional in a regional office is allocated to the operating companies served by that office. Travel expenses by that same professional to a rate case proceeding are charged directly to the operating company whose case is being heard.

III – Service Company Cost Comparison Approach

During the 12 months ended March 31, 2010, the Service Company billed TAWC \$5,008,401 in O&M-related charges and \$311,927 in capital-related charges. These total charges of \$5,320,328 were subjected to a market cost comparison.

Service Company Charges	12 Months Ended March 31, 2010
Management Fees - O&M	\$ 5,008,401
Management Fees - Capital	\$ 311,927
Total Testable SC Charges	\$ 5,320,328

For purposes of comparing these charges to certain outside benchmarks, Service Company services were placed into three categories:

- Managerial and Professional Services – Includes such services as management, accounting, legal, human resources, information technology and engineering.
- Customer Accounts Services – Includes customer-related services, such as call center, credit, billing, collection and payment processing.
- Field Resource Coordination Services – Includes the dispatching and oversight of work to operating company field crews.

Total test period Service Company charges break down between management/professional services, customer account services and field resource coordination as follows:

	12 Months Ended Mar. 31, 2010	
	Amount	Hours
Management and Professional Services	\$ 4,099,018	39,973
Customer Account Services	\$ 1,120,113	29,545
Field Resource Coordination	\$ 101,197	1,640
Total Service Company Charges	\$ 5,320,328	71,158

This study's first question—whether Service Company 12 months ended March 31, 2010 charges are reasonable—was determined by comparing TAWC's A&G-related Service Company charges per customer to the same charges for utility companies that must file the FERC Form 60 – Annual Report of Service Companies.

The second question—whether Service Company charges during the 12 months ended March 31, 2009 were at the lower of cost or market—was evaluated by comparing the cost per hour for managerial and professional services provided by Service Company personnel to hourly billing rates that would be charged by outside providers of equivalent services. Service Company costs per hour were based on actual charges to TAWC during the 12 months ended March 31, 2010. Outside providers' billing rates came from surveys or other information from professionals that could perform the services now provided by the Service Company.

III – Service Company Cost Comparison Approach

The third question—whether Service Company’s 12 months ended March 31, 2010 customer account services charges, including those of the National Call Center costs, were comparable to other utilities—was addressed by comparing TAWC’s customer accounts services expenses to those of neighboring electric utilities. This approach was selected because the costs of outside providers of call center services are not publicly available. However, electric utility customer account services expenses can be obtained from the FERC Form 1. The availability and transparency of FERC data adds to the validity of its use in this comparison.

The fourth question—the necessity of Service Company services—was investigated by defining the services provided to TAWC and determining if these services would be required if TAWC were a stand-alone utility.

IV – Question 1 – Reasonableness of Service Company Charges

TAWC's Service Company Cost per Customer

During the 12 months ended March 31, 2010, TAWC was charged \$59 per customer by the Service Company for A&G-related services. The calculation of this amount, shown in the table below, starts with total net testable Service Company charges and adjusts for capital and non-A&G functions (engineering, operations and water quality) charges. These adjustments are necessary to develop a per customer cost that is comparable to cost of utility service companies.

	12 Months ended Mar 31, 2010 Svc. Co. Charges
Testable Service Company charges	\$ 5,320,328
Less: Capital charges	\$ (311,927)
Less: Non-A&G function O&M charges	
Engineering	\$ (10,568)
Operations	\$ (541,144)
Water Quality	\$ (97,262)
Net A&G/O&M-related charges	\$ 4,359,427
TAWC customers	74,475
TAWC Cost Per Customer	\$ 59

Comparison Group Cost Per Customer

Every centralized service company in a holding company system must file a Form 60 in accordance with the Public Utility Holding Company Act of 2005, Section 1270, Section 390 of the Federal Power Act and 18 C.F.R. paragraph 366.23. This report is designed to collect financial information from service companies that are subject to regulation by the FERC.

For 2009, a Form 60 was filed by service companies that are part of 25 utility holding companies that own utilities providing regulated electric and, in some cases, gas service to retail customers. In order to make a valid comparison of these service companies' costs to those of American Water Works Service Company, it was necessary to isolate expenses that they have in common. These include A&G-related charges recorded in the following FERC accounts:

901 – Supervision	921 – Office supplies and expenses
903 – Customer records and collection expenses	923 – Outside services employed
905 – Miscellaneous customer accounts expenses	928 – Regulatory commission expenses
907 – Supervision	930.2 – Miscellaneous general expenses
910 – Misc customer service and info expenses	931 – Rents
911 – Supervision	935 – Maintenance of structures and equipment
920 – Administrative and general salaries	

Charges to utility affiliates for the comparison group service companies were obtained from Schedule XVI – Analysis of Charges for Service Associate and Non-Associate Companies (p. 303 to 306) of each entity's FERC Form 60. This schedule shows charges by FERC Account.

Comparison group service company 2009 expenses were also adjusted to remove charges to non-regulated affiliates from the cost pool used to calculate the cost per regulated service customer. This determination was made using information from the FERC Form 60 schedule: Account 457 – Analysis of Billing – Associate Companies.

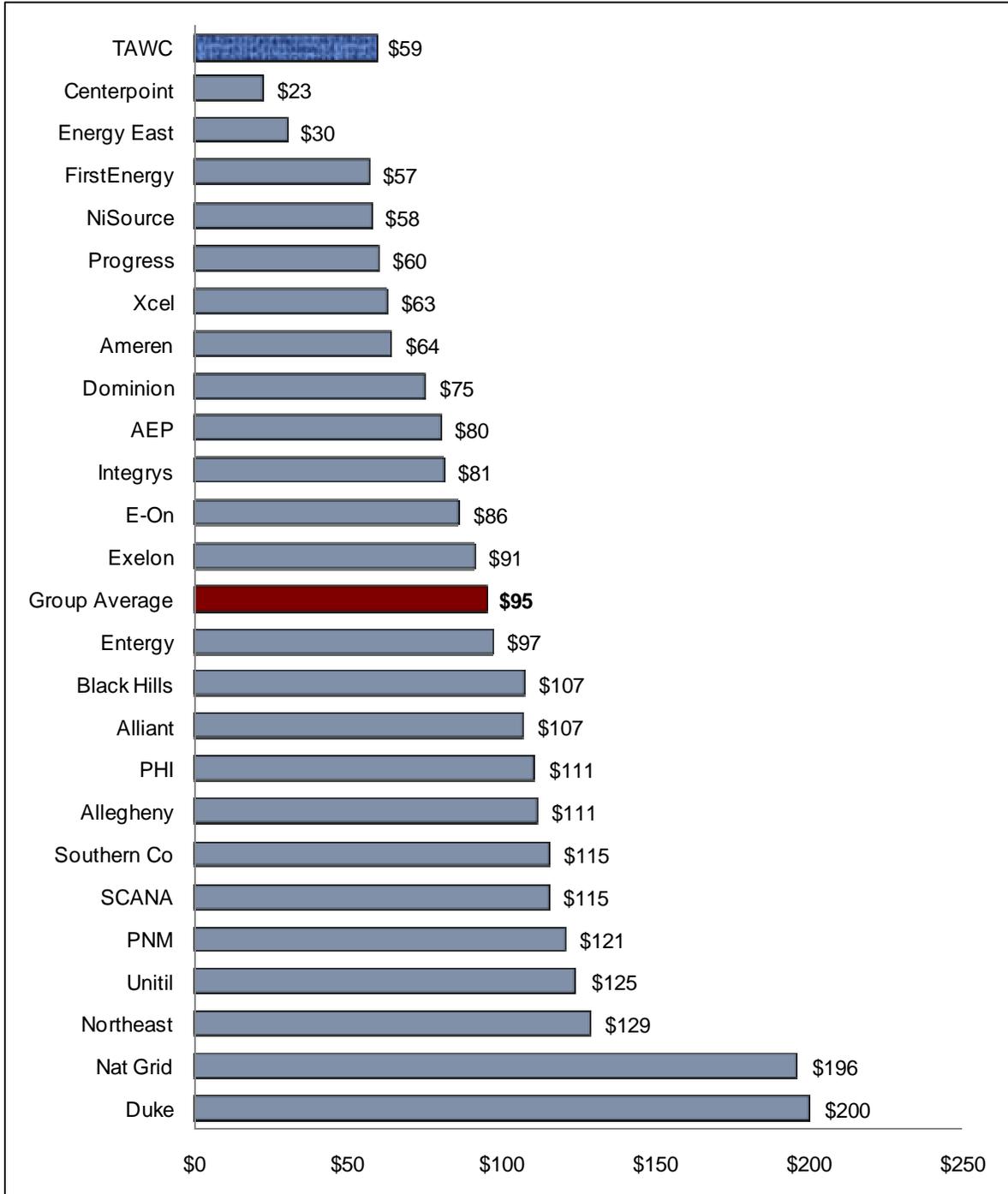
IV – Question 1 – Reasonableness of Service Company Charges

One service company that filed a Form 60 was excluded from the comparison group because its Form 60 contained no data for 2009. That service company, Great Plains Energy Services Incorporated, became inactive in 2009 and had no charges to its regulated utility affiliate. The A&G expenses per regulated utility customer for the other 24 utility companies that filed a Form 60 for 2009 are calculated below.

Utility Company	2009 Regulated Retail Service Company A&G Expenses	Regulated Retail Customers	Cost per Customer
AEP	\$418,484,117	5,213,000	\$ 80
Allegheny	\$176,685,245	1,585,700	\$ 111
Alliant	\$149,116,475	1,395,189	\$ 107
Ameren	\$212,036,412	3,300,000	\$ 64
Black Hills	\$81,484,333	759,400	\$ 107
Centerpoint	\$119,304,604	5,300,000	\$ 23
Dominion	\$279,128,940	3,700,000	\$ 75
Duke	\$901,762,388	4,500,000	\$ 200
Energy East	\$89,580,962	2,973,000	\$ 30
Entergy	\$262,596,172	2,700,000	\$ 97
E-On	\$105,893,093	1,226,000	\$ 86
Exelon	\$537,633,122	5,886,000	\$ 91
FirstEnergy	\$255,874,712	4,500,000	\$ 57
Integrus	\$175,423,352	2,157,700	\$ 81
Nat Grid	\$1,314,902,105	6,700,000	\$ 196
NiSource	\$216,480,637	3,750,000	\$ 58
Northeast	\$269,948,801	2,095,000	\$ 129
PHI	\$215,465,623	1,946,000	\$ 111
Progress	\$186,256,921	3,100,000	\$ 60
PNM	\$87,998,259	729,700	\$ 121
SCANA	\$166,555,883	1,445,000	\$ 115
Southern Co	\$508,130,523	4,402,000	\$ 115
Unitil	\$21,115,280	169,600	\$ 125
Xcel	\$333,389,459	5,300,000	\$ 63
Group Total	\$7,085,247,416	74,833,289	\$ 95

Exhibit 1 shows TAWC's 12 months ended March 31, 2010 Service Company cost per customer of \$59 to be considerably lower than the average of \$95 per customer for the comparison group service companies. Only 4 of 24 comparison group service companies had a lower cost per customer than TAWC. Based on this result, it is possible to conclude that the Service Company's 12 months ended March 31, 2010 charges to TAWC were reasonable.

**Tennessee American Water Company
Comparison of Service Company Annual Costs Per Customer**



V – Question 2 – Provision of Services at the Lower of Cost or Market

Methodology

The lower-of-cost-or-market comparison is accomplished by comparing the cost per hour for Service Company managerial and professional services to those of outside service providers to whom these duties could be assigned. Based on the nature of the Service Company services it was determined that the following outside providers could perform the categories of services indicated below:

- Management Consultants – executive and administrative management, risk management services, human resources and communications services
- Attorneys – legal services
- Certified Public Accountants – accounting, financial, information technology and rates and revenues services
- Professional Engineers – engineering, operations and water quality services.

The services provided by the Belleville lab are assumed to be transferable to professional engineers for purposes of this cost comparison. This was done for two reasons. First, there is no readily available survey of hourly billing rates for testing services such as those performed by Belleville. Second, Belleville personnel have similar, scientific educational backgrounds as Service Company engineering personnel. Thus, it is valid to compare the hourly rates of Belleville services to those of outside engineering firms.

Service Company's hourly rate were calculated for each of the four outside service provider categories, based on the dollars and hours charged to TAWC during the 12 months ended March 31, 2010. Hourly billing rates for outside service providers were developed using third party surveys or directly from information furnished by outside providers themselves.

It should be noted that by using the Service Company's hours charged TAWC during the 12 months ended March 31, 2010, its hourly rates are actually overstated because Service Company personnel charge a maximum 8 per day even when they work more. Outside service providers generally bill for every hour worked. If the overtime hours of Service Company personnel had been factored into the hourly rate calculation, Service Company hourly rates would have been lower.

The last step in the market cost comparison was to compare the Service Company's average cost per hour to the average cost per hour for outside providers.

Service Company Hourly Rates

Exhibit 2 (page 14) details the assignment of 12 months ended March 31, 2010 management and professional Service Company charges by outsider provider category. Exhibit 3 (page 15) shows the same assignment for Service Company management and professional hours charged to TAWC during the 12 months ended March 31, 2010.

Certain adjustments to these dollar amounts were necessary to calculate Service Company hourly rates that are directly comparable to those of outside providers. Adjustments were made to the following 12 months ended March 31, 2010 test period non-labor Service Company charges:

- Contract Services – 12 months ended March 31, 2010 Service Company charges to TAWC include expenses associated with the use of outside professional firms to perform certain corporate-wide services (e.g., legal, financial audit, actuarial services).

V – Question 2 – Provision of Services at the Lower of Cost or Market

These professional fees are excluded from the Service Company hourly rate calculation because the related services have effectively been out-sourced already.

- Travel Expenses – In general, client-related travel expenses are not recovered by outside service providers through their hourly billing rate. Rather, actual out-of-pocket travel expenses are billed to clients in addition to fees for professional services. Thus, it is appropriate to remove these Service Company charges from the hourly rate calculation.
- Information Technology Infrastructure Expenses – Included in the 12 months ended March 31, 2010 Service Company charges to TAWC are leases, maintenance fees and depreciation related to American Water's enterprise mainframe, server and network infrastructure and corporate business applications. An outside provider that would take over operation of this infrastructure would recover these expenses over and above the labor necessary to operate the data center.

Exhibit 4 (page 16) shows how contract services, travel expenses and computer hardware/software-related Service Company charges are assigned among the four outside provider categories.

Based on the assignment of expenses and hours shown in Exhibits 2 and 3 and the excludable items shown in Exhibit 4, the Service Company's equivalent costs per hour for the 12 months ended March 31, 2010 are calculated below.

	Attorney	Management Consultant	Certified Public Accountant	Professional Engineer	Total
Total management, professional & technical services charges	\$ 132,906	\$ 1,030,160	\$ 2,395,210	\$ 540,742	\$ 4,099,018
Less:					
Contract services	\$ 11,816	\$ 62,591	\$ 236,246	\$ (8,429)	\$ 302,224
Travel expenses	\$ 1,529	\$ 40,905	\$ 28,441	\$ 6,670	\$ 77,545
Computer hardware/software	\$ 3,397	\$ 143,421	\$ 156,874	\$ 17,524	\$ 321,216
Net Service Charges (A)	\$ 116,164	\$ 783,244	\$ 1,973,648	\$ 524,977	\$ 3,398,033
Total Hours (B)	899	6,118	24,293	8,664	39,973
Average Hourly Rate (A / B)	\$ 129	\$ 128	\$ 81	\$ 61	

Tennessee American Water Company
Analysis of 12 Months Ended December 31, 2009 Service Company Charges By Location And Function

Location	Function	12 Months Ended March 31, 2010 Service Company Charges				Total	
		Attorney	Management Consultant	Certified Public Accountant	Professional Engineer		
Belleville Lab	Water Quality				\$ 119,043	\$ 119,043	
Call Center	Human Resources		\$ 25,146			\$ 25,146	
Corporate	Accounting			\$ 262,142		\$ 262,142	
	Administration		\$ 276,758			\$ 276,758	
	Audit			\$ 42,398		\$ 42,398	
	Communications		\$ 61,742			\$ 61,742	
	Engineering			\$ 272,550		\$ 272,550	
	Finance		\$ 204,431			\$ 204,431	
	Human Resources			\$ 33,960		\$ 33,960	
	Legal	\$ 68,672				\$ 68,672	
	Operations		\$ 108,420		\$ 283,716	\$ 392,136	
	Rates & Revenue			\$ 47,325		\$ 47,325	
	Risk Management		\$ 27,185			\$ 27,185	
	Water Quality				\$ 2,099	\$ 2,099	
	Regional Offices	Accounting			\$ 16,440		\$ 16,440
Administration			\$ 108,473			\$ 108,473	
Communications			\$ 87,832			\$ 87,832	
Engineering					\$ 10,497	\$ 10,497	
Finance				\$ 360,493		\$ 360,493	
Human Resources			\$ 2,480			\$ 2,480	
Legal		\$ 64,234				\$ 64,234	
Operations			\$ 49,366		\$ 124,617	\$ 173,984	
Risk Management			\$ 21,326			\$ 21,326	
Water Quality					\$ 771	\$ 771	
Information Technology		Information Technology			\$ 1,010,475		\$ 1,010,475
Shared Services		Accounting			\$ 306,809		\$ 306,809
		Administration		\$ 57,000			\$ 57,000
	Finance			\$ 2,263		\$ 2,263	
	Rates & Revenue			\$ 40,355		\$ 40,355	
Total Dollars Charged		\$ 132,906	\$ 1,030,160	\$ 2,395,210	\$ 540,742	\$ 4,099,018	

Tennessee American Water Company
Analysis of 12 Months Ended December 31, 2009 Service Company Hours By Location And Function

Location	Function	12 Months Ended March 31, 2010 Service Company Hours					
		Attorney	Management Consultant	Certified Public Accountant	Professional Engineer	Total	
Belleville Lab	Water Quality				1,658	1,658	
Call Center	Human Resources		309			309	
Corporate	Accounting			3,268		3,268	
	Administration		676			676	
	Audit			372		372	
	Communications		287			287	
	Engineering			2,102		2,102	
	Finance		1,689			1,689	
	Human Resources			322		322	
	Legal	300				300	
	Operations		353		5,089	5,442	
	Rates & Revenue			319		319	
	Risk Management		256			256	
	Water Quality				-	-	
	Regional Offices	Accounting			179		179
		Administration		-			-
Communications			1,300			1,300	
Engineering					(1)	(1)	
Finance				4,507		4,507	
Human Resources			21			21	
Legal		599				599	
Operations			457		1,917	2,375	
Risk Management			449			449	
Water Quality					-	-	
Information Technology	Information Technology			6,208		6,208	
Shared Services	Accounting			6,489		6,489	
	Administration		320			320	
	Finance			-		-	
	Rates & Revenue			527		527	
Total Hours Charged		899	6,118	24,293	8,664	39,973	

Tennessee American Water Company
12 Months Ended December 31, 2009 Service Company Charges Excludable From The Hourly Rate Calculation

Charges By Function	Exclusions From Hourly Rate Calculation				Outside Service Provider Category
	Contract Services	Travel Expenses	Computer HW/SW	Total	
Accounting	\$ 49,641	\$ 3,649	\$ 2,646	\$ 55,937	Certified Public Accountant
Administration	\$ 9,743	\$ 3,174	\$ 130,234	\$ 143,151	Management Consultant
Audit	\$ 6,793	\$ 652	\$ 422	\$ 7,868	Certified Public Accountant
Communications	\$ 9,698	\$ 4,581	\$ 991	\$ 15,270	Management Consultant
Engineering		\$ 158	\$ 135	\$ 293	Professional Engineer
Finance	\$ 56,928	\$ 7,774	\$ 7,058	\$ 71,760	Certified Public Accountant
Human Resources	\$ 35,576	\$ 7,411	\$ 4,696	\$ 47,684	Management Consultant
Information Technology	\$ 114,727	\$ 14,041	\$ 145,956	\$ 274,724	Certified Public Accountant
Legal	\$ 11,816	\$ 1,529	\$ 3,397	\$ 16,742	Attorney
Operations	\$ 8,629	\$ 28,678	\$ 10,947	\$ 48,254	Management Consultant, Professional Engineer
Rates & Revenue	\$ 8,157	\$ 2,324	\$ 791	\$ 11,273	Certified Public Accountant
Risk Management	\$ 651	\$ 3,224	\$ 804	\$ 4,679	Management Consultant
Water Quality	\$ (10,135)	\$ 350	\$ 13,137	\$ 3,352	Professional Engineer
Total	\$ 302,224	\$ 77,545	\$ 321,216	\$ 700,985	

Recap By Outside Provider	Exclusions From Hourly Rate Calculation			
	Contract Services	Travel Expenses	Computer HW/SW	Total
Attorney	\$ 11,816	\$ 1,529	\$ 3,397	\$ 16,742
Management Consultant	\$ 62,591	\$ 40,905	\$ 143,421	\$ 246,916
Certified Public Accountant	\$ 236,246	\$ 28,441	\$ 156,874	\$ 421,561
Professional Engineer	\$ (8,429)	\$ 6,670	\$ 17,524	\$ 15,765
Total	\$ 302,224	\$ 77,545	\$ 321,216	\$ 700,985

V – Question 2 – Provision of Services at the Lower of Cost or Market

Outside Service Provider Hourly Rates

The next step in the cost comparison was to obtain the average billing rates for each outside service provider. The source of this information and the determination of the average rates are described in the paragraphs that follow.

It should be noted that professionals working for three of the five outside provider categories may be licensed to practice by state regulatory bodies. However, not every professional working for these firms is licensed. For instance, among Tennessee certified public accounting firms, only more experienced staff are predominantly CPAs (see table below). Some Service Company employees also have professional licenses. Thus, it is valid to compare the Service Company's hourly rates to those of the outside professional service providers included in this study.

Position	Tennessee Average
Partners/Owners	97%
Managers (6+ years experience)	83%
Sr Associates (4-5 years experience)	60%
Associates (1-3 years experience)	19%
New Professionals	6%

Source: AICPA's National PCPS/TSCPA
Management of an Accounting Practice Survey

Attorneys

The Tennessee State Bar does not survey its members as to their hourly billing rates. The Chattanooga Bar Association maintains a service called Chattanooga Lawyers Information Providers Service (CLIPS) to assist the public in finding a lawyer. CLIPS' website presents background information on a relatively small number of Chattanooga attorneys. Unfortunately, only 60% of the attorneys featured in CLIPS revealed their hourly billing rates. With this small sample size and incomplete hourly rate data, it was impossible to develop a valid set of Chattanooga attorney billing rates for comparison to the cost of the Service Company's legal services.

As a result, an estimate of Chattanooga hourly rates was developed from two surveys conducted by Lawyers Weekly in the states of Michigan and Missouri. The 2009 average rate for each firm in the surveys was adjusted for the cost of living differential between their locations and Chattanooga, Tennessee. The cost of living indices utilized in this analysis were obtained from the Council for Community and Economic Research, a membership organization created in 1961 to develop high quality regional economic data and analytical methods.

The resultant 2009 average hourly rate calculated in Exhibit 5 is in line with the few hourly billing rates shown on the CLIPS website. For instance, the following attorneys from the Chattanooga firm of Chambliss Bahner & Stophel were listed in the CLIP website. Their billing rates are relatively close to this study's cost-of-living-adjusted estimated average of \$265 per hour for Chattanooga attorneys.

- Mr. Robert Addison - \$260/hour
- Ms. Alicia Oliver - \$250/hour

V – Question 2 – Provision of Services at the Lower of Cost or Market

Management Consultants

The cost per hour for management consultants was developed from a 2009 survey performed by the Association of Management Consulting Firms—an industry trade organization. The survey includes rates that were in effect during 2008 for firms throughout the United States. Consultants typically do not limit their practice to any one region and must travel to a client's location. Thus, the U.S. national average is appropriate for comparison.

The first step in the calculation, presented in Exhibit 6, was to determine an average rate by consultant position level. From these rates, a single weighted average hourly rate was calculated based upon the percent of time that is typically applied to a consulting assignment by each consultant position level. The 2008 average rate was escalated to September 30, 2010—the midpoint of the 12 months ended March 31, 2010.

Certified Public Accountants

The average hourly rate for Tennessee CPAs was developed from a 2008 survey performed by the American Institute of Certified Public Accountants (AICPA). The Tennessee version of this survey was used to develop hourly rates for member firms in Tennessee.

As shown in Exhibit 7, a weighted average hourly rate was developed based on a set of accountant positions and a percent of time that is typically applied to an accounting assignment. This survey includes rate information in effect during 2007. Thus, the data had to be escalated to September 30, 2009—the test year's midpoint.

Professional Engineers

The Company provided hourly rate information for outside engineering firms that could have been used by TAWC in 2009. As presented in Exhibit 8, an average rate was developed for each engineering position level. Then, using a typical percentage mix of project time by engineering position, a weighted average cost per hour was calculated.

**Tennessee American Water Company
Estimated Billing Rates For Tennessee Attorneys Based On
Michigan and Missouri Attorney Billing Rates**

Billing rates during 2009		Billing Rate Range (A)					Average	Cost of Living Adjust (B)	Adjusted Rate
Firm	Location	Associate		Partner					
		Low	High	Low	High				
Dickinson Wright	Detroit, Mi	\$ 195	\$ 275	\$ 355	\$ 575	\$ 350	115%	\$ 306	
Dykema	Detroit, Mi	\$ 185	\$ 425	\$ 295	\$ 615	\$ 380	115%	\$ 332	
Butzel Long	Detroit, Mi	\$ 175	\$ 325	\$ 250	\$ 600	\$ 338	115%	\$ 295	
Jaffe Raitt Heuer & Weiss	Southfield, Mi	\$ 175	\$ 250	\$ 225	\$ 550	\$ 300	115%	\$ 262	
Brooks Kushman	Southfield, Mi	\$ 180	\$ 275	\$ 300	\$ 425	\$ 295	115%	\$ 258	
Kemp, Klein, Umphrey, Edelman & Ma	Troy, Mi	\$ 145	\$ 260	\$ 200	\$ 350	\$ 239	115%	\$ 208	
Rader, Fishman & Grauer	Bloomfield Hills, Mi	\$ 130	\$ 250	\$ 275	\$ 550	\$ 301	115%	\$ 263	
Williams, Williams, Rattner & Plunkett	Birmingham, Mi	\$ 150	\$ 250	\$ 275	\$ 450	\$ 281	115%	\$ 246	
Abbott, Nicholson, Quilter, Esshaki,	Detroit, Mi	\$ 150	\$ 220	\$ 300	\$ 375	\$ 261	115%	\$ 228	
Parmenter O'Toole	Muskegon, Mi			\$ 125	\$ 275	\$ 200	103%	\$ 194	
Lipson, Neilson, Cole, Seltzer & Garin	Bloomfield Hills, Mi	\$ 185	\$ 235	\$ 225	\$ 300	\$ 236	115%	\$ 206	
Berman DeLeve Kuchan & Chapman	Kansas City, Mo			\$ 250	\$ 250	\$ 250	109%	\$ 230	
Boggs, Avellino, Lach & Boggs	St. Louis, Mo			\$ 160	\$ 160	\$ 160	101%	\$ 159	
Bryan Cave	Kansas City, Mo	\$ 200	\$ 200	\$ 385	\$ 435	\$ 305	109%	\$ 280	
Danna McKittrick	St. Louis, Mo			\$ 300	\$ 300	\$ 300	101%	\$ 298	
David Shroeder Law Offices	Springfield, Mo			\$ 260	\$ 260	\$ 260	99%	\$ 263	
Dobson, Goldberg, Berns & Rich	St. Louis, Mo			\$ 300	\$ 425	\$ 363	101%	\$ 360	
Dunn & Davison	Kansas City, Mo			\$ 225	\$ 225	\$ 225	109%	\$ 207	
Evans Partnership	St. Louis, Mo			\$ 175	\$ 175	\$ 175	101%	\$ 174	
Greensfelder Hemker & Gale	St. Louis, Mo			\$ 235	\$ 300	\$ 268	101%	\$ 266	
Husch Blackwell Sanders	Kansas City, Mo	\$ 204	\$ 345	\$ 356	\$ 472	\$ 344	109%	\$ 316	
Karfeld Law Firm	St. Louis, Mo			\$ 265	\$ 265	\$ 265	101%	\$ 264	
Krigel & Krigel	Kansas City, Mo	\$ 175	\$ 225	\$ 200	\$ 250	\$ 213	109%	\$ 195	
Law Office of Brad Goss	St. Charles, Mo			\$ 175	\$ 175	\$ 175	101%	\$ 174	
Law Offices of George A. Barton	Kansas City, Mo	\$ 300	\$ 400	\$ 400	\$ 600	\$ 425	109%	\$ 390	
McDowell, Rice, Smith & Buchann	Kansas City, Mo			\$ 425	\$ 425	\$ 425	109%	\$ 390	
Neil Weintraub, Attorney at Law	St. Louis, Mo			\$ 260	\$ 260	\$ 260	101%	\$ 259	
Pennington Shea	St. Louis, Mo			\$ 190	\$ 260	\$ 225	101%	\$ 224	
Pletz and Reed	Jefferson City, Mo	\$ 150	\$ 150	\$ 180	\$ 180	\$ 165	103%	\$ 160	
Polsinelli Shughart	Kansas City, Mo	\$ 210	\$ 350	\$ 380	\$ 600	\$ 385	109%	\$ 353	
Raymond I. Plaster	Springfield, Mo			\$ 275	\$ 275	\$ 275	99%	\$ 278	
Shook, Hardy & Bacon	Kansas City, Mo	\$ 265	\$ 265	\$ 425	\$ 425	\$ 345	109%	\$ 317	
Speer Law Firm	Kansas City, Mo	\$ 400	\$ 400	\$ 500	\$ 500	\$ 450	109%	\$ 413	
Spencer Fane Britt & Browne	Kansas City, Mo	\$ 150	\$ 325	\$ 310	\$ 470	\$ 314	109%	\$ 288	
Stanton & Redlingshafer	Kansas City, Mo			\$ 195	\$ 195	\$ 195	109%	\$ 179	
Stinson Morrison Hecker	Kansas City, Mo	\$ 195	\$ 195	\$ 350	\$ 445	\$ 296	109%	\$ 272	
The Sader Law Firm	Kansas City, Mo	\$ 225	\$ 235	\$ 265	\$ 265	\$ 248	109%	\$ 227	
Thompson Coburn	St. Louis, Mo	\$ 200	\$ 200	\$ 480	\$ 480	\$ 340	101%	\$ 338	
Overall Cost-of-Living Adjusted Average 2009 Billing Rate								\$ 265	

Note A: Source is Michigan Lawyers Weekly and Missouri Lawyers Weekly

Note B: Source is Council for Community and Economic Research. This percentage represents the cost of living difference between the Michigan and Missouri cities and Chattanooga, Tenn. A number over 100% indicates the Michigan or Missouri city's cost of living is higher than Chattanooga. A number less than 100% indicates Chattanooga's cost of living is higher.

**Tennessee American Water Company
Billing Rates of U.S. Management Consultants**

Survey billing rates in effect in 2008 (Note A)						
A. Calculation of Average Hourly Billing Rate by Consultant Position						
Average	Average Hourly Rates (Note A)					
	Entry-Level Consultant	Associate Consultant	Senior Consultant	Junior Partner	Senior Partner	
	\$ 147	\$ 196	\$ 268	\$ 295	\$ 384	
B. Calculation of Overall Average Hourly Billing Rate Based on a Typical Distribution of Time on an Engagement						
Average Hourly Billing Rate (from above)	Entry-Level Consultant	Associate Consultant	Senior Consultant	Junior Partner	Senior Partner	
	\$ 147	\$196	\$268	\$295	\$384	
	30%	30%	20%	10%	10%	Weighted Average
Percent of Consulting Assignment	\$ 44	\$ 59	\$ 54	\$ 29	\$ 38	\$ 224
<u>Escalation to Test Period Midpoint (September 30, 2009) (Note B)</u>						
					CPI at December 31, 2008	210.2
					CPI at September 30, 2009	216.0
					Inflation/Escalation	2.8%
Average Hourly Billing Rate For Management Consultants At September 30, 2009					\$ 231	

Note A: Source is "Operating Ratios For Management Consulting Firms, 2009 Edition," Association of Management Consulting Firms

Note B: Source is U.S. Bureau of Labor Statistics (<ftp://ftp.bls.gov/pub/special.requests/cpi/cpia1.txt>)

Tennessee American Water Company
Billing Rates Of Tennessee Certified Public Accountants

Survey billing rates were those in effect in 2007 (Note A)				
	Average Hourly Billing Rate (Note A)			
Type of Firm	Staff Accountant	Senior Accountant	Manager	Partner
Average Hourly Rate	\$ 78	\$ 98	\$ 122	\$ 138
B. Calculation of Overall Average Accountant Billing Rate Based Upon Typical Distribution of Time on an Engagement				
	Staff Accountant	Senior Accountant	Manager	Partner
Average Hourly Billing Rate (From Above)	\$ 78	\$ 98	\$ 122	\$ 138
Typical Percent of Time Spent on an Accounting Assignment	30%	30%	20%	20%
	\$ 23	\$ 29	\$ 24	\$ 28
				\$ 105
<u>Escalation to Test Period Midpoint (June 30, 2009) (Note B)</u>				
			CPI at December 31, 2007	210.0
			CPI at June 30, 2009	215.7
			Inflation/Escalation	2.7%
			Average Hourly Billing Rate For CPAs At June 30, 2009	\$ 108

Note A: Source is AICPA's 2008 National PCPS/TSCPA Management of an Accounting Practice Survey (Tennessee edition)

Note B: source is US Bureau of Labor Statistics (<ftp://ftp.bls.gov/pub/special.requests/cpi/cpi.t>)



Tennessee American Water Company Billing Rates Of Tennessee Engineers

Note: Billing rates in effect during 2009

A. Calculation of Average Hourly Rate by Engineer Position

Name of Firm	Average Hourly Billing Rates			
	CAD Drafter Engineer Tech	Engineer Design Engineer Project Engineer	Project Manager Project Associate Sr. Mgr. Engineer	Officer Principal Engineer
	Firm #1	\$68	\$89	\$136
Firm #2	\$80	\$98	\$149	\$179
Firm #3	\$68	\$96	\$168	\$208

B. Calculation of Overall Average Engineering Hourly Billing Rate

	CAD Drafter Engineer Tech	Engineer Design Engineer Project Engineer	Project Manager Project Associate Sr. Mgr. Engineer	Officer Principal Engineer	Weighted Average
	Average Hourly Billing Rate (From Above)	\$72	\$94	\$151	
Typical Percent of Time on an Engineering Assignment	30%	35%	25%	10%	
	\$22	\$33	\$38	\$19	\$111

Source: Information provided by American Water Works Service Company. Firm names have not been disclosed to preserve the confidentiality of their hourly rates.

V – Question 2 – Provision of Services at the Lower of Cost or Market

Service Company versus Outside Provider Cost Comparison

As shown in the table below, Service Company costs per hour are considerably lower than those of outside providers.

Service Provider	12 Months Ended March 31, 2010		
	Service Company	Outside Provider	Difference-- Service Co. Greater(Less) Than Outside
Attorney	\$ 129	\$ 265	\$ (136)
Management Consultant	\$ 128	\$ 231	\$ (103)
Certified Public Accountant	\$ 81	\$ 108	\$ (27)
Professional Engineer	\$ 61	\$ 111	\$ (50)

Based on these cost per hour differentials and the number of managerial and professional services hours billed to TAWC during the 12-months ended March 31, 2010, outside service providers would have cost \$1,838,669 more than the Service Company (see table below). Thus, on average, outside provider's hourly rates are 45% higher than those of the Service Company (\$1,838,669 / \$4,099,018).

Service Provider	12 Months Ended March 31, 2010		
	Hourly Rate Difference-- Service Co. Greater(Less) Than Outside	Service Company Hours Charged	Dollar Difference
Attorney	\$ (136)	899	\$ (121,947)
Management Consultant	\$ (103)	6,118	\$ (630,010)
Certified Public Accountant	\$ (27)	24,293	\$ (650,038)
Professional Engineer	\$ (50)	8,664	\$ (436,675)
Service Company Less Than Outside Providers			\$ (1,838,669)

It should be noted that the cost differential associated with using outside providers is even greater because Service Company personnel do not charge for more than 8 hours per day even when they work more. Outside providers generally charge clients for all hours worked. If, for instance, Service Company personnel worked 5% overtime (2 hours) per week on TAWC's behalf, that would have amounted to 2,000 additional hours of work during the 12 months ended March 31, 2010. Based on the hourly rate differentials above, this overtime would have added another \$92,000 to the cost of using outside provider.

If TAWC were to use outside service providers rather than the Service Company for managerial and professional services, it would incur other additional expenses besides those associated with higher hourly rates. Managing outside firms who would perform almost 40,000 hours of work (more than 26 full-time equivalents at 1,500 "billable" hours per FTE per year) would add a significant workload to the existing TAWC management team. Thus, it would be necessary for TAWC to add at least one position to supervise the outside firms and ensure they delivered quality and timely services. The individuals that would fill this position would need a good understanding of each profession being managed. They must also have management experience and the authority necessary to give them credibility with the outside firms. As calculated in the table below, this position would add almost \$165,000 per year to TAWC's personnel expenses.

V – Question 2 – Provision of Services at the Lower of Cost or Market

Cost of Adding a Professional Position To TAWC's Staff

	<u>Total</u>
New Positions' Salary	\$ 100,000
Benefits (at 49.4%)	\$ 49,400
Office Expenses (15.2%)	\$ 15,200
Total Cost of Full Time Position	<u>\$ 164,600</u>

Thus, the total effect on the ratepayers of TAWC of contracting all services now provided by Service Company would be an increase in their costs of \$2,003,269 (\$1,838,669 + \$164,600). Based on the results of this comparison, it is possible to conclude that the Service Company charged TAWC at the lower of cost or market for services provided during the 12 months ended March 31, 2010.

VI - Question 3 - Reasonableness of Customer Accounts Services Costs

Background

Customer Accounts Services covers the following utility functions:

- Customer Call Center – customer calls/contact, credit, order taking/disposition, bill collection efforts, outage calls
- Call Center IT – maintenance of phone banks, voice recognition units, call center software applications, telecommunications
- Customer billing – bill printing, stuffing, and mailing
- Remittance processing – processing customer payments received in the mail
- Bill payment centers – locations where customers can pay their bills in person

It is difficult to compare the cost of the Service Company's customer accounts services-related charges to TAWC with outside providers of the same services because survey data is proprietary and expensive to obtain. For this reason, TAWC's charges from the Service Company for customer accounts services are compared to those of neighboring electric utilities because the data necessary to make such comparison is available to the public.

Neighboring electric utility cost information comes from the FERC Form 1 that each utility must file. FERC's chart of accounts is defined in Chapter 18, Part 101 of the Code of Federal Regulations. FERC accounts that contain customer accounts services-related expenses are Account 903 Customer Accounts Expense – Records and Collection Expense and Account 905 Customer Accounts Expense – Miscellaneous Customer Accounts Expense. Exhibit 9 provides FERC's definition of the type of expenses that should be recorded in these accounts.

In addition to the charges in these FERC accounts, labor-related overheads charged to the following FERC accounts must be added to the labor components of Accounts 903 and 905:

- Account 926 Employee Pension and Benefits
- Account 408 Taxes Other Than Income (employer's portion of FICA)

Comparison Group

Electric utilities included in the comparison group are shown in the table below. These are companies whose FERC Form 1 show amounts for accounts 903 and 905.

Tennessee	• Kingsport Power	
North Carolina	• Duke Energy Carolinas	• Progress Energy Carolinas
Kentucky	• Duke Energy Kentucky	• Kentucky Utilities
	• Kentucky Power	• Louisville Gas & Electric
Mississippi	• Entergy Mississippi	• Mississippi Power
Virginia	• Appalachian Power	• Virginia Electric Power
Georgia	• Georgia Power	
Alabama	• Alabama Power	
Arkansas	• Entergy Arkansas	
Missouri	• Empire District Electric	• Union Electric
	• Kansas City Power & Light	

Tennessee American Water Company FERC Account Descriptions

903 – Customer Records and Collection Expenses

This account shall include the cost of labor, materials used and expenses incurred in work on customer applications, contracts, orders, credit investigations, billing and accounting, collections and complaints.

Labor

1. Receiving, preparing, recording and handling routine orders for service, disconnections, transfers or meter tests initiated by the customer, excluding the cost of carrying out such orders, which is chargeable to the account appropriate for the work called for by such orders.
2. Investigations of customers' credit and keeping of records pertaining thereto, including records of uncollectible accounts written off.
3. Receiving, refunding or applying customer deposits and maintaining customer deposit, line extension, and other miscellaneous records.
4. Checking consumption shown by meter readers' reports where incidental to preparation of billing data.
5. Preparing address plates and addressing bills and delinquent notices.
6. Preparing billing data.
7. Operating billing and bookkeeping machines.
8. Verifying billing records with contracts or rate schedules.
9. Preparing bills for delivery, and mailing or delivering bills.
10. Collecting revenues, including collection from prepayment meters unless incidental to meter reading operations.
11. Balancing collections, preparing collections for deposit, and preparing cash reports.
12. Posting collections and other credits or charges to customer accounts and extending unpaid balances.
13. Balancing customer accounts and controls.
14. Preparing, mailing, or delivering delinquent notices and preparing reports of delinquent accounts.
15. Final meter reading of delinquent accounts when done by collectors incidental to regular activities.
16. Disconnecting and reconnecting services because of nonpayment of bills.
17. Receiving, recording, and handling of inquiries, complaints, and requests for investigations from customers, including preparation of necessary orders, but excluding the cost of carrying out such orders, which is chargeable to the account appropriate for the work called for by such orders.
18. Statistical and tabulating work on customer accounts and revenues, but not including special analyses for sales department, rate department, or other general purposes, unless incidental to regular customer accounting routines.
19. Preparing and periodically rewriting meter reading sheets.
20. Determining consumption and computing estimated or average consumption when performed by employees other than those engaged in reading meters.

Materials and expenses

21. Address plates and supplies.
22. Cash overages and shortages.
23. Commissions or fees to others for collecting.
24. Payments to credit organizations for investigations and reports.
25. Postage.
26. Transportation expenses, including transportation of customer bills and meter books under centralized billing procedure.
27. Transportation, meals, and incidental expenses.
28. Bank charges, exchange, and other fees for cashing and depositing customers' checks.
29. Forms for recording orders for services, removals, etc.
30. Rent of mechanical equipment.

**Tennessee American Water Company
FERC Account Descriptions**

905 – Miscellaneous Customer Accounts Expenses

This account shall include the cost of labor, materials used and expenses incurred not provided for in other accounts.

Labor

1. General clerical and stenographic work.
2. Miscellaneous labor.

Materials and expenses

3. Communication service.
4. Miscellaneous office supplies and expenses and stationery and printing other than those specifically provided for in accounts 902 and 903.

VI - Question 3 - Reasonableness of Customer Accounts Services Costs

TAWC Cost per Customer

As calculated below, TAWC's 12 months ended March 31, 2010 customer account services expense per customer was \$29.08. The cost pool used to calculate this average includes charges for Service Company services (e.g., call center, billing, payment processing) and postage and forms expenses, which are incurred directly by TAWC. It was necessary to adjust the National Call Center charges because electric utilities experience an average of 2.50 calls per customer compared to American Water's 1.32 calls per customer. Thus, National Call Center expenses had to be increased, for comparison purposes, to reflect its costs at a 2.50 calls per customer level.

Tennessee American Water Company		Service Co	Adjustment Fewer Calls For Water Cos. (A)	Adjusted	
Cost Component		Charges			
<hr/>					
Service Company					
Call Centers	Call processing, order processing, credit, bill collection	\$ 1,120,113	\$ 450,805	\$ 1,570,918	
Service Company	Customer payment processing			\$ 130,927	Note B
Operating Company	Postage & forms			\$ 464,130	
			Cost Pool Total	<u>\$ 2,165,975</u>	
			Total Customers	<u>74,475</u>	
			12 Months Ended March 31, 2010 Cost Per Customer	<u>\$ 29.08</u>	

Note A: Adjustment for American Water's fewer calls per customer

This adjustment is necessary because water utilities experience fewer calls per customer than do electric utilities

Test year Call Handling charges	\$ 502,486	
Electric utility industry's avg calls/customer	2.50	
American Water's avg calls/customer	1.32	
Percent different	90%	90%
Total Adjustment	<u>\$ 450,805</u>	

Note B: Estimated customer payment processing expenses

Number of customers	74,475	
Number of payments/customer/year	12.0	
Total payments processed/year	<u>893,700</u>	
Bank charge per item	\$ 0.1465	
Total estimated annual expense	<u>\$ 130,927</u>	

Electric Utility Group Cost per Customer

Exhibit 10 shows the actual 2009 customer accounts expense per customer calculation for the electric utility comparison group. All of the underlying data was obtained from the utilities' FERC Form 1.

VI - Question 3 - Reasonableness of Customer Accounts Services Costs

Summary of Results

As shown in the table below, TAWC's cost per customer is below the average cost of the neighboring electric utility comparison group. It can therefore be concluded that TAWC's 12 months ended March 31, 2010 customer accounts-related expenses, including those of the Alton and Pensacola Call Centers, assigned by the Service Company to TAWC were comparable to those of other utilities.

Customer Account Services Expenses Per Customer	
Virginia Electric Power	\$ 17.53
Louisville Gas & Electric	\$ 20.40
Union Electric	\$ 21.87
Progress Energy Carolinas	\$ 22.96
Duke Energy Carolinas	\$ 26.96
Tennessee American Water	\$ 29.08
Kansas City Power & Light	\$ 29.64
Comparison Group Average	\$ 32.01
Appalachian Power	\$ 32.70
Kingsport Power	\$ 32.78
Duke Energy Kentucky	\$ 34.65
Kentucky Utilities	\$ 35.47
Kentucky Power	\$ 36.03
Empire District Electric	\$ 37.79
Georgia Power	\$ 42.84
Entergy Mississippi	\$ 45.84
Entergy Arkansas	\$ 47.60
Alabama Power	\$ 49.05
Mississippi Power	\$ 67.39

**Tennessee American Water Company
Comparison Group 2009 Actual Customer Accounts Expense Per Customer**

	Tennessee		Missouri		Alabama	Arkansas
	Kingsport Power	Empire District Electric	Kansas City Power & Light	Union Electric	Alabama Power	Entergy Arkansas
Customer Account Services Cost Pool						
FERC Account Balances:						
Acct 903 - Customer Records & Collection (page 322, line 161)	\$ 1,458,469	\$ 4,985,478	\$ 12,163,465	\$ 22,713,638	\$ 60,153,942	\$ 25,616,113
Acct 905 - Misc Customer Accounts (page 322, line 163)	\$ 1,697	\$ 184,860	\$ 2,371	\$ 200,456	\$ -	\$ 103,284
Subtotal	\$ 1,460,166	\$ 5,170,338	\$ 12,165,836	\$ 22,914,094	\$ 60,153,942	\$ 25,719,397
Add: Employee Benefits & Employer FICA (not included in above amounts)						
Account 926 - Employee Pension & Benefits	\$ 63,259	\$ 930,079	\$ 2,636,671	\$ 2,267,993	\$ 7,147,923	\$ 6,817,930
Account 408 - Taxes Other Than Income (Employer's Portion of FICA)	\$ 18,076	\$ 250,143	\$ 558,111	\$ 788,888	\$ 3,121,268	\$ 333,631
Total Cost Pool	\$ 1,541,501	\$ 6,350,560	\$ 15,360,618	\$ 25,970,975	\$ 70,423,133	\$ 32,870,958
Total Customers (page 304, line 43)	47,027	168,032	518,196	1,187,613	1,435,612	690,500
Customer Account Services Expense per Customer	\$ 32.78	\$ 37.79	\$ 29.64	\$ 21.87	\$ 49.05	\$ 47.60
Note A: Calculation of Pension & Benefits Pertaining to Customer Acct Mgmt						
Account 926 - Employee Pension & Benefits (page 323, line 187)	\$ 526,873	\$ 11,454,549	\$ 60,579,650	\$ 80,158,501	\$ 49,906,316	\$ 64,841,181
Total O&M Payroll (page 355, line 65)	\$ 1,967,933	\$ 40,270,300	\$ 167,621,486	\$ 364,470,026	\$ 284,869,068	\$ 41,476,558
Benefits as Percent of Payroll	26.8%	28.4%	36.1%	22.0%	17.5%	156.3%
Payroll Applicable to Customer Account Services						
Total Payroll Charged to Customer Accounts Function						
Electric (page 354, line 7)	\$ 261,311	\$ 4,346,335	\$ 9,742,970	\$ 14,738,859	\$ 49,380,337	\$ 5,473,554
Gas (page 354, line 37)	\$ -	\$ -	\$ -	\$ 3,534,098	\$ -	\$ -
Total Payroll Charged to Customer Accounts	\$ 261,311	\$ 4,346,335	\$ 9,742,970	\$ 18,272,957	\$ 49,380,337	\$ 5,473,554
Percent Applicable to Customer Accounts Services (903 and 905):						
Acct 903 - Customer Records & Collection (page 322, line 161)	\$ 1,458,469	\$ 4,985,478	\$ 12,163,465	\$ 22,713,638	\$ 60,153,942	\$ 25,616,113
Acct 905 - Misc Customer Accounts (page 322, line 163)	\$ 1,697	\$ 184,860	\$ 2,371	\$ 200,456	\$ -	\$ 103,284
Subtotal - Total Charges Applicable to Customer Accounts Services	\$ 1,460,166	\$ 5,170,338	\$ 12,165,836	\$ 22,914,094	\$ 60,153,942	\$ 25,719,397
Acct 902 - Meter Reading Expenses (page 322, line 160)	\$ 154,677	\$ 1,702,173	\$ 4,081,210	\$ 17,688,852	\$ 12,648,925	\$ 6,560,032
Total Charges Applicable to Customer Accounts Svcs & Meter Reading	\$ 1,614,843	\$ 6,872,511	\$ 16,247,046	\$ 40,602,946	\$ 72,802,867	\$ 32,279,429
Percent Applicable to Customer Accounts Services (903 and 905)	90.4%	75.2%	74.9%	56.4%	82.6%	79.7%
Customer Account Services Portion of Total Payroll	\$ 236,281	\$ 3,269,841	\$ 7,295,565	\$ 10,312,263	\$ 40,800,892	\$ 4,361,183
Pension & Benefits Pertaining to Customer Accounts Services	\$ 63,259	\$ 930,079	\$ 2,636,671	\$ 2,267,993	\$ 7,147,923	\$ 6,817,930
Note B: Calculation of Employer's FICA Pertaining to Customer Accounts Services						
Customer Account Services Portion of Total Payroll	\$ 236,281	\$ 3,269,841	\$ 7,295,565	\$ 10,312,263	\$ 40,800,892	\$ 4,361,183
Employer's Portion of FICA (6.20%) and Medicare (1.45%)	7.65%	7.65%	7.65%	7.65%	7.65%	7.65%
Estimated Employer's Portion of FICA	\$ 18,076	\$ 250,143	\$ 558,111	\$ 788,888	\$ 3,121,268	\$ 333,631

Tennessee American Water Company
Comparison Group 2009 Actual Customer Accounts Expense Per Customer

	Virginia		Kentucky			
	Appalachian Power	Virginia Electric Power	Duke Energy Kentucky	Kentucky Power	Kentucky Utilities	Louisville Gas & Electric
Customer Account Services Cost Pool						
FERC Account Balances:						
Acct 903 - Customer Records & Collection (page 322, line 161)	\$ 28,380,733	\$ 34,105,089	\$ 3,864,114	\$ 5,769,938	\$ 14,908,295	\$ 5,312,623
Acct 905 - Misc Customer Accounts (page 322, line 163)	\$ 40,577	\$ -	\$ -	\$ 11,053	\$ 381,731	\$ 376,263
Subtotal	\$ 28,421,310	\$ 34,105,089	\$ 3,864,114	\$ 5,780,991	\$ 15,290,026	\$ 5,688,886
Add: Employee Benefits & Employer FICA (not included in above amounts)						
Account 926 - Employee Pension & Benefits Note A	\$ 2,437,214	\$ 6,239,031	\$ 574,673	\$ 425,941	\$ 3,361,029	\$ 1,963,008
Account 408 - Taxes Other Than Income (Employer's Portion of FICA) Note B	\$ 529,463	\$ 1,787,731	\$ 232,521	\$ 97,581	\$ 526,276	\$ 322,726
Total Cost Pool	\$ 31,387,987	\$ 42,131,851	\$ 4,671,308	\$ 6,304,513	\$ 19,177,331	\$ 7,974,620
Total Customers (page 304, line 43)	959,814	2,403,558	134,819	174,994	540,618	390,825
Customer Account Services Expense per Customer	\$ 32.70	\$ 17.53	\$ 34.65	\$ 36.03	\$ 35.47	\$ 20.40
Note A: Calculation of Pension & Benefits Pertaining to Customer Acct Mgmt						
Account 926 - Employee Pension & Benefits (page 323, line 187)	\$ 38,645,990	\$167,027,121	\$ 6,660,396	\$ 7,869,045	\$ 38,828,205	\$ 37,681,044
Total O&M Payroll (page 355, line 65)	\$ 109,744,984	\$625,619,817	\$ 35,227,412	\$ 23,565,539	\$ 79,474,397	\$ 80,979,200
Benefits as Percent of Payroll	35.2%	26.7%	18.9%	33.4%	48.9%	46.5%
Payroll Applicable to Customer Account Services						
Total Payroll Charged to Customer Accounts Function						
Electric (page 354, line 7)	\$ 7,978,348	\$ 30,292,243	\$ 2,598,192	\$ 1,433,061	\$ 8,670,255	\$ 3,198,589
Gas (page 354, line 37)	\$ -	\$ -	\$ 1,383,512	\$ -	\$ -	\$ 2,615,816
Total Payroll Charged to Customer Accounts	\$ 7,978,348	\$ 30,292,243	\$ 3,981,704	\$ 1,433,061	\$ 8,670,255	\$ 5,814,405
Percent Applicable to Customer Accounts Services (903 and 905):						
Acct 903 - Customer Records & Collection (page 322, line 161)	\$ 28,380,733	\$ 34,105,089	\$ 3,864,114	\$ 5,769,938	\$ 14,908,295	\$ 5,312,623
Acct 905 - Misc Customer Accounts (page 322, line 163)	\$ 40,577	\$ -	\$ -	\$ 11,053	\$ 381,731	\$ 376,263
Subtotal - Total Charges Applicable to Customer Accounts Services	\$ 28,421,310	\$ 34,105,089	\$ 3,864,114	\$ 5,780,991	\$ 15,290,026	\$ 5,688,886
Acct 902 - Meter Reading Expenses (page 322, line 160)	\$ 4,341,650	\$ 10,103,836	\$ 1,197,835	\$ 713,762	\$ 3,980,247	\$ 2,151,907
Total Charges Applicable to Customer Accounts Svcs & Meter Reading	\$ 32,762,960	\$ 44,208,925	\$ 5,061,949	\$ 6,494,753	\$ 19,270,273	\$ 7,840,793
Percent Applicable to Customer Accounts Services (903 and 905)	86.7%	77.1%	76.3%	89.0%	79.3%	72.6%
Customer Account Services Portion of Total Payroll	\$ 6,921,081	\$ 23,369,029	\$ 3,039,493	\$ 1,275,570	\$ 6,879,426	\$ 4,218,641
Pension & Benefits Pertaining to Customer Accounts Services	\$ 2,437,214	\$ 6,239,031	\$ 574,673	\$ 425,941	\$ 3,361,029	\$ 1,963,008
Note B: Calculation of Employer's FICA Pertaining to Customer Accounts Services						
Customer Account Services Portion of Total Payroll	\$ 6,921,081	\$ 23,369,029	\$ 3,039,493	\$ 1,275,570	\$ 6,879,426	\$ 4,218,641
Employer's Portion of FICA (6.20%) and Medicare (1.45%)	7.65%	7.65%	7.65%	7.65%	7.65%	7.65%
Estimated Employer's Portion of FICA	\$ 529,463	\$ 1,787,731	\$ 232,521	\$ 97,581	\$ 526,276	\$ 322,726

**Tennessee American Water Company
Comparison Group 2009 Actual Customer Accounts Expense Per Customer**

	Georgia	Mississippi		North Carolina		
	Georgia Power	Energy Mississippi	Mississippi Power	Duke Energy Carolinas	Prog Energy Carolinas	
Customer Account Services Cost Pool						
FERC Account Balances:						
Acct 903 - Customer Records & Collection (page 322, line 161)	\$ 84,911,244	\$ 17,647,249	\$ 9,277,161	\$ 58,491,837	\$ 25,264,008	
Acct 905 - Misc Customer Accounts (page 322, line 163)	\$ 88,908	\$ 71,579	\$ 1,162,224	\$ 63,286	\$ 2,913,845	
Subtotal	\$ 85,000,152	\$ 17,718,828	\$ 10,439,385	\$ 58,555,123	\$ 28,177,853	
Add: Employee Benefits & Employer FICA (not included in above amounts)						
Account 926 - Employee Pension & Benefits	\$ 12,582,725	\$ 2,024,275	\$ 1,664,015	\$ 3,743,004	\$ 4,374,673	
Account 408 - Taxes Other Than Income (Employer's Portion of FICA)	\$ 3,286,888	\$ 202,332	\$ 426,091	\$ 1,771,092	\$ 1,007,671	
Total Cost Pool	\$ 100,869,765	\$ 19,945,435	\$ 12,529,491	\$ 64,069,219	\$ 33,560,198	\$ 495,139,462
Total Customers (page 304, line 43)	2,354,531	435,133	185,924	2,376,853	1,461,874	15,465,923
Customer Account Services Expense per Customer	\$ 42.84	\$ 45.84	\$ 67.39	\$ 26.96	\$ 22.96	\$ 32.01
Note A: Calculation of Pension & Benefits Pertaining to Customer Acct Mgmt						
Account 926 - Employee Pension & Benefits (page 323, line 187)	\$ 120,553,041	\$ 25,179,302	\$ 18,913,231	\$ 123,891,641	\$ 135,011,713	
Total O&M Payroll (page 355, line 65)	\$ 411,648,938	\$ 32,898,611	\$ 63,306,677	\$ 766,304,539	\$ 406,521,358	
Benefits as Percent of Payroll	29.3%	76.5%	29.9%	16.2%	33.2%	
Payroll Applicable to Customer Account Services						
Total Payroll Charged to Customer Accounts Function						
Electric (page 354, line 7)	\$ 59,384,131	\$ 3,205,909	\$ 6,716,310	\$ 25,491,667	\$ 15,865,023	
Gas (page 354, line 37)	\$ -	\$ -	\$ -	\$ -	\$ -	
Total Payroll Charged to Customer Accounts	\$ 59,384,131	\$ 3,205,909	\$ 6,716,310	\$ 25,491,667	\$ 15,865,023	
Percent Applicable to Customer Accounts Services (903 and 905):						
Acct 903 - Customer Records & Collection (page 322, line 161)	\$ 84,911,244	\$ 17,647,249	\$ 9,277,161	\$ 58,491,837	\$ 25,264,008	
Acct 905 - Misc Customer Accounts (page 322, line 163)	\$ 88,908	\$ 71,579	\$ 1,162,224	\$ 63,286	\$ 2,913,845	
Subtotal - Total Charges Applicable to Customer Accounts Services	\$ 85,000,152	\$ 17,718,828	\$ 10,439,385	\$ 58,555,123	\$ 28,177,853	
Acct 902 - Meter Reading Expenses (page 322, line 160)	\$ 32,480,565	\$ 3,758,629	\$ 2,148,847	\$ 5,918,702	\$ 5,760,524	
Total Charges Applicable to Customer Accounts Svcs & Meter Reading	\$ 117,480,717	\$ 21,477,457	\$ 12,588,232	\$ 64,473,825	\$ 33,938,377	
Percent Applicable to Customer Accounts Services (903 and 905)	72.4%	82.5%	82.9%	90.8%	83.0%	
Customer Account Services Portion of Total Payroll	\$ 42,965,861	\$ 2,644,864	\$ 5,569,817	\$ 23,151,530	\$ 13,172,176	
Pension & Benefits Pertaining to Customer Accounts Services	\$ 12,582,725	\$ 2,024,275	\$ 1,664,015	\$ 3,743,004	\$ 4,374,673	
Note B: Calculation of Employer's FICA Pertaining to Customer Accounts Services						
Customer Account Services Portion of Total Payroll	\$ 42,965,861	\$ 2,644,864	\$ 5,569,817	\$ 23,151,530	\$ 13,172,176	
Employer's Portion of FICA (6.20%) and Medicare (1.45%)	7.65%	7.65%	7.65%	7.65%	7.65%	
Estimated Employer's Portion of FICA	\$ 3,286,888	\$ 202,332	\$ 426,091	\$ 1,771,092	\$ 1,007,671	

Analysis of Services

The final aspect of this study was an assessment of whether the services that are provided to TAWC by the Service Company would be necessary if TAWC were a stand-alone water utility. The first step in this evaluation was to determine specifically what the Service Company does for TAWC. Based on discussions with Service Company personnel, the matrix in Exhibit 11 was created showing which entity—TAWC or a Service Company location—is responsible for each of the functions TAWC requires to ultimately provide service to its customers. This matrix was reviewed to determine: (1) if there was redundancy or overlap in the services being provided by the Service Company and (2) if Service Company services are typical of those needed by a stand-alone water utility.

Upon review of Exhibit 11, the following conclusions can be drawn:

- The services that the Service Company provides are necessary and would be required even if TAWC were a stand-alone water utility.
- There is no redundancy or overlap in the services provided by the Service Company to TAWC. For all of the services listed in Exhibit 11, there was only one entity that was primarily responsible for the service.

Tennessee American Water Company Designation Of Responsibility For Water Utility Functions

P - Primarily Responsible S - Provides Support	Performed By:						
	TAWC	American Water Service Company					
		Customer Call Center	Division Office	Shared Services	Corporate Office	IT Service Centers	Belleville Lab
Water Company Function	TAWC	Customer Call Center	Division Office	Shared Services	Corporate Office	IT Service Centers	Belleville Lab
Engineering and Construction Management							
CPS Preparation	S				P		
Five-Year System Planning	S				P		
Engineering Standards & Policies Development	S				P		
Project Design							
Major Projects (e.g., new treatment plant)	S				P		
Special Projects	P				S		
Minor Projects (e.g., pipelines)	P						
Construction Project Management							
Major Projects	S				P		
Special Projects	S				P		
Minor Projects	P						
Hydraulics Review	P				S		
Developers Extensions	P						
Tank Painting	P				S		
Water Quality and Purification							
Water Quality Standards Development	S				S		P
Research Studies	S				S		P
Water Quality Program Implementation	P				S		
Water Treatment Operations & Maintenance	P		S		S		
Compliance Sampling and Chemical Testing	S				S		P
Sample Collection and Other Testing	S				S		P
Transmission and Distribution							
Preventive Maintenance Program Development	P						
System Maintenance	P						
Leak Detection	P						
Customer Service							
Community Relations	P		S		S		
Customer Contact	S	P	S				
Call Processing	S	P	S				
Service Order Creation	S	P	S				
Service Order Processing	P	S	S				
Customer Credit	S	P	S				
Meter Reading	P					S	
Customer Bill Preparation		S				P	
Bill Collection	S	P				S	
Customer Payment Processing	S			P			
Meter Standards Development	S		S		P		
Meter Testing, Maintenance & Replacement	P		S				

Tennessee American Water Company Designation Of Responsibility For Water Utility Functions

P - Primarily Responsible S - Provides Support	Performed By:					
	TAWC	American Water Service Company				
		Customer Call Center	Division Office	Shared Services	Corporate Office	IT Service Centers
Water Company Function	TAWC					
Financial Management						
Financial Planning	S		P		S	
Financings--Equity					P	
Financings--Long Term Debt & Preferred (Note A)	S		P			
Short Term Lines of Credit Arrangements(Note A)	S		P			
Investor Relations			S		P	
Insurance Program Administration	S				P	
Loss Control/Safety Program Administration	S		P		S	
Pension Fund Asset Management					P	
Cash Management/Disbursements	S			P		
Internal Auditing	S		S		P	
Budgeting and Variance Reporting						
Corporate Guidelines & Instructions					P	
Regional Guidelines & Instructions			P			
Budget Preparation						
Revenue and O&M	P		S			
O&M	P		S			
Depreciation and Interest Expense	S		S	P		
Budget Preparation--Service Company Charges		S	P	S	S	S
Capital Budget Preparation—Projects	P				S	
Capital Budget Preparation—Non-Project Work	P					
Prepare Monthly Budget Variance Report (“Budget/Plan Analysis”)	p		S	S		
Prepare Capital Project Budget Status Report	P			S		
Year-End Projections	P			S		
Accounting and Taxes						
Accounts Payable Accounting	S			P		
Payroll Accounting	S			P		
Work Order Accounting	S			P		
Fixed Asset Accounting	S			P		
Journal Entry Preparations--Billing Corrections	S			P		
Journal Entry Preparation--All Others	S			P		
Financial Statement Preparation	S			P		
State Commission Reporting	S		S	P		
Income Taxes--State				P		
Income Taxes--Federal				P		
Property Taxes	S			P		
Gross Receipts (Tow n) Taxes	S			P		

Note A: Financings and lines of credit are the responsibility of American Capital Corporation

Tennessee American Water Company Designation Of Responsibility For Water Utility Functions

P - Primarily Responsible S - Provides Support	Performed By:					
	TAWC	American Water Service Company				
		Customer Call Center	Division Office	Shared Services	Corporate Office	IT Service Centers
Rates						
Rate Studies & Tariff Change Administration	S		P			
Rate Case Planning and Preparation	S		P			
Rate Case Administration	S		P			
Commission Inquiry Response	S		P			
Legal			P		S	
Purchasing and Materials Management – National (pipe, chemicals, meters, etc.)						
Specification Development	S		S	S	P	
Bid Solicitation	S			P		
Contract Administration	S			P		
Purchasing and Materials Management – State (state supplier service agreements)						
Specification Development	P				S	
Bid Solicitation	P			S		
Contract Administration	P			S		
Ordering	P					
Inventory Management	P			S		
Human Resources Management						
Benefit Program Development					P	
Benefits Program Administration	S				P	
Management Compensation Administration					P	
Wage & Salary Program Design					P	
Wage & Salary Administration	P			S		
Labor Relations - Wages	P			S		
Labor Relations - Benefits					P	
Labor Relations - Work Rules	P			S		
Training Program Development	S			S		P
Training--Course Delivery	P			S		
Affirmative Action/EEO--Plan Development	P					
Affirmative Action/EEO--Implementation	P					
Information Systems Services						
Service Company Data Centers						
System Operations & Maintenance						P
Software Maintenance						P
Network Administration	S			P		S
PC Acquisition & Support	S			P		S
Help Desk						P
				S		

VI - Question 4 – Need for Service Company Services

Governance Practices Associated With Service Company Charges

There are several ways by which TAWC exercises control over Service Company services and charges. The most important of these are described below.

- **Divisional Sr. Vice President Oversight** – The Eastern Division Senior Vice President is on the Executive Management Team (EMT) of American Water. The Divisional Sr. Vice President is responsible for the overall performance of each operating company in the Division, including Long Island Water Corp., Indiana American Water Company, Ohio American Water Company, Virginia American Water Company, West Virginia American Water Company, Kentucky American Water Company, Tennessee American Water Company, Michigan American Water Company, and Maryland American Water Company. As part of the EMT, each Divisional Senior Vice President has equal say with other EMT members in major business decisions of American Water and has the ability to monitor Service Company performance quality and spending.
- **Divisional Vice President & Treasurer** – The Divisional Vice President and Treasurer of the Eastern Division is responsible for the financial reporting, performance and internal controls of each of the operating companies in the division. The Vice President and Treasurer monitors the performance and expense levels of the Service Company and validates the cost of services received. Also, the Vice President and Treasurer reviews the monthly charges and investigates whenever the amount, quality and/or services are appropriate.
- **Operating Company Board Oversight** – TAWC board of directors includes members of American Water’s EMT, members of the Eastern Division’s management team, TAWC’s Management team and business and community leaders from outside the Company. This diverse board ensures that TAWC’s needs are a factor in the delivery of Service Company services. The TAWC Board meets at a minimum of four times each year and at every meeting financial and operational reports and issues are discussed at length.
- **Service Company Board Oversight** – The Service Company Board of Directors is comprised of 16 members, some of whom are the presidents of state operating companies. They typically meet four times a year to provide governance on the activities and bylaws of Service Company. Their primary responsibilities include:
 - Approve the Business Plan and Operating Budget
 - Review Financial Performance of the Service Center
 - Review performance metrics of certain functional groups
 - Approve policy, procedures and practices of AW as it relates to Service Company
- **Service Company Budget Review/Approval** – Several operating company presidents sit on the Service Company board and that board must formally approve the budget for Service Company charges for the next year. These budgeted charges are consolidated with the operating company’s own spending into an overall budget which must be approved by the operating company’s board of directors (e.g., TAWC).
- **Major Project Review And Approval** – Major projects undertaken by the Service Company must first be reviewed by American Water’s Executive Management Team, which includes the Divisional Senior Vice President. The Divisional Senior Vice President, with input from the divisional and state management teams (including TAWC) has the ability to impact all new initiatives and projects before they are authorized. Major non-capital projects and initiatives for the Service Company are approved through the Business Plan. All significant business initiatives (capital or non-capital) are required to be submitted to the “BATT” (Business and Technology Team) committee for final approval. The “BATT” team is comprised of C-level executive members (CEO, CFO, etc.).

VI - Question 4 – Need for Service Company Services

- **Accounting and Financial Reporting** – Similar to the states, the Service Company follows the same accounting and financial reporting processes. During the month accounting transactions are recorded. At month end, the SSC and Service Company Finance teams review all transactions. Variance analyses are performed based on month to month actual as well as actual to budget to ensure accuracy. Once completed, the service company bill is run and the actuals are “pushed down” and allocated to the states based on predetermined formulas. A conference call is schedule before the operating companies close their books each month to discuss Service Company performance. This is based at a functional level with explanation reported for those expense variances that meet or exceed certain thresholds. At this time, the operating companies may question expenses and spending for better understanding of results. Finance personnel review the monthly Service Company bill for accuracy and reasonableness on a monthly basis. Any mistakes or overcharges are credited on a subsequent billing.
- **Operating Company Budget Variance Reporting** – The “Budget/Plan Analysis,” produced monthly by each operating company, has line items for Management Fees and Shared Service Expense (i.e., IT, Call Center, etc.). In this way, Service Company budget versus actual charges as charged to the operating company can be monitored and reviewed for the month and year-to-date as compared to prior year, plan and reforecast.
- **Capital Investment Management (CIM)** – CIM covers capital and asset planning and is employed throughout American Water, including the Service Company. CIM provides a full range of governance practices, including a formal protocol for assessing system needs, prioritizing expenditures, managing the capital program, approving project spending, delivering projects and measuring outputs. CIM ensures that:
 - Capital expenditure plans are aligned with the strategic intent of the business,
 - The impact of capital expenditure and income plans are fully reflected in operating expense plans,
 - The impacts of these plans are understood and affordable, and
 - Effective controls are in place over budgets (through business plans) and individual capital projects (through appropriate authorization thresholds, management and reporting processes).

The CIM process was designed to optimize the effectiveness of asset investment. The process is managed at three levels (state, divisional, and national (corporate) for all American Water companies, including all Tennessee American Operating Units.

1 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 A. Patrick L. Baryenbruch, 2832 Claremont Road, Raleigh, North Carolina
3 27608.

4

5 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL AND PROFESSIONAL**
6 **BACKGROUND.**

7 A. I received a Bachelors degree in accounting from the University of
8 Wisconsin-Oshkosh in 1974 and a Masters in Business Administration
9 degree from the University of Michigan in 1979.

10 I am a financial consultant and a certified public accountant licensed by the
11 state of Wisconsin. I am a member of the American Institute of Certified
12 Public Accountants and the North Carolina Association of Certified Public
13 Accountants.

14 I began my career as a staff accountant with Arthur Andersen & Company
15 where I performed financial audits of utilities, banks and finance
16 companies. After three years I left to pursue an M.B.A. degree. Upon
17 graduation from business school, I worked with the consulting firms of
18 Theodore Barry & Associates and Scott, Madden & Associates.

19 During my consulting career, I have performed consulting assignments for
20 approximately 50 utilities and 10 public service commissions. I have
21 participated as project manager, lead or staff consultant for 24

1 commission-ordered management and prudence audits of public utilities.
2 Of these, I have been responsible for evaluating the area of affiliate
3 charges and allocation of corporate expenses in the Commission-ordered
4 audits of Connecticut Light and Power, Connecticut Natural Gas, General
5 Water Corporation (Pennsylvania Operations), Philadelphia Suburban
6 Water Company (now Aqua America), and Pacific Gas & Electric
7 Company.

8 My firm has performed the commission-ordered audit of Southern
9 California Edison's 2002, 2003, 2004 and 2005 transactions with its non-
10 regulated affiliate companies.

11

12 **Q. WHAT ARE YOUR DUTIES AND RESPONSIBILITIES IN YOUR**
13 **CURRENT POSITION?**

14 A. I am the President of my own consulting practice, Baryenbruch &
15 Company, LLC, which was established in 1985. In that capacity, I provide
16 consulting services to utilities and their regulators.

17

18 **Q. HAVE YOU PREVIOUSLY ACTED AS AN EXPERT WITNESS IN**
19 **UTILITY RATE CASES?**

20 A. Yes, I have acted as an expert witness on the subject of utility-affiliate
21 transactions in over 40 utility rate cases for 27 utility clients.

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Q. PLEASE DESCRIBE THE REASON FOR YOUR TESTIMONY IN THIS CASE.

A. I am presenting the results of my study which evaluated the services provided by American Water Works Service Company (“Service Company”) during the 12 months ending March 31, 2010 to Tennessee-American Water Company (“TAWC”). This study was undertaken in conjunction with TAWC’s rate case and is true to the best of my knowledge and belief. The study is attached as Exhibit PLB-1.

Q. WHAT WERE THE OBJECTIVES OF YOUR STUDY?

A. This study was undertaken to answer four questions concerning the services provided by the Service Company to TAWC during the 12 months ended March 31, 2010. The four questions are as follows:

1. Were the Service Company’s charges to TAWC during the 12 months ended March 31, 2010 reasonable?
2. Was TAWC charged the lower of cost or market for managerial and professional services provided by the Service Company during the 12 months ended March 31, 2010?
3. Were the 12 months ended March 31, 2010 costs of the Service Company’s customer accounts services, including those of the National Call

1 Centers, comparable to those of other utilities?

2 4. Are the services TAWC receives from Service Company necessary?

3

4 **Q. WHAT CONCLUSIONS WERE YOU ABLE TO DRAW CONCERNING**
5 **QUESTION NUMBER 1, WHETHER THE SERVICE COMPANY CHARGES TO**
6 **TAWC WERE REASONABLE?**

7 A. I was able to draw the following conclusions about the reasonableness of those
8 charges:

9 The Service Company's 12 months ended March 31, 2010 cost per TAWC
10 customer was reasonable compared to cost per customer for electric and
11 combination electric/gas service companies. During the 12 months ended
12 March 31, 2010, TAWC was charged \$59 per customer for administrative
13 and general (A&G)-related services provided by the Service Company.
14 This compares to an average of \$95 per customer for service companies
15 reporting to the Federal Energy Regulatory Commission (FERC). Only 4
16 of the 24 comparison group utility service companies filed a FERC Form
17 60 for 2009 had a lower per customer A&G cost than TAWC's charges
18 from the Service Company.

19

20 **Q. WHAT CONCLUSIONS WERE YOU ABLE TO DRAW CONCERNING**
21 **QUESTION NUMBER 2, WHETHER TAWC WAS CHARGED THE LOWER OF**
22 **COST OR MARKET SERVICES PROVIDED BY THE SERVICE COMPANY?**

23 A. I was able to draw the following conclusions:

1 (1) TAWC was charged the lower of cost or market for
2 managerial and professional services during the 12 months ended March
3 31, 2010.

4 (2) On average, the hourly rates for outside service providers
5 are 45% higher than the Service Company's hourly rates.

6 (3) The managerial and professional services provided by the
7 Service Company are vital and could not be procured externally by TAWC
8 without careful supervision on the part of TAWC. If these services were
9 contracted entirely to outside providers, TAWC would have to add at least
10 one position to manage activities of outside firms. This position would be
11 necessary to ensure the quality and timeliness of services provided.

12 (4) If all the managerial and professional services now provided
13 by the Service Company had been outsourced during the 12 months
14 ended March 31, 2010, TAWC and its ratepayers would have incurred
15 \$2,000,000 in additional expenses. This amount includes the higher cost
16 of outside providers and the cost of one TAWC position needed to direct
17 the outsourced work.

18 (5) This study's hourly rate comparison actually understates the
19 cost advantages that accrue to TAWC from its use of the Service
20 Company. Outside service providers generally bill for every hour worked.
21 Service Company exempt personnel, on the other hand, charge a
22 maximum of 8 hours per day even when they work more hours. If the
23 overtime hours of Service Company personnel were factored into the

1 hourly rate calculation, the Service Company would have had an even
2 greater annual dollar advantage than the \$2,000,000 cited above. For
3 instance, if Service Company overtime is conservatively estimated at 5%
4 (2 hours per week) then that work would have added more than \$92,000
5 in charges from outside providers.

6 (6) It would be difficult for TAWC to find local service providers
7 with the same specialized water industry expertise as that possessed by
8 the Service Company staff. Service Company personnel spend
9 substantially all their time serving operating water companies. This
10 specialization brings with it a unique knowledge of water utility operations
11 and regulation that is most likely unavailable from local service providers.

12 (7) Service Company fees do not include any profit markup.
13 Only its actual cost of service is being recovered from TAWC ratepayers.

14
15 **Q. WHAT IS YOUR CONCLUSION REGARDING THE REASONABLENESS OF**
16 **THE COSTS OF THE NATIONAL CALL CENTER THAT PROVIDES SERVICE**
17 **TO TAWC?**

18 **A.** I was able to determine that the cost of the Service Company's customer
19 accounts services, including those provided by the National Call Center, is below
20 the range of the average of the neighboring electric utility comparison group. As
21 will be explained further herein, this group of companies provides a reasonable
22 proxy group for comparison to a regulated utility of the size and scope of the
23 Service Company and TAWC. During the 12-months ended March 31, 2010, the

1 customer accounts cost for TAWC customers was \$29.08 compared to the 2009
2 average of \$32.01 for neighboring electric utilities. The highest comparison
3 group per customer cost was \$67.39 and the lowest \$17.53.

4

5 **Q. WHAT CONCLUSIONS WERE YOU ABLE TO DRAW CONCERNING**
6 **THE NECESSITY OF THE SERVICES TAWC RECEIVES FROM THE**
7 **SERVICE COMPANY?**

8 A. I was able to draw the following conclusions:

9 (1) The services that the Service Company provides are
10 necessary and would be required even if TAWC were a stand-alone
11 water utility.

12 (2) There is no redundancy or overlap in the services
13 provided by the Service Company to TAWC.

14

15 **Q. DID THE TENNESSEE REGULATORY AUTHORITY'S CONSULTANT**
16 **WHO RECENTLY COMPLETED THE AFFILIATE AUDIT OF TAWC**
17 **DRAW ANY CONCLUSION AS TO THE VALUE OF YOUR STUDIES?**

18 A. Yes. The firm of Schumaker & Company found as it relates to the Service
19 Company's charges to operating companies such as TAWC, my study's
20 methodology "is a reasonable approach to verify that ratepayers are not
21 being harmed by charging these services at cost rather than market."

1

2 **Q. DOES THIS COMPLETE YOUR TESTIMONY?**

3 A. Yes.

4

TENNESSEE REGULATORY AUTHORITY

STATE OF NORTH CAROLINA

COUNTY OF WAKE

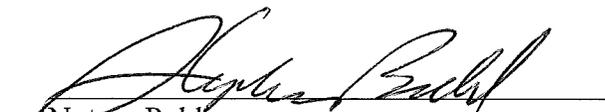
BEFORE ME, the undersigned authority, duly commissioned and qualified in and for the State and County aforesaid, personally came and appeared Patrick L. Baryenbruch, being by me first duly sworn deposed and said that:

He is appearing as a witness on behalf of Tennessee-American Water Company before the Tennessee Regulatory Authority, and if present before the Authority and duly sworn, his testimony would set forth in the annexed transcript consisting of 8 pages.

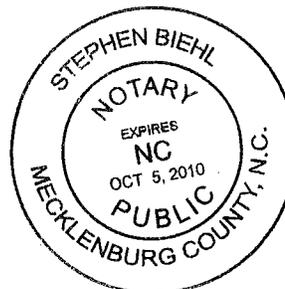


Patrick L. Baryenbruch

Sworn to and subscribed before me
this 9th day of September 2010.


Notary Public

My commission expires Oct 5th 2010



**Market Cost Comparison of Service Company Charges to
Tennessee American Water Company
12-Months Ended March 31, 2010**

**Tennessee American Water Company
Market Cost Comparison of Service Company Charges
12-Months Ended March 31, 2010**

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Purpose of This Study

This study was undertaken to answer four questions concerning the services provided by American Water Works Service Company, Inc. (Service Company) to Tennessee American Water Company (TAWC):

1. Are the Service Company's charges to TAWC during the 12 months ended March 31, 2010 reasonable?
2. Was TAWC charged the lower of cost or market for managerial and professional services provided by the Service Company during the 12 months ended March 31, 2010?
3. Were the 12 months ended March 31, 2010 costs of the Service Company's customer accounts services, including those of the National Call Centers, comparable to those of other utilities?
4. Are the services TAWC receives from Service Company necessary?

Study Results

Concerning question 1, the following conclusion was reached:

- The Service Company's 12 months ended March 31, 2010 cost per TAWC customer was reasonable compared to cost per customer for electric and combination electric/gas service companies. During the 12 months ended March 31, 2010, TAWC was charged \$59 per customer for administrative and general (A&G)-related services provided by the Service Company. This compares to an average of \$95 per customer for service companies reporting to the Federal Energy Regulatory Commission (FERC). Only 4 of the 24 comparison group utility service companies filed a FERC Form 60 for 2009 had a lower per customer A&G cost than TAWC's charges from the Service Company.

Concerning question 2, the following conclusions were drawn from this study:

- TAWC was charged the lower of cost or market for managerial and professional services during the 12 months ended March 31, 2010.
- On average, the hourly rates for outside service providers are 45% higher than the Service Company's hourly rates.
- The managerial and professional services provided by the Service Company are vital and could not be procured externally by TAWC without careful supervision on the part of TAWC. If these services were contracted entirely to outside providers, TAWC would have to add at least one position to manage activities of outside firms. This position would be necessary to ensure the quality and timeliness of services provided.
- If all the managerial and professional services now provided by the Service Company had been outsourced during the 12 months ended March 31, 2010, TAWC and its ratepayers would have incurred \$2,000,000 in additional expenses. This amount includes the higher cost of outside providers and the cost of one TAWC position needed to direct the outsourced work.
- This study's hourly rate comparison actually understates the cost advantages that accrue to TAWC from its use of the Service Company. Outside service providers generally bill



I – Introduction

for every hour worked. Service Company exempt personnel, on the other hand, charge a maximum of 8 hours per day even when they work more hours. If the overtime hours of Service Company personnel were factored into the hourly rate calculation, the Service Company would have had an even greater annual dollar advantage than the \$2,000,000 cited above. For instance, if Service Company overtime is conservatively estimated at 5% (2 hours per week) then that work would have added more than \$92,000 in charges from outside providers.

- It would be difficult for TAWC to find local service providers with the same specialized water industry expertise as that possessed by the Service Company staff. Service Company personnel spend substantially all their time serving operating water companies. This specialization brings with it a unique knowledge of water utility operations and regulation that is most likely unavailable from local service providers.
- Service Company fees do not include any profit markup. Only its actual cost of service is being recovered from TAWC ratepayers.

Concerning question 3, the following conclusion was reached:

- The cost of the Service Company's customer accounts services, including those provided by the National Call Center, is below the range of the average of the neighboring electric utility comparison group. As will be explained further herein, this group of companies provides a reasonable proxy group for comparison to a regulated utility of the size and scope of the Service Company and TAWC. During the 12-months ended March 31, 2010, the customer accounts cost for TAWC customers was \$29.08 compared to the 2009 average of \$32.01 for neighboring electric utilities. The highest comparison group per customer cost was \$67.39 and the lowest \$17.53.

Concerning question 4, the following conclusions were drawn:

- The services that the Service Company provides are necessary and would be required even if TAWC were a stand-alone water utility.
- Furthermore, there is no redundancy or overlap in the services provided by the Service Company to TAWC. For all of the services listed in Exhibit 11, there was only one entity primarily responsible for the service.

II – Background

Overview of American Water Works Service Company

American Water's Service Company exists to provide certain shared services to American Water subsidiaries. It follows a service company model used by many utility holding companies that own multiple regulated utilities. By consolidating executive and professional services into a single service company, utility holding companies are able to realize the following benefits for ratepayers:

- **Purchasing Economies** – Common expenses (e.g., insurance, chemicals, piping) can be procured on a much larger scale thereby providing greater bargaining power for the combined entity compared to individual utility operating companies. A service company facilitates corporate-wide purchasing programs through its procurement and contract administration functions.
- **Operating Economies of Scale** – A service company is able to deliver services more efficiently because workloads can be balanced across more persons and facilities. For instance, American Water's Service Company is able to maintain one principal data center for the entire corporation. This is much more cost-efficient than each operating utility funding their own data center with its large fixed hardware, software and staffing costs.
- **Continuity of Service** – Centralizing service company personnel who perform similar services facilitates job cross-training and sharing of knowledge and expertise. This makes it easier to deal with staff turnover and absences and to sustain high levels of service to operating utilities. An individual operating utility might experience considerable disruption if a key professional left and it was necessary to hire outside to fill the vacancy.
- **Maintenance of Corporate-Wide Standards** – Personnel in American Water's Service Company establish standards for many functions (e.g., engineering designs, operating procedures and maintenance practices). It is easier to ensure these standards are followed by every operating utility because their implementation is overseen by the Service Company.
- **Improved Governance** – American Water's Service Company provides another dimension of management and financial oversight that supplements local operating utility management. The Service Company facilitates standard planning and reporting that help ensure operating utilities meet the requirements of their customers in a cost effective manner.
- **Retention of Personnel** – A service company organization provides operating utility personnel with another career path beyond what may be available on a local level. These opportunities tend to improve employee retention.

American Water follows the model for other utility service companies in another important regard. Its services are provided to affiliate operating utilities, like TAWC, at cost. American Water's Service Company is not a profit-making entity. It assigns only its actual expenses to the American Water subsidiaries it services.

The Service Company provides services to American Water operating companies from the following locations:



II – Background

- Corporate Office – Includes American Water’s executive management and personnel from the various corporate support services. American Water’s corporate office is located in Voorhees, New Jersey.
- National Call Centers – Perform customer service functions, including: customer call processing, service order processing, correspondence processing, credit and collections. American Water maintains two call centers. One in Alton, Illinois that went into operation in 2001 and a second in Pensacola, Florida that went into operation in 2005. Prior to the establishment of these national call centers, customer service functions were performed by employees of TAWC, which incurred the expense on its books.
- National Shared Services Center – The Shared Services Center, located in Cherry Hill, New Jersey, provides various financial, accounting and treasury functions that had been performed by individual operating companies. This arrangement has improved and streamlined the Company’s financial processes and allowed operating companies to focus on providing utility service.
- Regional Offices – Regional offices provide operating companies with certain support services that can be performed more effectively on a regional basis because individual operating company/center workloads are not sufficient to warrant a full-time staff for these activities. At the same time, these services require closer proximity to operating companies served so they are not provided by the National Shared Services Center. Examples of regional office services include rates and revenues, engineering, operations and field resource coordination.
- Belleville Lab – The national trace substance laboratory is located in Belleville, Illinois and performs testing for all American Water operating companies.
- Information Technology Service Centers – American Water’s principal data center, located in Hershey, Pennsylvania, supports the IT infrastructure required to run corporate and operating company business applications and the communications systems. IT personnel rotate, as needed, throughout the regional offices and operating companies.

Service Company Expense Categories

The Service Company renders a monthly bill to operating companies. Charges are broken down into the following expense categories:

- Labor – base pay (salaries) of managerial and professional employees
- Labor-Related Overheads - employee benefit costs (payroll taxes, medical coverage, pensions, disability insurance) and other general expenses
- Support - wages and salaries of office support personnel, including secretaries, clerical personnel, telephone operators and mail clerks
- Office Expenses - office rent, equipment leases, telephone, electric, office supplies, property taxes, office maintenance
- Vouchers/Journal Entries – (1) travel expenses incurred by Service Company personnel, (2) other items submitted for reimbursement by employees, including professional association dues, (3) outside service contracts for such things as actuarial



II – Background

services, and (4) various other expenditures, including data center expenses for software licenses and hardware maintenance.

Service Company expenses are either assigned directly or allocated to operating companies, as shown in the table below.

Expense Category	Direct Charged	Allocated	Comments
Labor	X	X	Professional personnel working for one or several operating companies
Labor-Related Overheads	X	X	These are primarily employee benefit costs that relate directly to labor
Support		X	Administrative personnel support the professional staff, thus support costs are allocated on the basis of professional labor
Office Expense		X	Are all allocated on the basis of professional labor
Vouchers/Journals	X	X	May be either directly in support of one operating company (e.g., an engineer traveling from the Corporate Office to the operating company) or allocated to several operating companies

A direct charge occurs when Service Company work or expenses are incurred in support of only one operating company. Direct charge examples include work in support of an operating company's rate case, engineering design work on an operating company's project and the preparation of an operating company's financial statements.

Service Company expenses are allocated when more than one operating company benefits from the underlying work. Examples include assessments of new Federal water quality regulations, development of the company-wide materials procurement contracts and creation of company-wide engineering design standards.

Charging and Assignment Of Service Company Time and Expenses

Service Company transactions are assigned with the following information so there is a proper accounting and eventual charging to an operating company:

- Operating company
- Formula number
- Work order (where applicable)
- Authorization number (where applicable)

Charges can originate from the following systems:

- Payroll System
- RVI System (outside vendor payments)
- PCard System (credit card payments)
- Internal Purchase Order System
- Journal entries

II – Background

The Service Company's time reporting process enables labor and support charges to be assigned to the proper operating company. Labor charges are based on the time reported by managerial and professional Service Company employees. Every week, Service Company professional employees complete an electronic time sheet that shows:

- Formula number (this is linked to operating company within American Water's financial system)
- Employee hours worked
- Account number for non-labor charges

At month-end, time report information is processed and direct and allocated professional labor hours tabulated for each operating company. Dollar charges are then calculated using the hourly rate of each Service Company professional employee based upon their base salary (i.e., an employee's hours times his/her hourly rate of pay).

Support (administrative) personnel charge their time to the activity "General Admin." As described in the table on page 4, their labor charges are allocated to operating companies based upon how their office's professional personnel labor charges are assigned. For instance, if 20% of American Water's Southeast Region's professional labor is assigned to TAWC during a month, then 20% of that office's monthly administrative labor charges also are assigned to the operating company.

The overhead cost category is next assigned based on professional and administrative labor costs. Thus, if 20% of the Southeast Region's accumulated professional and support labor is charged to TAWC during the month, then 20% of that month's overhead expenses will be assigned to TAWC.

Each Service Company location's office expenses are allocated to operating companies based on how professional labor charges for that office have been assigned. For instance, if 2% of professional labor from one Service Company office is assigned to TAWC, then 2% of that office's office expenses would be assigned to TAWC. Thus, office expenses are allocated in the very same way as administrative labor.

Vouchers/journal entries may be charged directly or allocated, depending on who benefits from the expenditure. For instance, the cost of a continuing professional education course taken by a professional in a regional office is allocated to the operating companies served by that office. Travel expenses by that same professional to a rate case proceeding are charged directly to the operating company whose case is being heard.



III – Service Company Cost Comparison Approach

During the 12 months ended March 31, 2010, the Service Company billed TAWC \$5,008,401 in O&M-related charges and \$311,927 in capital-related charges. These total charges of \$5,320,328 were subjected to a market cost comparison.

Service Company Charges	12 Months Ended March 31, 2010
Management Fees - O&M	\$ 5,008,401
Management Fees - Capital	\$ 311,927
Total Testable SC Charges	\$ 5,320,328

For purposes of comparing these charges to certain outside benchmarks, Service Company services were placed into three categories:

- Managerial and Professional Services – Includes such services as management, accounting, legal, human resources, information technology and engineering.
- Customer Accounts Services – Includes customer-related services, such as call center, credit, billing, collection and payment processing.
- Field Resource Coordination Services – Includes the dispatching and oversight of work to operating company field crews.

Total test period Service Company charges break down between management/professional services, customer account services and field resource coordination as follows:

	12 Months Ended Mar. 31, 2010	
	Amount	Hours
Management and Professional Services	\$ 4,099,018	39,973
Customer Account Services	\$ 1,120,113	29,545
Field Resource Coordination	\$ 101,197	1,640
Total Service Company Charges	\$ 5,320,328	71,158

This study's first question—whether Service Company 12 months ended March 31, 2010 charges are reasonable—was determined by comparing TAWC's A&G-related Service Company charges per customer to the same charges for utility companies that must file the FERC Form 60 – Annual Report of Service Companies.

The second question—whether Service Company charges during the 12 months ended March 31, 2009 were at the lower of cost or market—was evaluated by comparing the cost per hour for managerial and professional services provided by Service Company personnel to hourly billing rates that would be charged by outside providers of equivalent services. Service Company costs per hour were based on actual charges to TAWC during the 12 months ended March 31, 2010. Outside providers' billing rates came from surveys or other information from professionals that could perform the services now provided by the Service Company.



III – Service Company Cost Comparison Approach

The third question—whether Service Company's 12 months ended March 31, 2010 customer account services charges, including those of the National Call Center costs, were comparable to other utilities—was addressed by comparing TAWC's customer accounts services expenses to those of neighboring electric utilities. This approach was selected because the costs of outside providers of call center services are not publicly available. However, electric utility customer account services expenses can be obtained from the FERC Form 1. The availability and transparency of FERC data adds to the validity of its use in this comparison.

The fourth question—the necessity of Service Company services—was investigated by defining the services provided to TAWC and determining if these services would be required if TAWC were a stand-alone utility.

IV – Question 1 – Reasonableness of Service Company Charges

TAWC's Service Company Cost per Customer

During the 12 months ended March 31, 2010, TAWC was charged \$59 per customer by the Service Company for A&G-related services. The calculation of this amount, shown in the table below, starts with total net testable Service Company charges and adjusts for capital and non-A&G functions (engineering, operations and water quality) charges. These adjustments are necessary to develop a per customer cost that is comparable to cost of utility service companies.

	12 Months ended Mar 31, 2010 Svc. Co. Charges
Testable Service Company charges	\$ 5,320,328
Less: Capital charges	\$ (311,927)
Less: Non-A&G function O&M charges	
Engineering	\$ (10,568)
Operations	\$ (541,144)
Water Quality	\$ (97,262)
Net A&G/O&M-related charges	\$ 4,359,427
TAWC customers	74,475
TAWC Cost Per Customer	\$ 59

Comparison Group Cost Per Customer

Every centralized service company in a holding company system must file a Form 60 in accordance with the Public Utility Holding Company Act of 2005, Section 1270, Section 390 of the Federal Power Act and 18 C.F.R. paragraph 366.23. This report is designed to collect financial information from service companies that are subject to regulation by the FERC.

For 2009, a Form 60 was filed by service companies that are part of 25 utility holding companies that own utilities providing regulated electric and, in some cases, gas service to retail customers. In order to make a valid comparison of these service companies' costs to those of American Water Works Service Company, it was necessary to isolate expenses that they have in common. These include A&G-related charges recorded in the following FERC accounts:

901 – Supervision	921 – Office supplies and expenses
903 – Customer records and collection expenses	923 – Outside services employed
905 – Miscellaneous customer accounts expenses	928 – Regulatory commission expenses
907 – Supervision	930.2 – Miscellaneous general expenses
910 – Misc customer service and info expenses	931 – Rents
911 – Supervision	935 – Maintenance of structures and equipment
920 - Administrative and general salaries	

Charges to utility affiliates for the comparison group service companies were obtained from Schedule XVI – Analysis of Charges for Service Associate and Non-Associate Companies (p. 303 to 306) of each entity's FERC Form 60. This schedule shows charges by FERC Account.

Comparison group service company 2009 expenses were also adjusted to remove charges to non-regulated affiliates from the cost pool used to calculate the cost per regulated service customer. This determination was made using information from the FERC Form 60 schedule: Account 457 – Analysis of Billing – Associate Companies.

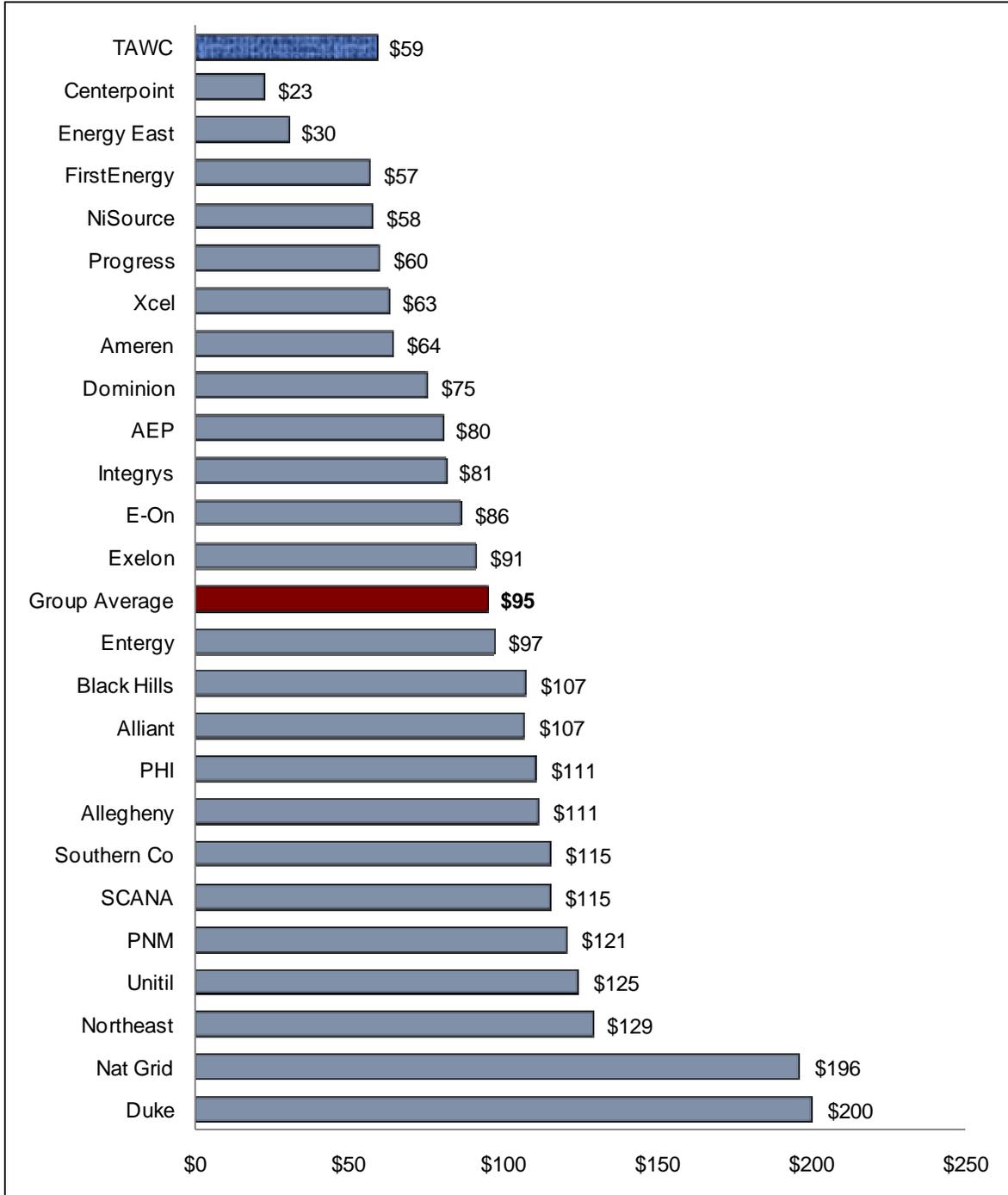
IV – Question 1 – Reasonableness of Service Company Charges

One service company that filed a Form 60 was excluded from the comparison group because its Form 60 contained no data for 2009. That service company, Great Plains Energy Services Incorporated, became inactive in 2009 and had no charges to its regulated utility affiliate. The A&G expenses per regulated utility customer for the other 24 utility companies that filed a Form 60 for 2009 are calculated below.

Utility Company	2009 Regulated Retail Service Company A&G Expenses	Regulated Retail Customers	Cost per Customer
AEP	\$418,484,117	5,213,000	\$ 80
Allegheny	\$176,685,245	1,585,700	\$ 111
Alliant	\$149,116,475	1,395,189	\$ 107
Ameren	\$212,036,412	3,300,000	\$ 64
Black Hills	\$81,484,333	759,400	\$ 107
Centerpoint	\$119,304,604	5,300,000	\$ 23
Dominion	\$279,128,940	3,700,000	\$ 75
Duke	\$901,762,388	4,500,000	\$ 200
Energy East	\$89,580,962	2,973,000	\$ 30
Entergy	\$262,596,172	2,700,000	\$ 97
E-On	\$105,893,093	1,226,000	\$ 86
Exelon	\$537,633,122	5,886,000	\$ 91
FirstEnergy	\$255,874,712	4,500,000	\$ 57
Integrus	\$175,423,352	2,157,700	\$ 81
Nat Grid	\$1,314,902,105	6,700,000	\$ 196
NiSource	\$216,480,637	3,750,000	\$ 58
Northeast	\$269,948,801	2,095,000	\$ 129
PHI	\$215,465,623	1,946,000	\$ 111
Progress	\$186,256,921	3,100,000	\$ 60
PNM	\$87,998,259	729,700	\$ 121
SCANA	\$166,555,883	1,445,000	\$ 115
Southern Co	\$508,130,523	4,402,000	\$ 115
Unitil	\$21,115,280	169,600	\$ 125
Xcel	\$333,389,459	5,300,000	\$ 63
Group Total	\$7,085,247,416	74,833,289	\$ 95

Exhibit 1 shows TAWC's 12 months ended March 31, 2010 Service Company cost per customer of \$59 to be considerably lower than the average of \$95 per customer for the comparison group service companies. Only 4 of 24 comparison group service companies had a lower cost per customer than TAWC. Based on this result, it is possible to conclude that the Service Company's 12 months ended March 31, 2010 charges to TAWC were reasonable.

**Tennessee American Water Company
Comparison of Service Company Annual Costs Per Customer**



Methodology

The lower-of-cost-or-market comparison is accomplished by comparing the cost per hour for Service Company managerial and professional services to those of outside service providers to whom these duties could be assigned. Based on the nature of the Service Company services it was determined that the following outside providers could perform the categories of services indicated below:

- Management Consultants – executive and administrative management, risk management services, human resources and communications services
- Attorneys – legal services
- Certified Public Accountants – accounting, financial, information technology and rates and revenues services
- Professional Engineers – engineering, operations and water quality services.

The services provided by the Belleville lab are assumed to be transferable to professional engineers for purposes of this cost comparison. This was done for two reasons. First, there is no readily available survey of hourly billing rates for testing services such as those performed by Belleville. Second, Belleville personnel have similar, scientific educational backgrounds as Service Company engineering personnel. Thus, it is valid to compare the hourly rates of Belleville services to those of outside engineering firms.

Service Company's hourly rate were calculated for each of the four outside service provider categories, based on the dollars and hours charged to TAWC during the 12 months ended March 31, 2010. Hourly billing rates for outside service providers were developed using third party surveys or directly from information furnished by outside providers themselves.

It should be noted that by using the Service Company's hours charged TAWC during the 12 months ended March 31, 2010, its hourly rates are actually overstated because Service Company personnel charge a maximum 8 per day even when they work more. Outside service providers generally bill for every hour worked. If the overtime hours of Service Company personnel had been factored into the hourly rate calculation, Service Company hourly rates would have been lower.

The last step in the market cost comparison was to compare the Service Company's average cost per hour to the average cost per hour for outside providers.

Service Company Hourly Rates

Exhibit 2 (page 14) details the assignment of 12 months ended March 31, 2010 management and professional Service Company charges by outsider provider category. Exhibit 3 (page 15) shows the same assignment for Service Company management and professional hours charged to TAWC during the 12 months ended March 31, 2010.

Certain adjustments to these dollar amounts were necessary to calculate Service Company hourly rates that are directly comparable to those of outside providers. Adjustments were made to the following 12 months ended March 31, 2010 test period non-labor Service Company charges:

V – Question 2 – Provision of Services at the Lower of Cost or Market

- Contract Services – 12 months ended March 31, 2010 Service Company charges to TAWC include expenses associated with the use of outside professional firms to perform certain corporate-wide services (e.g., legal, financial audit, actuarial services). These professional fees are excluded from the Service Company hourly rate calculation because the related services have effectively been out-sourced already.
- Travel Expenses – In general, client-related travel expenses are not recovered by outside service providers through their hourly billing rate. Rather, actual out-of-pocket travel expenses are billed to clients in addition to fees for professional services. Thus, it is appropriate to remove these Service Company charges from the hourly rate calculation.
- Information Technology Infrastructure Expenses – Included in the 12 months ended March 31, 2010 Service Company charges to TAWC are leases, maintenance fees and depreciation related to American Water's enterprise mainframe, server and network infrastructure and corporate business applications. An outside provider that would take over operation of this infrastructure would recover these expenses over and above the labor necessary to operate the data center.

Exhibit 4 (page 16) shows how contract services, travel expenses and computer hardware/software-related Service Company charges are assigned among the four outside provider categories.

Based on the assignment of expenses and hours shown in Exhibits 2 and 3 and the excludable items shown in Exhibit 4, the Service Company's equivalent costs per hour for the 12 months ended March 31, 2010 are calculated below.

	Attorney	Management Consultant	Certified Public Accountant	Professional Engineer	Total
Total management, professional & technical services charges	\$ 132,906	\$ 1,030,160	\$ 2,395,210	\$ 540,742	\$ 4,099,018
Less:					
Contract services	\$ 11,816	\$ 62,591	\$ 236,246	\$ (8,429)	\$ 302,224
Travel expenses	\$ 1,529	\$ 40,905	\$ 28,441	\$ 6,670	\$ 77,545
Computer hardware/software	\$ 3,397	\$ 143,421	\$ 156,874	\$ 17,524	\$ 321,216
Net Service Charges (A)	\$ 116,164	\$ 783,244	\$ 1,973,648	\$ 524,977	\$ 3,398,033
Total Hours (B)	899	6,118	24,293	8,664	39,973
Average Hourly Rate (A / B)	\$ 129	\$ 128	\$ 81	\$ 61	

Tennessee American Water Company
Analysis of 12 Months Ended December 31, 2009 Service Company Charges By Location And Function

		12 Months Ended March 31, 2010 Service Company Charges				
Location	Function	Attorney	Management Consultant	Certified Public Accountant	Professional Engineer	Total
Belleville Lab	Water Quality				\$ 119,043	\$ 119,043
Call Center	Human Resources		\$ 25,146			\$ 25,146
Corporate	Accounting			\$ 262,142		\$ 262,142
	Administration		\$ 276,758			\$ 276,758
	Audit			\$ 42,398		\$ 42,398
	Communications		\$ 61,742			\$ 61,742
	Engineering			\$ 272,550		\$ 272,550
	Finance		\$ 204,431			\$ 204,431
	Human Resources			\$ 33,960		\$ 33,960
	Legal		\$ 68,672			\$ 68,672
	Operations		\$ 108,420		\$ 283,716	\$ 392,136
	Rates & Revenue			\$ 47,325		\$ 47,325
Risk Management		\$ 27,185			\$ 27,185	
Water Quality				\$ 2,099	\$ 2,099	
Regional Offices	Accounting			\$ 16,440		\$ 16,440
	Administration		\$ 108,473			\$ 108,473
	Communications		\$ 87,832			\$ 87,832
	Engineering				\$ 10,497	\$ 10,497
	Finance			\$ 360,493		\$ 360,493
	Human Resources		\$ 2,480			\$ 2,480
	Legal	\$ 64,234				\$ 64,234
	Operations		\$ 49,366		\$ 124,617	\$ 173,984
	Risk Management		\$ 21,326			\$ 21,326
	Water Quality				\$ 771	\$ 771
Information Technology	Information Technology			\$ 1,010,475		\$ 1,010,475
Shared Services	Accounting			\$ 306,809		\$ 306,809
	Administration		\$ 57,000			\$ 57,000
	Finance			\$ 2,263		\$ 2,263
	Rates & Revenue			\$ 40,355		\$ 40,355
Total Dollars Charged		\$ 132,906	\$ 1,030,160	\$ 2,395,210	\$ 540,742	\$ 4,099,018

Tennessee American Water Company
Analysis of 12 Months Ended December 31, 2009 Service Company Hours By Location And Function

Location	Function	12 Months Ended March 31, 2010 Service Company Hours					Total
		Attorney	Management Consultant	Certified Public Accountant	Professional Engineer		
Belleville Lab	Water Quality				1,658		1,658
Call Center	Human Resources		309				309
Corporate	Accounting			3,268			3,268
	Administration		676				676
	Audit			372			372
	Communications		287				287
	Engineering			2,102			2,102
	Finance		1,689				1,689
	Human Resources			322			322
	Legal	300					300
	Operations		353		5,089		5,442
	Rates & Revenue			319			319
	Risk Management		256				256
	Water Quality				-		-
Regional Offices	Accounting			179			179
	Administration		-				-
	Communications		1,300				1,300
	Engineering				(1)		(1)
	Finance			4,507			4,507
	Human Resources		21				21
	Legal	599					599
	Operations		457		1,917		2,375
	Risk Management		449				449
	Water Quality				-		-
Information Technology	Information Technology			6,208			6,208
Shared Services	Accounting			6,489			6,489
	Administration		320				320
	Finance			-			-
	Rates & Revenue			527			527
	Total Hours Charged	899	6,118	24,293	8,664		39,973

Tennessee American Water Company
12 Months Ended December 31, 2009 Service Company Charges Excludable From The Hourly Rate Calculation

Charges By Function	Exclusions From Hourly Rate Calculation			Total	Outside Service Provider Category
	Contract Services	Travel Expenses	Computer HW/SW		
Accounting	\$ 49,641	\$ 3,649	\$ 2,646	\$ 55,937	Certified Public Accountant
Administration	\$ 9,743	\$ 3,174	\$ 130,234	\$ 143,151	Management Consultant
Audit	\$ 6,793	\$ 652	\$ 422	\$ 7,868	Certified Public Accountant
Communications	\$ 9,698	\$ 4,581	\$ 991	\$ 15,270	Management Consultant
Engineering	\$	\$ 158	\$ 135	\$ 293	Professional Engineer
Finance	\$ 56,928	\$ 7,774	\$ 7,058	\$ 71,760	Certified Public Accountant
Human Resources	\$ 35,576	\$ 7,411	\$ 4,696	\$ 47,684	Management Consultant
Information Technology	\$ 114,727	\$ 14,041	\$ 145,956	\$ 274,724	Certified Public Accountant
Legal	\$ 11,816	\$ 1,529	\$ 3,397	\$ 16,742	Attorney
Operations	\$ 8,629	\$ 28,678	\$ 10,947	\$ 48,254	Management Consultant, Professional Engineer
Rates & Revenue	\$ 8,157	\$ 2,324	\$ 791	\$ 11,273	Certified Public Accountant
Risk Management	\$ 651	\$ 3,224	\$ 804	\$ 4,679	Management Consultant
Water Quality	\$ (10,135)	\$ 350	\$ 13,137	\$ 3,352	Professional Engineer
Total	\$ 302,224	\$ 77,545	\$ 321,216	\$ 700,985	

Recap By Outside Provider	Exclusions From Hourly Rate Calculation			Total
	Contract Services	Travel Expenses	Computer HW/SW	
Attorney	\$ 11,816	\$ 1,529	\$ 3,397	\$ 16,742
Management Consultant	\$ 62,591	\$ 40,905	\$ 143,421	\$ 246,916
Certified Public Accountant	\$ 236,246	\$ 28,441	\$ 156,874	\$ 421,561
Professional Engineer	\$ (8,429)	\$ 6,670	\$ 17,524	\$ 15,765
Total	\$ 302,224	\$ 77,545	\$ 321,216	\$ 700,985

Outside Service Provider Hourly Rates

The next step in the cost comparison was to obtain the average billing rates for each outside service provider. The source of this information and the determination of the average rates are described in the paragraphs that follow.

It should be noted that professionals working for three of the five outside provider categories may be licensed to practice by state regulatory bodies. However, not every professional working for these firms is licensed. For instance, among Tennessee certified public accounting firms, only more experienced staff are predominantly CPAs (see table below). Some Service Company employees also have professional licenses. Thus, it is valid to compare the Service Company's hourly rates to those of the outside professional service providers included in this study.

Position	Tennessee Average
Partners/Owners	97%
Managers (6+ years experience)	83%
Sr Associates (4-5 years experience)	60%
Associates (1-3 years experience)	19%
New Professionals	6%

Source: AICPA's National PCPS/TSCPA
Management of an Accounting Practice Survey

Attorneys

The Tennessee State Bar does not survey its members as to their hourly billing rates. The Chattanooga Bar Association maintains a service called Chattanooga Lawyers Information Providers Service (CLIPS) to assist the public in finding a lawyer. CLIPS' website presents background information on a relatively small number of Chattanooga attorneys. Unfortunately, only 60% of the attorneys featured in CLIPS revealed their hourly billing rates. With this small sample size and incomplete hourly rate data, it was impossible to develop a valid set of Chattanooga attorney billing rates for comparison to the cost of the Service Company's legal services.

As a result, an estimate of Chattanooga hourly rates was developed from two surveys conducted by Lawyers Weekly in the states of Michigan and Missouri. The 2009 average rate for each firm in the surveys was adjusted for the cost of living differential between their locations and Chattanooga, Tennessee. The cost of living indices utilized in this analysis were obtained from the Council for Community and Economic Research, a membership organization created in 1961 to develop high quality regional economic data and analytical methods.

The resultant 2009 average hourly rate calculated in Exhibit 5 is in line with the few hourly billing rates shown on the CLIPS website. For instance, the following attorneys from the Chattanooga firm of Chambliss Bahner & Stophel were listed in the CLIP website. Their billing rates are relatively close to this study's cost-of-living-adjusted estimated average of \$265 per hour for Chattanooga attorneys.

- Mr. Robert Addison - \$260/hour
- Ms. Alicia Oliver - \$250/hour

Management Consultants

The cost per hour for management consultants was developed from a 2009 survey performed by the Association of Management Consulting Firms—an industry trade organization. The survey includes rates that were in effect during 2008 for firms throughout the United States. Consultants typically do not limit their practice to any one region and must travel to a client's location. Thus, the U.S. national average is appropriate for comparison.

The first step in the calculation, presented in Exhibit 6, was to determine an average rate by consultant position level. From these rates, a single weighted average hourly rate was calculated based upon the percent of time that is typically applied to a consulting assignment by each consultant position level. The 2008 average rate was escalated to September 30, 2010—the midpoint of the 12 months ended March 31, 2010.

Certified Public Accountants

The average hourly rate for Tennessee CPAs was developed from a 2008 survey performed by the American Institute of Certified Public Accountants (AICPA). The Tennessee version of this survey was used to develop hourly rates for member firms in Tennessee.

As shown in Exhibit 7, a weighted average hourly rate was developed based on a set of accountant positions and a percent of time that is typically applied to an accounting assignment. This survey includes rate information in effect during 2007. Thus, the data had to be escalated to September 30, 2009—the test year's midpoint.

Professional Engineers

The Company provided hourly rate information for outside engineering firms that could have been used by TAWC in 2009. As presented in Exhibit 8, an average rate was developed for each engineering position level. Then, using a typical percentage mix of project time by engineering position, a weighted average cost per hour was calculated.

**Tennessee American Water Company
Estimated Billing Rates For Tennessee Attorneys Based On
Michigan and Missouri Attorney Billing Rates**

Billing rates during 2009		Billing Rate Range (A)					Average	Cost of Living Adjust (B)	Adjusted Rate
Firm	Location	Associate		Partner					
		Low	High	Low	High				
Dickinson Wright	Detroit, Mi	\$ 195	\$ 275	\$ 355	\$ 575	\$ 350	115%	\$ 306	
Dykema	Detroit, Mi	\$ 185	\$ 425	\$ 295	\$ 615	\$ 380	115%	\$ 332	
Butzel Long	Detroit, Mi	\$ 175	\$ 325	\$ 250	\$ 600	\$ 338	115%	\$ 295	
Jaffe Raitt Heuer & Weiss	Southfield, Mi	\$ 175	\$ 250	\$ 225	\$ 550	\$ 300	115%	\$ 262	
Brooks Kushman	Southfield, Mi	\$ 180	\$ 275	\$ 300	\$ 425	\$ 295	115%	\$ 258	
Kemp, Klein, Umphrey, Edelman & Ma	Troy, Mi	\$ 145	\$ 260	\$ 200	\$ 350	\$ 239	115%	\$ 208	
Rader, Fishman & Grauer	Bloomfield Hills, Mi	\$ 130	\$ 250	\$ 275	\$ 550	\$ 301	115%	\$ 263	
Williams, Williams, Rattner & Plunkett	Birmingham, Mi	\$ 150	\$ 250	\$ 275	\$ 450	\$ 281	115%	\$ 246	
Abbott, Nicholson, Quilter, Esshaki,	Detroit, Mi	\$ 150	\$ 220	\$ 300	\$ 375	\$ 261	115%	\$ 228	
Parmenter O'Toole	Muskegon, Mi			\$ 125	\$ 275	\$ 200	103%	\$ 194	
Lipson, Neilson, Cole, Seltzer & Garin	Bloomfield Hills, Mi	\$ 185	\$ 235	\$ 225	\$ 300	\$ 236	115%	\$ 206	
Berman DeLeve Kuchan & Chapman	Kansas City, Mo			\$ 250	\$ 250	\$ 250	109%	\$ 230	
Boggs, Avellino, Lach & Boggs	St. Louis, Mo			\$ 160	\$ 160	\$ 160	101%	\$ 159	
Bryan Cave	Kansas City, Mo	\$ 200	\$ 200	\$ 385	\$ 435	\$ 305	109%	\$ 280	
Danna McKittrick	St. Louis, Mo			\$ 300	\$ 300	\$ 300	101%	\$ 298	
David Shroeder Law Offices	Springfield, Mo			\$ 260	\$ 260	\$ 260	99%	\$ 263	
Dobson, Goldberg, Berns & Rich	St. Louis, Mo			\$ 300	\$ 425	\$ 363	101%	\$ 360	
Dunn & Davison	Kansas City, Mo			\$ 225	\$ 225	\$ 225	109%	\$ 207	
Evans Partnership	St. Louis, Mo			\$ 175	\$ 175	\$ 175	101%	\$ 174	
Greensfelder Hemker & Gale	St. Louis, Mo			\$ 235	\$ 300	\$ 268	101%	\$ 266	
Husch Blackwell Sanders	Kansas City, Mo	\$ 204	\$ 345	\$ 356	\$ 472	\$ 344	109%	\$ 316	
Karfeld Law Firm	St. Louis, Mo			\$ 265	\$ 265	\$ 265	101%	\$ 264	
Krigel & Krigel	Kansas City, Mo	\$ 175	\$ 225	\$ 200	\$ 250	\$ 213	109%	\$ 195	
Law Office of Brad Goss	St. Charles, Mo			\$ 175	\$ 175	\$ 175	101%	\$ 174	
Law Offices of George A. Barton	Kansas City, Mo	\$ 300	\$ 400	\$ 400	\$ 600	\$ 425	109%	\$ 390	
McDowell, Rice, Smith & Buchann	Kansas City, Mo			\$ 425	\$ 425	\$ 425	109%	\$ 390	
Neil Weintraub, Attorney at Law	St. Louis, Mo			\$ 260	\$ 260	\$ 260	101%	\$ 259	
Pennington Shea	St. Louis, Mo			\$ 190	\$ 260	\$ 225	101%	\$ 224	
Pletz and Reed	Jefferson City, Mo	\$ 150	\$ 150	\$ 180	\$ 180	\$ 165	103%	\$ 160	
Polsinelli Shughart	Kansas City, Mo	\$ 210	\$ 350	\$ 380	\$ 600	\$ 385	109%	\$ 353	
Raymond I. Plaster	Springfield, Mo			\$ 275	\$ 275	\$ 275	99%	\$ 278	
Shook, Hardy & Bacon	Kansas City, Mo	\$ 265	\$ 265	\$ 425	\$ 425	\$ 345	109%	\$ 317	
Speer Law Firm	Kansas City, Mo	\$ 400	\$ 400	\$ 500	\$ 500	\$ 450	109%	\$ 413	
Spencer Fane Britt & Browne	Kansas City, Mo	\$ 150	\$ 325	\$ 310	\$ 470	\$ 314	109%	\$ 288	
Stanton & Redlingshafer	Kansas City, Mo			\$ 195	\$ 195	\$ 195	109%	\$ 179	
Stinson Morrison Hecker	Kansas City, Mo	\$ 195	\$ 195	\$ 350	\$ 445	\$ 296	109%	\$ 272	
The Sader Law Firm	Kansas City, Mo	\$ 225	\$ 235	\$ 265	\$ 265	\$ 248	109%	\$ 227	
Thompson Coburn	St. Louis, Mo	\$ 200	\$ 200	\$ 480	\$ 480	\$ 340	101%	\$ 338	
Overall Cost-of-Living Adjusted Average 2009 Billing Rate								\$ 265	

Note A: Source is Michigan Lawyers Weekly and Missouri Lawyers Weekly

Note B: Source is Council for Community and Economic Research. This percentage represents the cost of living difference between the Michigan and Missouri cities and Chattanooga, Tenn. A number over 100% indicates the Michigan or Missouri city's cost of living is higher than Chattanooga. A number less than 100% indicates Chattanooga's cost of living is higher.

**Tennessee American Water Company
Billing Rates of U.S. Management Consultants**

Survey billing rates in effect in 2008 (Note A)

A. Calculation of Average Hourly Billing Rate by Consultant Position

Average Hourly Rates (Note A)				
Entry-Level Consultant	Associate Consultant	Senior Consultant	Junior Partner	Senior Partner
\$ 147	\$ 196	\$ 268	\$ 295	\$ 384

Average

B. Calculation of Overall Average Hourly Billing Rate Based on a Typical Distribution of Time on an Engagement

	Entry-Level Consultant	Associate Consultant	Senior Consultant	Junior Partner	Senior Partner	
Average Hourly Billing Rate (from above)	\$ 147	\$ 196	\$ 268	\$ 295	\$ 384	
Percent of Consulting Assignment	30%	30%	20%	10%	10%	Weighted Average
	\$ 44	\$ 59	\$ 54	\$ 29	\$ 38	\$ 224

Escalation to Test Period Midpoint (September 30, 2009) (Note B)

CPI at December 31, 2008	210.2
CPI at September 30, 2009	216.0
Inflation/Escalation	<u>2.8%</u>
Average Hourly Billing Rate For Management Consultants At September 30, 2009	\$ 231

Note A: Source is "Operating Ratios For Management Consulting Firms, 2009 Edition," Association of Management Consulting Firms

Note B: Source is U.S. Bureau of Labor Statistics (<ftp://ftp.bls.gov/pub/special.requests/cpi/cpiiai.txt>)

**Tennessee American Water Company
Billing Rates Of Tennessee Certified Public Accountants**

Survey billing rates were those in effect in 2007 (Note A)					
Average Hourly Billing Rate (Note A)					
Type of Firm	Staff Accountant	Senior Accountant	Manager	Partner	
Average Hourly Rate	\$ 78	\$ 98	\$ 122	\$ 138	
B. Calculation of Overall Average Accountant Billing Rate Based Upon Typical Distribution of Time on an Engagement					
Average Hourly Billing Rate (From Above)					
Average Hourly Billing Rate (From Above)	\$ 78	\$ 98	\$ 122	\$ 138	
Typical Percent of Time Spent on an Accounting Assignment	30%	30%	20%	20%	Weighted Average
	\$ 23	\$ 29	\$ 24	\$ 28	\$ 105
<u>Escalation to Test Period Midpoint (June 30, 2009) (Note B)</u>					
				CPI at December 31, 2007	210.0
				CPI at June 30, 2009	215.7
				Inflation/Escalation	2.7%
				Average Hourly Billing Rate For CPAs At June 30, 2009	\$ 108

Note A: Source is AICPA's 2008 National PCPS/TSCPA Management of an Accounting Practice Survey (Tennessee edition)

Note B: source is US Bureau of Labor Statistics (<ftp://ftp.bls.gov/pub/special.requests/cpi/cpi.ai.t>)

Tennessee American Water Company Billing Rates Of Tennessee Engineers

Note: Billing rates in effect during 2009				
A. Calculation of Average Hourly Rate by Engineer Position				
Name of Firm	Average Hourly Billing Rates			
	CAD Drafter Engineer Tech	Engineer Design Engineer Project Engineer	Project Manager Project Associate Sr. Mgr. Engineer	Officer Principal Engineer
Firm #1	\$68	\$89	\$136	\$173
Firm #2	\$80	\$98	\$149	\$179
Firm #3	\$68	\$96	\$168	\$208
B. Calculation of Overall Average Engineering Hourly Billing Rate				
Average Hourly Billing Rate (From Above)	CAD Drafter Engineer Tech	Engineer Design Engineer Project Engineer	Project Manager Project Associate Sr. Mgr. Engineer	Officer Principal Engineer
	\$72	\$94	\$151	\$187
Typical Percent of Time on an Engineering Assignment	30%	35%	25%	10%
	\$22	\$33	\$38	\$19
				Weighted Average \$111

Source: Information provided by American Water Works Service Company. Firm names have not been disclosed to preserve the confidentiality of their hourly rates.

V – Question 2 – Provision of Services at the Lower of Cost or Market

Service Company versus Outside Provider Cost Comparison

As shown in the table below, Service Company costs per hour are considerably lower than those of outside providers.

Service Provider	12 Months Ended March 31, 2010		
	Service Company	Outside Provider	Difference-- Service Co. Greater(Less) Than Outside
Attorney	\$ 129	\$ 265	\$ (136)
Management Consultant	\$ 128	\$ 231	\$ (103)
Certified Public Accountant	\$ 81	\$ 108	\$ (27)
Professional Engineer	\$ 61	\$ 111	\$ (50)

Based on these cost per hour differentials and the number of managerial and professional services hours billed to TAWC during the 12-months ended March 31, 2010, outside service providers would have cost \$1,838,669 more than the Service Company (see table below). Thus, on average, outside provider's hourly rates are 45% higher than those of the Service Company (\$1,838,669 / \$4,099,018).

Service Provider	12 Months Ended March 31, 2010		
	Hourly Rate Difference-- Service Co. Greater(Less) Than Outside	Service Company Hours Charged	Dollar Difference
Attorney	\$ (136)	899	\$ (121,947)
Management Consultant	\$ (103)	6,118	\$ (630,010)
Certified Public Accountant	\$ (27)	24,293	\$ (650,038)
Professional Engineer	\$ (50)	8,664	\$ (436,675)
Service Company Less Than Outside Providers			\$ (1,838,669)

It should be noted that the cost differential associated with using outside providers is even greater because Service Company personnel do not charge for more than 8 hours per day even when they work more. Outside providers generally charge clients for all hours worked. If, for instance, Service Company personnel worked 5% overtime (2 hours) per week on TAWC's behalf, that would have amounted to 2,000 additional hours of work during the 12 months ended March 31, 2010. Based on the hourly rate differentials above, this overtime would have added another \$92,000 to the cost of using outside provider.

If TAWC were to use outside service providers rather than the Service Company for managerial and professional services, it would incur other additional expenses besides those associated with higher hourly rates. Managing outside firms who would perform almost 40,000 hours of work (more than 26 full-time equivalents at 1,500 "billable" hours per FTE per year) would add a significant workload to the existing TAWC management team. Thus, it would be necessary for TAWC to add at least one position to supervise the outside firms and ensure they delivered quality and timely services. The individuals that would fill this position would need a good understanding of each profession being managed. They must also have management experience and the authority necessary to give them credibility with the outside firms. As calculated in the table below, this position would add almost \$165,000 per year to TAWC's personnel expenses.

V – Question 2 – Provision of Services at the Lower of Cost or Market

Cost of Adding a Professional Position To TAWC's Staff

	<u>Total</u>
New Positions' Salary	\$ 100,000
Benefits (at 49.4%)	\$ 49,400
Office Expenses (15.2%)	\$ 15,200
Total Cost of Full Time Position	<u>\$ 164,600</u>

Thus, the total effect on the ratepayers of TAWC of contracting all services now provided by Service Company would be an increase in their costs of \$2,003,269 (\$1,838,669 + \$164,600). Based on the results of this comparison, it is possible to conclude that the Service Company charged TAWC at the lower of cost or market for services provided during the 12 months ended March 31, 2010.

VI - Question 3 - Reasonableness of Customer Accounts Services Costs

Background

Customer Accounts Services covers the following utility functions:

- Customer Call Center – customer calls/contact, credit, order taking/disposition, bill collection efforts, outage calls
- Call Center IT – maintenance of phone banks, voice recognition units, call center software applications, telecommunications
- Customer billing – bill printing, stuffing, and mailing
- Remittance processing – processing customer payments received in the mail
- Bill payment centers – locations where customers can pay their bills in person

It is difficult to compare the cost of the Service Company's customer accounts services-related charges to TAWC with outside providers of the same services because survey data is proprietary and expensive to obtain. For this reason, TAWC's charges from the Service Company for customer accounts services are compared to those of neighboring electric utilities because the data necessary to make such comparison is available to the public.

Neighboring electric utility cost information comes from the FERC Form 1 that each utility must file. FERC's chart of accounts is defined in Chapter 18, Part 101 of the Code of Federal Regulations. FERC accounts that contain customer accounts services-related expenses are Account 903 Customer Accounts Expense – Records and Collection Expense and Account 905 Customer Accounts Expense – Miscellaneous Customer Accounts Expense. Exhibit 9 provides FERC's definition of the type of expenses that should be recorded in these accounts.

In addition to the charges in these FERC accounts, labor-related overheads charged to the following FERC accounts must be added to the labor components of Accounts 903 and 905:

- Account 926 Employee Pension and Benefits
- Account 408 Taxes Other Than Income (employer's portion of FICA)

Comparison Group

Electric utilities included in the comparison group are shown in the table below. These are companies whose FERC Form 1 show amounts for accounts 903 and 905.

Tennessee	• Kingsport Power	
North Carolina	• Duke Energy Carolinas	• Progress Energy Carolinas
Kentucky	• Duke Energy Kentucky	• Kentucky Utilities
	• Kentucky Power	• Louisville Gas & Electric
Mississippi	• Entergy Mississippi	• Mississippi Power
Virginia	• Appalachian Power	• Virginia Electric Power
Georgia	• Georgia Power	
Alabama	• Alabama Power	
Arkansas	• Entergy Arkansas	
Missouri	• Empire District Electric	• Union Electric
	• Kansas City Power & Light	

Tennessee American Water Company FERC Account Descriptions

903 – Customer Records and Collection Expenses

This account shall include the cost of labor, materials used and expenses incurred in work on customer applications, contracts, orders, credit investigations, billing and accounting, collections and complaints.

Labor

1. Receiving, preparing, recording and handling routine orders for service, disconnections, transfers or meter tests initiated by the customer, excluding the cost of carrying out such orders, which is chargeable to the account appropriate for the work called for by such orders.
2. Investigations of customers' credit and keeping of records pertaining thereto, including records of uncollectible accounts written off.
3. Receiving, refunding or applying customer deposits and maintaining customer deposit, line extension, and other miscellaneous records.
4. Checking consumption shown by meter readers' reports where incidental to preparation of billing data.
5. Preparing address plates and addressing bills and delinquent notices.
6. Preparing billing data.
7. Operating billing and bookkeeping machines.
8. Verifying billing records with contracts or rate schedules.
9. Preparing bills for delivery, and mailing or delivering bills.
10. Collecting revenues, including collection from prepayment meters unless incidental to meter reading operations.
11. Balancing collections, preparing collections for deposit, and preparing cash reports.
12. Posting collections and other credits or charges to customer accounts and extending unpaid balances.
13. Balancing customer accounts and controls.
14. Preparing, mailing, or delivering delinquent notices and preparing reports of delinquent accounts.
15. Final meter reading of delinquent accounts when done by collectors incidental to regular activities.
16. Disconnecting and reconnecting services because of nonpayment of bills.
17. Receiving, recording, and handling of inquiries, complaints, and requests for investigations from customers, including preparation of necessary orders, but excluding the cost of carrying out such orders, which is chargeable to the account appropriate for the work called for by such orders.
18. Statistical and tabulating work on customer accounts and revenues, but not including special analyses for sales department, rate department, or other general purposes, unless incidental to regular customer accounting routines.
19. Preparing and periodically rewriting meter reading sheets.
20. Determining consumption and computing estimated or average consumption when performed by employees other than those engaged in reading meters.

Materials and expenses

21. Address plates and supplies.
22. Cash overages and shortages.
23. Commissions or fees to others for collecting.
24. Payments to credit organizations for investigations and reports.
25. Postage.
26. Transportation expenses, including transportation of customer bills and meter books under centralized billing procedure.
27. Transportation, meals, and incidental expenses.
28. Bank charges, exchange, and other fees for cashing and depositing customers' checks.
29. Forms for recording orders for services, removals, etc.
30. Rent of mechanical equipment.



**Tennessee American Water Company
FERC Account Descriptions**

905 – Miscellaneous Customer Accounts Expenses

This account shall include the cost of labor, materials used and expenses incurred not provided for in other accounts.

Labor

1. General clerical and stenographic work.
2. Miscellaneous labor.

Materials and expenses

3. Communication service.
4. Miscellaneous office supplies and expenses and stationery and printing other than those specifically provided for in accounts 902 and 903.



VI - Question 3 - Reasonableness of Customer Accounts Services Costs

TAWC Cost per Customer

As calculated below, TAWC's 12 months ended March 31, 2010 customer account services expense per customer was \$29.08. The cost pool used to calculate this average includes charges for Service Company services (e.g., call center, billing, payment processing) and postage and forms expenses, which are incurred directly by TAWC. It was necessary to adjust the National Call Center charges because electric utilities experience an average of 2.50 calls per customer compared to American Water's 1.32 calls per customer. Thus, National Call Center expenses had to be increased, for comparison purposes, to reflect its costs at a 2.50 calls per customer level.

Tennessee American Water Company		Service Co	Adjustment Fewer Calls For	Water Cos. (A)	Adjusted
Cost Component		Charges			
<hr/>					
Service Company					
Call Centers	Call processing, order processing, credit, bill collection	\$ 1,120,113	\$ 450,805		\$ 1,570,918
Service Company	Customer payment processing				\$ 130,927
Operating Company	Postage & forms				\$ 464,130
				Cost Pool Total	\$ 2,165,975
				Total Customers	74,475
					<u>\$ 29.08</u>

Note A: Adjustment for American Water's fewer calls per customer

This adjustment is necessary because water utilities experience fewer calls per customer than do electric utilities

Test year Call Handling charges	\$ 502,486
Electric utility industry's avg calls/customer	2.50
American Water's avg calls/customer	1.32
Percent different	90%
Total Adjustment	\$ 450,805

Note B: Estimated customer payment processing expenses

Number of customers	74,475
Number of payments/customer/year	12.0
Total payments processed/year	893,700
Bank charge per item	\$ 0.1465
Total estimated annual expense	\$ 130,927

Electric Utility Group Cost per Customer

Exhibit 10 shows the actual 2009 customer accounts expense per customer calculation for the electric utility comparison group. All of the underlying data was obtained from the utilities' FERC Form 1.

VI - Question 3 - Reasonableness of Customer Accounts Services Costs

Summary of Results

As shown in the table below, TAWC's cost per customer is below the average cost of the neighboring electric utility comparison group. It can therefore be concluded that TAWC's 12 months ended March 31, 2010 customer accounts-related expenses, including those of the Alton and Pensacola Call Centers, assigned by the Service Company to TAWC were comparable to those of other utilities.

Customer Account Services Expenses Per Customer	
Virginia Electric Power	\$ 17.53
Louisville Gas & Electric	\$ 20.40
Union Electric	\$ 21.87
Progress Energy Carolinas	\$ 22.96
Duke Energy Carolinas	\$ 26.96
Tennessee American Water	\$ 29.08
Kansas City Power & Light	\$ 29.64
Comparison Group Average	\$ 32.01
Appalachian Power	\$ 32.70
Kingsport Power	\$ 32.78
Duke Energy Kentucky	\$ 34.65
Kentucky Utilities	\$ 35.47
Kentucky Power	\$ 36.03
Empire District Electric	\$ 37.79
Georgia Power	\$ 42.84
Entergy Mississippi	\$ 45.84
Entergy Arkansas	\$ 47.60
Alabama Power	\$ 49.05
Mississippi Power	\$ 67.39

Tennessee American Water Company
Comparison Group 2009 Actual Customer Accounts Expense Per Customer

	Tennessee		Missouri		Alabama		Arkansas	
	Kingsport Power	Empire District Electric	Kansas City Power & Light	Union Electric	Alabama Power	Entergy Arkansas		
	\$ 1,458,469	\$ 4,985,478	\$ 12,163,465	\$ 22,713,638	\$ 60,153,942	\$ 25,616,113		
	\$ 1,697	\$ 184,860	\$ 2,371	\$ 200,456	\$ -	\$ 103,284		
	\$ 1,460,166	\$ 5,170,338	\$ 12,165,836	\$ 22,914,094	\$ 60,153,942	\$ 25,719,397		
Note A	\$ 63,259	\$ 930,079	\$ 2,636,671	\$ 2,267,993	\$ 7,147,923	\$ 6,817,930		
Note B	\$ 18,076	\$ 250,143	\$ 558,111	\$ 788,888	\$ 3,121,268	\$ 333,631		
Total Cost Pool	\$ 1,541,501	\$ 6,350,560	\$ 15,360,618	\$ 25,970,975	\$ 70,423,133	\$ 32,870,958		
	47,027	168,032	518,196	1,187,613	1,435,612	690,500		
	\$ 32.78	\$ 37.79	\$ 29.64	\$ 21.87	\$ 49.05	\$ 47.60		
	\$ 526,873	\$ 11,454,549	\$ 60,579,650	\$ 80,158,501	\$ 49,906,316	\$ 64,841,181		
	\$ 1,967,933	\$ 40,270,300	\$ 167,621,486	\$ 364,470,026	\$ 284,869,068	\$ 41,476,558		
	26.8%	28.4%	36.1%	22.0%	17.5%	156.3%		
	\$ 261,311	\$ 4,346,335	\$ 9,742,970	\$ 14,738,859	\$ 49,380,337	\$ 5,473,554		
	\$ -	\$ -	\$ -	\$ 3,534,098	\$ -	\$ -		
	\$ 261,311	\$ 4,346,335	\$ 9,742,970	\$ 18,272,957	\$ 49,380,337	\$ 5,473,554		
	\$ 1,458,469	\$ 4,985,478	\$ 12,163,465	\$ 22,713,638	\$ 60,153,942	\$ 25,616,113		
	\$ 1,697	\$ 184,860	\$ 2,371	\$ 200,456	\$ -	\$ 103,284		
	\$ 1,460,166	\$ 5,170,338	\$ 12,165,836	\$ 22,914,094	\$ 60,153,942	\$ 25,719,397		
	\$ 154,677	\$ 1,702,173	\$ 4,081,210	\$ 17,688,852	\$ 12,648,925	\$ 6,560,032		
	\$ 1,614,843	\$ 6,872,511	\$ 16,247,046	\$ 40,602,946	\$ 72,802,867	\$ 32,279,429		
	90.4%	75.2%	74.9%	56.4%	82.6%	79.7%		
	\$ 236,281	\$ 3,269,841	\$ 7,295,565	\$ 10,312,263	\$ 40,800,892	\$ 4,361,183		
	\$ 63,259	\$ 930,079	\$ 2,636,671	\$ 2,267,993	\$ 7,147,923	\$ 6,817,930		
	\$ 236,281	\$ 3,269,841	\$ 7,295,565	\$ 10,312,263	\$ 40,800,892	\$ 4,361,183		
	7.65%	7.65%	7.65%	7.65%	7.65%	7.65%		
	\$ 18,076	\$ 250,143	\$ 558,111	\$ 788,888	\$ 3,121,268	\$ 333,631		

Customer Account Services Cost Pool

FERC Account Balances:

Acct 903 - Customer Records & Collection (page 322, line 161)

Acct 905 - Misc Customer Accounts (page 322, line 163)

Subtotal

Add: Employee Benefits & Employer FICA (not included in above amounts)

Account 926 - Employee Pension & Benefits

Account 408 - Taxes Other Than Income (Employer's Portion of FICA)

Total Cost Pool

Total Customers (page 304, line 43)

Customer Account Services Expense per Customer

Note A: Calculation of Pension & Benefits Pertaining to Customer Acct Mgmt

Account 926 - Employee Pension & Benefits (page 323, line 187)

Total O&M Payroll (page 355, line 65)

Benefits as Percent of Payroll

Payroll Applicable to Customer Account Services

Total Payroll Charged to Customer Accounts Function

Electric (page 354, line 7)

Gas (page 354, line 37)

Total Payroll Charged to Customer Accounts

Percent Applicable to Customer Accounts Services (903 and 905):

Acct 903 - Customer Records & Collection (page 322, line 161)

Acct 905 - Misc Customer Accounts (page 322, line 163)

Subtotal - Total Charges Applicable to Customer Accounts Services

Acct 902 - Meter Reading Expenses (page 322, line 160)

Total Charges Applicable to Customer Accounts Svcs & Meter Reading

Percent Applicable to Customer Accounts Services (903 and 905)

Customer Account Services Portion of Total Payroll

Pension & Benefits Pertaining to Customer Accounts Services

Note B: Calculation of Employer's FICA Pertaining to Customer Accounts Services

Customer Account Services Portion of Total Payroll

Employer's Portion of FICA (6.20%) and Medicare (1.45%)

Estimated Employer's Portion of FICA

Tennessee American Water Company
Comparison Group 2009 Actual Customer Accounts Expense Per Customer

	Virginia		Kentucky				Louisville Gas & Electric
	Appalachian Power	Virginia Electric Power	Duke Energy Kentucky	Kentucky Power	Kentucky Utilities		
	\$ 28,380,733	\$ 34,105,089	\$ 3,864,114	\$ 5,769,938	\$ 14,908,295	\$ 5,312,623	
	\$ 40,577	\$ -	\$ -	\$ 11,053	\$ 381,731	\$ 376,263	
	\$ 28,421,310	\$ 34,105,089	\$ 3,864,114	\$ 5,780,991	\$ 15,290,026	\$ 5,688,886	
	\$ 2,437,214	\$ 6,239,031	\$ 574,673	\$ 425,941	\$ 3,361,029	\$ 1,963,008	
	\$ 529,463	\$ 1,787,731	\$ 232,521	\$ 97,581	\$ 526,276	\$ 322,726	
	\$ 31,387,987	\$ 42,131,851	\$ 4,671,308	\$ 6,304,513	\$ 19,177,331	\$ 7,974,620	
	959,814	2,403,558	134,819	174,994	540,618	390,825	
	\$ 32.70	\$ 17.53	\$ 34.65	\$ 36.03	\$ 35.47	\$ 20.40	
	\$ 38,645,990	\$ 167,027,121	\$ 6,660,396	\$ 7,869,045	\$ 38,828,205	\$ 37,681,044	
	\$ 109,744,984	\$ 625,619,817	\$ 35,227,412	\$ 23,565,539	\$ 79,474,397	\$ 80,979,200	
	35.2%	26.7%	18.9%	33.4%	48.9%	46.5%	
	\$ 7,978,348	\$ 30,292,243	\$ 2,598,192	\$ 1,433,061	\$ 8,670,255	\$ 3,198,589	
	\$ -	\$ -	\$ 1,383,512	\$ -	\$ -	\$ 2,615,816	
	\$ 7,978,348	\$ 30,292,243	\$ 3,981,704	\$ 1,433,061	\$ 8,670,255	\$ 5,814,405	
	\$ 28,380,733	\$ 34,105,089	\$ 3,864,114	\$ 5,769,938	\$ 14,908,295	\$ 5,312,623	
	\$ 40,577	\$ -	\$ -	\$ 11,053	\$ 381,731	\$ 376,263	
	\$ 28,421,310	\$ 34,105,089	\$ 3,864,114	\$ 5,780,991	\$ 15,290,026	\$ 5,688,886	
	\$ 4,341,650	\$ 10,103,836	\$ 1,197,835	\$ 713,762	\$ 3,980,247	\$ 2,151,907	
	\$ 32,762,960	\$ 44,208,925	\$ 5,061,949	\$ 6,494,753	\$ 19,270,273	\$ 7,840,793	
	86.7%	77.1%	76.3%	89.0%	79.3%	72.6%	
	\$ 6,921,081	\$ 23,369,029	\$ 3,039,493	\$ 1,275,570	\$ 6,879,426	\$ 4,218,641	
	\$ 2,437,214	\$ 6,239,031	\$ 574,673	\$ 425,941	\$ 3,361,029	\$ 1,963,008	
	\$ 6,921,081	\$ 23,369,029	\$ 3,039,493	\$ 1,275,570	\$ 6,879,426	\$ 4,218,641	
	7.65%	7.65%	7.65%	7.65%	7.65%	7.65%	
	\$ 529,463	\$ 1,787,731	\$ 232,521	\$ 97,581	\$ 526,276	\$ 322,726	

Customer Account Services Cost Pool

FERC Account Balances:

Acct 903 - Customer Records & Collection (page 322, line 161)

Acct 905 - Misc Customer Accounts (page 322, line 163)

Subtotal

Add: Employee Benefits & Employer FICA (not included in above amounts)

Account 926 - Employee Pension & Benefits

Account 408 - Taxes Other Than Income (Employer's Portion of FICA)

Total Cost Pool

Total Customers (page 304, line 43)

Customer Account Services Expense per Customer

Note A

Note B

Note A: Calculation of Pension & Benefits Pertaining to Customer Acct Mgmt

Account 926 - Employee Pension & Benefits (page 323, line 187)

Total O&M Payroll (page 355, line 65)

Benefits as Percent of Payroll

Payroll Applicable to Customer Account Services

Total Payroll Charged to Customer Accounts Function

Electric (page 354, line 7)

Gas (page 354, line 37)

Total Payroll Charged to Customer Accounts

Percent Applicable to Customer Accounts Services (903 and 905):

Acct 903 - Customer Records & Collection (page 322, line 161)

Acct 905 - Misc Customer Accounts (page 322, line 163)

Subtotal - Total Charges Applicable to Customer Accounts Services

Acct 902 - Meter Reading Expenses (page 322, line 160)

Total Charges Applicable to Customer Accounts Svcs & Meter Reading

Percent Applicable to Customer Accounts Services (903 and 905)

Customer Account Services Portion of Total Payroll

Pension & Benefits Pertaining to Customer Accounts Services

Note B: Calculation of Employer's FICA Pertaining to Customer Accounts Services

Customer Account Services Portion of Total Payroll

Employer's Portion of FICA (6.20%) and Medicare (1.45%)

Estimated Employer's Portion of FICA

Tennessee American Water Company
Comparison Group 2009 Actual Customer Accounts Expense Per Customer

Georgia		Mississippi		North Carolina	
Georgia Power	Energy Mississippi	Mississippi Power	Duke Energy Carolinas	Prog Energy Carolinas	
\$ 84,911,244	\$ 17,647,249	\$ 9,277,161	\$ 58,491,837	\$ 25,264,008	
\$ 88,908	\$ 71,579	\$ 1,162,224	\$ 63,286	\$ 2,913,845	
\$ 85,000,152	\$ 17,718,828	\$ 10,439,385	\$ 58,555,123	\$ 28,177,853	
\$ 12,582,725	\$ 2,024,275	\$ 1,664,015	\$ 3,743,004	\$ 4,374,673	
\$ 3,286,888	\$ 202,332	\$ 426,091	\$ 1,771,092	\$ 1,007,671	
\$ 100,869,765	\$ 19,945,435	\$ 12,529,491	\$ 64,069,219	\$ 33,560,198	
2,354,531	435,133	185,924	2,376,853	1,461,874	
\$ 42.84	\$ 45.84	\$ 67.39	\$ 26.96	\$ 22.96	\$ 32.01
					Group Average
					\$ 495,139,462
					15,465,923
					\$

Customer Account Services Cost Pool

FERC Account Balances:

Acct 903 - Customer Records & Collection (page 322, line 161)
Acct 905 - Misc Customer Accounts (page 322, line 163)

Subtotal

Add: Employee Benefits & Employer FICA (not included in above amounts)

Account 926 - Employee Pension & Benefits
Account 408 - Taxes Other Than Income (Employer's Portion of FICA)

Note A
Note B

Total Cost Pool

Total Customers (page 304, line 43)

Customer Account Services Expense per Customer

Note A: Calculation of Pension & Benefits Pertaining to Customer Acct Mgmt

Account 926 - Employee Pension & Benefits (page 323, line 187)

Total O&M Payroll (page 355, line 65)

Benefits as Percent of Payroll

Payroll Applicable to Customer Account Services

Total Payroll Charged to Customer Accounts Function

Electric (page 354, line 7)

Gas (page 354, line 37)

Total Payroll Charged to Customer Accounts

Percent Applicable to Customer Accounts Services (903 and 905):

Acct 903 - Customer Records & Collection (page 322, line 161)

Acct 905 - Misc Customer Accounts (page 322, line 163)

Subtotal - Total Charges Applicable to Customer Accounts Services

Acct 902 - Meter Reading Expenses (page 322, line 160)

Total Charges Applicable to Customer Accounts Svcs & Meter Reading

Percent Applicable to Customer Accounts Services (903 and 905)

Customer Account Services Portion of Total Payroll

Pension & Benefits Pertaining to Customer Accounts Services

Note B: Calculation of Employer's FICA Pertaining to Customer Accounts Services

Customer Account Services Portion of Total Payroll

Employer's Portion of FICA (6.20%) and Medicare (1.45%)

Estimated Employer's Portion of FICA

Baryenbruch & Company,



LLC

VI - Question 4 – Need for Service Company Services

Analysis of Services

The final aspect of this study was an assessment of whether the services that are provided to TAWC by the Service Company would be necessary if TAWC were a stand-alone water utility. The first step in this evaluation was to determine specifically what the Service Company does for TAWC. Based on discussions with Service Company personnel, the matrix in Exhibit 11 was created showing which entity—TAWC or a Service Company location—is responsible for each of the functions TAWC requires to ultimately provide service to its customers. This matrix was reviewed to determine: (1) if there was redundancy or overlap in the services being provided by the Service Company and (2) if Service Company services are typical of those needed by a stand-alone water utility.

Upon review of Exhibit 11, the following conclusions can be drawn:

- The services that the Service Company provides are necessary and would be required even if TAWC were a stand-alone water utility.
- There is no redundancy or overlap in the services provided by the Service Company to TAWC. For all of the services listed in Exhibit 11, there was only one entity that was primarily responsible for the service.

Tennessee American Water Company Designation Of Responsibility For Water Utility Functions

Water Company Function	Performed By:						
	TAWC	Customer Call Center	Division Office	Shared Services	Corporate Office	IT Service Centers	Belleville Lab
P - Primarily Responsible							
S - Provides Support							
Engineering and Construction Management							
CFS Preparation	S				P		
Five-Year System Planning	S				P		
Engineering Standards & Policies Development Project Design	S				P		
Major Projects (e.g., new treatment plant)	S				P		
Special Projects	P				S		
Minor Projects (e.g., pipelines)	P						
Construction Project Management					P		
Major Projects	S				P		
Special Projects	S				P		
Minor Projects	P						
Hydraulics Review	P				S		
Developers Extensions	P						
Tank Painting	P				S		
Water Quality and Purification							
Water Quality Standards Development	S				S		P
Research Studies	S				S		P
Water Quality Program Implementation	P				S		
Water Treatment Operations & Maintenance	P		S		S		
Compliance Sampling and Chemical Testing	S				S		P
Sample Collection and Other Testing	S				S		P
Transmission and Distribution							
Preventive Maintenance Program Development	P						
System Maintenance	P						
Leak Detection	P						
Customer Service							
Community Relations	P				S		
Customer Contact	S	P					
Call Processing	S	P					
Service Order Creation	S	P					
Service Order Processing	P	S					
Customer Credit	S	P					
Meter Reading	P						S
Customer Bill Preparation		S					P
Bill Collection	S	P					S
Customer Payment Processing	S			P			
Meter Standards Development	S						
Meter Testing, Maintenance & Replacement	P				P		

Tennessee American Water Company Designation Of Responsibility For Water Utility Functions

Water Company Function	TAWC	Performed By:					
		Customer Call Center	Division Office	Shared Services	Corporate Office	IT Service Centers	Belleville Lab
Financial Management							
Financial Planning	S		P		S		
Financings--Equity					P		
Financings--Long Term Debt & Preferred (Note A)	S		P				
Short Term Lines of Credit Arrangements (Note A)	S		P				
Investor Relations			S		P		
Insurance Program Administration	S				P		
Loss Control/Safety Program Administration	S		P		S		
Pension Fund Asset Management					P		
Cash Management/Disbursements	S						
Internal Auditing	S		S		P		
Budgeting and Variance Reporting							
Corporate Guidelines & Instructions							
Regional Guidelines & Instructions			P				
Budget Preparation							
Revenue and O&M	P		S				
O&M	P		S				
Depreciation and Interest Expense	S		S		P		
Budget Preparation--Service Company Charges		S	P		S		S
Capital Budget Preparation--Projects	P				S		
Capital Budget Preparation--Non-Project Work	P						
Prepare Monthly Budget Variance Report ("Budget/Plan Analysis")	P		S		S		
Prepare Capital Project Budget Status Report	P						
Year-End Projections	P				S		
Accounting and Taxes							
Accounts Payable Accounting	S				P		
Payroll Accounting	S				P		
Work Order Accounting	S				P		
Fixed Asset Accounting	S				P		
Journal Entry Preparations--Billing Corrections	S				P		
Journal Entry Preparation--All Others	S				P		
Financial Statement Preparation	S				P		
State Commission Reporting	S		S		P		
Income Taxes --State					P		
Income Taxes --Federal					P		
Property Taxes					P		
Gross Receipts (Town) Taxes	S				P		

Note A: Financings and lines of credit are the responsibility of American Capital Corporation

Tennessee American Water Company Designation Of Responsibility For Water Utility Functions

Water Company Function	TAWC	Performed By:						
		Customer Call Center	Division Office	Shared Services	Corporate Office	IT Service Centers	Belleville Lab	
Rates								
Rate Studies & Tariff Change Administration	S		P					
Rate Case Planning and Preparation	S		P					
Rate Case Administration	S		P					
Commission Inquiry Response	S		P					
Legal								
Purchasing and Materials Management – National (pipe, chemicals, meters, etc.)								
Specification Development	S		S	S	P			
Bid Solicitation	S			P				
Contract Administration	S			P				
Purchasing and Materials Management – State (state supplier service agreements)								
Specification Development	P				S			
Bid Solicitation	P			S				
Contract Administration	P			S				
Ordering	P							
Inventory Management	P			S				
Human Resources Management								
Benefit Program Development								
Benefits Program Administration					P			
Management Compensation Administration	S				P			
Wage & Salary Program Design					P			
Wage & Salary Administration	P		S		P			
Labor Relations - Wages	P		S					
Labor Relations - Benefits								
Labor Relations - Work Rules	P		S		P			
Training Program Development	S		S		P			
Training--Course Delivery	P		S					
Affirmative Action/EEO--Plan Development	P							
Affirmative Action/EEO--Implementation	P							
Information Systems Services								
Service Company Data Centers								
System Operations & Maintenance								P
Software Maintenance								P
Network Administration	S		P					S
PC Acquisition & Support	S		P					S
Help Desk				S				P



VI - Question 4 – Need for Service Company Services

Governance Practices Associated With Service Company Charges

There are several ways by which TAWC exercises control over Service Company services and charges. The most important of these are described below.

- **Divisional Sr. Vice President Oversight** – The Eastern Division Senior Vice President is on the Executive Management Team (EMT) of American Water. The Divisional Sr. Vice President is responsible for the overall performance of each operating company in the Division, including Long Island Water Corp., Indiana American Water Company, Ohio American Water Company, Virginia American Water Company, West Virginia American Water Company, Kentucky American Water Company, Tennessee American Water Company, Michigan American Water Company, and Maryland American Water Company. As part of the EMT, each Divisional Senior Vice President has equal say with other EMT members in major business decisions of American Water and has the ability to monitor Service Company performance quality and spending.
- **Divisional Vice President & Treasurer** – The Divisional Vice President and Treasurer of the Eastern Division is responsible for the financial reporting, performance and internal controls of each of the operating companies in the division. The Vice President and Treasurer monitors the performance and expense levels of the Service Company and validates the cost of services received. Also, the Vice President and Treasurer reviews the monthly charges and investigates whenever the amount, quality and/or services are appropriate.
- **Operating Company Board Oversight** – TAWC board of directors includes members of American Water's EMT, members of the Eastern Division's management team, TAWC's Management team and business and community leaders from outside the Company. This diverse board ensures that TAWC's needs are a factor in the delivery of Service Company services. The TAWC Board meets at a minimum of four times each year and at every meeting financial and operational reports and issues are discussed at length.
- **Service Company Board Oversight** – The Service Company Board of Directors is comprised of 16 members, some of whom are the presidents of state operating companies. They typically meet four times a year to provide governance on the activities and bylaws of Service Company. Their primary responsibilities include:
 - Approve the Business Plan and Operating Budget
 - Review Financial Performance of the Service Center
 - Review performance metrics of certain functional groups
 - Approve policy, procedures and practices of AW as it relates to Service Company
- **Service Company Budget Review/Approval** – Several operating company presidents sit on the Service Company board and that board must formally approve the budget for Service Company charges for the next year. These budgeted charges are consolidated with the operating company's own spending into an overall budget which must be approved by the operating company's board of directors (e.g., TAWC).
- **Major Project Review And Approval** – Major projects undertaken by the Service Company must first be reviewed by American Water's Executive Management Team, which includes the Divisional Senior Vice President. The Divisional Senior Vice President, with input from the divisional and state management teams (including TAWC) has the ability to impact all new initiatives and projects before they are authorized. Major non-capital projects and initiatives for the Service Company are approved through the Business Plan. All significant business initiatives (capital or non-capital) are required to be submitted to the "BATT" (Business and Technology Team) committee for final

VI - Question 4 – Need for Service Company Services

approval. The “BATT” team is comprised of C-level executive members (CEO, CFO, etc.).

- **Accounting and Financial Reporting** – Similar to the states, the Service Company follows the same accounting and financial reporting processes. During the month accounting transactions are recorded. At month end, the SSC and Service Company Finance teams review all transactions. Variance analyses are performed based on month to month actual as well as actual to budget to ensure accuracy. Once completed, the service company bill is run and the actuals are “pushed down” and allocated to the states based on predetermined formulas. A conference call is schedule before the operating companies close their books each month to discuss Service Company performance. This is based at a functional level with explanation reported for those expense variances that meet or exceed certain thresholds. At this time, the operating companies may question expenses and spending for better understanding of results. Finance personnel review the monthly Service Company bill for accuracy and reasonableness on a monthly basis. Any mistakes or overcharges are credited on a subsequent billing.
- **Operating Company Budget Variance Reporting** – The “Budget/Plan Analysis,” produced monthly by each operating company, has line items for Management Fees and Shared Service Expense (i.e., IT, Call Center, etc.). In this way, Service Company budget versus actual charges as charged to the operating company can be monitored and reviewed for the month and year-to-date as compared to prior year, plan and reforecast.
- **Capital Investment Management (CIM)** – CIM covers capital and asset planning and is employed throughout American Water, including the Service Company. CIM provides a full range of governance practices, including a formal protocol for assessing system needs, prioritizing expenditures, managing the capital program, approving project spending, delivering projects and measuring outputs. CIM ensures that:
 - Capital expenditure plans are aligned with the strategic intent of the business,
 - The impact of capital expenditure and income plans are fully reflected in operating expense plans,
 - The impacts of these plans are understood and affordable, and
 - Effective controls are in place over budgets (through business plans) and individual capital projects (through appropriate authorization thresholds, management and reporting processes).

The CIM process was designed to optimize the effectiveness of asset investment. The process is managed at three levels (state, divisional, and national (corporate) for all American Water companies, including all Tennessee American Operating Units.

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**TENNESSEE REGULATORY AUTHORITY
NASHVILLE, TENNESSEE
DOCKET NO. 10-00189**

TAWC EXHIBIT _____

**REBUTTAL TESTIMONY OF
PATRICK L. BARYENBRUCH**

TENNESSEE-AMERICAN WATER COMPANY

FEBRUARY 8, 2011

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TENNESSEE AMERICAN WATER COMPANY
REBUTTAL TESTIMONY

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I – WITNESS INTRODUCTION

1. Q. Please state your name and business address.

A. Patrick L. Baryenbruch, 2832 Claremont Road, Raleigh, North Carolina 27608.

2. Q. Did you previously file direct testimony in this case?

A. Yes, I filed direct testimony and a study that evaluated the necessity of services provided by American Water Works Service Company, Inc. (“Service Company”) to Tennessee American Water Company (“TAWC”) and the reasonableness of those charges.

My study answered four questions concerning the services provided by the Service Company to TAWC, each of which bears on the appropriateness of those charges as incurred during the 12 months ended March 31, 2010. First, are the Service Company’s charges to TAWC during the 12 months ended March 31, 2010 reasonable? Second, was TAWC charged the lower of cost or market for managerial and professional services provided by the Service Company during those 12 months? Third, were the costs of the Service Company’s customer accounts services, including those of the National Call Centers, comparable to those of other utilities for those 12 months? Fourth, are the services TAWC receives from the Service Company necessary?

II – PURPOSE OF TESTIMONY

3. Q. Please describe the reason for your rebuttal testimony.

TENNESSEE AMERICAN WATER COMPANY
REBUTTAL TESTIMONY

1 A. I am responding to the following sections from the direct testimony of Kimberly H.
2 Dismukes, witness for the City of Chattanooga:

- 3 • Are the Service Company’s charges to TAWC during the 12 months ended
4 March 31, 2010 reasonable? – Dismukes: Section VI
- 5 • Was TAWC charged the lower of cost or market for managerial and
6 professional services provided by the Service Company during the 12 months
7 ended March 31, 2010? – Dismukes: Section VII
- 8 • Were the 12 months ended March 31, 2010 costs of the Service Company’s
9 customer accounts services, including those of the National Call Centers,
10 comparable to those of other utilities? – Dismukes: Section VIII
- 11 • Are the services TAWC receives from the Service Company necessary? –
12 Dismukes: Section IX

13 **III – MS. DISMUKES’ TESTIMONY CONCERNING**
14 **SERVICE COMPANY COST COMPARISON**

15 **4. Q. What is Ms. Dismukes’ argument against your answer to the question**
16 **regarding the reasonableness of Service Company costs?**

17 A. The benchmarking I employ in answering this question compares A&G costs per
18 customer for TAWC’s Service Company charges to the same charges for electric
19 and combination electric/gas services companies that must file the Form 60 with
20 the FERC.

TENNESSEE AMERICAN WATER COMPANY
REBUTTAL TESTIMONY

1 Ms. Dismukes would prefer that I use data only from other water companies.
2 This is impossible because no publicly available cost information exists for water
3 service companies. Very few water companies have a centralized service
4 company arrangement. Those that do are not overseen by a single regulatory
5 authority that requires standard informational filings, as does the FERC.

6 Ms. Dismukes contends it is impossible to compare any costs of water utilities to
7 those of electric utilities. On page 4 of her testimony, Ms. Dismukes states that I
8 have “provided no evidence that the service company charges of electric
9 companies are comparable to or should be compared to the service company
10 charges of water companies.”

11 Ms. Dismukes attempts to argue against the service company comparison group
12 by discussing the various ways electric generation, transmission and distribution
13 are different from water treatment and distribution. She is correct in noting that
14 these operating and maintenance (O&M) functions are completely different for
15 the two industries. This is not relevant to the question, however, because I do
16 not make comparisons of O&M expenses. I compare American Water’s Service
17 Company costs for administrative and general (A&G) expenses to the same
18 costs for electric and electric/gas utility service companies. In pages 27 through
19 38, Ms. Dismukes presents various arguments against my comparison group
20 approach. She tries to extrapolate differences in utility O&M functions to A&G
21 services, although A&G services involve similar processes across utilities. I will

TENNESSEE AMERICAN WATER COMPANY
REBUTTAL TESTIMONY

1 demonstrate in this rebuttal testimony that her arguments are flawed. In this
2 rebuttal testimony, I will demonstrate why A&G service activities are similar
3 among different utility types.

4 **5. Q. Please define what comprises the A&G services that you include in your**
5 **service company cost comparison.**

6 A. A&G functions include the following:

- 7 • Legal
- 8 • Internal Auditing
- 9 • Accounting & Property Records
- 10 • Taxes
- 11 • Budgeting and Reporting
- 12 • Information Technology
- 13 • Rates and Regulatory
- 14 • Procurement
- 15 • Human Resources
- 16 • Customer Services
- 17 • Executive Management

18 The question Ms. Dismukes should have addressed in her direct testimony is
19 “Are there significant differences in the nature of these A&G-related services
20 between water and electric utilities?” I will demonstrate that A&G services

TENNESSEE AMERICAN WATER COMPANY
REBUTTAL TESTIMONY

1 provided by utility service companies are generally similar and, therefore, valid
2 cost comparisons can be made across utility industry types.

3 **6. Q. Please describe your experience to make this determination.**

4 A. Based on Ms. Dismukes' description of her background in her direct testimony,
5 the focus of her career has been in representing parties on the opposite side of
6 regulated utilities in regulatory proceedings. Her lack of direct work experience
7 within utility organizations is evident in her analysis and presentation of her water
8 sample group and unsupported assertions about service company organizations
9 in general as pointed out in this testimony.

10 In contrast to Ms. Dismukes' background, I have significant experience working
11 for utility clients over 35 years, performing a wide variety of consulting
12 assignments that provide me a thorough understanding of their structure,
13 organization, operations and business processes. I have worked for 46 investor-
14 owned utility companies and 8 public power entities. My clients include several
15 utilities served by service companies in this study's comparison group, including
16 Allegheny, Dominion, Duke Energy, Entergy, E-On, Exelon, First Energy,
17 NiSource, Northeast and Progress Energy.

18 For the past several years, I have helped manage a number of information
19 technology projects involving over 500,000 hours of work. These projects require
20 a detailed understanding of the utility client's processes affected by the new
21 systems.

TENNESSEE AMERICAN WATER COMPANY
REBUTTAL TESTIMONY

1 I have performed consulting assignments at several nuclear stations, including
2 Brunswick, Robinson, Harris, Limerick, Grand Gulf, ANO 1, Waterford, Salem,
3 Hope Creek, Comanche Peak and Diablo Canyon.

4 During 2004, I helped Duke Energy manage its implementation of Sarbanes-
5 Oxley 404, a project that involved the work of hundreds of employees and
6 outside consultants. I later assisted Duke Energy with its 2006 merger with
7 Cinergy, helping to integrate the two companies' financial systems, charts of
8 accounts and business processes.

9 Besides working directly for utility clients, I have worked for their regulators,
10 participating in the 22 commission-ordered general management audits. In
11 addition, my firm conducted the 2002-2005 audits of Southern California Edison's
12 affiliate transactions for compliance with the California Public Utilities
13 Commission's regulations.

14 This extensive utility industry experience puts me in a position to determine that
15 the cost of administrative and general services can be validly compared across
16 different utility types. This is so because A&G processes are similar even though
17 the utility services differ.

18 **7. Q. Please provide examples of how A&G services are similar across different**
19 **utility types.**

TENNESSEE AMERICAN WATER COMPANY
REBUTTAL TESTIMONY

1 A. Take, for instance, accounting services. Regardless of utility type, the work of
2 accountants revolves around their assigned set of general ledger accounts; they
3 ensure transactions have been processed and properly posted to their accounts,
4 reconcile accounts to subsidiary ledgers, prepare journal entries, compile budget
5 versus actual data, research variances and prepare cost performance reports for
6 operating managers. These activities take place in water utilities in just the same
7 way as in electric utilities.

8 Investor-owned utilities of any type have similar processes for tax accounting and
9 compliance. They all have to deal with federal and state income, property, sales
10 and use taxes. In general, tax personnel are responsible for determining tax
11 provisions and preparing and filing various tax returns.

12 Information technology services cover a broad range of activities that are also
13 generally quite similar among utilities. Employees are provided with
14 workstations, email, Microsoft Office, phone service, internet connections and
15 access to financial, human resources and various other corporate applications.
16 Many of the same applications are used by different utilities. For example,
17 American Water uses an application called PowerPlant for project and fixed
18 asset accounting. My clients Duke Energy and Progress Energy use the same
19 application.

20 Information technology hardware and software is operated and maintained in the
21 same way regardless of utility type. Servers reside in a data center that is

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1 operated and maintained by the central IT organization. Telecom and network
2 services are handled in the same centralized way. Corporate applications are
3 supported by technical personnel in the central IT organizations of any type of
4 utility. Thus, American Water’s data center in Harrisburg, Pennsylvania, provides
5 the same type of services as the data centers of electric service companies.

6 The processes and activities associated with delivering other A&G services, such
7 as legal, procurement, human resources, customer services and executive
8 management are likewise similar among different types of utilities.

9 For all these reasons, I believe my comparison provides a valid and useful way to
10 put into perspective the A&G-related charges from American Water’s service
11 company compared to the cost of other utility service companies.

12 **8. Q. What is Ms. Dismukes’ first mischaracterization of utility A&G differences?**

13 A. Beginning with line 21 on page 28, Ms. Dismukes contends the level of regulation
14 of electric utilities is monumentally greater than that faced by water companies.
15 Her statement that “electric companies are regulated by numerous agencies”
16 suggests that water companies face little regulation. This, of course, is not the
17 case. Water is ingested and is highly regulated by federal and state authorities.
18 For instance, TAWC must comply with many regulations established by the
19 Tennessee Division of Water Supply and US Environmental Protection Agency
20 (“EPA”). In states where American Water utilities have water impoundments or
21 stream supplies, they may face regulation related to dams and fish and wildlife

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1 agencies. Some American Water utilities are also subject to regulation by the
2 Army Corps of Engineers and National Oceanic and Atmospheric Administration.

3 On page 29, Ms. Dismukes includes an excerpt from an Exelon statement that
4 describes the aspects of its nuclear generation stations that are regulated by the
5 Nuclear Regulatory Commission (“NRC”). She then contends the “operating and
6 regulatory framework of nuclear power generators and water treatment plants is
7 so dissimilar it is unrealistic to think their A&G expenses would be in any way
8 comparable.”

9 If, as Ms. Dismukes contends, regulatory costs of electric/gas utilities were highly
10 significant, that would be reflected in their affiliate service company charges
11 associated with FERC Account 928 – Regulatory Commission Expenses.
12 However, as shown in Schedule PLB-1, the 2009 cost per customer for such
13 charges are not material. The 2009 average annual cost per customer was only
14 \$0.55, which represents 1% of total service company A&G charges.

15 Also, if regulatory costs for nuclear utility companies are driven up significantly by
16 the NRC’s regulation, as Ms. Dismukes contends, you would expect their A&G
17 costs to be much higher than non-nuclear utility companies. However, an
18 analysis of the underlying numbers shows this to be untrue. As shown in
19 Schedule PLB-2, the service companies that have affiliates with nuclear
20 generation actually have a lower total A&G annual cost per customer (\$95)
21 compared to those without nuclear generation (\$97). Furthermore, a review of

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1 each utility’s per-customer costs in Schedule PLB-2 shows there is no
2 relationship between A&G costs and the extent of a utility company’s nuclear
3 generation.

4 In conclusion, an analysis of the relevant data shows Ms. Dismukes to overstate
5 the impact of nuclear regulation on electric utility A&G costs.

6 **9. Q. What is Ms. Dismukes’ next mischaracterization of utility A&G differences?**

7 A. Beginning on page 30, line 1, Ms. Dismukes describes the operational aspects of
8 running an electric utility generation fleet. In this aspect she is correct that these
9 are clearly different and more complex than running water company treatment
10 facilities. The problem with her application of this finding, however, is that
11 expenses associated with the generation plant functions she describes are all
12 recorded in FERC O&M accounts 500-545 and are largely recorded on the books
13 of the regulated utility itself, not its service company. They are irrelevant to the
14 study of service company costs. My cost comparison focuses on service
15 company A&G costs which are recorded in the 900 series of FERC accounts.
16 Again, Ms. Dismukes is mistaken in her contention that the nature of electric
17 utility A&G costs is different than water company A&G costs.

18 **10.Q. What is Ms. Dismukes’ next mischaracterization of utility A&G differences?**

19 A. Starting on line 14 on page 30, Ms. Dismukes states that electric generating
20 plants “...demand a more skilled workforce which also requires a more skilled

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1 and higher paid management team, including those that are employed by the
2 service company and those in an administrative capacity.”

3 The cost of the more highly skilled generation station workers, their supervisors
4 and the layers of plant and group management are recorded in FERC O&M
5 accounts 500-554. If service company executives are primarily responsible for
6 generation-related functions, then FERC requires that their salaries be charged
7 to the appropriate O&M, not A&G, account. This is required by FERC's order
8 684 (issued October 19, 2006), which required electric utility service companies
9 to record transactions to the same set of accounts to which they would be
10 recorded if regulated utility affiliates had directly incurred the costs. Thus, if a
11 service company employee is performing generation-related services, the
12 associated costs must be charged by the service company to the applicable
13 O&M account.

14 **11.Q. What is the next erroneous assertion in Ms. Dismukes' testimony regarding**
15 **utility A&G differences?**

16 A. On page 30, starting on line 21, she points out that electric utility chief executive
17 compensation is greater than water utility chief executive compensation. In her
18 schedule KHD-8, Ms. Dismukes shows absolute compensation amounts in an
19 attempt to show that the higher cost structure of electric utilities proves the lack
20 of comparability to water companies.

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1 The flaw in this argument is her failure to factor in the much larger size of the
2 electric utility companies than the water companies. When chief executive officer
3 (CEO) compensation is appropriately denominated in terms of cost per customer,
4 her argument falls apart. As shown in Schedule PLB-3, the average annual cost
5 per customer for water company CEOs is actually higher than that of electric
6 companies (\$0.41 versus \$0.31). Total CEO compensation cost per customer for
7 electric companies (\$2.36 per customer) is not significantly higher than that of
8 water companies (\$2.19 per customer). My entire service company cost
9 comparison is denominated in costs per customer, so CEO compensation must
10 also be analyzed on a cost-per-customer basis. Once again, an analysis of the
11 relevant data proves Ms. Dismukes' contention to be false.

12 Schedule PLB-3 illustrates one other very important point. Total compensation
13 per customer for American Water's CEO is the lowest of any utility—water or
14 electric—in the comparison group. This is another data point that supports the
15 reasonableness of Service Company charges.

16 **12.Q. What is the next erroneous assertion in Ms. Dismukes' testimony regarding**
17 **utility A&G differences?**

18 A. On page 31, starting on line 10, Ms. Dismukes cites the existence of more rate
19 schedules and riders for one electric utility, Kingsport Power Company,
20 compared to TAWC. While she does not state it directly, I assume she offers this
21 as further evidence of electric utilities higher A&G cost structure.

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1 An analysis of the underlying data shows Ms. Dismukes' arguments again to be
2 without merit. Presented in Schedule PLB-4 is an analysis of Kingsport Power
3 Company's customers, revenues and Mwh sales by rate schedule per the
4 company's FERC Form 1. The vast majority (87%) fall into one customer
5 category—Residential Sales.

6 Ms. Dismukes may not be aware that every Kingsport Power Company customer
7 service representative does not have to be proficient in every rate schedule.
8 Thus, the majority of representatives spend their time working with residential
9 service customers who have one rate schedule. A certain amount of
10 specialization occurs, whereby the most experienced service representatives are
11 assigned the more complex schedules. Thus, the existence of more electric/gas
12 utility rate schedules does not create a significantly greater customer services-
13 related workload compared to water utilities.

14 **13.Q. What is the next erroneous assertion in Ms. Dismukes' testimony regarding**
15 **utility A&G differences?**

16 A. On page 32, starting on line 25, she states that electric utilities have fewer
17 customers per employee because of the number of personnel required to run
18 their generating stations. Here again, I point to the fact that the costs of
19 operating and maintaining generating stations are charged to FERC O&M
20 accounts 500-554. My cost comparison is based on A&G costs recorded in the

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1 900 series of FERC accounts. These are the types of services that are similar
2 between water and electric/gas utilities.

3 I might point out an error in her analysis of customers per employee, as shown in
4 Schedule KHD-9. Ms. Dismukes calculates customers per corporate employee
5 for both water and electric utilities. By using total corporate employees in her
6 analysis, however, she understates electric utilities' customer-to-employee ratio
7 because some electric utility companies have considerable unregulated revenues
8 and employees. To show the effect of her error, in the top half of Schedule PLB-
9 5, I calculate Duke Energy's total revenues by segment. Only 74% of Duke's
10 total revenues come from regulated revenues. The remainder is produced by
11 Duke's unregulated business segments. In order to produce an apples-to-apples
12 comparison, Ms. Dismukes should have removed unregulated customers from
13 her electric utility calculation, comparing regulated customer per regulated
14 employee. As shown in the lower half of Schedule PLB-5, that adjustment would
15 have increased Duke Energy's regulated customers per regulated employee to
16 324. Ms. Dismukes' calculation understated Duke's ratio by 35%.

17 **14.Q. Ms. Dismukes has set forth a number of issues with the way you calculate**
18 **the comparison group's A&G cost per customer. Would you briefly**
19 **describe how you selected the FERC accounts to include in your cost**
20 **calculation?**

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1 A. I selected the following 13 of 24 FERC A&G-related accounts for inclusion in my
2 calculation of the comparison group's cost per customer:

- 3 • 901 Supervision
- 4 • 903 Customer Records and Collection Expenses
- 5 • 905 Miscellaneous Customer Accounts Expenses
- 6 • 907 Supervision
- 7 • 910 Miscellaneous Customer Service and Information Expenses
- 8 • 911 Supervision
- 9 • 920 Administrative and General Salaries
- 10 • 921 Office Supplies and Expenses
- 11 • 923 Outside Services Employed
- 12 • 928 Regulatory Commission Expenses
- 13 • 930.2 Miscellaneous General Expenses
- 14 • 931 Rents
- 15 • 935 Maintenance of Structures and Equipment

16 **15.Q. Which FERC accounts did you exclude from the comparison group cost-**
17 **per-customer calculation?**

18 A. I excluded 12 A&G-related FERC accounts from the calculation for the reasons
19 described below:

- 20 • Account 902 Meter Reading Expenses – Generally, meter reading is a
21 function that resides within the regulated utility and not the service

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- 1 company. Any charges to this account from a service company would be
2 unusual, so the account is excluded from my cost calculations.
- 3 • Account 904 Uncollectible Accounts – The regulated utility and not the
4 service company generally incurs this expense, the size of which could be
5 influenced by regulations that vary from state to state.
 - 6 • Account 908 Customer Assistance Expenses – The regulated utility and
7 not the service company generally incurs this expense, the size of which
8 could be influenced by regulations that vary from state to state.
 - 9 • Account 909 Informational and Instructional Advertising Expenses – This
10 is an expense that is generally recorded on the books of the regulated
11 utility.
 - 12 • Account 912 Demonstrating and Selling Expenses – I exclude all
13 advertising and sales-related expenses from my cost calculations.
 - 14 • Account 913 Advertising Expenses – I exclude all advertising and sales-
15 related expenses from my cost calculations.
 - 16 • Account 916 Miscellaneous Sales Expenses - I exclude all advertising and
17 sales-related expenses from my cost calculations.
 - 18 • Account 924 Property Insurance – There may be instances where the
19 property insurance expenses in this account relate to property owned by
20 the regulated utility, not just the service company.

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- 1 • Account 925 Injuries and Damages - This is an expense that is generally
2 recorded on the books of the regulated utility.

- 3 • Account 926 Employee Pensions and Benefits – Pension and benefit plan
4 costs for service company employees are charged to this account, which
5 has one of the largest balances of any A&G account. My cost calculation
6 excludes this account because the pension and benefits costs pertain to
7 all service company employees, including those involved in O&M-related
8 services (e.g., power generation and transmission services, engineering).
9 Thus, some portion of this account does not relate to the cost of providing
10 A&G services. To be conservative, I excluded the entire balance from my
11 cost calculation. The impact of this exclusion is considerable. In PLB-
12 Schedule 6, I calculate the estimated A&G-related cost per customer for
13 pensions and benefits was \$9 for the comparison group. Had I included
14 these pension and benefits costs, the total service company A&G
15 expenses per customer for the comparison group would have increased
16 from \$95 to \$104. When I calculated TAWC’s \$59 per customer A&G
17 expenses, however, I included pension and benefit costs. The effect is to
18 increase the calculated cost of TAWC’s Service Company relative to the
19 comparison group. This is just one instance of the very conservative
20 approach I take in my market cost comparisons.

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- 1 • Account 930.1 General Advertising Expenses - I exclude all advertising
2 and sales-related expenses from my cost calculations.

3 **16.Q. Would you respond to Ms. Dismukes’ first issue with your calculation of**
4 **the comparison group A&G cost per customer?**

5 A. In two places (starting on page 35, line 9 and starting on page 36, line 16), Ms.
6 Dismukes contends that supervision costs associated with the FERC accounts
7 not included in my comparison group should also be excluded. For instance, she
8 contends a portion of the included FERC account 901 Supervision should be
9 excluded because it relates to supervision of meter readers, whose expenses are
10 recorded in the excluded FERC account 902.

11 She does not calculate what the exclusion should be and how that would affect
12 the comparison group’s \$95 average per-customer cost. This is a pattern with
13 most of her complaints about my comparison group cost calculations. She
14 attempts to cast doubt on my methodology without employing facts to back up
15 her position.

16 I disagree with her proposal for two reasons. First, it is not possible to tell from
17 the FERC Form 60 how much of the supervisory costs in the included accounts
18 in question (901 and 911) are associated with the excluded FERC accounts.

19 Second, the average balances in the included accounts 901 and 911 are not
20 material and do not warrant adjustment. As shown in Schedule PLB-7, the 2009
21 average comparison group costs per customer for account 901 was 32 cents and

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1 for account 911 was less than a penny. These amounts are immaterial
2 compared to the \$95 total A&G cost per customer. The issue is insignificant
3 when subjected to factual analysis.

4 My approach in performing market cost-comparison studies is to use data from
5 publicly available sources and to keep the numbers intact without making
6 adjustments that have insignificant effects. In this way, it is easier for reviewers
7 to trace the numbers in my calculations back to their original source.

8 **17.Q. What is Ms. Dismukes' next issue with your calculation of the comparison**
9 **group A&G cost per customer?**

10 A. Starting on page 37, line 1, she contends that some portion of FERC account
11 920 Administrative and General Salaries, which I include in comparison group
12 cost calculation, should be excluded because it relates in some vague way to the
13 excluded FERC account 930.1 General Advertising. I am unaware of any
14 relationship between these accounts.

15 Ms. Dismukes provides no data to back up her claim and again does not attempt
16 to analyze the impact of the issue. I am puzzled by her insistence on its
17 importance.

18 As shown in Schedule PLB-8, the total balance in account 930.1 represents
19 around 1% of the total of account 920. Eliminating the portion of account 920
20 associated with the insignificant amount in account 930.1 would produce very
21 little change in the \$95 overall comparison group cost per customer. This is

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1 demonstrated in Schedule PLB-9, which shows that eliminating an amount equal
2 to even the entire balance of account 930.1 would produce a drop of only \$0.60
3 per customer.

4 **18.Q. What is Ms. Dismukes' next issue with your calculation of the comparison**
5 **group A&G cost per customer?**

6 A. On page 37, starting on line 16, Ms. Dismukes criticizes my method for
7 estimating service company charges by A&G account to their regulated utility
8 affiliates.

9 The Form 60 does not report charges by FERC Account to every individual
10 affiliate. Thus, I must estimate those charges. I do so based on the overall
11 percent of total charges from service companies to regulated and unregulated
12 affiliates. This is the most reasonable method absent more detailed information.

13 On page 38, Ms. Dismukes alleges "Use of the average percentage of service
14 company costs charged to regulated companies as opposed to actual amount
15 (sic) charged to the regulated accounts overestimates the amount of
16 administrative and general service company expenses charged to the regulated
17 electric and electric/gas companies." Perhaps Ms. Dismukes mistakenly
18 assumes there is a source from which to obtain the "actual amount" of charges
19 by FERC Account to each affiliate. That information is similarly not available.
20 Therefore, it is necessary to develop a reasonable estimation of those charges in
21 my analysis.

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1 **19.Q. Ms. Dismukes goes on to contend that your estimating method overstates**
2 **service company A&G expenses to regulated utility affiliates. What is your**
3 **response?**

4 A. Ms. Dismukes' allegation is based on her schedule KHD-14, in which she
5 compares my total service company A&G expenses charged to regulated utility
6 affiliates to total A&G expenses per affiliate in FERC Form 1. In some cases, my
7 estimate of total A&G service company charges exceeds the total she developed
8 from her Form 1 analysis. If her analysis were correct, this would be the most
9 substantive of her complaints.

10 Ms. Dismukes' Schedule KHD-14 is wrong, however; she includes only electric
11 utility affiliate A&G expenses from FERC Form 1s. She misses regulated A&G
12 expenses for gas utility affiliates, which do not file a FERC Form 1 – Report of
13 Major Electric Utilities. My tabulation of A&G expenses included comparison of
14 group service company charges to both gas and electric utility affiliates. As
15 shown in Schedule PLB-10, in a number of cases, the comparison group of utility
16 companies have significant numbers of retail gas customers. I have highlighted
17 the percent of retail gas to total customers and Ms. Dismukes' "percent of FERC
18 Form 1 expenses." In most cases where Ms. Dismukes' A&G percentage is high,
19 the utility company had both retail electric and gas customers. For instance,
20 schedule PLB-11 shows the retail gas affiliates Ms. Dismukes failed to include in

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1 her calculation for the three utility companies with the largest A&G percentages
2 in KHD-14.

3 Unlike regulated electric utilities, retail gas distribution utilities are not regulated
4 by FERC, so they are not required to submit an annual report to FERC. Thus,
5 there is no single source of retail gas utility data with which to tabulate their A&G
6 charges. Ms. Dismukes' desired comparison cannot be made.

7 **20.Q. Does this mean Ms. Dismukes' re-calculation of comparison group service**
8 **company A&G charges of \$79 per customer is incorrect?**

9 A. Yes. I have demonstrated that her Schedule KHD-14 incorrectly excludes A&G
10 charges to affiliate retail gas distribution utilities. Her cost per customer is
11 therefore wrong because she based it on flawed data in Schedule KHD-14. She
12 has therefore failed to disprove the accuracy of my comparison group per
13 customer amount of \$95.

14 **21.Q. Why is it important that this claim of Ms. Dismukes be refuted?**

15 A. This particular criticism, supported by the faulty Schedule KHD-14, is the
16 centerpiece of Ms. Dismukes' attack on my service company cost comparison.
17 Her mistaken analysis does not detract from the validity of my methodology for
18 calculating service company cost comparisons. Nor can her inaccurate analysis
19 cast doubt on the accuracy of my results, which show TAWC's Service Company
20 A&G charges of \$59 to be less than the comparison group's \$95 average.

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1 Ms. Dismukes uses her false critique as an opening for introducing what she
2 calls her “superior analysis” A&G comparison, which I will address next.

3 **22.Q. What are your overall thoughts on Ms. Dismukes’ comparative analysis,**
4 **which she introduces on page 39 of her testimony?**

5 A. Before I get into the details of why Ms. Dismukes’ comparison should be
6 rejected, I would like us to contemplate what she recommends based on her
7 flawed comparison. In her schedule KHD-17, she recommends a disallowance
8 of \$4,089,360, or 100%, of total attrition-year A&G charges. The only possible
9 conclusion is that, in her professional opinion, the services currently provided to
10 TAWC can continue to be rendered at zero cost.

11 It is inconceivable that her recommendation could be taken seriously or
12 considered as credible evidence as to the delivery of corporate services through
13 a service company arrangement. If she is going to recommend such an
14 enormous disallowance, then she needs to be held accountable for defining
15 exactly how TAWC will continue to deliver water service to its customers without
16 the Service Company’s administrative and management support.

17 **23.Q. Is the scope of Ms. Dismukes’ comparison the same as your service**
18 **company cost comparison?**

19 A. The scope of my cost comparison is TAWC’s A&G charges from its Service
20 Company affiliate. Ms. Dismukes’ comparison is broadened to cover those

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1 charges plus A&G expenses that were incurred directly by and recorded on the
2 books of TAWC. Thus, her comparison is not an alternative to mine because it
3 does not cover the same base of A&G charges.

4 **24.Q. Did you find anything unusual with the cost data used by Ms. Dismukes?**

5 A. Yes. By coincidence, I am acting as an expert witness in a September 30, 2010
6 rate case for Water Service Corporation of Kentucky (“WSCK”), one of the
7 regulated utilities in Ms. Dismukes’ comparison group. What caught my attention
8 in first reading Ms. Dismukes’ testimony was the enormous discrepancy between
9 her numbers for WSCK in KHD-15 and the actual numbers from WSCK’s rate
10 case filing. In Schedule KHD-15, Ms. Dismukes calculates an annual A&G cost
11 per customer of \$5 for WSCK compared to an A&G cost per customer of \$72
12 from my rate case study. The actual WSCK A&G costs per customer are over 14
13 times greater than Ms. Dismukes alleges.

14 **25.Q. Are you familiar enough with Water Service Corporation of Kentucky’s**
15 **service company to calculate their cost per customer?**

16 A. I have knowledge of Water Service Corporation (“WSC”), WSCK’s service
17 company affiliate and its operation. WSCK has no employees of its own. All
18 Kentucky operations personnel are employees of the service company, WSC.
19 Off-site A&G and O&M services are provided by WSC personnel:

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- 1 • Executive management, accounting, legal, rates and regulatory,
2 information technology, human resources, billing and customer relations,
3 engineering, construction and operations (in the Northbrook, Illinois
4 headquarters)
- 5 • Regional management, operations, engineering (regional offices)
- 6 • National call centers (Charlotte, North Carolina, Altamonte Springs,
7 Florida and Pahrump, Nevada)

8 Schedule PLB-12 shows WSC's positions that serve its regulated utility affiliates
9 such as WSCK.

10 **26.Q. How does your calculation of WSCK's A&G cost per customer compare to**
11 **Ms. Dismukes' calculation?**

12 A. The top portion of Schedule PLB-13 shows my calculation of WSCK's \$72 A&G
13 cost per customer based on the many services it receives from its affiliate service
14 company. The lower half of Schedule PLB-13 shows Ms. Dismukes' \$5 per
15 customer calculation, which has only one cost element—contractual services-
16 other.

17 **27.Q. Do you believe a regulated utility can function on \$5 per customer in A&G**
18 **spending?**

19 A. No. The idea that a utility can function on Ms. Dismukes' A&G costs of \$5 per
20 customer (or \$37,000 per year for WSCK) is preposterous and should have been
21 a sign to her there are serious problems with her data on WSCK. She should

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1 have eliminated WSCK from her analysis. Instead, she kept WSCK in her
2 comparison group with the effect of driving down the group’s average cost and
3 increasing the size of her recommended disallowance. This discrepancy
4 illustrates the massive flaws in her entire cost comparison, which has the sole
5 purpose of generating an enormous and erroneous disallowance of TAWC’s
6 Service Company charges.

7 **28.Q. Do you suspect numbers for any other utilities in Ms. Dismukes’**
8 **comparison group?**

9 A. Yes. Numbers for the following utilities in her comparison group do not make
10 sense:

- 11 • Carolina Water Services has a negative \$110,912 in salaries.
- 12 • The Empire District Electric Company has relatively little salaries
13 (\$17,645) and no contractual services charges. This level of salaries
14 amounts to \$5 per customer. Just as with WSCK, this is unbelievably low.

15 Data aberrations like this should have caused Ms. Dismukes to eliminate these
16 utilities, as well, from her comparison group.

17 **29.Q. Do these unusual numbers reflect on the source of Ms. Dismukes’ data?**

18 A. Yes. These problems with Ms. Dismukes’ data illustrates perfectly why I do not
19 use water companies’ annual reports to perform my cost comparisons. The
20 reliability of the data is sometimes questionable. There is obviously some
21 discretion in how expenses are functionalized (i.e., designated as O&M, A&G,

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1 customer services) and reported in these water utility annual reports. This differs
2 markedly from FERC Form 60 filers. Electric utility service companies must
3 follow the FERC's uniform system of accounts, which have discrete accounts for
4 every function (e.g., account 574 – Maintenance of Transmission Plant, 920 –
5 Administrative and General Salaries). Finally, the FERC checks Form 60
6 submissions and periodically conducts audits that may involve detailed reviews
7 of the Form 60. The data available from the Form 60 have a high degree of
8 reliability.

9 **30.Q. Do you agree with the costs Ms. Dismukes included in her A&G cost**
10 **calculation?**

11 A. No. She excluded charges from the following two accounts that are listed as
12 A&G-related expenses in the annual reports.

- 13 • 642–Rental of equipment
- 14 • 650–Transportation expenses

15 She also includes pension and benefits expenses in her calculation. Normally,
16 these are a cost of service. However, pension and benefit costs reported vary
17 wildly among the water utilities. Four water companies reported no pension and
18 benefits charges to 604-Employee Pension and Benefits. One reported the
19 equivalent of \$91 per customer. Even when the cost reported falls within a
20 reasonable range, the data are unreliable. Charges to this account cover
21 pension and benefit costs of all utility personnel, including those involved in O&M

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1 functions. Thus, these are not entirely a cost of A&G services. For these
2 reasons, I believe pension and benefit costs should be removed from the A&G
3 cost calculation to arrive at an apples-to-apples comparison showing TAWC's
4 cost position relative to Ms. Dismukes' utility group.

5 **31.Q. What is TAWC's A&G cost per customer when pension and benefits costs**
6 **are removed?**

7 A. Schedule PLB-14 shows TAWC's A&G costs per customer to be \$74, which is
8 close to Ms. Dismukes' cost of \$76 when recalculated to remove pension and
9 benefit costs. (Ms. Dismukes used an incorrect amount for Service Company
10 charges which accounts for the \$2 difference in our calculations.)

11 **32.Q. What happens when you remove water utility data aberrations and pension**
12 **and benefits from Ms. Dismukes' comparison group cost calculation?**

13 A. When I make the previously discussed adjustments to get costs on an apples-to-
14 apples comparative basis, the result is quite different than Ms. Dismukes
15 calculation in Schedule KHD-15. Schedule PLB-15 shows the water utility
16 comparison group average to be \$63. TAWC costs fall within the mid-range of
17 the comparison group. Six water utilities had higher A&G costs than TAWC.
18 This is a considerably different result than that produced by Ms. Dismukes'
19 aberrant comparison group cost calculation.

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1 **33.Q. Please summarize your thoughts on Ms. Dismukes' overall critique of your**
2 **service company cost comparison.**

3 A. Ms. Dismukes first presented a series of arguments to exaggerate the
4 differences in water and electric utility A&G functions in order to discredit my use
5 of service company A&G cost data from the FERC Form 60. I successfully
6 refuted each of her points with analyses of relevant data.

7 She then criticizes my methodology for calculating A&G expenses per customer
8 based on data from the FERC Form 60. The foundation for her criticism
9 crumbled when I showed she had forgotten to include in her Schedule KHD-14
10 my comparison group service companies' A&G charges to regulated gas utility
11 affiliates.

12 Finally, Ms. Dismukes attempted to perform an alternative cost comparison. She
13 did not benchmark service company charges. Instead, she looked at the broader
14 measure of total utility A&G expenses. She selected 19 water utilities, three of
15 which had severe data aberrations and should not have been included in her
16 comparison group. Her calculation includes total utility pension and benefits
17 costs which creates an apples-to-oranges comparison effect. I corrected all of
18 these issues and recalculated the average A&G cost per customer for the
19 adjusted set of water utilities based on the seriously deficient data in her sample.
20 Even with these shortcomings, in the end, TAWC's A&G cost per customer
21 turned out to be very close to the water utility comparison group. Most

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REBUTTAL TESTIMONY

1 importantly, the enormous disallowance Ms. Dismukes produced with her
2 erroneous cost comparison turned out to be fictitious.

3 I believe Ms. Dismukes' testimony and schedules related to my service company
4 cost comparison should be completely disregarded. My original conclusion that
5 the Service Company's charges to TAWC during the 12 months ended March 31,
6 2010 still holds.

7 **34. Please respond to Ms. Dismukes' complaint concerning the spreadsheet you**
8 **provided with service company data used in your cost comparison.**

9 A. The spreadsheet to which Ms. Dismukes refers should have contained
10 2009 FERC Form 60 data for my service company comparison group. Instead, I
11 mistakenly provided 2008 data. This was caused when I used a data request
12 template from a previous American Water 2008 cost comparison study. I used
13 this spreadsheet because it already had headers, footers, page numbers and
14 print areas set. Unfortunately, I pasted the TAWC study's 2009 data in only 4 of
15 7 tabs of the spreadsheet. I was unaware of this mistake until I read Ms.
16 Dismukes' testimony. I apologize for the extra effort it took her to retrieve the
17 data from the FERC website and replicate my analysis.

18 The data contained in the spreadsheet was copied in as absolute values
19 because many of the tabs are linked and an incorrect keystroke can break the
20 formulas and cause the final analysis to be off from my report tables. Again, I
21 apologize for this causing Ms. Dismukes additional work.

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**IV – MS. DISMUKES’ TESTIMONY CONCERNING
COST COMPARISON OF CUSTOMER ACCOUNTS SERVICES**

35.Q. Would you please describe the customer services and costs you evaluated in answering your study’s second question?

A. I evaluated the cost of the following customer services provided to TAWC by the Service Company:

- Customer Call Center Support – customer calls/contact, credit, order taking/disposition, bill collection efforts, outage calls
- Call Center and Customer System Support – maintenance of phone banks, voice recognition units, call center software applications, telecommunications, customer system maintenance and support
- Customer Billing – bill printing, stuffing, and mailing

During the test period ended March 31, 2010, the Service Company charged TAWC \$1,120,000 for customer services. I tested these charges plus other customer services-related charges incurred directly by TAWC.

I benchmarked these costs against the same charges for Tennessee and neighboring states’ electric utilities that must file a Form 1 with the FERC.

36.Q. What is Ms. Dismukes’ argument against your comparison methodology?

A. As with my service company A&G cost comparison, Ms. Dismukes would prefer that I use data only from other water companies. Here too, this is impossible because no publicly available cost information exists for water service

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REBUTTAL TESTIMONY

1 companies. Very few water companies have a centralized service company
2 arrangement. Those that do are not overseen by a single regulatory authority
3 that requires standard informational filings, as does the FERC.

4 In her testimony, Ms. Dismukes repeats her arguments that electric and water
5 customer services functions are so dramatically different that cost comparisons
6 are impossible. In fact, customer services functions are quite similar across
7 utility types.

8 **37.Q. Do you make adjustments for the one difference between water and electric**
9 **call center costs?**

10 A. Yes. Electric utilities customers make more call center calls on average
11 compared to other utility types due to a greater occurrence of service problems. I
12 adjust for this difference by increasing the cost pool I use to calculate TAWC's
13 cost per customer.

14 Ms. Dismukes contends electric utilities also experience longer call durations.
15 Her testimony provides no evidence to back up this assertion or its alleged
16 impact on the cost-per-customer calculation. When asked for that support in
17 interrogatory TAWC 2-16, Ms. Dismukes provided 17 pages of documents
18 containing statistics from only two utilities--Aqua America and Connecticut Light
19 & Power—with no explanation as to which data prove her point. This is hardly
20 enough evidence to reach her definitive conclusion on call duration.

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REBUTTAL TESTIMONY

1 **38.Q. What is your assessment of Ms. Dismukes alternative customer service**
2 **cost comparison?**

3 A. As with her A&G cost comparison, she attempts to use data from utility annual
4 reports filed with state commissions to calculate a cost per customer for
5 customer services. This analysis suffers from the same data problems as her
6 A&G cost comparison. Two of her utilities, incredibly, had no customer services
7 expenses. One of these water companies, North Sumter Utility Company, LLC,
8 disclosed on its annual report page E-10(a), that it has affiliate transactions with
9 an affiliate that provides "Billing, accounting, customer service and management"
10 services at a cost of \$1,031,809 for 2009. Yet North Sumter Utility Company
11 reported no customer accounts expenses for that year. As evidence, Schedule
12 PLB-16 shows a copy of North Sumter's affiliate transactions disclosure page
13 and its water service income statement with no customer accounts charges
14 listed. This annual report is obviously incorrect.

15 In addition, three other utilities in Ms. Dismukes' comparison group have no
16 salaries and no contractual services charges. It is not credible that customer
17 services can be delivered to their customers without any labor costs.

18 Here again, data aberrations like this should have caused Ms. Dismukes to
19 eliminate these utilities from her comparison group.

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1 Quality and reliability is not a problem with the FERC Form 1, the source of my
2 comparative data. FERC requires the Form 1 be audited and that the CPA firm's
3 opinion letter contain the following language:

4 "In connection with our regular examination of the financial statements of
5 _____ for the year ended on which we have reported separately under
6 date of _____, we have also reviewed schedules _____ of FERC
7 Form No. 1 for the year filed with the Federal Energy Regulatory Commission, for
8 conformity in all material respects with the requirements of the Federal Energy
9 Regulatory Commission as set forth in its applicable Uniform System of Accounts
10 and published accounting releases. Our review for this purpose included such
11 tests of the accounting records and such other auditing procedures as we
12 considered necessary in the circumstances. Based on our review, in our opinion
13 the accompanying schedules identified in the preceding paragraph (except as
14 noted below) conform in all material respects with the accounting requirements of
15 the Federal Energy Regulatory Commission as set forth in its applicable Uniform
16 System of Accounts and published accounting releases." (FERC Form 1
17 instructions, page ii)

18 **39.Q. What happens when you remove water utility data aberrations from Ms.**
19 **Dismukes' comparison group cost calculation?**

20 A. When I remove the costs of utilities with data aberrations in order to get costs on
21 an apples-to-apples comparative basis, the result is quite different than Ms.

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1 Dismukes' calculation in Schedule KHD-16. Schedule PLB-18 shows TAWC's
2 customer services cost of \$30 per customer to be relatively close to the water
3 utility comparison group average of \$26. Three water utilities had higher
4 customer services costs than TAWC. Again, as with the analysis of the A&G
5 costs, the data for her water utility comparison group is seriously flawed and
6 should not be relied upon to draw any valid conclusion.

7 **40.Q. Are there factors Ms. Dismukes does not address in her cost comparison?**

8 A. Yes. Her comparison does not consider different levels of service in calculating
9 her per customer costs. For instance, the Service Company's call centers offer
10 TAWC customers the ability to reach a representative every hour of every day.
11 Customers also receive monthly bills. The water companies' annual reports do
12 not provide information necessary to delineate service level differences that are
13 necessary for an accurate cost comparison. These can only be determined
14 through a more detailed, painstaking benchmarking study. If Ms. Dismukes is
15 going to use her cost comparisons to recommend disallowances, she needs to
16 be considerably more precise.

17 **41.Q. Please summarize your views on Ms. Dismukes' customer service cost**
18 **comparison.**

19 A. Ms. Dismukes is exacting in the use of her cost comparisons—if a utility exceeds
20 the average cost of her comparison group, then that is definitive evidence of
21 inefficiency and grounds for disallowance. There are several problems with this

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1 approach. First, I have shown that data from water utility annual reports is not
2 consistently reliable for valid cost comparisons. Second, her comparisons give
3 no consideration to service level differences and their cost impacts. Finally, she
4 declares some costs prudent and others not based on suspect data, and no
5 studies to detect and correct. When asked to support her claims and assertions
6 from studies or analysis in discovery she indicated no studies or analysis was
7 done or referenced. Ms. Dismukes has never managed a customer service
8 function. Nor has she ever performed a customer services-related consulting
9 assignment such as implementing a new customer accounting system or
10 improving related processes on which to develop proper and accurate analysis
11 and recommendations.

12 Ms. Dismukes recommends a disallowance of \$676,655, or 59%, of attrition year
13 Service Company customer accounts expenses. I recommend Ms. Dismukes'
14 disallowance, testimony and alternative cost comparison be completely
15 disregarded.

**V – MS. DISMUKES’ TESTIMONY CONCERNING
LOWER OF COST OR MARKET PRICING COMPARISON**

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18 **42.Q. What issues does Ms. Dismukes take with your market comparison of**
19 **hourly rates for Service Company services?**

20 A. She cites two issues. First, she complains that I do not consider discounts
21 outside providers might grant to secure outsourcing contracts. Second, she

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1 contends that not every Service Company position should be a candidate for
2 outsourcing and therefore should not be considered in my lower of cost or market
3 pricing analysis.

4 **43.Q. Please address her first issue related to outsourcing discounts.**

5 A. My comparison showed outside providers to be 45% more expensive than the
6 Service Company. It would have cost TAWC ratepayers \$2 million more if all
7 Service Company services were outsourced during the 12 months ended March
8 31, 2009.

9 There is a possibility that some outside providers might provide discounts but it is
10 not possible to estimate how much. Such information on outsourcing
11 arrangements is not generally disclosed due to contractual restrictions. Take one
12 example, I doubt TAWC would receive a much lower cost per hour than the rate I
13 calculated for CPA firms, one of my outsourcing comparison groups. An
14 American Institute of Certified Public Accountants' survey showed the overall
15 average hourly rate for Tennessee CPAs to be \$108 per hour. This is a very
16 conservative number because large national CPA firms, who have higher billing
17 rates, generally do not participate in this survey. I do not believe the firms TAWC
18 would turn to for outsourcing bids would provide hourly rates substantially lower
19 than this.

20 Ms. Dismukes does not identify how much of a discount she believes TAWC
21 would realize in negotiating with outside providers. I do not believe the discount

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1 would be significant and certainly nowhere near my study’s 45% differential
2 between the Service Company and outside providers. Ms. Dismukes is incorrect
3 when she contends that outside provider discounts would be so significant as to
4 invalidate my hourly rate comparison.

5 **44.Q. Please address Ms. Dismukes’ second issue related to outsourcing**
6 **discounts?**

7 A. Starting on page 47, line 10, Ms. Dismukes contends that my hourly rate
8 comparison should only have been applied to certain “skilled” positions because
9 those would be outsourced. Other “day-to-day” activities would not be
10 outsourced she claims and thus should be omitted from my comparison. She is
11 wrong about this. Outsourcers will take over any function, routine to complex.
12 They will take over all aspects of functions, as different as payroll accounting,
13 internal auditing services and information technology. Thus, it is appropriate that
14 I consider all management and professional positions as candidates for
15 outsourcing.

16 Her criticisms of my lower of cost or market comparison are invalid, and as a
17 result, my conclusion stands that Service Company services were provided at the
18 lower of cost or market. Ms. Dismukes’ testimony should be disregarded.

19 **VI – MS. DISMUKES’ TESTIMONY CONCERNING**
20 **THE NEED FOR SERVICE COMPANY SERVICES**

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1 **45.Q. What is Ms. Dismukes stated concern with the final aspect of your study,**
2 **the necessity of Service Company services?**

3 A. On page 48, starting on line 15, she erroneously asserts that I have failed to
4 “demonstrate that the level of services provided by AWWSC would be required if
5 TAWC were a standalone water company”.

6 I demonstrate the Service Company’s services are needed in Exhibit 11 where I
7 list all the functions and activities any water utility—stand-alone or with a service
8 company arrangement—must perform to deliver service to its customers. I
9 designate which of these activities the Service Company performs for TAWC. I
10 looked for duplication and overlap and found none. In this way, I proved the
11 services provided by the Service Company are vital and would be required even
12 if TAWC were a standalone water company.

13 I dealt with the level of services provided by the Service Company in the first part
14 of my study which compared the Service Company’s A&G charges to TAWC to a
15 comparison group of other utility service companies. That analysis showed the
16 Service Company’s cost per customer to be lower than the comparison group
17 average. Since the quantity of services affects the cost per customer, I have
18 demonstrated that the level of Service Company services is appropriate.

19 I believe Ms. Dismukes’ testimony and criticism concerning my determination that
20 TAWC needs the services it is provided by the Service Company should be
21 disregarded.

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**VII – OVERALL ASSESSMENT OF MS. DISMUKES’ TESTIMONY
RELATED TO THE BARYENBRUCH STUDY**

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46.Q. What is your overall assessment of Ms. Dismukes' testimony covering your work?

A. I have subjected Ms. Dismukes’ testimony to a thorough analysis of the data and facts surrounding her concerns. In the process, I was able to show Ms. Dismukes criticisms of my direct testimony and report to be invalid.

Ms. Dismukes A&G and customer services costs comparisons were based on faulty and unreliable data from water company annual reports filed with public utility commissions. When I adjusted for aberrant data in her numbers, TAWC and the Service Company’s relative position improved among the comparison group.

In calculating disallowances of Service Company A&G and customer services charges to TAWC, Ms. Dismukes takes a simplistic and biased approach. Any costs above the comparison group average are deemed to be imprudent without regard to the nature and level of services provided. I strongly recommend her disallowances be disregarded.

**VIII MR. BUCKNER’S TESTIMONY CONCERNING ATMOS ENERGY’S
SERVICE COMPANY PER CUSTOMER COSTS**

47.Q. Did Mr. Buckner criticize your service company cost comparison?

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1 A. . Yes. On page 41, starting on line 2 of his direct testimony, Mr. Buckner
2 indicates “The Consumer Advocate, however, does not believe that TAWC’s
3 service company cost comparisons are particularly meaningful just because they
4 are easily accessible through FERC.”

5 Mr. Buckner is incorrect about the validity of my service company cost
6 comparisons. I believe my detailed rebuttal of Ms. Dismukes’ various criticisms
7 proved that service company A&G-related functions and costs are similar across
8 utility industries.

9 In performing my cost comparisons, I use the best data that is publicly available.
10 For service company A&G costs, this information comes from the FERC Form
11 60. Quality of data, not its accessibility, is the most important factor in my choice
12 of comparative cost information. I have demonstrated, with many examples, the
13 aberrations in water company annual report information used by Ms. Dismukes.
14 FERC data is of a higher quality and, therefore, more reliable.

15 **48.Q. Why did you not include Atmos Energy in your service company cost**
16 **comparison group?**

17 A. . Because Atmos Energy’s service company, Atmos Energy Services, LLC, is not
18 required to file a Form 60 with FERC and I do not have access to their cost data.
19 It is likely that Atmos Energy Services, LLC has been granted an exemption from
20 filing the Form 60 because Atmos Energy Corporation’s local distribution utilities

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1 are not subject to FERC’s regulation as natural gas companies under the natural
2 gas act.

3 Mr. Buckner indicates that Atmos Energy Services, LLC’s charges to its
4 Tennessee utility affiliate amount to \$39 per customer. I am not familiar with how
5 this was calculated. Atmos Energy Services, LLC may or may not perform
6 services for its Tennessee utility affiliate that are similar to those provided by the
7 Service Company to TAWC. Without the availability of this information, I am not
8 able to comment on the comparability of Atmos and American Water service
9 company costs per Tennessee customer. The information Mr. Buckner cites to
10 support his statement is not provided in a way that consistent with the information
11 I have relied on from FERC Form 60 filings and therefore cannot be used for
12 comparison purposes.

13 **VIII – SUMMARY OF REBUTTAL TESTIMONY**

14 **49.Q. Have your market cost comparison studies been accepted by other state**
15 **utility commissions?**

16 A. Yes. Besides Tennessee, I have acted as a witness in 43 cases before
17 commissions in the following states:

- 18 • Connecticut
- 19 • Georgia
- 20 • Illinois
- 21 • Kentucky

TENNESSEE AMERICAN WATER COMPANY
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- 1 • Massachusetts
- 2 • Missouri
- 3 • New Mexico
- 4 • New York
- 5 • Ohio
- 6 • Pennsylvania
- 7 • Virginia
- 8 • West Virginia

9 These commissions all have accepted my methodology. One that stands out is
10 the Virginia State Corporation Commission, which stated the following in order
11 PUE-2002-00375, dated September 3, 2003:

12 *As this Commission has found previously that the methodology of the*
13 *Baryenbruch study is satisfactory, we decline today to find that the Company*
14 *[Virginia American Water Company] failed to meet its burden of proof regarding*
15 *the reasonableness of the affiliate expenses. Virginia Code paragraph 56-79*
16 *provides that we may approve such arrangements where reasonable, and we*
17 *find that it is reasonable in this case to do so.*

18 **50.Q. Does this complete your rebuttal testimony?**

19 A. Yes.

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REBUTTAL TESTIMONY
SERVICE COMPANY REGULATORY COST PER CUSTOMER

Utility Company	2009 Acct 928 Charges	Regulated Retail Customers	Acct 928 Cost per Customer	Total Svc Co Cost per Customer	Acct 928 as % of Total
AEP	\$3,201,440	5,213,000	\$ 0.61	\$ 80.28	1%
Allegheny	\$394,084	1,585,700	\$ 0.25	\$ 111.42	0%
Alliant	\$1,804,077	1,395,189	\$ 1.29	\$ 106.88	1%
Ameren	\$990,033	3,300,000	\$ 0.30	\$ 64.25	0%
Black Hills	\$942,198	759,400	\$ 1.24	\$ 107.30	1%
Centerpoint	\$0	5,300,000	\$ -	\$ 22.51	0%
Dominion	\$3,078,964	3,700,000	\$ 0.83	\$ 75.44	1%
Duke Energy	\$0	4,500,000	\$ -	\$ 200.39	0%
Energy East	\$0	2,973,000	\$ -	\$ 30.13	0%
Entergy	\$6,087,274	2,700,000	\$ 2.25	\$ 97.26	2%
E-On	\$509,799	1,226,000	\$ 0.42	\$ 86.37	0%
Exelon	\$207,867	5,886,000	\$ 0.04	\$ 91.34	0%
FirstEnergy	\$1,021,181	4,500,000	\$ 0.23	\$ 56.86	0%
Integrus	\$215	2,157,700	\$ 0.00	\$ 81.30	0%
Nat Grid	\$630,244	6,700,000	\$ 0.09	\$ 196.25	0%
NiSource	\$0	3,750,000	\$ -	\$ 57.73	0%
Northeast	\$2,562,812	2,095,000	\$ 1.22	\$ 128.85	1%
PHI	\$6,016	1,946,000	\$ 0.00	\$ 110.72	0%
Progress Energy	\$0	3,100,000	\$ -	\$ 60.08	0%
PNM	\$1,930,717	729,700	\$ 2.65	\$ 120.60	2%
SCANA	\$1,131,010	1,445,000	\$ 0.78	\$ 115.26	1%
Southern Co	\$92,972	4,402,000	\$ 0.02	\$ 115.43	0%
Unitil	\$0	169,600	\$ -	\$ 124.50	0%
Xcel	\$125,366	5,300,000	\$ 0.02	\$ 62.90	0%
Total	\$24,716,269	74,833,289	\$ 0.33	\$ 94.68	0%

TENNESSEE AMERICAN WATER COMPANY
REBUTTAL TESTIMONY
NUCLEAR/NON-NUCLEAR SERVICE COMPANY
REGULATORY COST PER CUSTOMER

	Service Co	2009 Service Company Cost/Regulated Customer	Nuclear Generation Percent	Nuclear/ Non-Nuclear Group Average Cost/Customer
Nuclear Utilities	Exelon	\$91	93%	\$95
	Entergy	\$97	58%	
	FirstEnergy	\$57	45%	
	Progress Energy	\$60	44%	
	Dominion	\$75	43%	
	Duke Energy	\$200	37%	
	SCANA	\$115	26%	
	Southern Co	\$115	23%	
	Xcel	\$63	17%	
	PNM	\$121	15%	
	Ameren	\$64	14%	
	AEP	\$80	6%	
Non-Nuclear Utilities	Nat Grid	\$196		\$97
	Northeast	\$129		
	Unitil	\$125		
	Allegheny	\$111		
	PHI	\$111		
	Black Hills	\$107		
	Alliant	\$107		
	E-On	\$86		
	Integrus	\$81		
	NiSource	\$58		
	Energy East	\$30		
	Centerpoint	\$23		

Source: FERC Form 60, Dismukes Schedule KHD-7 (corrected to show Progress Energy with nuclear generation)

TENNESSEE AMERICAN WATER COMPANY
REBUTTAL TESTIMONY
ANALYSIS OF CHIEF EXECUTIVE OFFICE COMPENSATION

	2009 Compensation		Number of Customers	2009 Compensation Per Customer	
	Base Salary	Total			
<u>Water and Wastewater Utilities</u>					
American Water Works	\$ 610,615	\$ 2,407,571	3,330,929	\$ 0.25	\$ 0.72
Aqua America	\$ 507,527	\$ 2,548,984	953,437	\$ 0.20	\$ 2.67
California Water Service Group	\$ 904,619	\$ 2,159,139	494,700	\$ 0.42	\$ 4.36
American States Water Company	\$ 449,212	\$ 1,003,796	291,638	\$ 0.45	\$ 3.44
SJW Corp.	\$ 475,000	\$ 1,396,575	234,900	\$ 0.34	\$ 5.95
SouthWest Water Company	\$ 467,308	\$ 522,699	129,956	\$ 0.89	\$ 4.02
Middlesex Water Co.	\$ 370,200	\$ 459,146	102,220	\$ 0.81	\$ 4.49
Connecticut Water Service Inc.	\$ 345,000	\$ 673,873	88,390	\$ 0.51	\$ 7.62
Artesian Resources Corp	\$ 390,225	\$ 572,131	76,900	\$ 0.68	\$ 7.44
York Water Co.	\$ 237,685	\$ 329,989	62,186	\$ 0.72	\$ 5.31
Pennichuck Corp.	\$ 265,000	\$ 396,649	33,600	\$ 0.67	\$ 11.81
Pure Cycle Corp.	\$ 250,000	\$ 250,000	404	\$ 1.00	\$ 618.81
Water Utilities Total	\$ 5,272,391	\$ 12,720,552	5,799,260	\$ 0.41	\$ 2.19
<u>Electric/Gas Utilities</u>					
Exelon Corporation	\$ 1,468,077	\$ 12,210,448	5,886,000	\$ 0.25	\$ 2.07
Xcel Energy Inc.	\$ 1,175,000	\$ 11,340,182	5,300,000	\$ 0.22	\$ 2.14
CenterPoint Energy Inc.	\$ 1,060,000	\$ 7,618,537	5,300,000	\$ 0.20	\$ 1.44
American Electric Power Co	\$ 1,254,808	\$ 7,539,278	5,213,000	\$ 0.24	\$ 1.45
FirstEnergy Corporation	\$ 1,159,615	\$ 12,441,092	4,500,000	\$ 0.26	\$ 2.76
Duke Energy Corporation	\$ -	\$ 6,927,663	4,500,000	\$ -	\$ 1.54
Southern Company	\$ 1,172,908	\$ 10,804,474	4,402,000	\$ 0.27	\$ 2.45
NiSource Inc.	\$ 800,000	\$ 4,138,377	3,750,000	\$ 0.21	\$ 1.10
Dominion Resources Inc.	\$ 1,200,000	\$ 11,973,541	3,700,000	\$ 0.32	\$ 3.24
Pepco Holdings, Inc.	\$ 796,669	\$ 3,116,833	1,946,000	\$ 0.41	\$ 1.60
Ameren Corporation	\$ 616,667	\$ 2,763,059	3,300,000	\$ 0.19	\$ 0.84
Progress Energy Inc.	\$ 979,231	\$ 6,454,010	3,100,000	\$ 0.32	\$ 2.08
Entergy Corporation	\$ 1,341,174	\$ 15,166,209	2,700,000	\$ 0.50	\$ 5.62
Integrus Energy Group Inc.	\$ 1,090,385	\$ 5,517,783	2,157,700	\$ 0.51	\$ 2.56
SCANA Corporation	\$ 1,099,000	\$ 5,033,358	1,445,000	\$ 0.76	\$ 3.48
Allegheny Energy	\$ 1,200,000	\$ 12,589,731	1,585,700	\$ 0.76	\$ 7.94
Alliant Energy	\$ 832,000	\$ 3,332,497	1,395,189	\$ 0.60	\$ 2.39
PNM Resources, Inc.	\$ 874,067	\$ 3,532,176	729,700	\$ 1.20	\$ 4.84
Black Hills Corporation	\$ 564,000	\$ 1,873,600	759,400	\$ 0.74	\$ 2.47
Unitil Corp.	\$ 456,601	\$ 1,306,751	169,600	\$ 2.69	\$ 7.70
Electric/Gas Utilities Total	\$ 19,140,202	\$ 145,679,599	61,839,289	\$ 0.31	\$ 2.36

Source: Dismukes Schedules KHD-8 and KHD-9

TENNESSEE AMERICAN WATER COMPANY
REBUTTAL TESTIMONY

KINGSPORT POWER COMPANY NUMBER OF CUSTOMERS PER RATE SCHEDULE

Rate Schedule		Number of Customers	% of Total
Residential	Residential Service Employee	2	0%
	Residential Service	41,073	87%
Commercial	Church Service	186	0%
	Electric Heating General	630	1%
	Industrial Power Service	1	0%
	Large General Service	216	0%
	Medium General Service	1,261	3%
	Medium General Service TOD	4	0%
	Small General Service	3,326	7%
Industrial Service	Electric Heating General	15	0%
	Industrial Power Service	6	0%
	Large General Service	39	0%
	Medium General Service	67	0%
	Medium General Service TOD	1	0%
	Small General Service	47	0%
Public Street & Highway	Small General Service	115	0%
	Street Lighting	4	0%
Public Authorities	Public School	34	0%
Total		47,027	100%

source: Kingsport Power Company 2009 FERC Form 1, page 304

TENNESSEE AMERICAN WATER COMPANY
REBUTTAL TESTIMONY
ANALYSIS OF DUKE ENERGY'S CUSTOMERS PER EMPLOYEE

Analysis of 2009 Revenues

Duke Energy Business Segment	2009 Revenues	
	Amount (millions)	Percent of Total
Franchised Electric & Gas (regulated)	\$ 9,433	74%
Commercial Power (unregulated)	\$ 2,114	17%
International Energy (unregulated)	\$ 1,158	9%
Total Segment Revenues	\$ 12,705	100%

Source: Duke Energy Corporation's 2009 10K

Analysis of 2009 Revenues

Calculation	Customers	Employees	Estimated Regulated Utility Employees		Customers Per Employee
			% of Total	Number	
Ms. Dismukes (Regulated Customers per Corporate Employee)	4,500,000	18,680			241
Mr. Baryenbruch (Regulated Customers per Regulated Employee)	4,500,000	18,680	74%	13,869	324

Percent Ms. Dismukes' understatement 35%

**TENNESSEE AMERICAN WATER COMPANY
REBUTTAL TESTIMONY
ANALYSIS OF SERVICE COMPANY
ESTIMATED A&G-RELATED PENSION AND BENEFITS COSTS PER CUSTOMER**

Utility	2009 Total Account 926 Cost Per Regulated Customer					Portion of Account 926 That Pertains to A&G Services			
	Total Acct 926 Charges	Regulated Percent	Regulated Charges	Number of Customers	Total Cost Per Customer	A&G Portion of Service Company Charges			A&G Cost Per Customer
						Total Charges		A&G Percent	
						A&G Accounts	Total Charges		
AEP	\$ 9,257,354	93%	\$ 8,636,616	5,213,000	\$ 2	\$ 418,484,117	\$ 675,892,933	62%	\$ 1
Allegheny	\$ 100,723,967	95%	\$ 96,030,672	1,585,700	\$ 61	\$ 176,685,245	\$ 690,714,070	26%	\$ 15
Alliant	\$ 38,247,122	96%	\$ 36,545,585	1,395,189	\$ 26	\$ 149,116,475	\$ 692,240,990	22%	\$ 6
Ameren	\$ (472,381)	76%	\$ (360,111)	3,300,000	\$ (0)	\$ 212,036,412	\$ 552,287,141	38%	\$ (0)
Black Hills	\$ 17,718,689	77%	\$ 13,594,054	759,400	\$ 18	\$ 81,484,333	\$ 555,825,628	15%	\$ 3
CenterPoint	\$ 64,409,659	51%	\$ 32,725,577	5,300,000	\$ 6	\$ 119,304,604	\$ 368,092,920	32%	\$ 2
Dominion	\$ 86,919,779	64%	\$ 55,316,577	3,700,000	\$ 15	\$ 279,128,940	\$ 461,060,420	61%	\$ 9
Duke	\$ 114,253,295	97%	\$ 110,282,493	4,500,000	\$ 25	\$ 901,762,388	\$ 699,292,706	129%	\$ 32
Energy East	\$ 30,699,569	85%	\$ 26,002,396	2,973,000	\$ 9	\$ 89,580,962	\$ 613,623,873	15%	\$ 1
Entergy	\$ 214,447,561	76%	\$ 162,394,405	2,700,000	\$ 60	\$ 262,596,172	\$ 548,619,334	48%	\$ 29
E-On	\$ 37,844,988	88%	\$ 33,369,703	1,226,000	\$ 27	\$ 105,893,093	\$ 638,800,320	17%	\$ 5
Exelon	\$ 79,327,589	91%	\$ 72,470,435	5,886,000	\$ 12	\$ 537,633,122	\$ 661,847,255	81%	\$ 10
FirstEnergy	\$ 83,019,982	88%	\$ 73,344,734	4,500,000	\$ 16	\$ 255,874,712	\$ 640,040,503	40%	\$ 7
Integrus	\$ 69,122,193	89%	\$ 61,223,306	2,157,700	\$ 28	\$ 175,423,352	\$ 641,682,843	27%	\$ 8
Nat Grid	\$ 125,982,398	95%	\$ 119,318,756	6,700,000	\$ 18	\$ 1,314,902,105	\$ 686,151,479	192%	\$ 34
NiSource	\$ 31,896,661	75%	\$ 23,834,415	3,750,000	\$ 6	\$ 216,480,637	\$ 541,352,854	40%	\$ 3
Northeast	\$ 61,855,941	99%	\$ 60,980,843	2,095,000	\$ 29	\$ 269,948,801	\$ 714,221,903	38%	\$ 11
PHI	\$ 130,891,572	84%	\$ 109,307,946	1,946,000	\$ 56	\$ 215,465,623	\$ 605,008,128	36%	\$ 20
PNM	\$ 13,823,207	99%	\$ 13,699,003	3,100,000	\$ 4	\$ 186,256,921	\$ 717,961,728	26%	\$ 1
Progress	\$ 41,073,239	88%	\$ 36,340,039	729,700	\$ 50	\$ 87,998,259	\$ 640,984,603	14%	\$ 7
SCANA	\$ 19,109,671	83%	\$ 15,831,048	1,445,000	\$ 11	\$ 166,555,883	\$ 600,174,588	28%	\$ 3
Southern Co	\$ 163,672,130	96%	\$ 157,050,806	4,402,000	\$ 36	\$ 508,130,523	\$ 695,162,911	73%	\$ 26
Unitil	\$ 6,209,264	92%	\$ 5,686,425	169,600	\$ 34	\$ 21,115,280	\$ 663,468,616	3%	\$ 1
Xcel	\$ 49,393,402	99%	\$ 48,692,080	5,300,000	\$ 9	\$ 333,389,459	\$ 714,184,713	47%	\$ 4
Total	\$ 1,589,426,851		\$ 1,372,317,802	74,833,289	\$ 18	\$ 7,085,247,416	\$ 15,018,692,461	47%	\$ 9

TENNESSEE AMERICAN WATER COMPANY
 REBUTTAL TESTIMONY
 COMPARISON GROUP FERC ACCOUNT 930.1 AS PERCENT OF ACCOUNT 920

Comparison Group Total	2009
Acct 901 Charges	23,679,964
Total Comparison Group Customers	<u>74,833,289</u>
Acct 901 Annual Cost per Customer	\$ 0.32
Comparison Group Overall Average	<u>\$ 95.00</u>
Acct 901 as a % of Overall Average	0.3%

Comparison Group Total	2009
Acct 911 Charges	311,954
Total Comparison Group Customers	<u>74,833,289</u>
Acct 911 Annual Cost per Customer	\$ 0.00
Comparison Group Overall Average	<u>\$ 95.00</u>
Acct 911 as a % of Overall Average	0.0%

Source: FERC Form 60s; Baryenbruch workpapers

TENNESSEE AMERICAN WATER COMPANY
REBUTTAL TESTIMONY
COMPARISON GROUP FERC ACCOUNT 930.1 AS PERCENT OF ACCOUNT 920

Utility Company	2009 Acct 930.1 Charges	2009 Acct 920 Charges	Acct 930.1 as % of Total
AEP	\$3,236,317	\$209,472,332	2%
Allegheny	\$55,692	\$92,369,193	0%
Alliant	\$134,191	\$78,594,490	0%
Ameren	\$109,750	\$119,065,172	0%
Black Hills	\$488,272	\$46,316,732	1%
Centerpoint	\$5,491,173	\$107,957,561	5%
Dominion	\$1,240,571	\$281,246,679	0%
Duke	\$2,639,693	\$351,329,220	1%
Energy East	\$124,416	\$46,047,881	0%
Entergy	\$655,034	\$141,507,830	0%
E-On	\$1,309,969	\$42,191,042	3%
Exelon	\$3,348,298	\$253,721,484	1%
FirstEnergy	\$4,395,824	\$130,597,355	3%
Integrus	\$317,819	\$77,617,719	0%
Nat Grid	\$2,381,951	\$516,012,030	0%
NiSource	\$74,101	\$87,313,477	0%
Northeast	\$0	\$153,573,629	0%
PHI	\$225,122	\$107,199,846	0%
Progress	\$1,192,114	\$89,255,961	1%
PNM	\$0	\$47,963,133	0%
SCANA	\$683,976	\$56,887,556	1%
Southern Co	\$8,588,616	\$125,961,507	7%
Unitil	\$16,863	\$17,487,105	0%
Xcel	\$8,117,941	\$121,867,585	7%
Total	\$44,827,703	\$3,301,556,519	1%

Source: FERC Form 60s

TENNESSEE AMERICAN WATER COMPANY
REBUTTAL TESTIMONY
COMPARISON GROUP FERC ACCOUNT 930.1 AS PERCENT OF TOTAL A&G

Utility Company	2009 Acct 903.1 Charges	Regulated Retail Customers	Acct 930.1 Cost per Customer	Total Svc Co Cost per Customer	Acct 930.1 as % of Total
AEP	\$3,236,317	5,213,000	\$ 0.62	\$ 80.28	1%
Allegheny	\$55,692	1,585,700	\$ 0.04	\$ 111.42	0%
Alliant	\$134,191	1,395,189	\$ 0.10	\$ 106.88	0%
Ameren	\$109,750	3,300,000	\$ 0.03	\$ 64.25	0%
Black Hills	\$488,272	759,400	\$ 0.64	\$ 107.30	1%
Centerpoint	\$5,491,173	5,300,000	\$ 1.04	\$ 22.51	5%
Dominion	\$1,240,571	3,700,000	\$ 0.34	\$ 75.44	0%
Duke	\$2,639,693	4,500,000	\$ 0.59	\$ 200.39	0%
Energy East	\$124,416	2,973,000	\$ 0.04	\$ 30.13	0%
Entergy	\$655,034	2,700,000	\$ 0.24	\$ 97.26	0%
E-On	\$1,309,969	1,226,000	\$ 1.07	\$ 86.37	1%
Exelon	\$3,348,298	5,886,000	\$ 0.57	\$ 91.34	1%
FirstEnergy	\$4,395,824	4,500,000	\$ 0.98	\$ 56.86	2%
Integrus	\$317,819	2,157,700	\$ 0.15	\$ 81.30	0%
Nat Grid	\$2,381,951	6,700,000	\$ 0.36	\$ 196.25	0%
NiSource	\$74,101	3,750,000	\$ 0.02	\$ 57.73	0%
Northeast	\$0	2,095,000	\$ -	\$ 128.85	0%
PHI	\$225,122	1,946,000	\$ 0.12	\$ 110.72	0%
Progress	\$1,192,114	3,100,000	\$ 0.38	\$ 60.08	1%
PNM	\$0	729,700	\$ -	\$ 120.60	0%
SCANA	\$683,976	1,445,000	\$ 0.47	\$ 115.26	0%
Southern Co	\$8,588,616	4,402,000	\$ 1.95	\$ 115.43	2%
Unitil	\$16,863	169,600	\$ 0.10	\$ 124.50	0%
Xcel	\$8,117,941	5,300,000	\$ 1.53	\$ 62.90	2%
Total	\$44,827,703	74,833,289	\$ 0.60	\$ 94.68	1%

Source: FERC Form 60s

TENNESSEE AMERICAN WATER COMPANY
REBUTTAL TESTIMONY
COMPARISON GROUP RETAIL ELECTRIC AND GAS CUSTOMERS

Service Co	Number of Customers			Percent of Total Customers			Dismuke A&G % of FERC Form 1
	Electric	Gas	Total	Electric	Gas	Total	
AEP	5,213,000		5,213,000	100%		100%	67%
Allegheny	1,585,700		1,585,700	100%		100%	123%
Alliant	982,462	412,727	1,395,189	70%	30%	100%	127%
Ameren	2,400,000	900,000	3,300,000	73%	27%	100%	67%
Black Hills	202,100	557,300	759,400	27%	73%	100%	180%
Centerpoint	2,100,000	3,200,000	5,300,000	40%	60%	100%	88%
Dominion	2,400,000	1,300,000	3,700,000	65%	35%	100%	82%
Duke	4,000,000	500,000	4,500,000	89%	11%	100%	109%
Energy East	908,000	318,000	1,226,000	74%	26%	100%	27%
Entergy	2,008,000	965,000	2,973,000	68%	32%	100%	78%
E-On	2,700,000		2,700,000	100%		100%	97%
Exelon	5,400,000	486,000	5,886,000	92%	8%	100%	95%
FirstEnergy	4,500,000		4,500,000	100%		100%	70%
Integrys	488,900	1,668,800	2,157,700	23%	77%	100%	213%
Nat Grid	3,300,000	3,400,000	6,700,000	49%	51%	100%	249%
NiSource	450,000	3,300,000	3,750,000	12%	88%	100%	237%
Northeast	1,890,000	205,000	2,095,000	90%	10%	100%	78%
PHI	1,823,000	123,000	1,946,000	94%	6%	100%	64%
Progress	3,100,000		3,100,000	100%		100%	55%
PNM	729,700		729,700	100%		100%	102%
SCANA	659,000	786,000	1,445,000	46%	54%	100%	114%
Southern Co	4,402,000		4,402,000	100%		100%	72%
Unitil	100,300	69,300	169,600	59%	41%	100%	162%
Xcel	3,400,000	1,900,000	5,300,000	64%	36%	100%	92%
Total	54,742,162	20,091,127	74,833,289				

Source: Baryenbruch workpapers; Dismukes Schedule KHD-14

TENNESSEE AMERICAN WATER COMPANY
REBUTTAL TESTIMONY

RETAIL GAS UTILITIES A&G MISSING FROM MS. DISMUKES' SCHEDULE KHD-14

Utility Company	Incorrect (regulated electric only)	Correct (regulated electric & gas affiliates)
	Included in Dismukes' A&G Calculation	Included in Baryenbruch's A&G Calculation
Integrus	Upper Peninsula Power Company Wisconsin Public Service Corporation Wisconsin River Power Company	Upper Peninsula Power Company Wisconsin Public Service Corporation Wisconsin River Power Company Peoples Gas Light and Coke Company Minnesota Energy Resources Corporation Michigan Gas Utilities Corporation North Shore Gas Company
National Grid	Granite State Electric Company Massachusetts Electric Company Nantucket Electric Company National Grid Generation, LLC New England Electric Transmission Corporation New England Hydro-Trans. Elec. Co., Inc. New England Hydro-Transmission Corporation New England Power Company Niagara Mohawk Power Corporation The Narragansett Electric Company Yankee Atomic Electric Company	Granite State Electric Company Massachusetts Electric Company Nantucket Electric Company National Grid Generation, LLC New England Electric Transmission Corporation New England Hydro-Trans. Elec. Co., Inc. New England Hydro-Transmission Corporation New England Power Company Niagara Mohawk Power Corporation The Narragansett Electric Company Yankee Atomic Electric Company Boston Gas Company Essex Gas Company Colonial Gas Company Energy North Natural Gas, Inc. KeySpan Gas East Corporation The Brooklyn Union Gas Company Narragansett Gas Company
NiSource	Northern Indiana Public Service Company	Northern Indiana Public Service Company Columbia Gas of Kentucky, Inc. Columbia Gas of Maryland, Inc. Columbia Gas of Ohio, Inc. Columbia Gas of Pennsylvania, Inc. Columbia Gas of Virginia, Inc. Kokomo Gas & Fuel Company

TENNESSEE AMERICAN WATER COMPANY
REBUTTAL TESTIMONY
WATER SERVICE COMPANY POSITIONS SERVING
REGULATED UTILITY AFFILIATES

Location	Group	WSC Position	Location	Group	WSC Position
Northbrook	Regulatory	Regulatory Staff Accountant II	FL Regional Office	Customer Service	CSR II
Northbrook	Billing	Billing Manager	FL Regional Office	Customer Service	CSR II
Northbrook	Regulatory	Regulatory Staff Accountant I	FL Regional Office	Customer Service	CSR II
Northbrook	Regulatory	Regulatory Staff Accountant I	FL Regional Office	Customer Service	CSR II
Northbrook	Officer	President & CEO	FL Regional Office	Customer Service	Customer Care Specialist
Northbrook	Finance / Accounting	Senior Fixed Asset Accountant	FL Regional Office	Customer Service	CSR I
Northbrook	Finance / Accounting	AP Supervisor	FL Regional Office	Customer Service	Customer Care Manager
Northbrook	Regulatory	Regulatory Accounting Manager	FL Regional Office	Customer Service	CSR II
Northbrook	Regulatory	Director, Governmental Affairs	FL Regional Office	Customer Service	Lead Customer Service Rep
Northbrook	Finance / Accounting	Director, Tax & Accounting Operations	FL Regional Office	Customer Service	CSR I
Northbrook	Finance / Accounting	Chief Operating Officer	FL Regional Office	Customer Service	CSR I
Northbrook	Finance / Accounting	Corporate Staff Accountant I	FL Regional Office	Customer Service	CSR I
Northbrook	Finance / Accounting	Corporate Accounting Manager	FL Regional Office	Customer Service	CSR I
Northbrook	Billing	Asst. Manager of Billing	FL Regional Office	Customer Service	CSR I
Northbrook	Officer	Chief Financial Officer	FL Regional Office	Customer Service	CSR Temp
Northbrook	Finance / Accounting	Payroll Supervisor	FL Regional Office	Customer Service	CSR Temp
Northbrook	Regulatory	Regulatory Staff Accountant I	FL Regional Office	Customer Service	CSR Temp
Northbrook	Regulatory	Regulatory Staff Accountant II	FL Regional Office	Customer Service	CSR Temp
Northbrook	IT	IT Manager	FL Regional Office	Customer Service	CSR Temp
Northbrook	Finance / Accounting	Senior Corporate Accountant	NV Regional Office	Customer Service	CSR II
Northbrook	Finance / Accounting	Senior Regulatory Accountant	NV Regional Office	Customer Service	Collections Specialist
Northbrook	Finance / Accounting	Financial Planning & Analysis Manager	NV Regional Office	Customer Service	Customer Care Manager
Northbrook	Administration	Executive Assistant	NV Regional Office	Customer Service	Collections Specialist
Northbrook	Finance / Accounting	Tax Specialist	NV Regional Office	Customer Service	CSR I
Northbrook	Finance / Accounting	AP Clerk	NV Regional Office	Customer Service	CSR I
Northbrook	Finance / Accounting	AP Clerk	NV Regional Office	Customer Service	CSR I
Northbrook	Finance / Accounting	AP Clerk	NC Regional Office	Customer Service	Lead Customer Service Rep
Northbrook	Billing	Billing Specialist	NC Regional Office	Customer Service	CSR I
Northbrook	Regulatory	Senior Regulatory Accountant	NC Regional Office	Customer Service	CSR II
Northbrook	IT	Network Administrator	NC Regional Office	Customer Service	CSR II
Northbrook	Officer	VP, General Counsel	NC Regional Office	Customer Service	CSR Temp
Northbrook	Regulatory	Regulatory Accounting Manager	FL Regional Office	Customer Service	Customer Service Manager
Northbrook	Regulatory	Regulatory Staff Accountant I	NC Regional Office	Customer Service	Customer Care Manager
Northbrook	HR	Human Resources Generalist	NC Regional Office	Customer Service	CSR II
Northbrook	Administration	Operations Administration Manager	Kentucky Operations	Operations	Field Tech III
Northbrook	Finance / Accounting	AP Clerk	Kentucky Operations	Operations	Water-Wastewater Operator II
Northbrook	HR/ Payroll	Payroll/HR Administrator	Kentucky Operations	Operations	Field Tech II
Northbrook	IT	Desktop Support Analyst II	Kentucky Operations	Operations	Regional Manager
Northbrook	Finance / Accounting	AP Clerk	Kentucky Operations	Operations	Lead Water-Wastewater Operator
Northbrook	Administration	Operations Administrator	Kentucky Operations	Operations	Field Tech I
Northbrook	Administration	Regulatory Assistant	Kentucky Operations	Operations	Water-Wastewater Operator II
Northbrook	Administration	Receptionist	Kentucky Operations	Operations	Area Manager - JCT
Northbrook	Finance / Accounting	Senior Corporate Accountant	Kentucky Operations	Operations	Field Tech I
Northbrook	Administration	Compliance & Safety Coordinator	Kentucky Operations	Operations	Water-Wastewater Operator I
Northbrook	IT	Desktop Support Analyst II	Kentucky Operations	Operations	Administrative Assistant
Northbrook	Finance / Accounting	AP Clerk	Regional Offices	Operations	Regional Director
Northbrook	Finance / Accounting	Senior Financial Analyst	Regional Offices	Officer	Regional Vice President
Northbrook	Finance / Accounting	Capital Projects Analyst	Regional Offices	Administration	Executive Assistant
Northbrook	Officer	VP, Corporate Development	Regional Offices	Finance / Accounting	Regional Finance Manager
Northbrook	Regulatory	Executive Director, Regulatory Affairs	Regional Offices	Administration	Regional Compliance & Safety Manager
Northbrook	Finance / Accounting	Corporate Services Manager			
Northbrook	HR	Benefits Administrator			
Northbrook	Regulatory	Regulatory Staff Accountant I			
Northbrook	Administration	Process & Performance Manager			
Northbrook	HR	HR Manager			
Northbrook	Administration	Mail Clerk			

Source: Baryenbruch & Company, LLC

TENNESSEE AMERICAN WATER COMPANY
 REBUTTAL TESTIMONY
 WATER SERVICE COMPANY OF KENTUCKY A&G EXPENSES PER CUSTOMER

Baryenbruch calculation (based on actual numbers)	
General Expenses	A&G-Related WSC Charges
Salaries and Wages	\$ 151,264
Office Supplies and Other Office Exp.	\$ 102,242
Regulatory Commission Expense	\$ 82,845
Pension and Other Benefits	\$ 36,828
Rent	\$ 18,906
Insurance	\$ 59,054
Office Utilities	\$ 53,825
Miscellaneous	\$ 26,283
Total	<u>\$ 531,246</u>
Total WSCK Customers	<u>7,349</u>
A&G Expenses Per Customer	\$ 72

Source: Baryenbruch & Company, LLC

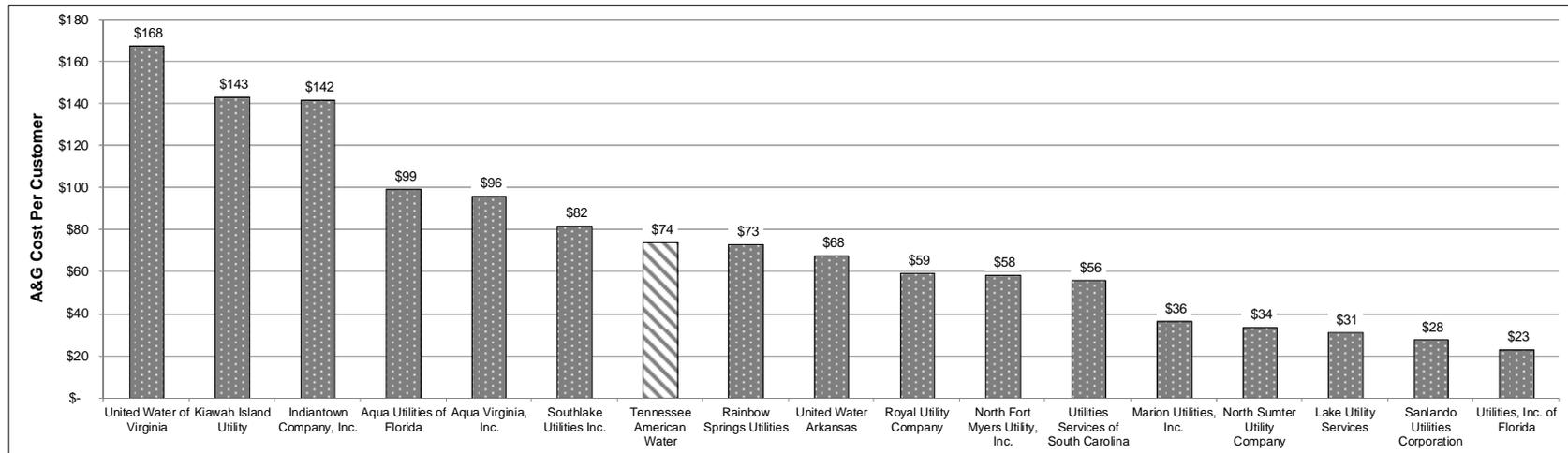
Dismukes calculation (based on data from WSCK's annual report to the KPSC)	
Contractual Services - Other	\$ 33,841
Total WSCK Customers	<u>7,344</u>
A&G Expenses Per Customer	\$ 5

Source: Dismukes KHD-15

TENNESSEE AMERICAN WATER COMPANY
REBUTTAL TESTIMONY
CALCULATION OF TAWC'S A&G COSTS PER CUSTOMER

TAWC A&G Cost Calculation		
	Dismukes	Baryenbruch
Salaries & Wages - Employees	\$ 1,538,187	\$ 1,538,187
Salaries & Wages - Officers	\$ -	
Employee Pensions & Benefits		
Materials and Supplies	\$ 6,895	\$ 6,895
Contractual Services - Engineering	\$ -	\$ -
Contractual Services - Accounting	\$ 71,356	\$ 71,356
Contractual Services - Legal	\$ 43,151	\$ 43,151
Contractual Services - Mgt. Fees	\$ -	\$ -
Contractual Services - Other	\$ 3,310,287	
Mgmt & Professional Svc Co Charges		\$ 4,099,018
Less: Capital Charges		\$ (311,927)
Less: Non-A&G O&M Charges		
Engineering		\$ (10,568)
Operations		\$ (541,144)
Water Quality		\$ (97,262)
Net - A&G Expenses		\$ 3,138,117
Rental of Building/Real Property	\$ 2,511	\$ 2,511
Misc. Expense	\$ 732,990	\$ 732,990
Total Selected A&G Expenses	\$ 5,705,377	\$ 5,533,207
Average Number of Customers	74,625	74,625
A&G Expenses Per Customer	\$ 76	\$ 74

TENNESSEE AMERICAN WATER COMPANY
 REBUTTAL TESTIMONY
 COMPARISON OF WATER COMPANY A&G EXPENSES



Utility	601-Salaries & Wages - Employees	603-Salaries & Wages - Officers	620-Materials & Supplies	631-Contractual Servicers - Engineering	632-Contractual Servicers - Accounting	633-Contractual Servicers - Legal	634-Contractual Servicers - Mgmt Fees	636-Contractual Servicers - Other	641-Rental of Buildings/ Real Property	642-Rental of Equipment	650-Transport Expenses	675-Misc Expenses	Total	Average Customers	A&G/ Customer
1 Aqua Utilities of Florida	\$ 14,110	\$ 18,157	\$ 31	\$ 7,279	\$ 21,132	\$ 97,312	\$ 1,471,184	\$ 84,765	\$ -	\$ 836	\$ -	\$ 115,955	\$ 1,830,761	18,415	\$ 99
2 Indiantown Company, Inc.	\$ 56,315	\$ -	\$ 14,834	\$ 16,743	\$ 8,959	\$ 3,273	\$ 154,387	\$ -	\$ 1,509	\$ -	\$ 1,989	\$ 453	\$ 258,462	1,822	\$ 142
3 Lake Utility Services	\$ 136,090	\$ 60,686	\$ 7,669	\$ -	\$ 9,776	\$ 3,837	\$ -	\$ 11,704	\$ -	\$ -	\$ 6,242	\$ 42,938	\$ 278,942	8,934	\$ 31
4 Marion Utilities, Inc.	\$ 6,754	\$ 99,987	\$ -	\$ -	\$ 25,176	\$ 2,644	\$ -	\$ -	\$ 39,552	\$ -	\$ 1,793	\$ 47,207	\$ 223,113	6,122	\$ 36
5 North Fort Myers Utility, Inc.	\$ -	\$ 33,150	\$ -	\$ -	\$ 11,760	\$ 1,142	\$ 16,209	\$ -	\$ 6,522	\$ -	\$ 237	\$ 38,876	\$ 107,896	1,846	\$ 58
6 North Sumter Utility Company	\$ -	\$ -	\$ 3,100	\$ 64,984	\$ 24,885	\$ 10,740	\$ 382,627	\$ 90,768	\$ -	\$ -	\$ 1,114	\$ -	\$ 578,218	17,126	\$ 34
7 Rainbow Springs Utilities	\$ 42,567	\$ -	\$ 1,378	\$ -	\$ 26,662	\$ 8,982	\$ 60,982	\$ -	\$ 8,101	\$ 375	\$ -	\$ 29,011	\$ 178,058	2,432	\$ 73
8 Royal Utility Company	\$ -	\$ 44,000	\$ -	\$ 480	\$ 12,898	\$ 2,915	\$ -	\$ -	\$ -	\$ -	\$ 910	\$ 52,953	\$ 114,156	1,926	\$ 59
9 Sanlando Utilities Corporation	\$ 180,599	\$ 80,430	\$ 10,356	\$ -	\$ 13,004	\$ 3,841	\$ -	\$ 2,077	\$ -	\$ -	\$ 8,723	\$ 38,384	\$ 337,414	12,160	\$ 28
10 Southlake Utilities Inc.	\$ 14,686	\$ -	\$ 1,127	\$ 13,524	\$ 23,463	\$ 51,541	\$ 66,300	\$ -	\$ 15,378	\$ -	\$ 4,924	\$ 2,887	\$ 193,830	2,366	\$ 82
11 The Empire District Electric Co.	Small Salaries, No Contractual Services Charges														
12 United Water Arkansas	\$ 357,251	\$ -	\$ 12,579	\$ -	\$ 12,669	\$ 1,225	\$ 556,012	\$ 163,592	\$ -	\$ 3,270	\$ 1,168	\$ 65,929	\$ 1,173,695	17,333	\$ 68
13 Utilities, Inc. of Florida	\$ 1	\$ -	\$ 1	\$ -	\$ 7,502	\$ 1,864	\$ -	\$ 41,635	\$ -	\$ -	\$ 3	\$ 104,014	\$ 155,020	6,746	\$ 23
14 Water Service Corp. of KY	Data In Conflict With Rate Case Filing														
15 Carolina Water Services	Negative Salaries,														
16 Kiawah Island Utility	\$ 355,756	\$ -	\$ 5,924	\$ -	\$ 7,083	\$ 3,326	\$ 59,065	\$ -	\$ 19,072	\$ -	\$ -	\$ 53,691	\$ 503,917	3,524	\$ 143
17 Utilities Services of So Carolina	\$ 63,193	\$ -	\$ 203,332	\$ (14,256)	\$ 7,004	\$ 39,366	\$ -	\$ 45,960	\$ -	\$ 18,378	\$ -	\$ 27,451	\$ 390,428	6,960	\$ 56
18 Aqua Virginia, Inc.	\$ 4,760	\$ -	\$ 3,769	\$ -	\$ 12,972	\$ 14,520	\$ 321,652	\$ 21,155	\$ -	\$ 2,306	\$ 119	\$ 35,519	\$ 416,772	4,337	\$ 96
19 United Water of Virginia	\$ 186,573	\$ -	\$ 935	\$ -	\$ 18,632	\$ -	\$ -	\$ 149,280	\$ 4,500	\$ -	\$ -	\$ 73,555	\$ 433,475	2,585	\$ 168
Total	\$ 1,418,655	\$ 336,410	\$ 265,035	\$ 88,754	\$ 224,945	\$ 265,160	\$ 3,088,418	\$ 610,936	\$ 94,634	\$ 25,165	\$ 26,108	\$ 729,937	\$ 7,174,157	114,631	\$ 63
Tennessee American Water	\$ 1,538,187	\$ -	\$ 6,895	\$ -	\$ 71,356	\$ 43,151	\$ 3,138,117	\$ -	\$ 2,511	\$ -	\$ -	\$ 732,990	\$ 5,533,207	74,625	\$ 74

removed from comparison group cost calculation due to aberrant data

TENNESSEE AMERICAN WATER COMPANY
 REBUTTAL TESTIMONY
 NORTH SUMTER UTILITY COMPANY, LLC AFFILIATE TRANSACTIONS

UTILITY NAME: North Sumter Utility Company, LLC

YEAR OF REPORT December 31, 2009

BUSINESS TRANSACTIONS WITH RELATED PARTIES

List each contract, agreement, or other business transaction exceeding a cumulative amount of \$500 in any one year, entered into between the Respondent and a business or financial organization, firm, or partnership named on pages E-2 and E-6 identifying the parties, amounts, dates and product, asset, or service involved.

Part I. Specific Instructions: Services and Products Received or Provided

- Enter in this part all transactions involving services and products received or provided.
- Below are some types of transactions to include:
 - management, legal and accounting services
 - computer services
 - engineering & construction services
 - repairing and servicing of equipment
 - material and supplies furnished
 - leasing of structures, land and equipment
 - rental transactions
 - sale, purchase or transfer of various products

NAME OF COMPANY OR RELATED PARTY (a)	DESCRIPTION SERVICE AND/OR NAME OF PRODUCT (b)	CONTRACT OR AGREEMENT EFFECTIVE DATES (c)	ANNUAL CHARGES	
			(P)urchased or (S)old (d)	AMOUNT (e)
The Villages of Lake-Sumter	Billing, accounting, customer service & management	Open	P	\$ 1,031,809

TENNESSEE AMERICAN WATER COMPANY
REBUTTAL TESTIMONY
NORTH SUMTER UTILITY COMPANY, LLC AFFILIATE TRANSACTIONS

UTILITY NAME: North Sumter Utility Company, LLC
SYSTEM NAME / COUNTY: The Villages / Sumter

YEAR OF REPORT
December 31, 2009

WATER UTILITY EXPENSE ACCOUNTS

ACCT. NO. (a)	ACCOUNT NAME (b)	CURRENT YEAR (c)	.1 SOURCE OF SUPPLY AND EXPENSES - OPERATIONS (d)	.2 SOURCE OF SUPPLY AND EXPENSES - MAINTENANCE (e)
601	Salaries and Wages - Employees	\$ -	\$ -	\$ -
603	Salaries and Wages - Officers, Directors and Majority Stockholders			
604	Employee Pensions and Benefits			
610	Purchased Water			
615	Purchased Power	127,309		
616	Fuel for Power Production			
618	Chemicals			
620	Materials and Supplies	3,100		
631	Contractual Services - Engineering	64,984		
632	Contractual Services - Accounting	24,885		
633	Contractual Services - Legal	10,740		
634	Contractual Services - Mgt. Fees	407,523		24,896
635	Contractual Services - Testing			
636	Contractual Services - Other	895,396		
641	Rental of Building/Real Property			
642	Rental of Equipment			
650	Transportation Expense			
656	Insurance - Vehicle			
657	Insurance - General Liability	4,168		
658	Insurance - Workmens Comp.			
659	Insurance - Other	26,398		
660	Advertising Expense			
666	Regulatory Commission Expenses - Amortization of Rate Case Expense			
667	Regulatory Commission Exp. -Other			
670	Bad Debt Expense			
675	Miscellaneous Expenses	3,394		
Total Water Utility Expenses		\$ 1,567,897		\$ 24,896

TENNESSEE AMERICAN WATER COMPANY
REBUTTAL TESTIMONY
NORTH SUMTER UTILITY COMPANY, LLC AFFILIATE TRANSACTIONS

UTILITY NAME: North Sumter Utility Company, LLC
SYSTEM NAME / COUNTY: The Villages / Sumter

YEAR OF REPORT
December 31, 2009

WATER EXPENSE ACCOUNT MATRIX					
.3 WATER TREATMENT EXPENSES - OPERATIONS (f)	.4 WATER TREATMENT EXPENSES - MAINTENANCE (g)	.5 TRANSMISSION & DISTRIBUTION EXPENSES - OPERATIONS (h)	.6 TRANSMISSION & DISTRIBUTION EXPENSES - MAINTENANCE (i)	.7 CUSTOMER ACCOUNTS EXPENSE (j)	.8 ADMIN. & GENERAL EXPENSES (k)
\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
127,309					
					3,100
					64,984
					24,885
					10,740
					382,627
310,316	171,479	318,771	4,062		90,768
					4,168
					26,398
2,280					1,114
\$ 439,905	\$ 171,479	\$ 318,771	\$ 4,062		\$ 608,784

TENNESSEE AMERICAN WATER COMPANY
REBUTTAL TESTIMONY
TAWC CUSTOMER SERVICE EXPENSES PER CUSTOMER

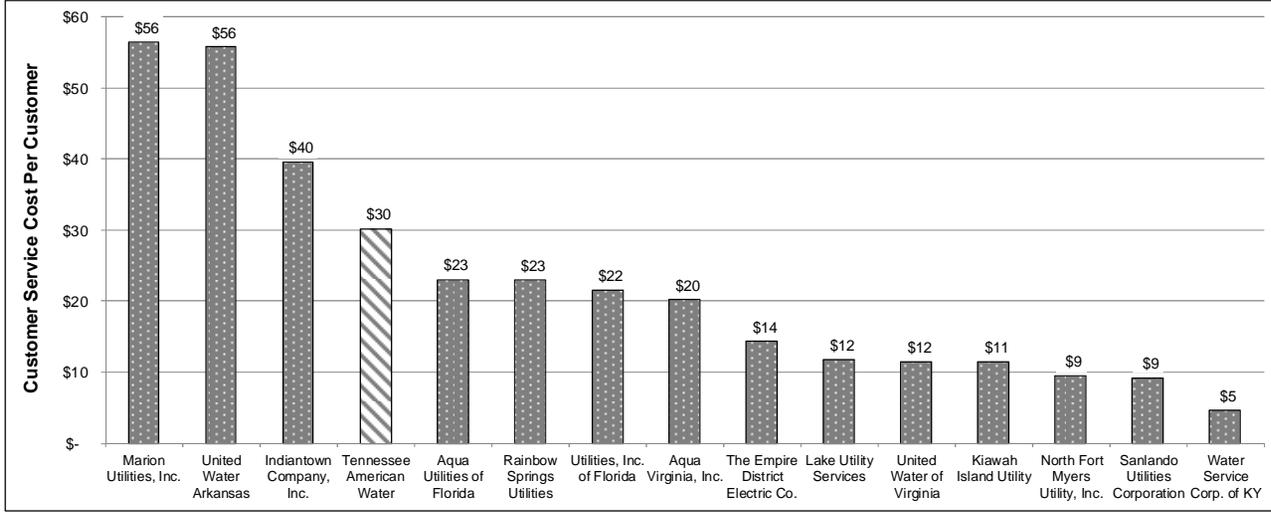
TAWC Customer Service
Cost Calculation

	Dismukes	Baryenbruch
Salaries & Wages - Employees	\$ 409,442	\$ 409,442
Materials and Supplies	\$ 1,943	\$ 1,943
Contractual Services - Other	\$ 1,132,225	\$ 1,120,113
Misc. Expense	\$ 823,670	\$ 732,990
Total Selected A&G Expenses	\$ 2,367,280	\$ 2,264,488
Average Number of Customers	74,625	74,625
Cust Svc Expenses Per Customer	\$ 32	\$ 30

Source: Baryenbruch workpapers; Dismukes workpapers

TENNESSEE AMERICAN WATER COMPANY
 REBUTTAL TESTIMONY

COMPARISON OF WATER COMPANY CUSTOMER SERVICE EXPENSES



Utility	636-Contractual Services						Total	Average Customers	A&G/ Customer
	601-Salaries & Wages - Employees	603-Salaries & Wages - Officers	620-Materials and Supplies	Contractual Services - Other	650-Transport Expenses	675-Misc Expenses			
1 Aqua Utilities of Florida	\$ 144,015	\$ -	\$ 515	\$ 280,666	\$ -	\$ -	\$ 425,196	18,415	\$ 23
2 Indiantown Company, Inc.	\$ 44,492	\$ -	\$ 27,427	\$ -	\$ 223	\$ -	\$ 72,142	1,822	\$ 40
3 Lake Utility Services	\$ 37,394	\$ -	\$ 7,669	\$ 11,704	\$ 6,242	\$ 42,938	\$ 105,947	8,934	\$ 12
4 Marion Utilities, Inc.	\$ 86,150	\$ 199,973	\$ -	\$ -	\$ 2,131	\$ 57,389	\$ 345,643	6,122	\$ 56
5 North Fort Myers Utility, Inc.	\$ 3,134	\$ -	\$ -	\$ 3,061	\$ -	\$ 11,337	\$ 17,532	1,846	\$ 9
6 North Sumter Utility Company	No Data								
7 Rainbow Springs Utilities	\$ 51,296	\$ -	\$ 1,012	\$ -	\$ -	\$ 3,656	\$ 55,964	2,432	\$ 23
8 Royal Utility Company	No Data								
9 Sanlando Utilities Corporation	\$ 52,755	\$ -	\$ 10,356	\$ 2,077	\$ 8,723	\$ 38,384	\$ 112,295	12,160	\$ 9
10 Southlake Utilities Inc.	No Salaries, No Contractual Services Charges								
11 The Empire District Electric Co.	\$ 27,143	\$ (434)	\$ -	\$ 38,818	\$ -	\$ -	\$ 65,527	4,558	\$ 14
12 United Water Arkansas	\$ 556,713	\$ -	\$ 9,486	\$ 276,656	\$ 43,761	\$ 80,600	\$ 967,216	17,333	\$ 56
13 Utilities, Inc. of Florida	\$ -	\$ -	\$ -	\$ 41,635	\$ -	\$ 104,014	\$ 145,649	6,746	\$ 22
14 Water Service Corp. of KY	No Salaries, No Contractual Services								
15 Carolina Water Services	No Salaries, No Contractual Services								
16 Kiawah Island Utility	\$ 40,479						\$ 40,479	3,524	\$ 11
17 Utilities Services of So Carolina	No Salaries, No Contractual Services								
18 Aqua Virginia, Inc.	\$ 14,880	\$ -	\$ 8	\$ 72,946	\$ -	\$ -	\$ 87,834	4,337	\$ 20
19 United Water of Virginia	\$ 25,082	\$ -	\$ -	\$ -	\$ -	\$ 4,667	\$ 29,749	2,585	\$ 12
Total	\$ 1,043,054	\$ 199,539	\$ 96,952	\$ 761,404	\$ 61,080	\$ 342,985	\$ 2,505,014	98,154	\$ 26

Tennessee American Water	\$ 409,442	\$ 1,943	\$ 1,120,113	\$ 732,990	\$ 2,264,488	74,625	\$ 30
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removed from comparison group cost calculation due to no data or aberrant data

TENNESSEE AMERICAN WATER COMPANY
REBUTTAL TESTIMONY
COMPARISON OF WATER COMPANY CUSTOMER SERVICE EXPENSES

9176787.2

TENNESSEE REGULATORY AUTHORITY



460 James Robertson Parkway
Nashville, Tennessee 37243-0505

April 1, 2011

Director Sara Kyle
Director Eddie Roberson
460 James Robertson Parkway
Nashville, TN 37243

**Re: Docket No. 10-00189 Petition of Tennessee American Water Company for a
General Rate Increase**

Dear Directors Kyle and Roberson:

Attached is the motion I intend to make at the Convening of the Panel to be held on Monday, April 4, 2011 in the above-referenced docket. This document is being filed for your convenience and to help expedite deliberations.

Sincerely,

A handwritten signature in black ink that reads "Mary W. Freeman".

Mary W. Freeman
Chairman

Attachment

Director Mary W. Freeman's Motion
Docket No. 10-00189

Test Period and Attrition Period

Because the TRA is not limited to adopting one test period for use throughout this case, I find that the normalized test period for the twelve months ended March 31, 2010 as proposed by Tennessee American Water Company ("Company" or "TAWC") or the September 30, 2010 normalized test period proposed by Consumer Advocate and Protection Division of the Tennessee Attorney General's Office ("CAPD") are both acceptable and move that the Tennessee Regulatory Authority ("Authority" or "TRA") use the test period which best fits the individual items being forecasted.

Because both the Company and the CAPD are in agreement as to the attrition period, I move we adopt the forward looking attrition period of the twelve months ending December 31, 2011.

Revenues and AWR Earnings

I move that the Authority adopt attrition period revenues of \$37,614,978. This amount is derived from:

- 1) Adopting the Company's calculated attrition period Residential Revenue, less the Weather Normalization Adjustment, which results in residential revenues of \$15,555,318;
- 2) Adopting the Company's calculated attrition period Commercial Revenues, less the Weather Normalizing Adjustment, which results commercial revenues of \$11,540,748;
- 3) Adopting the Company's attrition period Industrial Revenue of \$3,401,964;
- 4) Adopting the Company's attrition period Other Public Authority Revenue of \$2,556,253;
- 5) Adopting the Company's attrition period Other Water Utilities Revenue of \$1,308,493;
- 6) Adopting the Company's attrition period Public/Private Fire Service Revenue of \$1,735,066; and
- 7) Adopting the Company's attrition period Other Operating Revenues of \$1,517,135.

Additionally, I move that the Authority impute the Tennessee Net Income from the AWR Water and Sewer Protection Programs of \$306,611.

Expenses

Salaries and Wages

I move that the Authority adopt the Salaries and Wages Expense for the attrition period of \$5,279,477. Further, I move that the Company be required to submit semi-annual reports on

staffing levels with the Utility Division Chief. Such reports should include the following: the actual number of full-time employees (“FTEs”) for the previous period, an explanation for any differences between authorized and actual FTEs, and the date TAWC expects to fill any vacant positions.

I also move that TAWC be required to submit a semi-annual report to the Utility Division Chief regarding its Valve Operation and Maintenance Program. The report should include the following: 1) the number of employees assigned to the valve program; 2) the target number of larger and smaller valves to be inspected/operated and maintained during the previous period; 3) the number of valves actually inspected/operated and maintained during that period; 4) the number of valves found to be in need of repair or replacement; 5) the date for repair or replacement of such valves; and 6) if TAWC decided not to repair or replace those valves in need of such, the number of valves that were not repaired or replaced and the reason for not doing so.

Purchased Water

I move that the Authority adopt the Company’s attrition period forecast for Purchased Water Expense of \$47,692.

Fuel and Power

I move that the Authority adopt Fuel and Power Expense for the attrition period of \$2,277,057. This amount is based upon the Company’s normalized test period usage and a water loss percentage of 15%.

Chemicals

I move that the Authority adopt Chemicals Expense for the attrition period of \$881,439. This amount is based upon the Company’s normalized test period usage and a water loss percentage of 15%.

Waste Disposal

I move that the Authority adopt an attrition period Waste Disposal Expense of \$194,993.

Management Fees

I move that the Authority adopt an attrition period Management Fees Expense of \$4,741,068. This amount is based upon the Company-normalized amount of \$5,048,200 for the twelve months ended September 30, 2010 and (1) eliminating \$172,295 of External Affairs Expense; (2) eliminating \$89,720 of Business Development Expense; and (3) eliminating 50% (\$89,734) of the Annual Incentive Plan. The residual amount is then grown by an annual inflation factor of 0.76% for fifteen (15) months.

Group Insurance

I move that the Authority adopt an attrition period amount of \$2,111,420 for Group Insurance Expense.

Pensions

I move that the Authority adopt an attrition period amount of \$839,965 for Pension Expense.

Regulatory Expense

I move that the Authority adopt an attrition period amount of \$277,880 for Regulatory Expense.

Insurance Other Than Group

I move that the Authority adopt the CAPD's attrition period forecast of \$322,151 for Insurance Other Than Group Expense.

Customer Accounting

I move that the Authority adopt the CAPD's attrition period projection for Customer Accounting Expense of \$841,097.

Uncollectible Expense

I move that the Authority adopt an attrition period amount for Uncollectible Expense at current rates of \$198,122.

Rents

I move that the Authority adopt the CAPD's attrition period forecast of \$8,436 for Rent Expense.

General Office Expense

I move that the Authority adopt the CAPD's projected General Office Expense of \$218,374 for the attrition year.

Miscellaneous Expense

I move that the Authority adopt an attrition period amount of \$2,006,364 for Miscellaneous Expense.

Other Maintenance Expense

I move that the Authority adopt the CAPD's attrition period forecast of \$1,143,531 for Other Maintenance Expense.

Depreciation and Amortization Expense

I move that the Authority adopt the CAPD's forecast for Depreciation Expense of \$4,703,804 for the attrition period as originally filed in CAPD's Direct Testimony.

Taxes Other Than Income

Gross Receipts Tax

I move that the Authority accept \$704,308 for the attrition period forecast of Gross Receipts tax; this amount is based on the methodology actually used to calculate these taxes.

TRA Inspection Fees

I move that the Authority adopt \$116,262 for the TRA Inspection Fee which is based on the attrition period Revenue at current rates.

Property Taxes

I move that the Authority adopt the CAPD's Property Taxes for the attrition period of \$2,572,725.

Franchise Taxes

I move that the Authority adopt the CAPD's Franchise Taxes for the attrition period of \$391,255.

FICA Tax

I move that the Authority adopt \$397,217 for FICA Taxes for the attrition period.

Unemployment Tax

I move that the Authority adopt \$16,688 for Unemployment Taxes for the attrition period.

State Excise Tax

I move that the Authority adopt Excise Taxes for the attrition period of \$223,534.

Federal Income Tax

I move that the Authority adopt Federal Income Taxes for the attrition period of \$1,672,871.

Allowance for Funds Used During Construction (AFUDC)

I move that the Authority adopt \$204,000 for AFUDC for the attrition period as agreed to by the Company and the CAPD.

Net Operating Income

Based upon the preceding determinations, I move that the Authority find that the Net Operating Income for the company is \$5,937,860 for the attrition period prior to the application of taxes for the additional attrition period revenues.

Rate Base

I move that the Authority adopt a rate base of \$118,459,808 for the attrition year ending December 31, 2011 consisting of the following:

Utility Plant in Service

I move that the Authority adopt Utility Plant in Service of \$225,496,165 for the attrition period.

Construction Work in Progress (CWIP)

I move that the Authority adopt a CWIP balance of \$2,681,318 for the attrition period.

Utility Plant Capital Lease

I move that the Authority adopt the amount agreed to by TAWC and the CAPD for Utility Plant Capital Lease of \$1,590,500 for the attrition period.

Working Capital

I move that the Authority adopt Working Capital in the amount of \$1,675,829 for the attrition period.

Accumulated Depreciation

I move that the Authority adopt the CAPD's projection of \$73,137,622 for Accumulated Depreciation for the attrition period.

Retired Work In Process (RWIP)

I move that the Authority adopt the unchallenged RWIP amount of \$0 for the attrition period.

Accumulated Amortization of Utility Capital Lease

I move that the Authority adopt the amount agreed to by TAWC and the CAPD for Accumulated Amortization of Utility Plant Capital Lease of \$1,387,268 for the attrition period.

Accumulated Deferred Income Taxes

I move that the Authority adopt Accumulated Deferred Income Taxes in the amount of \$22,638,057 for the attrition period.

Customer Advances for Construction

I move that the Authority adopt \$5,786,757 as proposed by TAWC and the CAPD for Customer Advances for Construction for the attrition period.

Contributions In Aid of Construction (CIAC)

I move that the Authority adopt \$9,932,550 as proposed by TAWC and the CAPD for Contributions in Aid of Construction for the attrition period.

Unamortized Investment Tax Credit (UITC)

I move that the Authority adopt \$26,899 for Unamortized Investment Tax Credits for the attrition period.

Utility Plant Acquisition Adjustment

I move that the Authority adopt the CAPD's projection of \$74,850 for Utility Plant Acquisition Adjustment for the attrition period.

Revenue Conversion Factor

I move that the Authority adopt an overall Revenue Conversion Factor of 1.643037 for the attrition year.

Rate of Return

I move that TAWC's rate of return be set using a double leveraged capital structure. To implement the double leverage methodology, I move that the Authority set the portion of TAWC's capitalization held by parties outside the American Water Works system at 6.81% at a cost of 8.3%. For TAWC's parent company, I move adoption of a capital structure consisting of 53.13% long-term debt, 2.63% short-term debt, 0.25% preferred stock and 43.99% equity. Additionally, I move adoption of a long-term debt cost of 6.27%, a short-term debt cost of 1.9% and the cost of preferred stock of 5%. I move adoption of an equity return of 10.0%. Using these values, I move for an overall rate of return of 7.83% for TAWC.

Revenue Deficiency

Based upon the preceding determinations, I find that the Revenue Deficiency is \$5,551,013 for the attrition period.

Rate Design

I move that the Authority deny the Settlement between the Chattanooga Regional Manufacturers Association and TAWC. The *Summary of Settlement between CRMA and TAWC* filed on March 28, 2011 did not contain sufficient information to determine the terms of the Settlement and potential impact on customers throughout the industrial class.

I move that the Authority deny the TAWC's proposed tariffs and instruct the Company to file new tariffs reflecting a 14.98% increase to rates in all rate classes. I also move that the Company file a rate design spreading the approved revenue change proportionately to all rates based on its attrition year billing determinants less the WNA adjustment, and that such price-out demonstrate that the proposed rates result in the approved revenue change.

**Market Cost Comparison of Service Company Charges to
Virginia American Water Company**

12-Months Ended September 30, 2011



**Virginia American Water Company
Market Cost Comparison of Service Company Charges
12-Months Ended September 30, 2011**

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Purpose of This Study

This study was undertaken to answer four questions concerning the services provided by American Water Works Service Company, Inc. (Service Company) to Virginia American Water Company (VAWC):

1. Were the Service Company's charges to VAWC during the 12 months ended September 30, 2011 reasonable?
2. Was VAWC charged the lower of cost or market for managerial and professional services provided by the Service Company during the 12 months ended September 30, 2011?
3. Were the 12 months ended September 30, 2011 costs of the Service Company's customer accounts services, including those of the National Call Centers, comparable to those of other utilities?
4. Are the services VAWC receives from the Service Company necessary?

Study Results

Concerning question 1, the following conclusion was reached:

- The Service Company's costs for the 12 months ended September 30, 2011 per VAWC customer are very reasonable. For example, during the 12 months ended September 30, 2011, VAWC was charged \$66 per customer for administrative and general ('A&G')-related services provided by the Service Company. This compares favorably to costs per customer for electric and combination electric/gas service companies that average \$111 for service companies reporting to the Federal Energy Regulatory Commission ("FERC"). Only 4 of the 24 utility service companies that filed a FERC Form 60 for 2010 had a lower A&G cost per customer than VAWC's charges from the Service Company.

Concerning question 2, the following conclusions were drawn from this study:

- VAWC was charged the lower of cost or market for managerial and professional services during the 12 months ended September 30, 2011.
- On average, the hourly rates for outside service providers are 40% higher than the Service Company's hourly rates.
- The managerial and professional services provided by the Service Company are vital and could only be procured effectively by VAWC from outside professionals if it provided careful supervision to those service providers. If these services were contracted entirely from outside providers, VAWC would have to add at least one position to manage activities of outside firms. This position would be necessary to ensure the quality and timeliness of services provided.
- If all the managerial and professional services now provided by the Service Company had been outsourced during the 12 months ended September 30, 2011, VAWC and its ratepayers would have incurred almost \$2.4 million in additional expenses. This amount includes the higher cost of outside providers and the cost of one VAWC position needed to direct the outsourced work.



I – Introduction

- This study's hourly rate comparison actually understates the cost advantages that accrue to VAWC from its use of the Service Company. Outside service providers generally bill for every hour worked. Service Company exempt personnel, on the other hand, charge a maximum of 8 hours per day even when they work more hours. If all overtime hours of Service Company personnel were factored into the hourly rate calculation, the Service Company would have had an even greater annual dollar advantage than the \$2.4 million cited above.
- It would be difficult for VAWC to find local service providers with the same specialized water industry expertise as that possessed by the Service Company staff. Service Company personnel spend substantially all their time serving operating water companies. This specialization brings with it a unique knowledge of water utility operations and regulation that is most likely unavailable from local service providers.
- Service Company fees do not include any profit markup. Only its actual cost of service is being recovered from VAWC customers.

Concerning question 3, the following conclusion was reached:

- The cost of the Service Company's customer accounts services, including those provided by the National Call Center, is below the average of the neighboring electric utility comparison group. As will be explained further, this group of companies provides a reasonable proxy group for comparison to a regulated utility of the size and scope of the Service Company and VAWC. During the 12-months ended September 30, 2011, the customer accounts cost for VAWC customers was \$22.69 compared to the 2010 average of \$32.87 for neighboring electric utilities. The highest comparison group per customer cost was \$75.43 and the lowest \$16.81.

Concerning question 4, the following conclusions was drawn:

- The services that the Service Company provides are necessary and would be required even if VAWC were a stand-alone water utility.
- Furthermore, there is no redundancy or overlap in the services provided by the Service Company to VAWC. For all of the services listed in Exhibit 12, there was only one entity primarily responsible for the service and thus no duplication of efforts between the Service Company and VAWC.



II – Background

Overview of American Water Works Service Company

American Water's Service Company exists to provide certain shared services to American Water subsidiaries. It follows a service company model used by many utility holding companies that own multiple regulated utilities. By consolidating executive and professional services into a single service company, utility holding companies are able to realize the following benefits for ratepayers:

- Purchasing Economies – Common expenses (e.g., insurance, chemicals, piping) can be procured on a much larger scale thereby providing greater bargaining power for the combined entity compared to individual utility operating companies. A service company facilitates corporate-wide purchasing programs through its procurement and contract administration functions.
- Operating Economies of Scale – A service company is able to deliver services more efficiently because workloads can be balanced across more persons and facilities. For instance, American Water's Service Company is able to maintain one principal data center for the entire corporation. This is much more cost-efficient than each operating utility funding its own data center with its large fixed hardware, software and staffing costs.
- Continuity of Service – Centralizing service company personnel who perform similar services facilitates job cross-training and sharing of knowledge and expertise. This makes it easier to deal with staff turnover and absences and to sustain high levels of service to operating utilities. An individual operating utility might experience considerable disruption if a key professional left and it was necessary to hire outside to fill the vacancy.
- Maintenance of Corporate-Wide Standards – Personnel in American Water's Service Company establish standards for many functions (e.g., engineering designs, operating procedures and maintenance practices). It is easier to ensure these standards are followed by every operating utility because their implementation is overseen by the Service Company.
- Improved Governance – American Water's Service Company provides another dimension of management and financial oversight that supplements local operating utility management. The Service Company facilitates standard planning and reporting that help ensure operating utilities meet the requirements of their customers in a cost effective manner.
- Retention of Personnel – A service company organization provides operating utility personnel with another career path beyond what may be available on a local level. These opportunities tend to improve employee retention.

American Water follows the model for other utility service companies in another important regard. Its services are provided to affiliate operating utilities, like VAWC, at cost. American Water's Service Company is not a profit-making entity. It assigns only its actual expenses to the American Water subsidiaries it services.

The Service Company provides services to American Water operating companies from the following locations:



II – Background

- Corporate Office – Includes American Water's executive management and personnel from the various corporate support services. American Water's corporate office is located in Voorhees, New Jersey.
- National Call Centers – Perform customer service functions, including: customer call processing, service order processing, correspondence processing, credit and collections. American Water maintains two call centers. One in Alton, Illinois that went into operation in 2001 and a second in Pensacola, Florida that went into operation in 2005. Prior to the establishment of these national call centers, customer service functions were performed by employees of NJAWC, which incurred the expense on its books.
- National Shared Services Center – The Shared Services Center, located in Cherry Hill, New Jersey, provides various financial, accounting and treasury functions that had been performed by individual operating companies. This arrangement has improved and streamlined the Company's financial processes and allowed operating companies to focus on providing utility service.
- Regional Offices – Regional offices provide operating companies with certain support services that can be performed more effectively on a regional basis because individual operating company/center workloads are not sufficient to warrant a full-time staff for these activities. At the same time, these services require closer proximity to operating companies served so they are not provided by the National Shared Services Center. Examples of regional office services include legal, communication, human resources and maintenance.
- Belleville Lab – The national trace substance laboratory is located in Belleville, Illinois and performs testing for all American Water operating companies.
- Information Technology Service Centers – American Water's principal data center, located in Hershey, Pennsylvania, supports the IT infrastructure required to run corporate and operating company business applications and the communications systems. IT personnel rotate, as needed, throughout the regional offices and operating companies.

Service Company Expense Categories

The Service Company renders a monthly bill to operating companies. Charges are broken down into the following expense categories:

- Labor – base pay (salaries) of managerial and professional employees
- Labor-Related Overheads - employee benefit costs (payroll taxes, medical coverage, pensions, disability insurance) and other general expenses
- Support - wages and salaries of office support personnel, including secretaries, clerical personnel, telephone operators and mail clerks
- Office Expenses - office rent, equipment leases, telephone, electric, office supplies, property taxes, office maintenance
- Vouchers/Journal Entries – (1) travel expenses incurred by Service Company personnel, (2) other items submitted for reimbursement by employees, including professional association dues, (3) outside service contracts for such things as actuarial

II – Background

services, and (4) various other expenditures, including data center expenses for software licenses and hardware maintenance.

Service Company expenses are either assigned directly or allocated to operating companies, as shown in the table below.

Expense Category	Direct		Comments
	Charged	Allocated	
Labor	X	X	Professional personnel working for one or several operating companies
Labor-Related Overheads	X	X	These are primarily employee benefit costs that relate directly to labor
Support		X	Administrative personnel support the professional staff, thus support costs are allocated on the basis of professional labor
Office Expense		X	Are all allocated on the basis of professional labor
Vouchers/Journals	X	X	May be either directly in support of one operating company (e.g., an engineer traveling from the Corporate Office to the operating company) or allocated to several operating companies

A direct charge occurs when Service Company work or expenses are incurred in support of only one operating company. Direct charge examples include work in support of an operating company's rate case, engineering design work on an operating company's project and the preparation of an operating company's financial statements.

Service Company expenses are allocated when more than one operating company benefits from the underlying work. Examples include assessments of new Federal water quality regulations, development of the company-wide materials procurement contracts and creation of company-wide engineering design standards.

Charging and Assignment Of Service Company Time and Expenses

Service Company transactions are assigned with the following information so there is a proper accounting and eventual charging to an operating company:

- Operating company
- Formula number
- Work order (where applicable)
- Authorization number (where applicable)

Charges can originate from the following systems:

- Payroll System
- RVI System (outside vendor payments)
- PCard System (credit card payments)
- Internal Purchase Order System
- Journal entries

II – Background

The Service Company's time reporting process enables labor and support charges to be assigned to the proper operating company. Labor charges are based on the time reported by managerial and professional Service Company employees. Every week, Service Company professional employees complete an electronic time sheet that shows:

- Formula number (this is linked to operating company within American Water's financial system)
- Employee hours worked
- Account number for non-labor charges

At month-end, time report information is processed and direct and allocated professional labor hours tabulated for each operating company. Dollar charges are then calculated using the hourly rate of each Service Company professional employee based upon their base salary (i.e., an employee's hours times their hourly rate of pay).

Support (administrative) personnel charge their time to the activity "General Admin." As described in the table on page 5, their labor charges are allocated to operating companies based upon how their office's professional personnel labor charges are assigned. For instance, if 2% of American Water's Shared Services' professional labor is assigned to VAWC during a month, then 2% of that office's monthly administrative labor charges also are assigned to the operating company.

The overhead cost category is next assigned based on professional and administrative labor costs. Thus, if 2% of the Shared Services' accumulated professional and support labor is charged to VAWC during the month, then 2% of that month's overhead expenses will be assigned to VAWC.

Each Service Company location's office expenses are allocated to operating companies based on how professional labor charges for that office have been assigned. For instance, if 2% of professional labor from one Service Company office is assigned to VAWC, then 2% of that office's office expenses would be assigned to VAWC. Thus, office expenses are allocated in the very same way as administrative labor.

Vouchers/journal entries may be charged directly or allocated, depending on who benefits from the expenditure. For instance, the cost of a continuing professional education course taken by a professional in a regional office is allocated to the operating companies served by that office. Travel expenses by that same professional to a rate case proceeding are charged directly to the operating company whose case is being heard.

III – Service Company Cost Comparison Approach

During the 12 months ended September 30, 2011, the Service Company billed VAWC approximately \$6.455 million. As shown in the table below, certain adjustments are made to per books O&M management fees to arrive at total proforma O&M management fees of \$5.156 million for purposes of VAWC’s rate case. VAWC’s per books management fees were subjected to analysis in this market cost comparison.

Management Fees	12 Months Ended Sep. 30, 2011		
	O&M	Capital	Total
Per Books Total	\$ 4,605,478	\$ 1,849,875	\$ 6,455,353
Rate Case Adjustments:			
Projected Increase	\$ 588,507		
Non-Recurring Items	\$ (55,582)		
Other Adjustments	\$ 17,527		
Proforma Total	\$ 5,155,930		

For purposes of comparing these charges to certain outside benchmarks, Service Company services were placed into two categories:

- Managerial and Professional Services – Includes such services as management, accounting, legal, human resources, information technology, and engineering.
- Customer Accounts Services – Includes customer-related services, such as call center, credit, billing, collection and payment processing.

Total test period Service Company charges break down between management/professional services and customer account services as follows:

	12 Months Ended Sep 30, 2011	
	Amount	Hours
Management and Professional Services	\$ 5,657,728	39,475
Customer Account Services	\$ 797,625	15,851
Total Service Company Charges	\$ 6,455,353	55,326

This study’s first question—whether Service Company 12 months ended September 30, 2011 charges were reasonable—was determined by comparing VAWC’s A&G-related Service Company charges per customer to the same charges for utility companies that must file the FERC Form 60 – Annual Report of Service Companies.

The second question—whether Service Company charges during the 12 months ended September 30, 2011 were at the lower of cost or market—was evaluated by comparing the cost per hour for managerial and professional services provided by Service Company personnel to hourly billing rates that would be charged by outside providers of equivalent services. Service Company costs per hour were based on actual charges to VAWC during the 12 months ended September 30, 2011. Outside providers’ billing rates came from surveys or other information from professionals that could perform the services now provided by the Service Company.

III – Service Company Cost Comparison Approach

The third question—whether Service Company's 12 months ended September 30, 2011 customer account services charges, including those of the National Call Center costs, were comparable to other utilities—was addressed by comparing VAWC's customer accounts services expenses to those of neighboring electric utilities. This utility comparison group was selected because the cost of outside providers of customer accounts services is proprietary and not publicly available. Comparison to electric utilities is appropriate because all utilities, regardless of service type, must perform customer account services activities, including updating customer records for meter reads, printing and mailing bills, and the collection and processing of customer payments. Electric utility costs are available from the Federal Energy Regulatory Commission (FERC) Form 1, thus there is appropriate data transparency. The selection of electric utilities from Virginia and neighboring states provides a sufficiently sized comparison group.

The fourth question—the necessity of Service Company services—was investigated by defining the services provided to VAWC and determining if these services would be required if VAWC were a stand-alone utility.



IV – Question 1 – Reasonableness of Service Company Charges

VAWC's Service Company Cost per Customer

During the 12 months ended September 30, 2011, VAWC was charged \$66 per customer by the Service Company for A&G/O&M-related services. The calculation of this amount, shown in the table below, starts with total net testable Service Company charges and adjusts for capital and non-A&G functions (engineering, operations and water quality) charges. These adjustments are necessary to develop a per customer cost that is comparable to cost of utility service companies.

	12 Months ended Sep 30, 2011 Svc. Co. Charges
Testable Service Company charges	\$ 6,455,353
Less: Capital charges	\$ (1,849,875)
Less: Non-A&G function O&M charges	
Engineering	\$ (34,682)
Operations	\$ (609,740)
Water Quality	\$ (136,175)
Net A&G/O&M-related charges	\$ 3,824,882
VAWC customers	57,928
VAWC Cost Per Customer	\$ 66

Comparison Group Cost Per Customer

Every centralized service company in a holding company system subject to regulation by the FERC must file a Form 60 in accordance with the Public Utility Holding Company Act of 2005, Section 1270, Section 390 of the Federal Power Act and 18 C.F.R. paragraph 366.23. This report is designed to collect financial information from service companies that are subject to regulation by the FERC.

For 2010, a Form 60 was filed by 25 utility service companies, all of which serve utilities that provide regulated electric and, in some cases, gas service to retail customers. In order to make a valid comparison of this group's costs to those of American Water Works Service Company, it was necessary to isolate expenses that they have in common. These include A&G-related charges associated with the following FERC accounts:

901 – Supervision	921 – Office supplies and expenses
903 – Customer records and collection expenses	923 – Outside services employed
905 – Miscellaneous customer accounts expenses	926 – Employee pensions and benefits
907 – Supervision	928 – Regulatory commission expenses
910 – Misc customer service and info expenses	930.2 – Miscellaneous general expenses
911 – Supervision	931 – Rents
920 - Administrative and general salaries	935 – Maintenance of structures and equipment

Charges to utility affiliates for the comparison group service companies were obtained from Schedule XVI – Analysis of Charges for Service Associate and Non-Associate Companies (p. 303 to 306) of each entity's FERC Form 60. This schedule shows charges by FERC Account.

Comparison group service company 2010 expenses were also adjusted to remove charges to non-regulated affiliates from the cost pool used to calculate the cost per regulated service customer. This determination was made using information from the FERC Form 60 schedule: Account 457 – Analysis of Billing – Associate Companies.

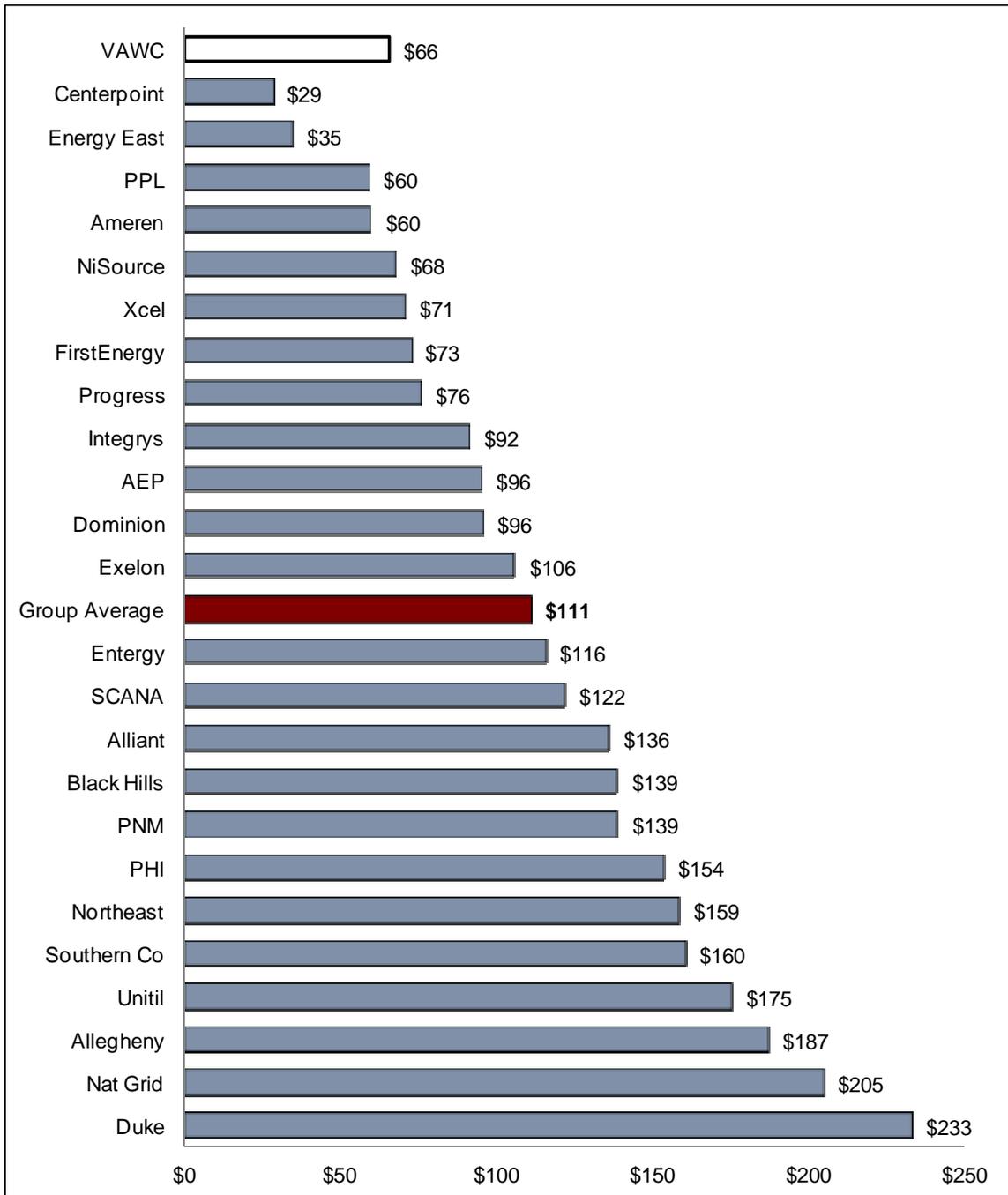
IV – Question 1 – Reasonableness of Service Company Charges

One service company that filed a Form 60 was excluded from the comparison group because its Form 60 contained no data for 2010. That service company, Great Plains Energy Services Incorporated, became inactive in 2010 and had no charges to its regulated utility affiliate. The A&G expenses per regulated utility customer for the other 24 utility companies that filed a Form 60 for 2010 are calculated below.

Utility Company	2010 Regulated Retail Service Company A&G Expenses	Regulated Retail Customers	Cost per Customer
AEP	\$504,470,290	5,270,000	\$ 96
Allegheny	\$280,648,832	1,500,000	\$ 187
Alliant	\$190,279,242	1,397,000	\$ 136
Ameren	\$199,214,264	3,300,000	\$ 60
Black Hills	\$101,069,342	728,000	\$ 139
Centerpoint	\$154,637,102	5,400,000	\$ 29
Dominion	\$355,526,659	3,700,000	\$ 96
Duke	\$1,050,793,575	4,510,000	\$ 233
Energy East	\$104,272,025	2,973,000	\$ 35
Entergy	\$312,275,947	2,700,000	\$ 116
Exelon	\$625,208,791	5,890,000	\$ 106
FirstEnergy	\$328,067,979	4,500,000	\$ 73
Integrus	\$201,979,742	2,200,000	\$ 92
Nat Grid	\$1,412,608,875	6,900,000	\$ 205
NiSource	\$255,900,005	3,755,000	\$ 68
Northeast	\$332,151,577	2,095,000	\$ 159
PHI	\$298,918,585	1,946,000	\$ 154
Progress	\$236,500,882	3,100,000	\$ 76
PNM	\$101,288,510	728,700	\$ 139
PPL	\$158,366,212	2,659,000	\$ 60
SCANA	\$177,720,204	1,457,000	\$ 122
Southern Co	\$708,564,089	4,417,000	\$ 160
Unitil	\$30,113,132	171,700	\$ 175
Xcel	\$376,977,165	5,300,000	\$ 71
Group Total	\$8,497,553,025	76,597,400	\$ 111

Exhibit 1 shows VAWC's 12 months ended September 30, 2011 Service Company cost per customer of \$66 to be considerably lower than the average of \$111 per customer for the comparison group service companies. Only 4 of 24 comparison group service companies had a lower cost per customer than VAWC. Based on this result, it is possible to conclude that the Service Company's 12 months ended September 30, 2011 charges to VAWC were reasonable.

Virginia-American Water Company
Comparison of Service Company Annual Costs Per Customer



Methodology

The lower-of-cost-or-market comparison is accomplished by comparing the cost per hour for Service Company managerial and professional services to those of outside service providers to whom these duties could be assigned. Based on the nature of the Service Company services it was determined that the following outside providers could perform the categories of services indicated below:

- Management Consultants – executive and administrative management, risk management services, human resources and communications services
- Attorneys – legal services
- Certified Public Accountants – accounting, financial and rates and revenues services
- Information Technology Professional – information technology services
- Professional Engineers – engineering, operations and water quality services.

The services provided by the Belleville lab are assumed to be transferable to professional engineers for purposes of this cost comparison. This was done for two reasons. First, there is no readily available survey of hourly billing rates for testing services such as those performed by Belleville. Second, Belleville personnel have similar, scientific educational backgrounds as Service Company engineering personnel. Thus, it is valid to compare the hourly rates of Belleville services to those of outside engineering firms.

Service Company's hourly rate were calculated for each of the five outside service provider categories, based on the dollars and hours charged to VAWC during the 12 months ended September 30, 2011. Hourly billing rates for outside service providers were developed using third party surveys or directly from information furnished by outside providers themselves.

It should be noted that by using the Service Company's hours charged VAWC during the 12 months ended September 30, 2011, its hourly rates are actually overstated because some Service Company personnel charge a maximum 8 per day even when they work more. Outside service providers generally bill for every hour worked. If all overtime hours of Service Company personnel had been factored into the hourly rate calculation, Service Company hourly rates would have been lower.

The last step in the market cost comparison was to compare the Service Company's average cost per hour to the average cost per hour for outside providers.

Service Company Hourly Rates

Exhibit 2 (page 14) details the assignment of 12 months ended September 30, 2011 management and professional Service Company charges by outsider provider category. Exhibit 3 (page 15) shows the same assignment for Service Company management and professional hours charged to VAWC during the 12 months ended September 30, 2011.

Certain adjustments to these dollar amounts were necessary to calculate Service Company hourly rates that are directly comparable to those of outside providers. Adjustments were made to the following 12 months ended September 30, 2011 test period non-labor Service Company charges:

V – Question 2 – Provision of Services at the Lower of Cost or Market

- Contract Services – 12 months ended September 30, 2011 Service Company charges to VAWC include expenses associated with the use of outside professional firms to perform certain corporate-wide services (e.g., legal, financial audit, actuarial services). These professional fees are excluded from the Service Company hourly rate calculation because the related services have effectively been out-sourced already.
- Travel Expenses – In general, client-related travel expenses are not recovered by outside service providers through their hourly billing rate. Rather, actual out-of-pocket travel expenses are billed to clients in addition to fees for professional services. Thus, it is appropriate to remove these Service Company charges from the hourly rate calculation.
- Information Technology Infrastructure Expenses – Included in the 12 months ended September 30, 2011 Service Company charges to VAWC are leases, maintenance fees and depreciation related to American Water’s enterprise mainframe, server and network infrastructure and corporate business applications. An outside provider that would take over operation of this infrastructure would recover these expenses over and above the labor necessary to operate the data center.

Exhibit 4 (page 16) shows how contract services, travel expenses and computer hardware/software-related Service Company charges are assigned among the four outside provider categories.

Based on the assignment of expenses and hours shown in Exhibits 2 and 3 and the excludable items shown in Exhibit 4, the Service Company's equivalent costs per hour for the 12 months ended September 30, 2011 are calculated below.

	Attorney	Management Consultant	Certified Public Accountant	IT Professional	Professional Engineer	Total
Total management, professional & technical services charges	\$ 131,772	\$ 2,015,125	\$ 1,283,252	\$ 1,126,275	\$ 1,101,305	\$ 5,657,728
Less:						
Contract services	\$ 10,948	\$ 868,645	\$ 143,991	\$ 181,587	\$ 40,060	\$ 1,245,230
Travel expenses	\$ 3,180	\$ 40,110	\$ 26,502	\$ 13,365	\$ 30,378	\$ 113,535
IT infrastructure expenses	\$ 3,155	\$ 272,975	\$ 7,362	\$ 175,439	\$ 19,468	\$ 478,400
Net Service Charges (A)	\$ 114,489	\$ 833,395	\$ 1,105,397	\$ 755,884	\$ 1,011,399	\$ 3,820,563
Total Hours (B)	499	6,448	15,320	4,798	12,410	39,475
Average Hourly Rate (A / B)	\$ 229	\$ 129	\$ 72	\$ 158	\$ 82	

Virginia-American Water Company
Analysis of 12 Months Ended September 30, 2011 Service Company Charges By Location And Function

Location	Function	12 Months Ended September 30, 2011 Service Company Charges					Total
		Attorney	Management Consultant	Certified Public Accountant	IT Professional	Professional Engineer	
Belleville Lab	Water Quality					\$ 95,760	\$ 95,760
Call Center	Human Resources		\$ 18,936				\$ 18,936
Corporate	Accounting			\$ 149,874			\$ 149,874
	Administration		\$ 96,850				\$ 96,850
	Audit			\$ 20,607			\$ 20,607
	Communications		\$ 40,234				\$ 40,234
	Engineering					\$ 85,206	\$ 85,206
	Finance		\$ 1,178,808	\$ 173,831			\$ 1,352,640
	Human Resources		\$ 140,483				\$ 140,483
	Information Technology				\$ 33,658		\$ 33,658
	Legal		\$ 57,671				\$ 57,671
	Operations		\$ 70,070			\$ 251,655	\$ 321,726
	Procurement			\$ 103,985			\$ 103,985
	Rates & Revenue			\$ 34,299			\$ 34,299
	Risk Management		\$ 20,065				\$ 20,065
	Water Quality					\$ 62,391	\$ 62,391
	Division/Region Offices	Administration		\$ 276,602			
Business Development			\$ 16,730				\$ 16,730
Communications			\$ 44,487				\$ 44,487
Engineering						\$ 140,036	\$ 140,036
Finance				\$ 427,562			\$ 427,562
Human Resources			\$ 32,199				\$ 32,199
Legal			\$ 74,101				\$ 74,101
Operations			\$ 863			\$ 466,144	\$ 467,007
Procurement				\$ 13,987			\$ 13,987
Risk Management			\$ 18,159				\$ 18,159
Information Technology	Information Technology				\$ 1,092,617		\$ 1,092,617
	Information Technology					\$ 111	\$ 111
Shared Services	Accounting			\$ 327,299			\$ 327,299
	Administration		\$ 60,640				\$ 60,640
	Finance			\$ 9,296			\$ 9,296
	Rates & Revenue			\$ 22,510			\$ 22,510
Total Dollars Charged		\$ 131,772	\$ 2,015,125	\$ 1,283,252	\$ 1,126,275	\$ 1,101,305	\$ 5,657,728

Virginia-American Water Company
Analysis of 12 Months Ended September 30, 2011 Service Company Hours By Location And Function

		12 Months Ended September 30, 2011 Service Company Hours						
Location	Function	Attorney	Management Consultant	Certified Public Accountant	IT Professional	Professional Engineer	Total	
Belleville Lab	Water Quality					873	873	
Call Center	Human Resources		203				203	
Corporate	Accounting			901			901	
	Administration		75				75	
	Audit			136			136	
	Communications		205				205	
	Engineering					1,238	1,238	
	Finance		2,281	1,806			4,087	
	Human Resources		898				898	
	Information Technology				1,459		1,459	
	Legal		160				160	
	Operations			185			2,000	2,186
	Procurement				819			819
	Rates & Revenue				138			138
	Risk Management			176				176
	Water Quality						510	510
	Division/Region Offices	Administration		1,514				1,514
Business Development			82				82	
Communications			237				237	
Engineering						1,708	1,708	
Finance				4,828			4,828	
Human Resources				-			-	
Legal			339				339	
Operations				33			6,080	6,113
Procurement					92		92	
Risk Management				391			391	
Water Quality						-	-	
Information Technology	Information Technology				3,338		3,338	
Shared Services	Accounting			6,378			6,378	
	Administration		168				168	
	Finance			-			-	
	Rates & Revenue			223			223	
Total Hours Charged		499	6,448	15,320	4,798	12,410	39,475	

Virginia-American Water Company
12 Months Ended September 30, 2011 Service Company Charges Excludable From The Hourly Rate Calculation

Charges By Function	Exclusions From Hourly Rate Calculation				Outside Service Provider Category
	Contract Services	IT HW/SW	Travel Expenses	Total	
Accounting	\$ 87,502	\$ 1,130	\$ 4,187	\$ 92,819	Certified Public Accountant
Administration	\$ 4,055	\$ 127,494	\$ 1,325	\$ 132,875	Management Consultant
Audit	\$ 682	\$ 447	\$ 227	\$ 1,356	Certified Public Accountant
Business Development	\$ -	\$ 69	\$ 994	\$ 1,063	Management Consultant
Communications	\$ 10,908	\$ 1,263	\$ 2,271	\$ 14,443	Management Consultant
Engineering	\$ (1)	\$ 676	\$ 13,632	\$ 14,307	Professional Engineer
Finance	\$ 818,461	\$ 137,074	\$ 23,904	\$ 979,438	Management Consultant
	\$ 17,352	\$ 4,610	\$ 19,895	\$ 41,857	Certified Public Accountant
Human Resources	\$ 33,502	\$ 5,210	\$ 7,978	\$ 46,690	Management Consultant
Information Technology	\$ 181,587	\$ 175,439	\$ 13,365	\$ 370,391	IT Professional
Legal	\$ 10,948	\$ 3,155	\$ 3,180	\$ 17,283	Attorney
Operations	\$ 1,647	\$ 1,032	\$ 1,377	\$ 4,056	Management Consultant
	\$ 40,992	\$ 6,100	\$ 14,802	\$ 61,894	Professional Engineer
Procurement	\$ 31,178	\$ 508	\$ 1,105	\$ 32,791	Certified Public Accountant
Rates & Revenue	\$ 7,277	\$ 667	\$ 1,088	\$ 9,032	Certified Public Accountant
Risk Management	\$ 71	\$ 834	\$ 2,261	\$ 3,166	Management Consultant
Water Quality	\$ (931)	\$ 12,691	\$ 1,944	\$ 13,704	Professional Engineer
Total	\$ 1,245,230	\$ 478,400	\$ 113,535	\$ 1,837,165	

Recap By Outside Provider	Exclusions From Hourly Rate Calculation			
	Contract Services	IT HW/SW	Travel Expenses	Total
Attorney	\$ 10,948	\$ 3,155	\$ 3,180	\$ 17,283
Management Consultant	\$ 868,645	\$ 272,975	\$ 40,110	\$ 1,181,730
Certified Public Accountant	\$ 143,991	\$ 7,362	\$ 26,502	\$ 177,855
IT Professional	\$ 181,587	\$ 175,439	\$ 13,365	\$ 370,391
Professional Engineer	\$ 40,060	\$ 19,468	\$ 30,378	\$ 89,906
Total	\$ 1,245,230	\$ 478,400	\$ 113,535	\$ 1,837,165

Outside Service Provider Hourly Rates

The next step in the cost comparison was to obtain the average billing rates for each outside service provider. The source of this information and the determination of the average rates are described in the paragraphs that follow.

It should be noted that professionals working for three of the five outside provider categories may be licensed to practice by state regulatory bodies. However, not every professional working for these firms is licensed. For instance, among Virginia certified public accounting firms, only more experienced staff are predominantly CPAs (see table below). Some Service Company employees also have professional licenses. Thus, it is valid to compare the Service Company's hourly rates to those of the outside professional service providers included in this study.

Position	Virginia Average
Partners/Owners	98%
Directors (11+ years experience)	90%
Managers (6-10 years experience)	72%
Sr Associates (4-5 years experience)	61%
Associates (1-3 years experience)	17%
New Professionals	8%

Source: AICPA's National PCPS/TSCPA Management of an Accounting Practice Survey (2010)

Attorneys

The Virginia State Bar does not survey its members as to their hourly billing rates. In addition, publicly available billing rate information could not be found for Virginia attorneys. Therefore, an estimate of Virginia attorney rates was developed from surveys conducted by Lawyers Weekly in the states of Michigan, Missouri and Massachusetts. As presented in Exhibit 5 (page 19), the average rate for each firm was adjusted for the cost of living differential between its location and Richmond, Virginia. The Lawyers Weekly surveys included rates in effect at December 31, 2010. Thus, the 2010 average rate was escalated to March 31, 2011—the midpoint of the test year ended September 30, 2011.

Management Consultants

The cost per hour for management consultants was developed from a 2011 survey performed by the Association of Management Consulting Firms—an industry trade organization. The survey includes rates that were in effect during 2010 for firms throughout the United States. Consultants typically do not limit their practice to any one region and must travel to a client's location. Thus, the U.S. national average is appropriate for comparison.

The first step in the calculation, presented in Exhibit 6 (page 20), was to determine an average rate by consultant position level. From these rates, a single weighted average hourly rate was calculated based upon the percent of time that is typically applied to a consulting assignment by each consultant position level. The 2010 average rate was escalated to March 31, 2011—the midpoint of the 12 months ended September 30, 2011.

V – Question 2 – Provision of Services at the Lower of Cost or Market

Certified Public Accountants

The average hourly rate for Virginia CPAs was developed from a 2010 survey performed by the American Institute of Certified Public Accountants (AICPA). The Virginia version of this survey was used to develop hourly rates for member firms in Virginia.

As shown in Exhibit 7 (page 21), a weighted average hourly rate was developed based on a set of accountant positions and a percent of time that is typically applied to an accounting assignment. This survey includes rate information in effect during 2009. The 2010 average rate was escalated to March 31, 2011—the midpoint of the 12 months ended September 30, 2011.

Information Technology Professionals

The average hourly rate for information technology consultants and contractors was developed from Baryenbruch & Company, LLC IT industry hourly billing rate data. As shown in Exhibit 8 (page 22), that data was compiled and a weighted average was calculated based on a percent of time that is typically applied to an IT consulting assignment based on Baryenbruch & Company, LLC's experience.

Professional Engineers

The Company provided hourly rate information for outside engineering firms that could have been used by VAWC in 2011. As presented in Exhibit 9 (page 23), an average rate was developed for each engineering position level. Then, using a typical percentage mix of project time by engineering position, a weighted average cost per hour was calculated.

Virginia-American Water Company
Estimated Billing Rates For Virginia Attorneys Based On
Michigan, Missouri and Massachusetts Attorney Billing Rates

Billing rates as of December 31, 2010 (Note A)		Billing Rate Range					Average	Cost of Living Adjust (C)	Adjusted Rate
Firm	Location	Associate		Partner					
		Low	High	Low	High				
Dickinson Wright	Detroit, Mi	\$ 205	\$ 290	\$ 360	\$ 575	\$ 358	97%	\$ 369	
Dykema Gossett	Detroit, Mi	\$ 235	\$ 410	\$ 310	\$ 645	\$ 400	97%	\$ 413	
Butzel Long	Detroit, Mi	\$ 185	\$ 330	\$ 310	\$ 590	\$ 354	97%	\$ 365	
Maddin, Hauser, Wartell, Roth &	Southfield, Mi	\$ 195	\$ 295	\$ 225	\$ 400	\$ 279	97%	\$ 288	
Kemp Klein Law Firm	Troy, Mi	\$ 160	\$ 260	\$ 240	\$ 350	\$ 253	97%	\$ 261	
Rader, Fishman & Grauer	Bloomfield Hills, Mi	\$ 130	\$ 250	\$ 275	\$ 550	\$ 301	97%	\$ 311	
Jaffe Raitt Heuer & Weiss	Southfield, Mi	\$ 175	\$ 250	\$ 225	\$ 550	\$ 300	97%	\$ 310	
Hertz Schram	Bloomfield Hills, Mi	\$ 265	\$ 265	\$ 325	\$ 325	\$ 295	97%	\$ 305	
Lipson, Neilson, Cole, Seltzer & (Bloomfield Hills, Mi	\$ 185	\$ 185	\$ 225	\$ 345	\$ 235	97%	\$ 243	
O'Reilly Rancilio	Sterling Heights, Mi	\$ 160	\$ 200	\$ 225	\$ 300	\$ 221	97%	\$ 229	
Parmenter O'Toole	Muskegon, Mi	\$ 125	\$ 195	\$ 200	\$ 290	\$ 203	87%	\$ 232	
Scholten Fant	Grand Haven, Mi	\$ 180	\$ 180	\$ 220	\$ 220	\$ 200	87%	\$ 229	
Abbott, Nicholson, Quilter, Essha	Detroit, Mi	\$ 200	\$ 200	\$ 350	\$ 350	\$ 275	97%	\$ 284	
Greensfelder Hemker & Gale	St. Louis, Mo	\$ 175	\$ 240	\$ 285	\$ 435	\$ 284	85%	\$ 334	
Thompson Coburn	St. Louis, Mo	\$ 225	\$ 310	\$ 480	\$ 480	\$ 374	85%	\$ 440	
Armstrong Teasdale	St. Louis, Mo	\$ 200	\$ 325	\$ 335	\$ 475	\$ 334	85%	\$ 393	
HeplerBroom	St. Louis, Mo	\$ 150	\$ 150	\$ 275	\$ 275	\$ 213	85%	\$ 250	
Husch Blackwell	Kansas City, Mo	\$ 206	\$ 326	\$ 342	\$ 483	\$ 339	92%	\$ 368	
Lathrop & Gage	Kansas City, Mo	\$ 195	\$ 240	\$ 325	\$ 420	\$ 295	92%	\$ 320	
Polsinelli, Shughart	Kansas City, Mo	\$ 260	\$ 260	\$ 400	\$ 400	\$ 330	92%	\$ 358	
Spencer, Fane, Britt & Browne	St. Louis, Mo	\$ 220	\$ 230	\$ 280	\$ 390	\$ 280	85%	\$ 329	
Stinson, Morrison, Hecker	St. Louis, Mo	\$ 205	\$ 255	\$ 285	\$ 445	\$ 298	85%	\$ 350	
Burns & Levinson	Boston, Ma	\$ 210	\$ 350	\$ 375	\$ 525	\$ 365	124%	\$ 295	
Sullivan & Worcester	Boston, Ma	\$ 290	\$ 535	\$ 475	\$ 830	\$ 533	124%	\$ 431	
Holland & Knight	Boston, Ma	\$ 215	\$ 450	\$ 445	\$ 800	\$ 478	124%	\$ 386	
Seyfarth Shaw	Boston, Ma	\$ 327	\$ 327	\$ 511	\$ 511	\$ 419	124%	\$ 339	
Bowditch & Dewey	Worcester, Ma	\$ 125	\$ 220	\$ 250	\$ 550	\$ 286	124%	\$ 231	
Prince Lobel	Boston, Ma	\$ 195	\$ 325	\$ 325	\$ 525	\$ 343	124%	\$ 277	
Hinckley, Allen & Snyder	Boston, Ma	\$ 205	\$ 395	\$ 360	\$ 645	\$ 401	124%	\$ 324	
Mirick O'Connell	Worcester, Ma	\$ 220	\$ 220	\$ 350	\$ 350	\$ 285	124%	\$ 230	
Lawson & Weitzen	Boston, Ma	\$ 125	\$ 225	\$ 225	\$ 450	\$ 256	124%	\$ 207	
Sunstein Kann Murphy Timbers	Boston, Ma	\$ 285	\$ 535	\$ 575	\$ 825	\$ 555	124%	\$ 449	
Keegan Werlin	Boston, Ma	\$ 200	\$ 300	\$ 300	\$ 475	\$ 319	124%	\$ 258	
Rich May	Boston, Ma	\$ 150	\$ 325	\$ 295	\$ 400	\$ 293	124%	\$ 236	
Anderson Kreiger	Cambridge, Ma	\$ 285	\$ 285	\$ 450	\$ 450	\$ 368	124%	\$ 297	
Bernkopf Goodman	Boston, Ma	\$ 205	\$ 395	\$ 375	\$ 550	\$ 381	124%	\$ 308	
Tarlow Breed Hart & Rodgers	Boston, Ma	\$ 225	\$ 365	\$ 375	\$ 495	\$ 365	124%	\$ 295	
Donoghue Barrett & Singal	Boston, Ma	\$ 225	\$ 390	\$ 350	\$ 450	\$ 354	124%	\$ 286	
Cesari and McKenna	Boston, Ma	\$ 150	\$ 400	\$ 425	\$ 525	\$ 375	124%	\$ 303	
Overall Average 2010 Billing Rate								\$ 311	
<u>Escalation to Test Year's Mid-Point - March 31, 2011 (Note B)</u>									
CPI at December 31, 2010								219.2	
CPI at March 31, 2011								223.5	
Inflation/Escalation								2.0%	
Average Hourly Billing Rate For Attorneys At March 31, 2011								\$ 317	

Note A: Source is Michigan Lawyers Weekly (April 2010), Missouri Lawyers Weekly (April 2010) and Massachusetts Lawyers Weekly (April 2010)

Note B: Source is U.S. Bureau of Labor Statistics (<ftp://ftp.bls.gov/pub/special.requests/cpi/cpi.txt>)

Note C: Source is Council for Community and Economic Research. This percentage represents the cost of living difference between the Michigan and Massachusetts cities and Richmond, Virginia. A number over 100% indicates the Michigan/Missouri/Massachusetts city's cost of living is higher than Richmond. A number less than 100% indicates Richmond's cost of living is higher.

**Virginia-American Water Company
Billing Rates of U.S. Management Consultants**

Survey billing rates in effect in 2010 (Note A)

A. Calculation of Average Hourly Billing Rate by Consultant Position

		Average Hourly Rates (Note A)				
		Entry-Level Consultant	Associate Consultant	Senior Consultant	Junior Partner	Senior Partner
Average		\$ 188	\$ 244	\$ 306	\$ 319	\$ 395

B. Calculation of Overall Average Hourly Billing Rate Based on a Typical Distribution of Time on an Engagement

		Entry-Level Consultant	Associate Consultant	Senior Consultant	Junior Partner	Senior Partner	
Average Hourly Billing Rate (from above)		\$ 188	\$244	\$306	\$319	\$395	
Percent of Consulting Assignment		30%	30%	20%	10%	10%	Weighted Average
		\$ 56	\$ 73	\$ 61	\$ 32	\$ 39	\$ 262

Escalation to Test Period Midpoint (March 31, 2011) (Note B)

CPI at December 31, 2010	219.2
CPI at March 31, 2011	223.5
Inflation/Escalation	2.0%
Average Hourly Billing Rate For Management Consultants At March 31, 2011	\$ 267

Note A: Source is "Operating Ratios For Management Consulting Firms, 2011 Edition," Association of Management Consulting Firms

Note B: Source is U.S. Bureau of Labor Statistics (<ftp://ftp.bls.gov/pub/special.requests/cpi/cpi.txt>)



**Virginia-American Water Company
Estimated Billing Rates Of Virginia Certified Public Accountants**

A. Calculation of Average Hourly Billing Rate by Public Accounting Position
Survey billing rates were those in effect in 2009 (Note A)

Average Hourly Billing Rate (Note A)					
	Staff Accountant	Senior Accountant	Manager	Partner	
Average Hourly Billing Rate by CPA Firm Position	\$ 83	\$ 116	\$ 163	\$ 197	
Percent of Accounting Assignment	30%	30%	20%	20%	Weighted Average
	\$ 25	\$ 35	\$ 33	\$ 39	\$ 132

Escalation to Test Period Midpoint (March 31, 2011) (Note B)

CPI at December 31, 2009	216.0
CPI at March 31, 2011	223.5
Inflation/Escalation	3.5%
Average Hourly Billing Rate For CPAs At March 31, 2011	\$ 136

Note A: Source is AICPA's 2010 National PCPS/TSCPA Management of an Accounting Practice Survey (Virginia edition)



**Virginia-American Water Company
Estimated Billing Rates Of Virginia Information Technology Professionals**

IT Resource Level	2011 Hourly Rate (A)
Consultant Positions	
Senior Manager/Partner Consultant	\$ 369
Staff/Manager Consultant	\$ 255
Contractor Positions	
Senior Contractor	\$ 151
Contractor	\$ 73

Overall Average	2011 Rate	% of Project Assignment	
Senior Manager/Partner Consultant	\$ 369	10%	\$ 37
Staff/Manager Consultant	\$ 255	30%	\$ 76
Senior Contractor	\$ 151	30%	\$ 45
Contractor	\$ 73	30%	\$ 22
Weighted Average			\$ 180

Note A: Source is Baryenbruch & Company, LLC

**Virginia-American Water Company
Estimated Billing Rates Of Virginia Engineers**

Billing rates in effect in 2011

A. Calculation of Average Hourly Rate by Engineer Position

Name of Firm	Average Hourly Billing Rates			
	Technician	Engineer	Project Manager	Officer
	Senior Technician	Design Engineer Project Engineer	Sr. Mgr. Engineer	Principal Engineer
Firm #1	\$85	na	\$170	na
Firm #2	\$70	na	\$93	na
Firm #3	\$78	\$93	\$148	\$190
Firm #4	na	\$74	\$83	\$126

B. Calculation of Overall Average Engineering Hourly Billing Rate

	Technician	Engineer	Project Manager	Officer	Weighted Average
	Senior Technician	Design Engineer Project Engineer	Sr. Mgr. Engineer	Principal Engineer	
Average Hourly Billing Rate (From Above)	\$78	\$83	\$123	\$158	
Typical Percent of Time on an Engineering Assignment	30%	35%	25%	10%	
	\$23	\$29	\$31	\$16	\$99

Source: Information provided by American Water Works Service Company

V – Question 2 – Provision of Services at the Lower of Cost or Market

Service Company versus Outside Provider Cost Comparison

As shown in the table below, Service Company costs per hour are considerably lower than those of outside providers.

Service Provider	12 Months Ended September 30, 2011		
	Service Company	Outside Provider	Difference-- Service Co. Greater(Less) Than Outside
Attorney	\$ 229	\$ 317	\$ (88)
Management Consultant	\$ 129	\$ 267	\$ (138)
Certified Public Accountant	\$ 72	\$ 136	\$ (64)
IT Professional	\$ 158	\$ 180	\$ (23)
Professional Engineer	\$ 82	\$ 99	\$ (17)

Based on these cost per hour differentials and the number of managerial and professional services hours billed to VAWC during the 12-months ended September 30, 2011, outside service providers would have cost \$2,242,566 more than the Service Company (see table below). Thus, on average, outside provider's hourly rates are 40% higher than those of the Service Company (\$2,242,566 / \$5,657,728).

Service Provider	12 Months Ended September 30, 2011		
	Hourly Rate Difference-- Service Co. Greater(Less) Than Outside	Service Company Hours Charged	Dollar Difference
Attorney	\$ (88)	499	\$ (43,973)
Management Consultant	\$ (138)	6,448	\$ (888,648)
Certified Public Accountant	\$ (64)	15,320	\$ (983,614)
IT Professional	\$ (23)	4,798	\$ (109,178)
Professional Engineer	\$ (17)	12,410	\$ (217,153)
Service Company Less Than Outside Providers			\$ (2,242,566)

It should be noted that the cost differential associated with using outside providers is even greater because exempt Service Company personnel do not charge more than 8 hours per day even when they work more. Outside providers generally charge clients for all hours worked. Thus, VAWC would have been charged by outside providers for overtime worked by Service Company personnel who are not paid for that time.

If VAWC were to use outside service providers rather than the Service Company for managerial and professional services, it would incur other additional expenses besides those associated with higher hourly rates. Managing outside firms who would perform over 39,000 hours of work (more than 26 full-time equivalents at 1,500 "billable" hours per FTE per year) would add a significant workload to the existing VAWC management team. Thus, it would be necessary for VAWC to add at least one position to supervise the outside firms and ensure they delivered quality and timely services. The individuals that would fill this position would need a good understanding of each profession being managed. They must also have management experience and the authority necessary to give them credibility with the outside firms. As calculated in the table below, this position would add almost \$150,000 per year to VAWC's personnel expenses.

V – Question 2 – Provision of Services at the Lower of Cost or Market

Cost of Adding 1 Professional Position To VAWC's Staff

	<u>Total</u>
New Positions' Salary	\$ 100,000
Benefits (at 49.4%)	\$ 49,400
Office Expenses (15.2%)	\$ 15,200
Cost of One Position	<u>\$ 149,400</u>

Thus, the total effect on the ratepayers of VAWC of contracting all services now provided by Service Company would be an increase in their costs of \$2,391,966 (\$2,242,566 + \$149,400). Based on the results of this comparison, it is possible to conclude that the Service Company charged VAWC at the lower of cost or market for services provided during the 12 months ended September 30, 2011.



VI - Question 3 - Reasonableness of Customer Accounts Services Costs

Background

Customer Accounts Services covers the following utility functions:

- Customer Call Center – customer calls/contact, credit, order taking/disposition, bill collection efforts, outage calls
- Customer Call Center Maintenance – support of phone banks, voice recognition units, call center software applications and telecommunications
- Customer billing – bill printing, stuffing, and mailing
- Remittance processing – processing customer payments received in the mail
- Bill payment centers – processing customer payments at locations where customers can pay their bills in person

It is difficult to compare the cost of the Service Company's customer accounts services-related charges to VAWC with outside providers of the same services because survey data is proprietary and expensive to obtain. For this reason, VAWC's charges from the Service Company for customer accounts services are compared to those of neighboring electric utilities because the data necessary to make such comparison is available to the public.

Neighboring electric utility cost information comes from the FERC Form 1 that each utility must file. FERC's chart of accounts is defined in Chapter 18, Part 101 of the Code of Federal Regulations. FERC accounts that contain customer accounts services-related expenses are Account 903 Customer Accounts Expense – Records and Collection Expense and Account 905 Customer Accounts Expense – Miscellaneous Customer Accounts Expense. Exhibit 10 provides FERC's definition of the type of expenses that should be recorded in these accounts.

In addition to the charges in these FERC accounts, labor-related overheads charged to the following FERC accounts must be added to the labor components of Accounts 903 and 905:

- Account 926 Employee Pension and Benefits
- Account 408 Taxes Other Than Income (employer's portion of FICA)

Comparison Group

Electric utilities included in the comparison group are shown in the table below. These are companies whose FERC Form 1 show amounts for accounts 903 and 905.

Virginia	• Appalachian Power	• Virginia Electric Power
West Virginia	• Appalachian Power • Monongahela Power	• Wheeling Power
Maryland	• Baltimore Gas & Electric • Delmarva Power & Light	• Potomac Electric
North Carolina	• Duke Energy Carolinas	• Progress Energy Carolinas
Kentucky	• Duke Energy Kentucky • Kentucky Power	• Kentucky Utilities • Louisville Gas & Electric
Tennessee	• Kingsport Power	

Virginia-American Water Company FERC Account Descriptions

903 – Customer Records and Collection Expenses

This account shall include the cost of labor, materials used and expenses incurred in work on customer applications, contracts, orders, credit investigations, billing and accounting, collections and complaints.

Labor

1. Receiving, preparing, recording and handling routine orders for service, disconnections, transfers or meter tests initiated by the customer, excluding the cost of carrying out such orders, which is chargeable to the account appropriate for the work called for by such orders.
2. Investigations of customers' credit and keeping of records pertaining thereto, including records of uncollectible accounts written off.
3. Receiving, refunding or applying customer deposits and maintaining customer deposit, line extension, and other miscellaneous records.
4. Checking consumption shown by meter readers' reports where incidental to preparation of billing data.
5. Preparing address plates and addressing bills and delinquent notices.
6. Preparing billing data.
7. Operating billing and bookkeeping machines.
8. Verifying billing records with contracts or rate schedules.
9. Preparing bills for delivery, and mailing or delivering bills.
10. Collecting revenues, including collection from prepayment meters unless incidental to meter reading operations.
11. Balancing collections, preparing collections for deposit, and preparing cash reports.
12. Posting collections and other credits or charges to customer accounts and extending unpaid balances.
13. Balancing customer accounts and controls.
14. Preparing, mailing, or delivering delinquent notices and preparing reports of delinquent accounts.
15. Final meter reading of delinquent accounts when done by collectors incidental to regular activities.
16. Disconnecting and reconnecting services because of nonpayment of bills.
17. Receiving, recording, and handling of inquiries, complaints, and requests for investigations from customers, including preparation of necessary orders, but excluding the cost of carrying out such orders, which is chargeable to the account appropriate for the work called for by such orders.
18. Statistical and tabulating work on customer accounts and revenues, but not including special analyses for sales department, rate department, or other general purposes, unless incidental to regular customer accounting routines.
19. Preparing and periodically rewriting meter reading sheets.
20. Determining consumption and computing estimated or average consumption when performed by employees other than those engaged in reading meters.

Materials and expenses

21. Address plates and supplies.
22. Cash overages and shortages.
23. Commissions or fees to others for collecting.
24. Payments to credit organizations for investigations and reports.
25. Postage.
26. Transportation expenses, including transportation of customer bills and meter books under centralized billing procedure.
27. Transportation, meals, and incidental expenses.
28. Bank charges, exchange, and other fees for cashing and depositing customers' checks.
29. Forms for recording orders for services, removals, etc.
30. Rent of mechanical equipment.

**Virginia-American Water Company
FERC Account Descriptions**

905 – Miscellaneous Customer Accounts Expenses

This account shall include the cost of labor, materials used and expenses incurred not provided for in other accounts.

Labor

1. General clerical and stenographic work.
2. Miscellaneous labor.

Materials and expenses

3. Communication service.
4. Miscellaneous office supplies and expenses and stationery and printing other than those specifically provided for in accounts 902 and 903.



VI - Question 3 - Reasonableness of Customer Accounts Services Costs

VAWC Cost per Customer

As calculated below, VAWC's 12 months ended September 30, 2011 customer account services expense per customer was \$22.69. The cost pool used to calculate this average includes charges for Service Company services (e.g., call center, billing, payment processing) and postage and forms expenses, which are incurred directly by VAWC. It was necessary to adjust the National Call Center charges because electric utilities experience an average of 2.50 calls per customer compared to American Water's 1.32 calls per customer. Thus, National Call Center expenses have to be increased, for comparison purposes, to reflect its costs at a 2.50 calls per customer level.

Virginia-American Cost Per Customer		Year Ended 9/30/2011	Adjustment Fewer Service Co Calls For	Water Cos. (A)	Adjusted
Service Company	Call Centers	\$ 797,625	\$ 319,456		\$ 1,117,081
Operating Company	Customer payment processing				\$ 32,310
Operating Company	Postage & forms				\$ 164,723
				Cost Pool Total	\$ 1,314,114
				Total Customers	57,928
	12 Months Ended September 30, 2011 Cost Per VAWC Customer				\$ 22.69

Note A: Adjustment for American Water's fewer calls per customer

This adjustment is necessary because water utilities experience fewer calls per customer than do electric utilities

Call handling expenses	\$ 325,053
Electric utility industry's avg calls/customer	2.50
American Water's avg calls/customer	1.26
Percent different	98%
Total Adjustment	\$ 319,456

Note B: Estimated customer payment processing expenses

Number of customers	57,928
Number of payments/customer/year	5.6
Total payments processed/year	324,397
Bank charge per item	\$ 0.0996
Total estimated annual expense	\$ 32,310

Electric Utility Group Cost per Customer

Exhibit 11 shows the actual 12 months ending September 30, 2011 customer accounts expense per customer calculation for the electric utility comparison group. All of the underlying data was taken from the utilities' FERC Form 1.

VI - Question 3 - Reasonableness of Customer Accounts Services Costs

Summary of Results

As shown in the table below, VAWC's cost per customer is below the average cost of the neighboring electric utility comparison group. It can therefore be concluded that VAWC's 12 months ended September 30, 2011 customer accounts-related expenses, including those of the Alton and Pensacola Call Centers, assigned by the Service Company to VAWC were comparable to those of other utilities.

Average Customer Accounts Expense Per Customer	
Monongahela Power	\$ 16.81
Virginia Electric Power	\$ 17.69
Louisville Gas & Electric	\$ 20.01
Duke Power	\$ 21.19
Virginia American Water	\$ 22.69
Wheeling Power	\$ 27.63
Appalachian Power	\$ 30.44
Kingsport Power	\$ 32.03
Comparison Group Average	\$ 32.87
Kentucky Power	\$ 33.44
Kentucky Utilities	\$ 34.68
Prog Energy - Carolinas	\$ 35.14
Baltimore Gas & Electric	\$ 36.73
Duke Energy Kentucky	\$ 47.19
Delmarva Power & Light	\$ 74.83
Potomac Electric	\$ 75.43

Virginia-American Water Company
Comparison Group 12 Months Ended 9/30/2011 Actual Customer Accounts Expense Per Customer

Customer Account Services Cost Pool

FERC Account Balances:

Acct 903 - Customer Records & Collection (page 322, line 161)

Acct 905 - Misc Customer Accounts (page 322, line 163)

Subtotal

Add: Employee Benefits & Employer FICA (not included in above amounts)

Account 926 - Employee Pension & Benefits

Account 408 - Taxes Other Than Income (Employer's Portion of FICA)

Total Cost Pool

Total Customers (page 304, line 43)

Customer Account Services Expense per Customer

Note A: Calculation of Pension & Benefits Pertaining to Customer Acct Mgmt

Account 926 - Employee Pension & Benefits (page 323, line 187)

Total O&M Payroll (page 355, line 65)

Benefits as Percent of Payroll

Payroll Applicable to Customer Account Services

Total Payroll Charged to Customer Accounts Function

Electric (page 354, line 7)

Gas (page 354, line 37)

Total Payroll Charged to Customer Accounts

Percent Applicable to Customer Accounts Services (903 and 905):

Acct 903 - Customer Records & Collection (page 322, line 161)

Acct 905 - Misc Customer Accounts (page 322, line 163)

Subtotal - Total Charges Applicable to Customer Accounts Services

Acct 902 - Meter Reading Expenses (page 322, line 160)

Total Charges Applicable to Customer Accounts Svcs & Meter Reading

Percent Applicable to Customer Accounts Services (903 and 905)

Customer Account Services Portion of Total Payroll

Pension & Benefits Pertaining to Customer Accounts Services

Note B: Calculation of Employer's FICA Pertaining to Customer Accounts Services

Customer Account Services Portion of Total Payroll

Employer's Portion of FICA (6.20%) and Medicare (1.45%)

Estimated Employer's Portion of FICA

Virginia		West Virginia		
Appalachian Power	Virginia Electric Power	Appalachian Power	Monongahela Power	Wheeling Power
\$ 27,249,698	\$ 33,998,108		\$ 5,080,087	\$ 1,053,082
\$ 99,126	\$ -		\$ -	\$ 4,240
\$ 27,348,824	\$ 33,998,108		\$ 5,080,087	\$ 1,057,322
\$ 1,460,195	\$ 7,285,413		\$ 1,118,992	\$ 59,851
\$ 455,406	\$ 1,568,592		\$ 281,002	\$ 19,889
\$ 29,264,425	\$ 42,852,113		\$ 6,480,081	\$ 1,137,062
961,229	2,422,970		385,504	41,146
\$ 30.44	\$ 17.69	see Virginia	\$ 16.81	\$ 27.63
\$ 34,736,360	\$ 217,149,354		\$ 23,432,243	\$ 630,611
\$ 141,615,451	\$ 611,156,982		\$ 76,919,229	\$ 2,739,309
24.5%	35.5%		30.5%	23.0%
\$ 6,900,199	\$ 25,836,931		\$ 6,420,217	\$ 330,793
\$ -	\$ -		\$ -	\$ -
\$ 6,900,199	\$ 25,836,931		\$ 6,420,217	\$ 330,793
\$ 27,249,698	\$ 33,998,108		\$ 5,080,087	\$ 1,053,082
\$ 99,126	\$ -		\$ -	\$ 4,240
\$ 27,348,824	\$ 33,998,108		\$ 5,080,087	\$ 1,057,322
\$ 4,351,446	\$ 8,841,673		\$ 3,799,093	\$ 287,953
\$ 31,700,270	\$ 42,839,781		\$ 8,879,180	\$ 1,345,275
86.3%	79.4%		57.2%	78.6%
\$ 5,953,020	\$ 20,504,465		\$ 3,673,229	\$ 259,988
\$ 1,460,195	\$ 7,285,413		\$ 1,118,992	\$ 59,851
\$ 5,953,020	\$ 20,504,465		\$ 3,673,229	\$ 259,988
7.65%	7.65%		7.65%	7.65%
\$ 455,406	\$ 1,568,592		\$ 281,002	\$ 19,889

Virginia-American Water Company
Comparison Group 12 Months Ended 9/30/2011 Actual Customer Accounts Expense Per Customer

Customer Account Services Cost Pool

FERC Account Balances:

Acct 903 - Customer Records & Collection (page 322, line 131)

Acct 905 - Misc Customer Accounts (page 322, line 133)

Subtotal

Add: Employee Benefits & Employer FICA (not included in above amounts)

Account 926 - Employee Pension & Benefits

Account 408 - Taxes Other Than Income (Employer's Portion of FICA)

Total Cost Pool

Total Customers (page 304, line 43)

Customer Account Services Expense per Customer

Note A: Calculation of Pension & Benefits Pertaining to Customer Acct Mgmt

Account 926 - Employee Pension & Benefits (page 323, line 187)

Total O&M Payroll (page 355, line 65)

Benefits as Percent of Payroll

Payroll Applicable to Customer Account Services

Total Payroll Charged to Customer Accounts Function

Electric (page 354, line 7)

Gas (page 354, line 37)

Total Payroll Charged to Customer Accounts

Percent Applicable to Customer Accounts Services (903 and 905):

Acct 903 - Customer Records & Collection (page 322, line 161)

Acct 905 - Misc Customer Accounts (page 322, line 163)

Subtotal - Total Charges Applicable to Customer Accounts Services

Acct 902 - Meter Reading Expenses (page 322, line 160)

Total Charges Applicable to Customer Accounts Svcs & Meter Reading

Percent Applicable to Customer Accounts Services (903 and 905)

Customer Account Services Portion of Total Payroll

Pension & Benefits Pertaining to Customer Accounts Services

Note B: Calculation of Employer's FICA Pertaining to Customer Accounts Services

Customer Account Services Portion of Total Payroll

Employer's Portion of FICA (6.20%) and Medicare (1.45%)

Estimated Employer's Portion of FICA

	Maryland			North Carolina	
	Baltimore Gas & Electric	Delmarva Power & Light	Potomac Electric	Duke Energy Carolinas	Prog Energy Carolinas
	\$ 32,124,609	\$ 33,731,176	\$ 51,028,163	\$ 76,091,685	\$ 23,141,107
	\$ 3,467,467	\$ 2,228	\$ -	\$ 142,668	\$ 2,813,905
	\$ 35,592,076	\$ 33,733,404	\$ 51,028,163	\$ 76,234,353	\$ 25,955,012
	\$ 7,175,643	\$ 3,138,929	\$ 7,139,118	\$ 5,657,079	\$ 3,678,404
	\$ 2,664,148	\$ 517,430	\$ 900,454	\$ 2,038,709	\$ 863,719
	\$ 45,431,866	\$ 37,389,763	\$ 59,067,735	\$ 83,930,141	\$ 30,497,135
	1,236,939	499,689	783,069	2,388,580	1,438,889
	\$ 36.73	\$ 74.83	\$ 75.43	\$ 35.14	\$ 21.19
	\$ 41,908,186	\$ 19,690,595	\$ 37,396,545	\$184,003,526	\$134,644,705
	\$203,392,492	\$ 42,429,484	\$ 61,657,632	\$866,817,416	\$413,276,879
	20.6%	46.4%	60.7%	21.2%	32.6%
	\$ 26,762,799	\$ 6,765,452	\$ 13,188,369	\$ 28,448,738	\$ 13,660,562
	\$ 13,788,328	\$ 1,485,099	\$ -	\$ -	\$ -
	\$ 40,551,127	\$ 8,250,551	\$ 13,188,369	\$ 28,448,738	\$ 13,660,562
	\$ 32,124,609	\$ 33,731,176	\$ 51,028,163	\$ 76,091,685	\$ 23,141,107
	\$ 3,467,467	\$ 2,228	\$ -	\$ 142,668	\$ 2,813,905
	\$ 35,592,076	\$ 33,733,404	\$ 51,028,163	\$ 76,234,353	\$ 25,955,012
	\$ 5,851,707	\$ 7,414,978	\$ 6,146,168	\$ 5,146,079	\$ 5,448,525
	\$ 41,443,783	\$ 41,148,382	\$ 57,174,331	\$ 81,380,432	\$ 31,403,537
	85.9%	82.0%	89.3%	93.7%	82.6%
	\$ 34,825,460	\$ 6,763,794	\$ 11,770,636	\$ 26,649,786	\$ 11,290,450
	\$ 7,175,643	\$ 3,138,929	\$ 7,139,118	\$ 5,657,079	\$ 3,678,404
	\$ 34,825,460	\$ 6,763,794	\$ 11,770,636	\$ 26,649,786	\$ 11,290,450
	7.65%	7.65%	7.65%	7.65%	7.65%
	\$ 2,664,148	\$ 517,430	\$ 900,454	\$ 2,038,709	\$ 863,719

Virginia-American Water Company
Comparison Group 12 Months Ended 9/30/2011 Actual Customer Accounts Expense Per Customer

	Kentucky				Tennessee	
	Duke Energy Kentucky	Kentucky Pow er	Kentucky Utilities	Louisville Gas & Electric	Kingsport Pow er	
Customer Account Services Cost Pool						
FERC Account Balances:						
Acct 903 - Customer Records & Collection (page 322, line 131)	\$ 5,309,327	\$ 5,464,903	\$ 14,571,794	\$ 5,367,031	\$ 1,457,131	
Acct 905 - Misc Customer Accounts (page 322, line 133)	\$ -	\$ 30,730	\$ 514,885	\$ 368,105	\$ 4,563	
Subtotal	\$ 5,309,327	\$ 5,495,633	\$ 15,086,679	\$ 5,735,136	\$ 1,461,694	
Add: Employee Benefits & Employer FICA (not included in above amounts)						
Account 926 - Employee Pension & Benefits	\$ 777,756	\$ 250,814	\$ 3,286,611	\$ 1,857,239	\$ 34,377	
Account 408 - Taxes Other Than Income (Employer's Portion of FICA)	\$ 292,961	\$ 91,123	\$ 502,613	\$ 329,174	\$ 15,271	
Total Cost Pool	\$ 6,380,044	\$ 5,837,570	\$ 18,875,903	\$ 7,921,549	\$ 1,511,341	Group Average
Total Customers (page 304, line 43)	135,213	174,579	544,285	395,868	47,183	11,455,143
Customer Account Services Expense per Customer	\$ 47.19	\$ 33.44	\$ 34.68	\$ 20.01	\$ 32.03	\$ 32.87
Note A: Calculation of <u>Pension & Benefits</u> Pertaining to Customer Acct Mgmt						
Account 926 - Employee Pension & Benefits (page 323, line 187)	\$ 7,408,852	\$ 6,710,251	\$ 39,239,991	\$ 35,350,404	\$ 410,134	
Total O&M Payroll (page 355, line 65)	\$ 36,480,032	\$ 31,868,069	\$ 78,442,680	\$ 81,901,172	\$ 2,381,572	
Benefits as Percent of Payroll	20.3%	21.1%	50.0%	43.2%	17.2%	
Payroll Applicable to Customer Account Services						
Total Payroll Charged to Customer Accounts Function						
Electric (page 354, line 7)	\$ 2,803,590	\$ 1,335,667	\$ 8,535,558	\$ 3,203,900	\$ 227,434	
Gas (page 354, line 37)	\$ 1,739,242	\$ -	\$ -	\$ 2,620,974	\$ -	
Total Payroll Charged to Customer Accounts	\$ 4,542,832	\$ 1,335,667	\$ 8,535,558	\$ 5,824,874	\$ 227,434	
Percent Applicable to Customer Accounts Services (903 and 905):						
Acct 903 - Customer Records & Collection (page 322, line 161)	\$ 5,309,327	\$ 5,464,903	\$ 14,571,794	\$ 5,367,031	\$ 1,457,131	
Acct 905 - Misc Customer Accounts (page 322, line 163)	\$ -	\$ 30,730	\$ 514,885	\$ 368,105	\$ 4,563	
Subtotal - Total Charges Applicable to Customer Accounts Services	\$ 5,309,327	\$ 5,495,633	\$ 15,086,679	\$ 5,735,136	\$ 1,461,694	
Acct 902 - Meter Reading Expenses (page 322, line 160)	\$ 988,901	\$ 666,740	\$ 4,513,214	\$ 2,028,527	\$ 203,677	
Total Charges Applicable to Customer Accounts Svcs & Meter Reading	\$ 6,298,228	\$ 6,162,373	\$ 19,599,893	\$ 7,763,663	\$ 1,665,371	
Percent Applicable to Customer Accounts Services (903 and 905)	84.3%	89.2%	77.0%	73.9%	87.8%	
Customer Account Services Portion of Total Payroll	\$ 3,829,550	\$ 1,191,154	\$ 6,570,098	\$ 4,302,923	\$ 199,619	
Pension & Benefits Pertaining to Customer Accounts Services	\$ 777,756	\$ 250,814	\$ 3,286,611	\$ 1,857,239	\$ 34,377	
Note B: Calculation of <u>Employer's FICA</u> Pertaining to Customer Accounts Services						
Customer Account Services Portion of Total Payroll	\$ 3,829,550	\$ 1,191,154	\$ 6,570,098	\$ 4,302,923	\$ 199,619	
Employer's Portion of FICA (6.20%) and Medicare (1.45%)	7.65%	7.65%	7.65%	7.65%	7.65%	
Estimated Employer's Portion of FICA	\$ 292,961	\$ 91,123	\$ 502,613	\$ 329,174	\$ 15,271	

VI - Question 4 – Need for Service Company Services

Analysis of Services

The final aspect of this study was an assessment of whether the services that are provided to VAWC by the Service Company would be necessary if VAWC were a stand-alone water utility. The first step in this evaluation was to determine specifically what the Service Company does for VAWC. Based on discussions with Service Company personnel, the matrix in Exhibit 12 was created showing which entity—VAWC or a Service Company location—is responsible for each of the functions VAWC requires to ultimately provide service to its customers. This matrix was reviewed to determine: (1) if there was redundancy or overlap in the services being provided by the Service Company and (2) if Service Company services are typical of those needed by a stand-alone water utility.

Upon review of Exhibit 12, the following conclusions can be drawn:

- The services that the Service Company provides are necessary and would be required even if VAWC were a stand-alone water utility.
- There is no redundancy or overlap in the services provided by the Service Company to VAWC. For all of the services listed in Exhibit 12, there was only one entity that was primarily responsible for the service.



Virginia-American Water Company Designation Of Responsibility For Water Utility Functions

P - Primarily Responsible S - Provides Support	Performed By:						
	VAWC	American Water Service Company					
		Customer Call Center	Eastern Division	Shared Services	Corporate Office	IT Service Centers	Supply Chain
Water Company Function							
Engineering and Construction Management							
CPS Preparation	S			P			
Five-Year System Planning	S		S	P			
Engineering Standards & Policies Development				P			
Project Design							
Major Projects (e.g., new treatment plant)	S			P			
Special Projects	P			S			
Minor Projects (e.g., pipelines)	P						
Construction Project Management							
Major Projects	P			S			
Special Projects	P			S			
Minor Projects	P						
Hydraulics Review	P		S				
Developers Extensions	P						
Tank Painting	P			S			
Water Quality and Purification							
Water Quality Standards Development				P			S
Research Studies	S			P			S
Water Quality Program Implementation	P			S			S
Water Treatment Operations & Maintenance	P			S			
Compliance Sampling	S						P
Testing/Other Sampling	P						S
Transmission and Distribution							
Preventive Maintenance Program Development	P						
System Maintenance	P						
Leak Detection	P						
Customer Service							
Community Relations	S		P		S		
Customer Contact	S	P					
Call Processing		P					
Service Order Creation	S	P	S				
Service Order Processing	P	S	S				
Customer Credit		P	S				
Meter Reading	P		S			S	
Customer Bill Preparation		S				P	
Bill Collection	S	P	S			S	
Customer Payment Processing	S			P			
Meter Standards Development				P			
Meter Testing, Maintenance & Replacement	P						

Virginia-American Water Company Designation Of Responsibility For Water Utility Functions

Water Company Function	VAWC	Performed By:							
		American Water Service Company							
		Customer Call Center	Eastern Division	Shared Services	Corporate Office	IT Service Centers	Supply Chain	Belleville Lab	
Financial Management									
Financial Planning	S		P	S	S				
Financings--Equity				S	P				
Financings--Long Term Debt & Preferred (Note A)			S	S	P				
Short Term Lines of Credit Arrangements(Note A)			S	S	P				
Investor Relations			S		P				
Insurance Program Administration					P				
Loss Control/Safety Program Administration	P				S				
Pension Fund Asset Management					P				
Cash Management/Disbursements				P					
Internal Auditing					P				
Budgeting and Variance Reporting									
Corporate Guidelines & Instructions					P				
Regional Guidelines & Instructions			P						
Budget Preparation									
Revenue	P		S						
O&M	P		S						
Depreciation and Interest Expense	S		P	S					
Budget Preparation--Service Company Charges		S	P	S	S	S	S	S	
Capital Budget Preparation--Projects	P				S				
Capital Budget Preparation--Non-Project Work	P				S				
Prepare Monthly Budget Variance Report ("Budget/Plan Analysis")	P		S		S				
Prepare Capital Project Budget Status Report	P				S				
Year-End Projections	P		S						
Accounting and Taxes									
Accounts Payable Accounting	S		S	P					
Payroll Accounting	S		S	P					
Work Order Accounting	S		S	P					
Fixed Asset Accounting	S		S	P					
Journal Entry Preparations--Billing Corrections	S		S	P					
Journal Entry Preparation--All Others	S		S	P					
Financial Statement Preparation	S		S	P					
State Commission Reporting	S		S	P					
Income Taxes--State					P				
Income Taxes--Federal					P				
Property Taxes	S		S	P					
Gross Receipts (Tow n) Taxes	S		S	P					

Note A: Lines of credit are the responsibility of American Water Capital Corporation ("AWCC"). AWCC is also responsible for Corporate financings which may be distributed to the regulated subsidiaries.

Virginia-American Water Company Designation Of Responsibility For Water Utility Functions

P - Primarily Responsible S - Provides Support	Performed By:						
	VAWC	American Water Service Company					
		Customer Call Center	Eastern Division	Shared Services	Corporate Office	IT Service Centers	Supply Chain
Water Company Function	VAWC						
Rates							
Rate Studies & Tariff Change Administration	S		P	S			
Rate Case Planning and Preparation	S		P	S			
Rate Case Administration	S		P				
Commission Inquiry Response	S		P	S	S		
Legal			P		S		
Purchasing and Materials Management – National (pipe, chemicals, meters, etc.)							
Specification Development	S		S		P	S	
Bid Solicitation	S					P	
Contract Administration	S					P	
Purchasing and Materials Management – State (state supplier service agreements)							
Specification Development	P		S				
Bid Solicitation	P						
Contract Administration	P						
Ordering	P						
Inventory Management	P						
Human Resources Management							
Benefit Program Development				P			
Benefits Program Administration			P	S			
Management Compensation Administration				P			
Wage & Salary Program Design				P			
Wage & Salary Administration	S		P				
Labor Negotiations--Wages	S		P				
Labor Negotiations--Benefits				P			
Labor Negotiations-- Work Rules	S		P				
Training Program Development	S		S		P		
Training--Course Delivery	S		P				
Affirmative Action/EEO--Plan Development	S		P				
Affirmative Action/EEO--Implementation	S		P				
Information Systems Services							
Service Company Data Centers							
System Operations & Maintenance					P		
Software Maintenance					P		
Network Administration					P		
PC Acquisition & Support	S				P		
Help Desk				S	P		

VI - Question 4 – Need for Service Company Services

Governance Practices Associated With Service Company Charges

There are several ways by which VAWC exercises control over Service Company services and charges. The most important of these are described below.

- **President of Regulated Operations Oversight** – The President of Regulated Operations is on the Executive Leadership Team (ELT) of American Water. This position is responsible for the overall performance of each operating company in American Water. As part of the ELT, the President of Regulated Operations has equal say with other ELT members in major business decisions of American Water and has the ability to monitor Service Company performance quality and spending. The President of Regulated Operations also addresses local concerns with each operating company president.
- **Operating Company Board Oversight** – VAWC board of directors includes members of American Water’s ELT, members of the divisional management team and business and community leaders from outside the Company. VAWC’s president is Chairman of the VAWC board. This helps ensure that VAWC’s needs are a factor in the delivery of Service Company services.
- **Service Company Budget Review/Approval** – The ELT serves as the Board of Directors for the Service Company and must formally approve the budget for Service Company charges for the next year. These budgeted charges are consolidated with the operating company’s own spending into an overall budget which must be approved by the operating company’s board of directors. VAWC’s president also acts as ex officio and attends the Service Company board meetings.
- **Major Project Review And Approval** – Major projects undertaken by the Service Company must first be reviewed by American Water’s ELT, which includes the President of Regulated Operations. With input from the local presidents and Divisional Vice President & Treasurer, they have the ability to impact all new initiatives and projects before they are authorized.
- **Service Company Bill Scrutiny** – VAWC Finance personnel review the monthly Service Company bill for accuracy and reasonableness on a monthly basis. VAWC’s financial manager discusses the monthly bill with Shared Services Center office personnel and any mistakes or overcharges are credited on a subsequent billing. The VAWC Finance Manager prepares an actual-to-budget comparison of management fees each month for use in identifying unusual variances. Service Company actual-to-budget comparison is included in the monthly Financial Review Package (FRP). Unusual variances are researched, explanations are provided and any necessary corrections are made.
- **Service Company Budget Variance Reporting** – Each month, a summary variance analysis is prepared that explains differences between budgeted and actual Service Company spending. In addition, a more detailed monthly variance report, called the “Statement of Expenses and Billed Charges,” is produced by Service Company location and shows actual spending for the month.
- **Operating Company Budget Variance Reporting** – The “Budget/Plan Analysis,” produced monthly, has a line item for Management Fees (i.e., Service Company charges). In this way, Service Company budget versus actual charges can be monitored for the month and year-to-date. Additional information exists that allows more detailed analysis of "Divisional" and "Corporate" Management Fees.
- **Capital Investment Management (CIM)** – CIM is one of American Water’s primary business planning processes. It covers capital and asset planning and is employed throughout American Water. CIM provides a full range of governance practices, including a formal protocol for assessing system needs, prioritizing expenditures, managing the

VI - Question 4 – Need for Service Company Services

capital program, approving project spending, delivering projects and measuring outputs. CIM ensures that:

- Capital expenditure plans are aligned with the strategic intent of the business
- The impact of capital expenditure and income plans are fully reflected in operating expense plans
- The impacts of these plans are understood and affordable, and
- Effective controls are in place over budgets (through business plans) and individual capital projects (through appropriate authorization thresholds, management and reporting processes).

The CIM process was designed to optimize the effectiveness of asset investment. The process is managed at two levels for all American Water companies, including all VAWC Operating Units. Monthly meetings of the CIM are held to review capital spending compared to plan, review new project requests, and review updates or modifications to existing projects. The President of VAWC and others participate as necessary (e.g. VAWC operations managers and Rates Manager) and provide the data used in the monthly review schedules.

VIRGINIA AMERICAN WATER COMPANY

1 **1. Q. Please state your name and business address.**

2 A. Patrick L. Baryenbruch, 2832 Claremont Road, Raleigh, North Carolina 27608.

3 **2. Q. Please describe your educational and professional background.**

4 A. I received a Bachelors degree in accounting from the University of Wisconsin-
5 Oshkosh in 1974 and a Masters in Business Administration degree from the
6 University of Michigan in 1979.

7 I am a financial consultant and a certified public accountant. I am a member of the
8 American Institute of Certified Public Accountants and the North Carolina
9 Association of Certified Public Accountants.

10 I began my career as a staff accountant with Arthur Andersen & Company where I
11 performed financial audits of utilities, banks and finance companies. After three
12 years I left to pursue an M.B.A. degree. Upon graduation from business school, I
13 worked with the consulting firms of Theodore Barry & Associates and Scott,
14 Madden & Associates.

15 During my consulting career, I have performed consulting assignments for
16 approximately 50 utilities and 10 public service commissions. I have participated
17 as project manager, lead or staff consultant for 24 commission-ordered
18 management and prudence audits of public utilities. Of these, I have been
19 responsible for evaluating the area of affiliate charges and allocation of corporate
20 expenses in the Commission-ordered audits of Connecticut Light and Power,
21 Connecticut Natural Gas, General Water Corporation (Pennsylvania Operations),
22 Philadelphia Suburban Water Company (now Aqua America) and Pacific Gas &
23 Electric Company.

VIRGINIA AMERICAN WATER COMPANY

1 My firm has performed the commission-ordered audit of Southern California
2 Edison's 2002, 2003, 2004 and 2005 transactions with its non-regulated affiliate
3 companies.

4 **3. Q. What are your duties and responsibilities in your current position?**

5 A. I am the President of my own consulting practice, Baryenbruch & Company, LLC,
6 which was established in 1985. In that capacity, I provide consulting services to
7 utilities and their regulators.

8 **4. Q. Please describe the reason for your testimony in this case.**

9 A. I am presenting the results of my study which evaluated the services provided by
10 American Water Works Service Company, Inc. ("Service Company") during the 12
11 months ended September 30, 2011 to Virginia American Water Company
12 ("VAWC"). This study was undertaken in conjunction with VAWC's rate case and
13 is accurate to the best of my knowledge and belief. The study is attached as
14 Exhibit PLB-1.

15 **5. Q. What were the objectives of your study?**

16 A. This study was undertaken to answer four questions concerning the services
17 provided by Service Company to VAWC, each of which bears on the
18 reasonableness of those charges as incurred during the 12 months ended
19 September 30, 2011. First, were the Service Company's charges to VAWC during
20 the 12 months ended September 30, 2011 reasonable? Second, was VAWC
21 charged the lower of cost or market for managerial and professional services
22 provided by the Service Company during the 12 months ended September 30,
23 2011? Third, were the 12 months ended September 30, 2011 costs of the Service
24 Company's customer accounts services, including those of the National Call

VIRGINIA AMERICAN WATER COMPANY

1 Centers, comparable to those of other utilities? Fourth, are the services VAWC
2 receives from the Service Company necessary?

3 **6. Q. What conclusions were you able to draw as to the reasonableness of the**
4 **Service Company's charges to VAWC ?**

5 A. The Service Company's costs for the 12 months ended September 30, 2011 per
6 VAWC customer are very reasonable. For example, during the 12 months ended
7 September 30, 2011, VAWC was charged \$66 per customer for administrative and
8 general ('A&G')-related services provided by the Service Company. This
9 compares favorably to costs per customer for electric and combination electric/gas
10 service companies that average \$111 for service companies reporting to the
11 Federal Energy Regulatory Commission ("FERC"). Only 4 of the 24 utility service
12 companies that filed a FERC Form 60 for 2010 had a lower A&G cost per
13 customer than VAWC's charges from the Service Company.

14 **7. Q. What conclusions were you able to draw as to whether VAWC was charged**
15 **the lower of cost or market for the services provided by the Service**
16 **Company?**

17 A. I was able to draw the following conclusions:

18 (1) VAWC was charged the lower of cost or market for managerial
19 and professional services during the 12 months ended September 30,
20 2011.

21 (2) On average, the hourly rates for outside service providers are 40%
22 higher than the Service Company's hourly rates.

23 (3) The managerial and professional services provided by the Service
24 Company are vital and could only be procured effectively by VAWC from
25 outside professionals if it provided careful supervision to those service

VIRGINIA AMERICAN WATER COMPANY

1 providers. If these services were contracted entirely from outside
2 providers, VAWC would have to add at least one position to manage
3 activities of outside firms. This position would be necessary to ensure the
4 quality and timeliness of services provided.

5 (4) If all the managerial and professional services now provided by the
6 Service Company had been outsourced during the 12 months ended
7 September 30, 2011, VAWC and its ratepayers would have incurred
8 almost \$2.4 million in additional expenses. This amount includes the
9 higher cost of outside providers and the cost of one VAWC position
10 needed to direct the outsourced work.

11 (5) This study's hourly rate comparison actually understates the cost
12 advantages that accrue to VAWC from its use of the Service Company.
13 Outside service providers generally bill for every hour worked. Service
14 Company exempt personnel, on the other hand, charge a maximum of 8
15 hours per day even when they work more hours. If all overtime hours of
16 Service Company personnel were factored into the hourly rate calculation,
17 the Service Company would have had an even greater annual dollar
18 advantage than the \$2.4 million cited above.

19 (6) It would be difficult for VAWC to find local service providers with
20 the same specialized water industry expertise as that possessed by the
21 Service Company staff. Service Company personnel spend substantially
22 all their time serving operating water companies. This specialization
23 brings with it a unique knowledge of water utility operations and regulation
24 that is most likely unavailable from local service providers.

25 (7) Service Company fees do not include any profit markup. Only its
26 actual cost of service is being recovered from VAWC customers.

VIRGINIA AMERICAN WATER COMPANY

1 **8. Q. What conclusions were you able to draw concerning whether the 12 months**
2 **ended September 30, 2011 costs of the Service Company's customer**
3 **account services, including those of the National Call Centers, were**
4 **reasonable?**

5 A. The cost of the Service Company's customer accounts services, including those
6 provided by the National Call Center, is below the average of the neighboring
7 electric utility comparison group. As will be explained further, this group of
8 companies provides a reasonable proxy group for comparison to a regulated utility
9 of the size and scope of the Service Company and VAWC. During the 12-months
10 ended September 30, 2011, the customer accounts cost for VAWC customers was
11 \$22.69 compared to the 2010 average of \$32.87 for neighboring electric utilities.
12 The highest comparison group per customer cost was \$75.43 and the lowest
13 \$16.81.

14 **9. Q. What conclusions were you able to draw concerning whether the services**
15 **VAWC receives from the Service Company are necessary?**

16 A. I was able to draw the following conclusions:

17 (1) The services that the Service Company provides are necessary and
18 would be required even if VAWC were a stand-alone water utility.

19 (2) Furthermore, there is no redundancy or overlap in the services
20 provided by the Service Company to VAWC. For all of the services listed
21 in Exhibit 12 of my report, there was only one entity primarily responsible
22 for the service and thus no duplication of efforts between the Service
23 Company and VAWC.

24 **10. Q. Does this complete your testimony?**

25 A. Yes.



Virginia Natural Gas, Inc.
Market Cost Comparison for AGL Services Company Charges
during the Year Ended September 30, 2010

Virginia Natural Gas, Inc.
Market Cost Comparison for AGL Services Company Charges
during the Year Ended September 30, 2010

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Purpose Of This Study

This study was undertaken to answer four questions concerning the services provided by AGL Services Company (AGSC) to Virginia Natural Gas, Inc. (VNG), each of which bears on the reasonableness of those charges as incurred during the 12 months ended September 30, 2010:

1. Are AGSC's charges to VNG during the 12-months ended September 30, 2010 reasonable compared to other utility service companies?
2. Was VNG charged the lower of cost or market for managerial and professional services provided by the AGSC during the test period?
3. Were the 12 months ended September 30, 2010 costs of AGSC's customer accounts services comparable to those of other utilities?
4. Are the services VNG receives from AGSC necessary?

Study Results

Concerning question 1, the following conclusion was reached:

AGSC's costs for the 12 months ended September 30, 2010 per VNG customer were reasonable. During that period, VNG was charged \$67 per customer for administrative and general ("A&G")-related services provided by the Services Company. This compares favorably to costs per customer for electric and combination electric/gas service companies that average \$95 for A&G services provided by service companies reporting to the Federal Energy Regulatory Commission ("FERC").

Concerning question 2, the following conclusions can be drawn from this study:

- VNG was charged the lower of cost or market for managerial and professional services during the 12-months ended September 30, 2010.
- On average, the hourly rates for outside service providers are approximately 84% higher than the AGSC's hourly rates.
- If all the managerial and professional services now provided by AGSC had been outsourced during the 12-months ended September 30, 2010, VNG and its ratepayers would have incurred almost \$13 million in additional expenses.
- AGSC fees do not include any profit markup. Only its actual cost of service is being recovered from VNG ratepayers.

Concerning question 3, the following conclusion was reached:

- The cost of the Service Company's customer accounts services is below the average of the neighboring electric utility comparison group. As will be explained further herein, this group of companies provides a reasonable proxy group for comparison to a regulated utility of the size and scope of the AGSC and VNG. During the 12-months ended September 30, 2010, the customer accounts cost for VNG customers was \$28.96 compared to the 2009 average of \$30.56 for neighboring electric utilities. The highest comparison group per customer cost was \$72.58 and the lowest \$15.58.



Concerning question 4, the following conclusions were drawn:

- The services that AGSC provides are necessary and would be required even if VNG were a stand-alone utility.
- In addition, there is no redundancy or overlap in the services provided by AGSC to VNG. Based on an analysis of the structures and employee positions of AGSC and VNG, it is clear that functions are distinctly organized with no duplication of activities.



Overview of AGL Resources Inc.

AGSC is a wholly owned subsidiary of AGL Resources Inc. (AGLR), an energy services holding company whose principle business is the distribution of natural gas to approximately 2.2 million end-use customers in Georgia, Virginia, Tennessee, New Jersey, Florida and Maryland. AGLR’s principal subsidiaries are shown below.

Segment	Businesses
Distribution Operations	<ul style="list-style-type: none"> • Virginia Natural Gas, Inc. • Chattanooga Gas Company • Elizabethtown Gas Company • Elkton Gas Company • Florida City Gas Company • Virginia Natural Gas, Inc.
Retail Energy Operations	<ul style="list-style-type: none"> • SouthStar Energy Services
Wholesale Energy Services	<ul style="list-style-type: none"> • Sequent Energy Management • Compass Energy Services
Energy Investments	<ul style="list-style-type: none"> • Golden Triangle Storage • Jefferson Island Storage & Hub, LLC
Energy Services	<ul style="list-style-type: none"> • AGL Energy Services

Source: AGL Resources (<http://www.aglresources.com>)

AGSC follows a service company model used by many utility holding companies that own multiple regulated utilities. By consolidating executive, management and professional services into a single service company, utility holding companies are able to realize the following benefits for ratepayers:

- **Purchasing Economies** – Common expenses (e.g., insurance, piping) can be procured on a much larger scale thereby providing greater bargaining power for the combined entity compared to individual utility operating companies. A service company facilitates corporate-wide purchasing programs through its procurement and contract administration functions.
- **Operating Economies of Scale** – A service company is able to deliver services more efficiently because workloads can be balanced across more persons and facilities. For instance, AGSC is able to maintain one principal data center for the entire corporation. This is much more cost-efficient than each operating utility funding their own data center with its large fixed hardware, software and staffing costs.
- **Continuity of Service** – Centralizing service company personnel who perform similar services facilitates job cross-training and sharing of knowledge and expertise. This makes it easier to deal with staff turnover and absences and to sustain high levels of service to operating utilities. An individual operating utility might experience considerable disruption if a key professional left and it was necessary to hire outside to fill the vacancy.
- **Maintenance of Corporate-Wide Standards** – Personnel in AGSC establish standards for many functions (e.g., engineering designs, operating procedures and maintenance practices). It is easier to ensure these standards are followed by every operating utility because their implementation is overseen by AGSC.
- **Improved Governance** – AGSC provides another dimension of management and financial oversight that supplements local operating utility management. The Services Company facilitates standard planning and reporting that help ensure operating utilities meet the requirements of their customers in a cost effective manner.

II - Background

- Retention of Personnel – A service company organization provides operating utility personnel with another career path beyond what may be available on a local level. These opportunities tend to improve employee retention.

AGSC follows the model for other utility service companies in another important regard. Its services are provided to affiliate operating utilities, like VNG, at cost. AGSC is not a profit-making entity. It assigns only its actual expenses to the AGLR subsidiaries it serves.

AGSC provides affiliate companies, including VNG, with management and administrative services listed below and defined in Schedule 1.

Rates and regulatory	Executive
Internal auditing	Customer services
Strategic planning	Employee services
External relations	Engineering
Gas supply, capacity planning and capacity management	Business support
Legal services and risk management	Corporate communications
Marketing	Corporate compliance and corporate secretary
Financial services	Other
Information systems	

Schedule 2 lists the regulated and non-regulated affiliate entities that are provided service by AGSC.

Services provided by AGSC to VNG are governed by a services agreement approved by the Virginia State Corporation Commission's September 30, 2010 Order Granting Approval in Case No. PUE-2010-00070 and executed by the parties on November 11, 2010.

Virginia Natural Gas, Inc.
Definition of AGL Services Company Services

Rates and Regulatory	AGSC assists the AGLR System Companies in the analysis of their rate structures and in the formulation of rate policies and advises and assists AGLR System Companies in proceedings before regulatory bodies involving the rates and operations of AGLR System Companies and of other competitors where such rates and operations directly or indirectly affect the AGLR System Companies. AGSC also assists AGLR System Companies by analyzing pipeline safety, environmental and safety regulations; writing the appropriate procedures to assist the system companies to stay in compliance with those regulations; providing internal reviews to assure operational, environmental and safety compliance; assisting in work with state and federal pipeline safety regulators and managing leak survey, pipeline integrity, locate and right of way contractors.
Internal Auditing	AGSC performs periodic reviews of operational, compliance, financial and information systems for AGLR System Companies.
Strategic Planning	AGSC advises and assists AGLR System Companies with the preparation of strategic business plans and corporate strategies.
External Relations	AGSC maintains relationships with government policy makers, conducts lobbying activities and provides community relations support.
Gas Supply, Capacity Planning and Capacity Management	AGSC provides gas control, scheduling, capacity planning and monitoring services. AGSC manages a centralized gas control center which provides natural gas delivery for natural gas distribution affiliates. AGSC also provides scheduling functions between the natural gas distribution affiliates and the pipelines for their daily supply. AGSC provides capacity planning services for each natural gas distribution affiliate including identifying present and future gas requirements to meet the needs of each natural gas distribution affiliate. AGSC provides monitoring of natural gas storage facilities and telecommunications networks. AGSC also coordinates the management of gas supply for natural gas distribution affiliates who offer retail services and coordinates gas transmission and storage services for all natural gas distribution affiliates to ensure the most efficient use of services and to capture economies of scale as a larger purchaser in the market. Individually, natural gas distribution affiliates may, however, remain as the contract party under any agreement.
Legal Services and Risk Management	AGSC provides various legal services and general legal oversight. In addition, AGSC provides insurance, claims, security, records management, environmental and safety related services and performs corporate secretarial functions.
Marketing	AGSC assists AGLR System Companies by providing analysis, implementation and maintenance of line extension policies, by providing analysis of tariff rates in response to customer needs and by developing marketing strategies and programs.
Financial Services	AGSC provides various services to AGLR System Companies including corporate tax, treasury, corporate accounting and reporting, general ledger maintenance and all accounting recordkeeping, processing certain accounts such as accounts payable, cash management, and others as may be deemed necessary, including hedging policy and oversight, financial planning and regulatory support (for all natural gas distribution affiliates and other AGLR System Company that interact with regulators or regulated companies). In addition, AGSC maintains relationships with the financial community and provides shareholder services for the benefit of AGLR System Companies. Each AGLR System Company may also maintain its own corporate and accounting group and engage AGSC to provide advice and assistance on accounting matters, including the development of accounting practices, procedures and controls, the preparation and analysis of financial reports and the filing of financial reports with regulatory bodies, on a system-wide basis.

Virginia Natural Gas, Inc.
Definition of AGL Services Company Services

Information Systems	AGSC provides the AGLR System Companies with production support of web, mainframe and distributed computing applications, servers and networks. AGSC also provides deskside asset management, disaster recovery, data network, application security and voice communications services.
Executive	AGSC utilizes the executive staff of AGLR in order to assist the AGLR System Companies in formulating and executing general plans and policies, including operations, issuances of securities, appointment of executive personnel, budgets and financing plans, expansion of services, acquisitions and dispositions of property, public relationships and other related matters.
Customer Services	AGSC assists AGLR System Companies by providing billing, mailing, remittance processing, call center and customer communication services for customers; by providing credit and collections support and analysis; by providing support for response to customer complaints and by providing customer service surveys to improve service and efficiency.
Employee Services	AGSC assists AGLR System Companies in developing employee relations policies and programs, and training personnel in a coordinated manner throughout the AGLR System Companies. Each AGLR System Company may maintain a human resources group to handle the individualized application of policies and programs. AGSC also provides payroll services, management of the employee benefit plans and employee communications
Engineering	AGSC provides engineering services for the AGLR System Companies. These services include infrastructure expansion and improvements, system analysis and modeling, GIS mapping and updates and maintenance and general engineering expertise.
Business Support – Purchasing	AGSC provides procurement services to AGLR System Companies.
Business Support – Facilities Management	AGSC provides facilities management services for offices owned or leased by AGLR System Companies.
Business Support – Fleet	AGSC provides fleet management services for vehicles owned or leased by AGLR System Companies.
Corporate Communications	AGSC provides communications services to AGLR System Companies. The services include community affairs, customer communication, employee communications, public affairs and creative services.
Corporate Compliance and Corporate Secretary	AGSC provides corporate compliance and corporate secretary services to AGLR System Companies.
Other	AGSC provides other services, such as project management, as identified in this document or requested by the AGLR System Companies.



**Virginia Natural Gas, Inc.
Affiliates Served By AGL Services Company**

Regulated	Atlanta Gas Light Company Chattanooga Gas Company Elizabethtown Gas Company Elkton Gas Services Company Florida City Gas Company Jefferson Island Storage & Hub, LLC Pivotal Utility Holdings, Inc. Virginia Natural Gas, Inc.
FERC Regulated	Golden Triangle Inc.
Non-Regulated	AGL C&I Energy Services Inc. AGL Capital Corporation AGL Capital Trust II AGL Investments, Inc. AGL Peaking Services AGL Renewables, LLC AGL Resources Inc. AGL Southeast LNG, LLC Compass Energy Services Inc. Customer Care Services Company Distribution Operations Corp EnergyUSA Inc. ERISC Georgia Natural Gas Company GERIC Insurance Risk Retention Global Energy Res Insurance Co Magnolia Enterprise Holdings NUI Capital, Inc. NUI Energy Brokers NUI Headquarters Pivotal Energy Services, Inc. Pivotal Propane of Virginia In Pivotal Storage, Inc Renewco, LLC Renewco-Meadow Branch, LLC Sequent Energy Canada Corp Sequent Energy Mngmt, LP-Corp Sequent Holdings, LLC Sequent LLC Southeastern LNG, Inc. Triple Diamond Storage, Inc. Utilipro Services, LLC

AGSC Cost Assignment Process

AGSC provides services to operating companies at cost, as stipulated in the current services agreement with VNG. Within its accounting system, AGSC identifies its service costs through “account codes” including cost centers, account numbers, capital projects and O&M projects. This data enables AGSC to accumulate its expenses and properly assign them to the affiliate companies it serves.

To the extent practicable, AGSC expenses are assigned directly to affiliates being served. AGSC expenses that cannot be assigned directly are allocated among affiliates on a basis that is pertinent to the underlying services. The table shows the methods by which such non-directly assigned costs of service are allocated to AGSC affiliates.

Service Category	Allocation Basis
Rates and Regulatory	End-Use Customers Ratio
Internal Auditing	Composite Ratio (employees, assets, operating expenses, operating margin)
Strategic Planning	Composite Ratio
External Relations	Composite Ratio
Gas Supply and Capacity Mgmt	End-Use Customers Ratio
Legal Services and Risk Mgmt	Composite Ratio
Marketing	End-Use Customers Ratio
Financial Services	Composite Ratio
Information Services	Composite Ratio
Executive	Composite Ratio
Investor Relations	Composite Ratio
Customer Services	
- Call Center Services	Call/Phone Volume Ratio
- Non-Call Center Services	End-Use Customers Ratio
Employee Services	Employees Ratio
Engineering	End-Use Customers Ratio
Business Support	Composite Ratio

III - Service Company Cost Comparison Approach

During the 12 months ended September 30, 2010, AGSC billed VNG \$20,676,637. The table below shows the breakdown of these charges by major service category.

Service Category	Year Ended Sep 30, 2010
Customer Services	\$ 5,314,281
Employee Services	\$ 1,213,136
Engineering	\$ 1,103,899
Executive	\$ 1,347,471
External Relations	\$ 194,908
Facilities Mgt	\$ 1,329,132
Financial Services	\$ 1,345,922
Fleet	\$ 92,311
Gas Supply & Capacity Mgmt	\$ 1,300,490
Information Services	\$ 4,277,288
Internal Audit	\$ 206,037
Investor Relations	\$ (133)
Legal Services	\$ 945,816
Marketing Services	\$ 379,415
Other	\$ 757,344
Rates and Regulatory	\$ 703,324
Supply Chain Management	\$ 165,999
Total AGSC Billings to VNG	\$ 20,676,637

This study's first question—whether AGSC 12 months ended September 30, 2010 charges were reasonable—was determined by comparing VNG's A&G-related AGSC charges per customer to the same charges for utility companies that must file the FERC Form 60 – Annual Report of Service Companies. VNG's per customer cost is compared to Form 60 data from 2008, the latest year available (service companies must file their 2009 Form 60s by May 1, 2010).

The second question—whether AGSC's 12 months ended September 30, 2010 charges were priced at the lower of cost or market—was evaluated by comparing the cost per hour for managerial and professional services provided by AGSC personnel to hourly billing rates that would be charged by outside providers of equivalent services. AGSC costs per hour were based on actual charges to VNG during the 12 months ended September 30, 2010. Outside providers' billing rates came from surveys or other information from professionals that could perform the services now provided by AGSC.

The third question—whether AGSC's 12 months ended September 30, 2010 customer account services charges were comparable to other utilities—was addressed by comparing VNG's customer accounts services expenses to those of neighboring utilities. This approach was selected because the costs of outside providers of call center services are not publicly available. However, utility customer account services expenses can be obtained from the FERC Form 1 from those utilities required to file this form. The availability and transparency of FERC data adds to the validity of its use in this comparison.

The fourth question—the necessity of AGSC services—was investigated by defining the services provided to VNG and determining if these services would be required if VNG were a stand-alone utility.

VNG’s Service Company Cost Per Customer

During the 12 months ended September 30, 2010, VNG was charged \$67 per customer by AGSC for A&G-related services. As shown in the table below, total non-A&G items are eliminated from total AGSC charges to arrive at this per customer expense.

	12 Months Ended Sep. 30, 2010
Total AGSC Billings to AGL	\$ 20,676,637
Less: Non-A&G charges	
Engineering	\$ (1,103,899)
Gas Supply & Capacity Mgmt	\$ (1,300,490)
Net A&G-related charges	\$ 18,272,249
AGLC Customers (12/31/09)	273,000
AGSC A&G Per VNG Customer	\$ 67

Comparison Group Cost Per Customer

Every centralized service company in a holding company system must file a Form 60, unless exempt, in accordance with the Public Utility Holding Company Act of 2005, Section 1270, Section 390 of the Federal Power Act and 18 C.F.R. paragraph 366.23. This report is designed to collect financial information from service companies that are subject to regulation by the FERC.

AGLR is a holding company solely because it owns several local distribution companies (LDCs), such as VNG. However, since AGLR’s LDCs are not regulated as natural gas companies under the natural gas act, it has been granted an exemption from filing the Form 60.

For 2009, a Form 60 was filed by 24 utility service companies, all of which serve utilities that provide regulated electric and, in some cases, gas service to retail customers. In order to make a valid comparison of this group’s costs to those of AGSC, it was necessary to isolate expenses that that they have in common. These include A&G-related charges associated with the following FERC accounts:

901 – Supervision	921 – Office supplies and expenses
903 – Customer records and collection expenses	923 – Outside services employed
905 – Miscellaneous customer accounts expenses	928 – Regulatory commission expenses
907 – Supervision	930.2 – Miscellaneous general expenses
910 – Misc customer service and info expenses	931 – Rents
911 – Supervision	935 – Maintenance of structures and equipment
920 - Administrative and general salaries	

O&M expenses charged to utility affiliates for the comparison group service companies were obtained from Schedule XVI – Analysis of Charges for Service Associate and Non-Associate Companies (p. 303 to 306) of each entity’s FERC Form 60. This schedule shows charges by FERC Account.

Comparison group service company 2009 expenses were also adjusted to remove charges to non-regulated affiliates from the cost pool used to calculate the cost per regulated service customer. This determination was made using information from the FERC Form 60 schedule: Account 457 – Analysis of Billing – Associate Companies.

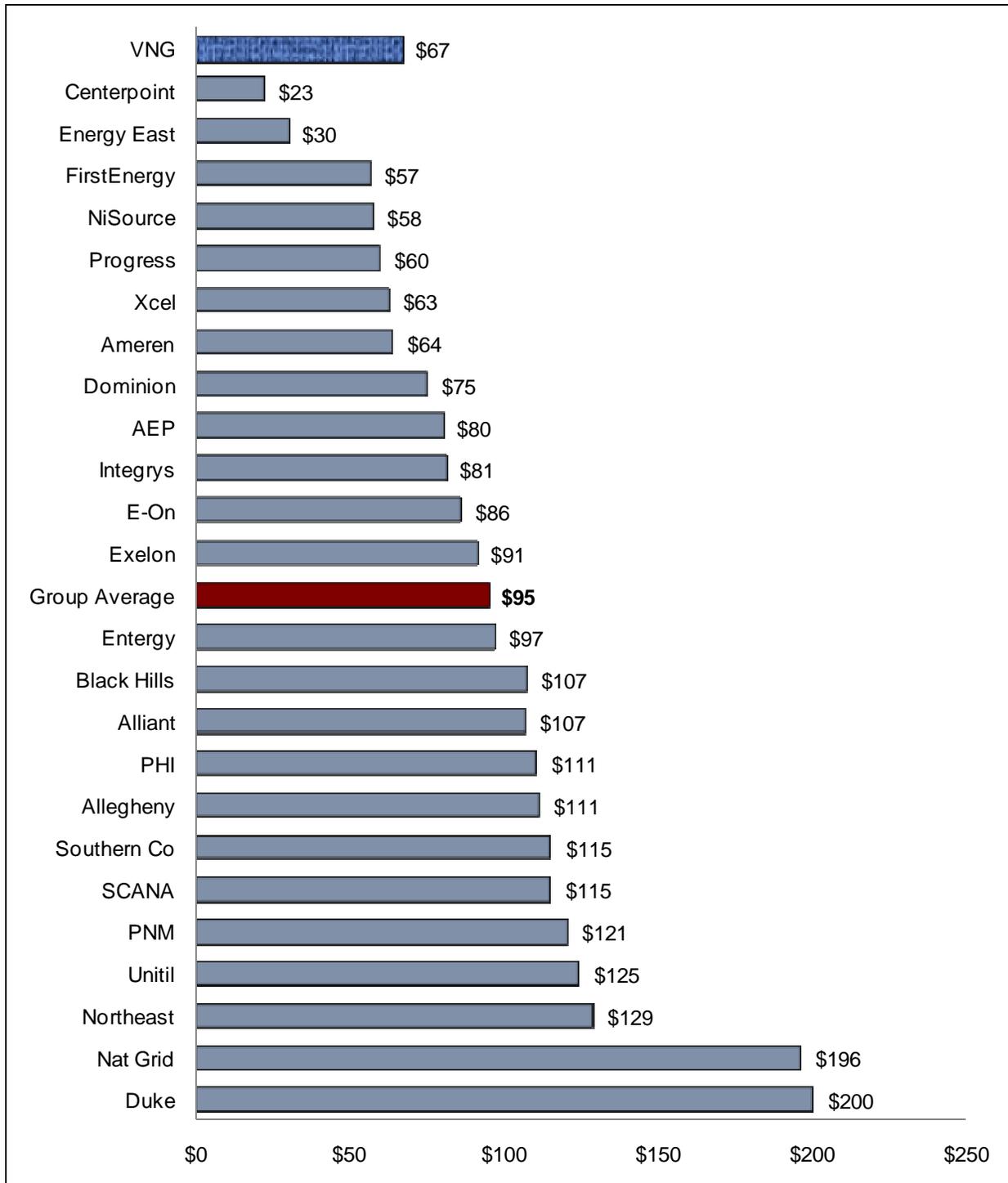
IV – Question 1 – Reasonableness of Service Company Charges

A&G expenses per regulated utility customer for the 24 utility companies that file Form 60 for 2009 are calculated below.

Utility Company	2009 Regulated Retail Service Company A&G Expenses	Regulated Retail Customers	Cost per Customer
AEP	\$418,484,117	5,213,000	\$ 80
Allegheny	\$176,685,245	1,585,700	\$ 111
Alliant	\$149,116,475	1,395,189	\$ 107
Ameren	\$212,036,412	3,300,000	\$ 64
Black Hills	\$81,484,333	759,400	\$ 107
Centerpoint	\$119,304,604	5,300,000	\$ 23
Dominion	\$279,128,940	3,700,000	\$ 75
Duke	\$901,762,388	4,500,000	\$ 200
Energy East	\$89,580,962	2,973,000	\$ 30
Entergy	\$262,596,172	2,700,000	\$ 97
E-On	\$105,893,093	1,226,000	\$ 86
Exelon	\$537,633,122	5,886,000	\$ 91
FirstEnergy	\$255,874,712	4,500,000	\$ 57
Integrus	\$175,423,352	2,157,700	\$ 81
Nat Grid	\$1,314,902,105	6,700,000	\$ 196
NiSource	\$216,480,637	3,750,000	\$ 58
Northeast	\$269,948,801	2,095,000	\$ 129
PHI	\$215,465,623	1,946,000	\$ 111
Progress	\$186,256,921	3,100,000	\$ 60
PNM	\$87,998,259	729,700	\$ 121
SCANA	\$166,555,883	1,445,000	\$ 115
Southern Co	\$508,130,523	4,402,000	\$ 115
Unitil	\$21,115,280	169,600	\$ 125
Xcel	\$333,389,459	5,300,000	\$ 63
Group Total	\$7,085,247,416	74,833,289	\$ 95

Schedule 3 shows VNG's 12 months ended September 30, 2010 AGSC A&G-related cost per customer of \$67 is considerably lower than the average of \$95 per customer for the comparison group service companies. Based on this result, it is possible to conclude that AGSC's 12 months ended September 30, 2010 charges to VNG were reasonable.

VIRGINIA NATURAL GAS, INC.
Comparison of Service Company Annual Costs Per Customer



Comparison Methodology

AGSC's billings to VNG during the twelve months ended September 30, 2010 were market tested by comparing the cost per hour for AGSC services to those of outside service providers to whom AGSC services could be outsourced. The outside providers selected for comparison were:

- Attorneys – legal services
- Certified Public Accountants – accounting, finance, internal audit, investor relations, information technology and rates and regulatory services
- Professional Engineers – engineering, gas management and operations-related services
- Management Consultants - executive management, external relations, human resources, communications services, marketing

Calculation Of AGSC Hourly Rates

During the twelve months ended September 30, 2010, AGSC billed VNG \$15,362,356 for management and professional-related services. This amount represents all test year charges to VNG except for Customer Services, which are performed to a large extent by non-exempt AGSC personnel. Schedule 4 shows the designation of the outside provider to which each category of service could be outsourced.

AGSC test year charges were compiled by each of the four outside provider category in Schedule 5. Test year AGSC hours charged to VNG are compiled by outside provider category in Schedule 6.

Certain adjustments to AGSC test year charges were necessary to properly calculate Services Company hourly rates that are directly comparable to those of outside providers. Schedule 7 shows the amounts for the following three categories of adjustments:

- Outside Services – 12 months ended September 30, 2010 AGSC charges to VNG include expenses associated with the use of outside professional firms to perform certain corporate-wide services (e.g., legal, financial audit, actuarial services). These professional fees are excluded from the AGSC hourly rate calculation because the related services have effectively been out-sourced already.
- Travel Expenses – In general, client-related travel expenses are not recovered by outside service providers through their hourly billing rate. Rather, actual out-of-pocket travel expenses are billed to clients in addition to fees for professional services. Thus, it is appropriate to remove these AGSC charges from the hourly rate calculation.
- Information Technology Infrastructure Expenses – Included in the 12 months ended September 30, 2010 AGSC charges to VNG are leases, maintenance fees and depreciation related to AGL Resource's enterprise mainframe, server and network infrastructure and corporate business applications. An outside provider that would take over operation of this infrastructure would recover these expenses over and above the labor necessary to operate the data center.

V – Question 2 – Provision of Services at the Lower of Cost or Market

Based on previously described cost and hour data for the twelve months ended September 30, 2010, the AGSC's hourly rates by service provider category are calculated in the table below.

	Outside Provider Category				Total
	Management Consultant	Attorney	Certified Public Accountant	Professional Engineer	
Mgmt/Professional Service-Related AGSC Charges (Exhibit 4)	\$ 3,892,272	\$ 945,816	\$ 6,698,437	\$ 2,404,388	\$ 13,940,913
Add: Overhead-Related AGSC Charges (A)	\$ 398,004	\$ 99,501	\$ 682,292	\$ 241,645	\$ 1,421,442
Less: Excluded Charges (Exhibit 6)	(580,825)	(120,944)	(3,391,066)	(171,151)	(4,263,986)
Net Cost Pool Expenses	\$ 3,709,451	\$ 924,373	\$ 3,989,663	\$ 2,474,883	\$ 11,098,370
Total Hours (Exhibit 5)	38,947	6,285	49,281	51,608	146,121
Average Hourly Rate	\$ 95	\$ 147	\$ 81	\$ 48	

Note A: Overheads are assigned to the outside provider categories on a prorata basis, as shown below:

	Management Consultant	Attorney	Certified Public Accountant	Professional Engineer	Total
	Service-Related Charges	\$ 3,892,272	\$ 945,816	\$ 6,698,437	\$ 2,404,388
Percent of Cost Pool Total	28%	7%	48%	17%	100%
Total Overhead	\$ 1,421,442	\$ 1,421,442	\$ 1,421,442	\$ 1,421,442	
Allocated Overhead	\$ 398,004	\$ 99,501	\$ 682,292	\$ 241,645	\$ 1,421,442

Virginia Natural Gas, Inc.
Determination Of Market Testability And Designation of Outside Providers
For AGSC Management and Professional Services
12-Months Ended September 30, 2010

Service Category	Year Ended Sep 30, 2010	Outside Provider
Employee Services	\$ 1,213,136	Management Consultant
Engineering	\$ 1,103,899	Professional Engineer
Executive	\$ 1,347,471	Management Consultant
External Relations	\$ 194,908	Management Consultant
Facilities Mgt	\$ 1,329,132	Overhead
Financial Services	\$ 1,345,922	Certified Public Accountant
Fleet	\$ 92,311	Overhead
Gas Supply & Capacity Mgmt	\$ 1,300,490	Professional Engineer
Information Services	\$ 4,277,288	Certified Public Accountant
Internal Audit	\$ 206,037	Certified Public Accountant
Investor Relations	\$ (133)	Certified Public Accountant
Legal Services	\$ 945,816	Attorney
Marketing Services	\$ 379,415	Management Consultant
Other	\$ 757,344	Management Consultant
Rates and Regulatory	\$ 703,324	Certified Public Accountant
Supply Chain Management	\$ 165,999	Certified Public Accountant
AGSC Management & Professional Billings to VNG	\$ 15,362,356	

Virginia Natural Gas, Inc.
AGSC Amounts Charged VNG By Outside Service Provider Category
12-Months Ended September 30, 2010

Service Category	Outside Provider Category					Total
	Management Consultant	Attorney	Certified Public Accountant	Professional Engineer	Overhead	
Employee Services	\$ 1,213,136					
Engineering				\$ 1,103,899		
Executive	\$ 1,347,471					
External Relations	\$ 194,908					
Facilities Mgt					\$ 1,329,132	
Financial Services			\$ 1,345,922			
Fleet					\$ 92,311	
Gas Supply & Capacity Mgmt				\$ 1,300,490		
Information Services			\$ 4,277,288			
Internal Audit			\$ 206,037			
Investor Relations			\$ (133)			
Legal Services		\$ 945,816				
Marketing Services	\$ 379,415					
Other	\$ 757,344					
Rates and Regulatory			\$ 703,324			
Supply Chain Management			\$ 165,999			
Total Cost Pool	\$ 3,892,272	\$ 945,816	\$ 6,698,437	\$ 2,404,388	\$ 1,421,442	\$ 15,362,356

Virginia Natural Gas, Inc.
AGSC Hours Charged VNG By Outside Service Provider Category
12-Months Ended September 30, 2010

Service Category	Outside Provider Category				
	Management Consultant	Attorney	Certified Public Accountant	Professional Engineer	
Employee Services	19,228				
Engineering				25,025	
Executive	10,629				
External Relations	2,018				
Facilities Mgt					
Financial Services			15,802		
Fleet					
Gas Supply & Capacity Mgmt				26,583	
Information Services			17,963		
Internal Audit			3,762		
Investor Relations			-		
Legal Services		6,285			
Marketing Services	2,779				
Other	4,293				
Rates and Regulatory			8,572		
Supply Chain Management			3,181		
Total Cost Pool	38,947	6,285	49,281	51,608	Total 146,121

Virginia Natural Gas, Inc.
Excluded AGSC Outside Services Charges
12-Months Ended September 30, 2010

Service Category/Outside Expense	Outside Provider Category				
	Management Consultant	Attorney	Certified Public Accountant	Professional Engineer	
Employee Services					
Outside Services	\$ 206,407				
Travel Expenses	\$ 46,834				
Engineering					
Outside Services				\$ 64,316	
Travel Expenses				\$ 22,483	
Executive					
Outside Services	\$ 124,407				
Travel Expenses	\$ 28,496				
External Relations					
Outside Services	\$ 3,858				
Travel Expenses	\$ 11,371				
Financial Services					
Outside Services			\$ 220,052		
Travel Expenses			\$ 11,401		
Gas Supply & Capacity Mgmt					
Outside Services				\$ 74,977	
Travel Expenses				\$ 9,375	
Information Services					
Outside Services			\$ 1,408,237		
Travel Expenses			\$ 8,284		
IT Infrastructure Expenses			\$ 1,648,309		
Internal Audit					
Outside Services			\$ 2,121		
Travel Expenses			\$ 896		
Investor Relations					
Outside Services					
Travel Expenses					
Legal Services					
Outside Services		\$ 105,320			
Travel Expenses		\$ 15,624			
Marketing Services					
Outside Services	\$ 13,918				
Travel Expenses	\$ 11,739				
Other					
Outside Services	\$ 113,249				
Travel Expenses	\$ 20,547				
Rates and Regulatory					
Outside Services			\$ 62,494		
Travel Expenses			\$ 23,203		
Supply Chain Management					
Outside Services			\$ 4,013		
Travel Expenses			\$ 2,056		
Total Excluded Outside Expenses	\$ 580,825	\$ 120,944	\$ 3,391,066	\$ 171,151	\$ 4,263,986

Outside Service Provider Hourly Rates

The next step in the cost comparison was to calculate the average billing rates for each type of outside service provider. The source of this information and the determination of the average rates are described in the paragraphs that follow.

It should be noted that professionals working for 3 of the 4 outside provider categories may be licensed to practice by state regulatory bodies. However, not every professional working for these firms is licensed. For instance, among Virginia certified public accounting firms only more experienced staff are predominantly CPAs, as shown in the table below. Some employees of the AGSC also have professional licenses. Thus, it is valid to compare the AGSC's hourly rates to those of the outside professional service providers included in this study.

Position	% In Va. Who Are CPAs
Partners/Owners	98%
Directors (over 10 years experience)	30%
Managers (6-10 years experience)	72%
Sr Associates (4-5 years experience)	61%
Associates (1-3 years experience)	17%
New Professionals	8%

Source: AICPA's National PCPS/TSCPA Management of an Accounting Practice Survey (2010)

Management Consultants

The cost per hour for management consultants was developed from a 2010 survey performed by the Association of Management Consulting Firms—an industry trade organization. The survey includes rates that were in effect during 2009 for firms throughout the United States. Consultants typically do not limit their practice to any one region and must travel to a client's location. Thus, the U.S. national average is appropriate for comparison.

The first step in the calculation, presented in Schedule 8, was to determine an average rate by consultant position level. From these rates, a single weighted average hourly rate was calculated based upon the percent of time that is typically applied to a consulting assignment by each consultant position level. The 2009 average rate was escalated to March 31, 2009—the midpoint of the test year ended September 30, 2010.

Attorneys

The Virginia Bar Association does not survey its members as to their hourly billing rates. In addition, publicly available billing rate information could not be found for Virginia attorneys. Therefore, an estimate of Virginia attorney rates was developed from two surveys conducted by Lawyers Weekly in the states of Michigan and Missouri. As presented in Schedule 9, the average rate for each firm was adjusted for the cost of living differential between its location and Richmond, Virginia. The Lawyers Weekly surveys included rates in effect at December 31, 2009. This average was escalated to March 31, 2010—the midpoint of the test year ended September 30, 2010.

Certified Public Accountants

The average hourly rate for Virginia certified public accountants was developed from a 2010 survey performed by the American Institute of Certified Public Accountants (AICPA). Hourly rates in the AICPA survey come from member firms in Virginia.

As shown in Schedule 10, a weighted average hourly rate was developed based on a set of accountant positions and an assumed percent of time on a typical assignment. This survey includes rate information in effect during 2009. Thus the data had to be escalated to March 31, 2010—the test year’s midpoint.

Professional Engineers

VNG provided hourly rate information for an engineering firm that is sometimes used by the company when outside engineering services are required. As shown in Schedule 11, an average rate was developed for each engineering position. Then, using a typical percentage mix by position for a typical engineering project, a weighted average cost per hour was calculated.



Virginia Natural Gas, Inc.
Billing Rates of U.S. Management Consultants

Survey billing rates in effect in 2009 (Note A)

A. Calculation of Average Hourly Billing Rate by Consultant Position

		Average Hourly Rates (Note A)				
		Entry-Level Consultant	Associate Consultant	Senior Consultant	Junior Partner	Senior Partner
Average		\$ 155	\$ 215	\$ 279	\$ 328	\$ 413

B. Calculation of Overall Average Hourly Billing Rate Based on a Typical Distribution of Time on an Engagement

		Entry-Level Consultant	Associate Consultant	Senior Consultant	Junior Partner	Senior Partner	
Average Hourly Billing Rate (from above)		\$ 155	\$215	\$279	\$328	\$413	
Percent of Consulting Assignment		30%	30%	20%	10%	10%	Weighted Average
		\$ 46	\$ 64	\$ 56	\$ 33	\$ 41	\$ 240

Escalation to Test Period Midpoint (March 31, 2010) (Note B)

	CPI at December 31, 2009	216.0
	CPI at March 31, 2010	217.6
	Inflation/Escalation	0.7%
Average Hourly Billing Rate For Management Consultants At March 31, 2010		\$ 242

Note A: Source is "Operating Ratios For Management Consulting Firms, 2010 Edition," Association of Management Consulting Firms

Note B: Source is U.S. Bureau of Labor Statistics (<ftp://ftp.bls.gov/pub/special.requests/cpi/cpi.ai.txt>)

Virginia Natural Gas, Inc.
Estimated Billing Rates of Virginia Attorneys

Billing rates during 2009		Billing Rate Range (A)					Average	Cost of Living Adjust (B)	Adjusted Rate
Firm	Location	Associate		Partner					
		Low	High	Low	High				
Dickinson Wright	Detroit, Mi	\$ 195	\$ 275	\$ 355	\$ 575	\$ 350	97%	\$ 362	
Dykema	Detroit, Mi	\$ 185	\$ 425	\$ 295	\$ 615	\$ 380	97%	\$ 393	
Butzel Long	Detroit, Mi	\$ 175	\$ 325	\$ 250	\$ 600	\$ 338	97%	\$ 349	
Jaffe Raitt Heuer & Weiss	Southfield, Mi	\$ 175	\$ 250	\$ 225	\$ 550	\$ 300	97%	\$ 310	
Brooks Kushman	Southfield, Mi	\$ 180	\$ 275	\$ 300	\$ 425	\$ 295	97%	\$ 305	
Kemp, Klein, Umphrey, Edelman & Ma	Troy, Mi	\$ 145	\$ 260	\$ 200	\$ 350	\$ 239	97%	\$ 247	
Rader, Fishman & Grauer	Bloomfield Hills, Mi	\$ 130	\$ 250	\$ 275	\$ 550	\$ 301	97%	\$ 311	
Williams, Williams, Rattner & Plunkett	Birmingham, Mi	\$ 150	\$ 250	\$ 275	\$ 450	\$ 281	97%	\$ 291	
Abbott, Nicholson, Quilter, Esshaki,	Detroit, Mi	\$ 150	\$ 220	\$ 300	\$ 375	\$ 261	97%	\$ 270	
Parmenter O'Toole	Muskegon, Mi			\$ 125	\$ 275	\$ 200	87%	\$ 229	
Lipson, Neilson, Cole, Seltzer & Garin	Bloomfield Hills, Mi	\$ 185	\$ 235	\$ 225	\$ 300	\$ 236	97%	\$ 244	
Berman DeLeve Kuchan & Chapman	Kansas City, Mo			\$ 250	\$ 250	\$ 250	92%	\$ 272	
Boggs, Avellino, Lach & Boggs	St. Louis, Mo			\$ 160	\$ 160	\$ 160	85%	\$ 188	
Bryan Cave	Kansas City, Mo	\$ 200	\$ 200	\$ 385	\$ 435	\$ 305	92%	\$ 331	
Danna McKittrick	St. Louis, Mo			\$ 300	\$ 300	\$ 300	85%	\$ 353	
David Shroeder Law Offices	Springfield, Mo			\$ 260	\$ 260	\$ 260	84%	\$ 311	
Dobson, Goldberg, Berns & Rich	St. Louis, Mo			\$ 300	\$ 425	\$ 363	85%	\$ 426	
Dunn & Davison	Kansas City, Mo			\$ 225	\$ 225	\$ 225	92%	\$ 244	
Evans Partnership	St. Louis, Mo			\$ 175	\$ 175	\$ 175	85%	\$ 206	
Greensfelder Hemker & Gale	St. Louis, Mo			\$ 235	\$ 300	\$ 268	85%	\$ 315	
Husch Blackwell Sanders	Kansas City, Mo	\$ 204	\$ 345	\$ 356	\$ 472	\$ 344	92%	\$ 374	
Karfeld Law Firm	St. Louis, Mo			\$ 265	\$ 265	\$ 265	85%	\$ 312	
Krigel & Krigel	Kansas City, Mo	\$ 175	\$ 225	\$ 200	\$ 250	\$ 213	92%	\$ 231	
Law Office of Brad Goss	St. Charles, Mo			\$ 175	\$ 175	\$ 175	85%	\$ 206	
Law Offices of George A. Barton	Kansas City, Mo	\$ 300	\$ 400	\$ 400	\$ 600	\$ 425	92%	\$ 462	
McDowell, Rice, Smith & Buchann	Kansas City, Mo			\$ 425	\$ 425	\$ 425	92%	\$ 462	
Neil Weintraub, Attorney at Law	St. Louis, Mo			\$ 260	\$ 260	\$ 260	85%	\$ 306	
Pennington Shea	St. Louis, Mo			\$ 190	\$ 260	\$ 225	85%	\$ 265	
Pletz and Reed	Jefferson City, Mo	\$ 150	\$ 150	\$ 180	\$ 180	\$ 165	87%	\$ 189	
Polsinelli Shughart	Kansas City, Mo	\$ 210	\$ 350	\$ 380	\$ 600	\$ 385	92%	\$ 418	
Raymond I. Plaster	Springfield, Mo			\$ 275	\$ 275	\$ 275	84%	\$ 329	
Shook, Hardy & Bacon	Kansas City, Mo	\$ 265	\$ 265	\$ 425	\$ 425	\$ 345	92%	\$ 375	
Speer Law Firm	Kansas City, Mo	\$ 400	\$ 400	\$ 500	\$ 500	\$ 450	92%	\$ 489	
Spencer Fane Britt & Browne	Kansas City, Mo	\$ 150	\$ 325	\$ 310	\$ 470	\$ 314	92%	\$ 341	
Stanton & Redlingshafer	Kansas City, Mo			\$ 195	\$ 195	\$ 195	92%	\$ 212	
Stinson Morrison Hecker	Kansas City, Mo	\$ 195	\$ 195	\$ 350	\$ 445	\$ 296	92%	\$ 322	
The Sader Law Firm	Kansas City, Mo	\$ 225	\$ 235	\$ 265	\$ 265	\$ 248	92%	\$ 269	
Thompson Coburn	St. Louis, Mo	\$ 200	\$ 200	\$ 480	\$ 480	\$ 340	85%	\$ 400	
Overall Cost-of-Living Adjusted Average 2009 Billing Rate								\$ 314	
<u>Escalation to Test Period Midpoint (March 31, 2010) (Notes B, C)</u>									
CPI at December 31, 2009								216.0	
CPI at March 31, 2010								217.6	
Inflation/Escalation								0.7%	
Average Hourly Billing Rate For Attorneys At March 31, 2010								\$ 316	

Note A: Source is Michigan Lawyers Weekly and Missouri Lawyers Weekly

Note B: Source is Council for Community and Economic Research. This percentage represents the cost of living difference between the Michigan and Missouri cities and Richmond, Va. A number over 100% indicates the Michigan or Missouri city's cost of living is higher than Richmond. A number less than 100% indicates Richmond's cost of living is higher.

Note C: source is US Bureau of Labor Statistics (<ftp://ftp.bls.gov/pub/special.requests/cpi/cpi.txt>)

Virginia Natural Gas, Inc.
Billing Rates of Virginia Certified Public Accountants

Survey billing rates were those in effect in 2009 (Note A)

Type of Firm	Average Hourly Billing Rate (Note A)			
	Staff Accountant	Senior Accountant	Manager	Partner
Average Hourly Rate	\$ 89	\$ 116	\$ 163	\$ 198

B. Calculation of Overall Average Accountant Billing Rate Based Upon Typical Distribution of Time on an Engagement

Average Hourly Billing Rate (From Above)	Staff Accountant	Senior Accountant	Manager	Partner	Weighted Average
	\$ 89	\$ 116	\$ 163	\$ 198	
Typical Percent of Time Spent on an Accounting Assignment	30%	30%	20%	20%	
	\$ 27	\$ 35	\$ 33	\$ 40	\$ 134

Escalation to Test Period Midpoint (March 31, 2010) (Note B)

CPI at December 31, 2009	216.0
CPI at March 31, 2010	217.6
Inflation/Escalation	0.7%
Average Hourly Billing Rate For CPAs At March 31, 2010	\$ 135

Note A: Source is AICPA's 2010 National PCPS/TSCPA Management of an Accounting Practice Survey (Virginia edition)

Note B: source is US Bureau of Labor Statistics (<ftp://ftp.bls.gov/pub/special.requests/cpi/cpiiai.txt>)



Virginia Natural Gas, Inc.
Billing Rates of Virginia Engineers

Note: Billing rates in effect during 2010

A. Calculation of Average Hourly Rate by Engineer Position

Name of Firm	Average Hourly Billing Rates			
	CAD Drafter	Engineer	Project Manager	Officer
	Engineer Tech	Design Engineer Project Engineer	Project Associate Sr. Mgr. Engineer	Principal Engineer
Firm #1	\$60	\$83	\$148	\$200
Firm #2	\$72	\$100	\$140	\$159
Firm #3	\$82	\$107	\$155	\$205
Firm #4	\$69	\$114	\$173	\$219

B. Calculation of Overall Average Engineering Hourly Billing Rate

	CAD Drafter	Engineer	Project Manager	Officer	Weighted Average
	Engineer Tech	Design Engineer Project Engineer	Project Associate Sr. Mgr. Engineer	Principal Engineer	
Average Hourly Billing Rate (From Above)	\$71	\$101	\$154	\$196	
Typical Percent of Time on an Engineering Assignment	30%	35%	25%	10%	
	\$21	\$35	\$38	\$20	\$114

Source: Information provided by AGSC. Firm names are not disclosed to preserve the confidentiality of their hourly rates.



AGSC Versus Outside Provider Cost Comparison

As shown in the table below, AGSC's costs per hour during the test year ended September 30, 2010 are considerably lower than those of outside providers.

Service Provider	Test Year Cost Per Hour Difference		
	AGSC	Outside Providers	Difference-- AGSC Greater(Less) Than Outside
Management Consultant	\$ 95	\$ 242	\$ (147)
Attorney	\$ 147	\$ 316	\$ (169)
Certified Public Accountant	\$ 81	\$ 135	\$ (54)
Professional Engineer	\$ 48	\$ 114	\$ (66)

As calculated below, based on these cost per hour differentials and the number of hours AGSC billed VNG during the test year, AGSC's services would have cost almost \$13 million more from outside providers. This is approximately 84% more than AGSC's management and professional services-related charges to VNG during the test year ended September 30, 2010 ($\$12,849,111 / \$15,362,356 = 84\%$).

Service Provider	Test Year Total Cost Difference		
	Hourly Rate Difference-- AGSC Greater(Less) Than Outside	AGSC Hours Charged	Dollar Difference
Management Consultant	\$ (147)	38,947	\$ (5,715,685)
Attorney	\$ (169)	6,285	\$ (1,061,646)
Certified Public Accountant	\$ (54)	49,281	\$ (2,663,335)
Professional Engineer	\$ (66)	51,608	\$ (3,408,445)
Net AGSC Less Than Outside Providers			\$ (12,849,111)

Background

Customer Accounts Services covers the following utility functions:

- Customer Call Center – customer calls/contact, credit, order taking/disposition, bill collection efforts, outage calls
- Call Center IT – maintenance of phone banks, voice recognition units, call center software applications, telecommunications
- Customer billing – bill printing, stuffing, and mailing
- Remittance processing – processing customer payments received in the mail
- Bill payment centers – locations where customers can pay their bills in person

It is difficult to compare the cost of AGSC customer accounts services-related charges to VNG with outside providers of the same services because survey data is proprietary and expensive to obtain. For this reason, VNG’s charges from AGSC for customer accounts services are compared to those of neighboring electric utilities because the data necessary to make such comparison is available to the public.

Neighboring electric utility cost information comes from the FERC Form 1 that each utility must file. FERC’s chart of accounts is defined in Chapter 18, Part 101 of the Code of Federal Regulations. FERC accounts that contain customer accounts services-related expenses are Account 903 Customer Accounts Expense – Records and Collection Expense and Account 905 Customer Accounts Expense – Miscellaneous Customer Accounts Expense. Exhibit 12 provides FERC’s definition of the type of expenses that should be recorded in these accounts.

In addition to the charges in these FERC accounts, labor-related overheads charged to the following FERC accounts must be added to the labor components of Accounts 903 and 905:

- Account 926 Employee Pension and Benefits
- Account 408 Taxes Other Than Income (employer’s portion of FICA)

Comparison Group

Electric utilities included in the comparison group are shown in the table below. These are companies whose FERC Form 1 show amounts for accounts 903 and 905.

Virginia	• Appalachian Power	• Virginia Electric Power
West Virginia	• Appalachian Power • Monongahela Power	• Wheeling Power
Maryland	• Baltimore Gas & Electric • Delmarva Power & Light	• Potomac Electric
North Carolina	• Duke Energy Carolinas	• Progress Energy Carolinas
Kentucky	• Duke Energy Kentucky • Kentucky Power	• Kentucky Utilities • Louisville Gas & Electric
Tennessee	• Kingsport Power	

**Virginia Natural Gas, Inc.
FERC Account Descriptions**

903 – Customer Records and Collection Expenses

This account shall include the cost of labor, materials used and expenses incurred in work on customer applications, contracts, orders, credit investigations, billing and accounting, collections and complaints.

Labor

1. Receiving, preparing, recording and handling routine orders for service, disconnections, transfers or meter tests initiated by the customer, excluding the cost of carrying out such orders, which is chargeable to the account appropriate for the work called for by such orders.
2. Investigations of customers' credit and keeping of records pertaining thereto, including records of uncollectible accounts written off.
3. Receiving, refunding or applying customer deposits and maintaining customer deposit, line extension, and other miscellaneous records.
4. Checking consumption shown by meter readers' reports where incidental to preparation of billing data.
5. Preparing address plates and addressing bills and delinquent notices.
6. Preparing billing data.
7. Operating billing and bookkeeping machines.
8. Verifying billing records with contracts or rate schedules.
9. Preparing bills for delivery, and mailing or delivering bills.
10. Collecting revenues, including collection from prepayment meters unless incidental to meter reading operations.
11. Balancing collections, preparing collections for deposit, and preparing cash reports.
12. Posting collections and other credits or charges to customer accounts and extending unpaid balances.
13. Balancing customer accounts and controls.
14. Preparing, mailing, or delivering delinquent notices and preparing reports of delinquent accounts.
15. Final meter reading of delinquent accounts when done by collectors incidental to regular activities.
16. Disconnecting and reconnecting services because of nonpayment of bills.
17. Receiving, recording, and handling of inquiries, complaints, and requests for investigations from customers, including preparation of necessary orders, but excluding the cost of carrying out such orders, which is chargeable to the account appropriate for the work called for by such orders.
18. Statistical and tabulating work on customer accounts and revenues, but not including special analyses for sales department, rate department, or other general purposes, unless incidental to regular customer accounting routines.
19. Preparing and periodically rewriting meter reading sheets.
20. Determining consumption and computing estimated or average consumption when performed by employees other than those engaged in reading meters.

Materials and expenses

21. Address plates and supplies.
22. Cash overages and shortages.
23. Commissions or fees to others for collecting.
24. Payments to credit organizations for investigations and reports.
25. Postage.
26. Transportation expenses, including transportation of customer bills and meter books under centralized billing procedure.
27. Transportation, meals, and incidental expenses.
28. Bank charges, exchange, and other fees for cashing and depositing customers' checks.
29. Forms for recording orders for services, removals, etc.
30. Rent of mechanical equipment.

**Virginia Natural Gas, Inc.
FERC Account Descriptions**

905 – Miscellaneous Customer Accounts Expenses

This account shall include the cost of labor, materials used and expenses incurred not provided for in other accounts.

Labor

1. General clerical and stenographic work.
2. Miscellaneous labor.

Materials and expenses

3. Communication service.
4. Miscellaneous office supplies and expenses and stationery and printing other than those specifically provided for in accounts 902 and 903.



VNG Cost Per Customer

In order to make a valid comparison to neighboring electric utilities, it was necessary to adjust the AGSC call center call handling charges because electric utilities experience an average of 2.50 calls per customer compared to VNG's 1.94 calls per customer. Thus, AGSC call center call handling charges had to be increased for comparison purposes, to reflect its costs at a 2.50 calls per customer level. As shown below, VNG's adjusted annual expense per customer is \$28.96—the number that can be compared to neighboring electric utilities' expenses. VNG's 12 months ended September 30, 2010 unadjusted annual expense per customer is \$26.03.

Virginia Natural Gas 12-Months Ended September 30, 2010 Cost Per Customer

	Cost Component	YE 9/30/10 Service Co Charges	Adjustment Fewer Calls For Gas Cos. (A)	Adjusted
AGSC	Call processing, order processing, credit, bill collection	\$ 5,314,281	\$ 804,448	\$ 6,118,729
VNG	Customer payment processing			\$ 345,817 (B)
VNG	Postage & forms			\$ 1,484,266
			Cost Pool Total	\$ 7,948,812
			Total VNG Customers	274,458
			12 Months Ended September 30, 2010 Cost Per VNG Customer	\$ 28.96

Note A: Adjustment for AGSC's fewer calls per customer

This adjustment is necessary because gas utilities experience fewer calls per customer than do electric utilities

Call handling expenses	\$	2,787,081
Electric utility industry's avg calls/customer	2.50	
VNG's avg calls/customer	1.94	
Percent different	29%	29%
Total Adjustment	\$	804,448

Note B: Estimated customer payment processing expenses

Number of customers	274,458
Number of payments/customer/year	12
Total payments processed/year	3,293,496
Bank charge per item	\$ 0.1050
Total estimated annual expense	\$ 345,817

Electric Utility Group Cost Per Customer

Exhibit 13 shows the calculation of the electric utility comparison group's average actual 2009 customer accounts expense to be \$30.56 per customer. All of the underlying data was taken from each utility's FERC Form 1.

Summary Of Results

As shown in the table below, VNG’s cost per customer of \$28.96 is less than the average of \$30.56 for the electric utility comparison group. It can therefore be concluded that VNG’s 12 months ended September 30, 2010 customer account services expenses, included those charged to it by AGSC, are reasonable.

Average Customer Accounts Expense Per Customer	
Monongahela Power	\$ 15.58
Virginia Electric Power	\$ 17.53
Louisville Gas & Electric	\$ 20.40
Progress Energy Carolinas	\$ 22.96
Duke Energy Carolinas	\$ 26.96
Wheeling Power	\$ 27.15
Virginia Natural Gas	\$ 28.96
Comparison Group Average	\$ 30.56
Appalachian Power	\$ 32.70
Kingsport Power	\$ 32.78
Baltimore Gas & Electric	\$ 33.24
Duke Energy Kentucky	\$ 34.65
Kentucky Utilities	\$ 35.47
Kentucky Power	\$ 36.03
Potomac Electric	\$ 69.99
Delmarva Power & Light	\$ 72.58

Virginia Natural Gas, Inc.
Comparison Group 2009 Actual Customer Accounts Expense Per Customer

	Virginia		Kentucky			
	Appalachian Power	Virginia Electric Power	Duke Energy Kentucky	Kentucky Power	Kentucky Utilities	Louisville Gas & Electric
Customer Account Services Cost Pool						
FERC Account Balances:						
Account 903 - Customer Records & Collection (page 322, line 161)	\$ 28,380,733	\$ 34,105,089	\$ 3,864,114	\$ 5,769,938	\$ 14,908,295	\$ 5,312,623
Account 905 - Misc Customer Accounts (page 322, line 163)	\$ 40,577	\$ -	\$ -	\$ 11,053	\$ 381,731	\$ 376,263
Subtotal	\$ 28,421,310	\$ 34,105,089	\$ 3,864,114	\$ 5,780,991	\$ 15,290,026	\$ 5,688,886
Add: Employee Benefits & Employer FICA (not included in above amounts)						
Account 926 - Employee Pension & Benefits	\$ 2,437,214	\$ 6,239,031	\$ 574,673	\$ 425,941	\$ 3,361,029	\$ 1,963,008
Account 408 - Taxes Other Than Income (Employer's Portion of FICA)	\$ 529,463	\$ 1,787,731	\$ 232,521	\$ 97,581	\$ 526,276	\$ 322,726
Total Cost Pool	\$ 31,387,987	\$ 42,131,851	\$ 4,671,308	\$ 6,304,513	\$ 19,177,331	\$ 7,974,620
Total Customers (page 304, line 43)	959,814	2,403,558	134,819	174,994	540,618	390,825
Customer Account Services Expense per Customer	\$ 32.70	\$ 17.53	\$ 34.65	\$ 36.03	\$ 35.47	\$ 20.40
Note A: Calculation of Pension & Benefits Pertaining to Customer Account Mgmt						
Account 926 - Employee Pension & Benefits (page 323, line 187)	\$ 38,645,990	\$ 167,027,121	\$ 6,660,396	\$ 7,869,045	\$ 38,828,205	\$ 37,681,044
Total O&M Payroll (page 355, line 65)	\$ 109,744,984	\$ 625,619,817	\$ 35,227,412	\$ 23,565,539	\$ 79,474,397	\$ 80,979,200
Benefits as Percent of Payroll	35.2%	26.7%	18.9%	33.4%	48.9%	46.5%
Payroll Applicable to Customer Account Services						
Total Payroll Charged to Customer Accounts Function						
Electric (page 354, line 7)	\$ 7,978,348	\$ 30,292,243	\$ 2,598,192	\$ 1,433,061	\$ 8,670,255	\$ 3,198,589
Gas (page 354, line 37)	\$ -	\$ -	\$ 1,383,512	\$ -	\$ -	\$ 2,615,816
Total Payroll Charged to Customer Accounts	\$ 7,978,348	\$ 30,292,243	\$ 3,981,704	\$ 1,433,061	\$ 8,670,255	\$ 5,814,405
Percent Applicable to Customer Accounts Services (903 and 905):						
Account 903 - Customer Records & Collection (page 322, line 161)	\$ 28,380,733	\$ 34,105,089	\$ 3,864,114	\$ 5,769,938	\$ 14,908,295	\$ 5,312,623
Account 905 - Misc Customer Accounts (page 322, line 163)	\$ 40,577	\$ -	\$ -	\$ 11,053	\$ 381,731	\$ 376,263
Subtotal - Total Charges Applicable to Customer Accounts Services	\$ 28,421,310	\$ 34,105,089	\$ 3,864,114	\$ 5,780,991	\$ 15,290,026	\$ 5,688,886
Account 902 - Meter Reading Expenses (page 322, line 160)	\$ 4,341,650	\$ 10,103,836	\$ 1,197,835	\$ 713,762	\$ 3,980,247	\$ 2,151,907
Total Charges Applicable to Customer Accounts Svcs & Meter Reading	\$ 32,762,960	\$ 44,208,925	\$ 5,061,949	\$ 6,494,753	\$ 19,270,273	\$ 7,840,793
Percent Applicable to Customer Accounts Services (903 and 905)	86.7%	77.1%	76.3%	89.0%	79.3%	72.6%
Customer Account Services Portion of Total Payroll	\$ 6,921,081	\$ 23,369,029	\$ 3,039,493	\$ 1,275,570	\$ 6,879,426	\$ 4,218,641
Pension & Benefits Pertaining to Customer Accounts Services	\$ 2,437,214	\$ 6,239,031	\$ 574,673	\$ 425,941	\$ 3,361,029	\$ 1,963,008
Note B: Calculation of Employer's FICA Pertaining to Customer Accounts Services						
Customer Account Services Portion of Total Payroll	\$ 6,921,081	\$ 23,369,029	\$ 3,039,493	\$ 1,275,570	\$ 6,879,426	\$ 4,218,641
Employer's Portion of FICA (6.20%) and Medicare (1.45%)	7.65%	7.65%	7.65%	7.65%	7.65%	7.65%
Estimated Employer's Portion of FICA	\$ 529,463	\$ 1,787,731	\$ 232,521	\$ 97,581	\$ 526,276	\$ 322,726

Virginia Natural Gas, Inc.
Comparison Group 2009 Actual Customer Accounts Expense Per Customer

	West Virginia			North Carolina	
	Appalachian Power	Monongahela Power	Wheeling Power	Duke Energy Carolinas	Prog Energy Carolinas
Customer Account Services Cost Pool					
FERC Account Balances:					
Account 903 - Customer Records & Collection (page 322, line 161)		\$ 4,787,060	\$ 988,941	\$ 58,491,837	\$ 25,264,008
Account 905 - Misc Customer Accounts (page 322, line 163)		\$ -	\$ 2,002	\$ 63,286	\$ 2,913,845
Subtotal		\$ 4,787,060	\$ 990,943	\$ 58,555,123	\$ 28,177,853
Add: Employee Benefits & Employer FICA (not included in above amounts)					
Account 926 - Employee Pension & Benefits		\$ 932,359	\$ 109,417	\$ 3,743,004	\$ 4,374,673
Account 408 - Taxes Other Than Income (Employer's Portion of FICA)		\$ 258,173	\$ 18,966	\$ 1,771,092	\$ 1,007,671
Total Cost Pool		\$ 5,977,591	\$ 1,119,326	\$ 64,069,219	\$ 33,560,198
Total Customers (page 304, line 43)		383,621	41,225	2,376,853	1,461,874
Customer Account Services Expense per Customer		\$ 15.58	\$ 27.15	\$ 26.96	\$ 22.96
Note A: Calculation of Pension & Benefits Pertaining to Customer Account Mgmt					
Account 926 - Employee Pension & Benefits (page 323, line 187)		\$ 19,760,966	\$ 763,622	\$123,891,641	\$135,011,713
Total O&M Payroll (page 355, line 65)		\$ 71,527,705	\$ 1,730,215	\$766,304,539	\$406,521,358
Benefits as Percent of Payroll		27.6%	44.1%	16.2%	33.2%
Payroll Applicable to Customer Account Services					
Total Payroll Charged to Customer Accounts Function					
Electric (page 354, line 7)		\$ 5,717,636	\$ 334,934	\$ 25,491,667	\$ 15,865,023
Gas (page 354, line 37)		\$ -	\$ -	\$ -	\$ -
Total Payroll Charged to Customer Accounts		\$ 5,717,636	\$ 334,934	\$ 25,491,667	\$ 15,865,023
Percent Applicable to Customer Accounts Services (903 and 905):					
Account 903 - Customer Records & Collection (page 322, line 161)		\$ 4,787,060	\$ 988,941	\$ 58,491,837	\$ 25,264,008
Account 905 - Misc Customer Accounts (page 322, line 163)		\$ -	\$ 2,002	\$ 63,286	\$ 2,913,845
Subtotal - Total Charges Applicable to Customer Accounts Services		\$ 4,787,060	\$ 990,943	\$ 58,555,123	\$ 28,177,853
Account 902 - Meter Reading Expenses (page 322, line 160)		\$ 3,323,228	\$ 347,807	\$ 5,918,702	\$ 5,760,524
Total Charges Applicable to Customer Accounts Svcs & Meter Reading		\$ 8,110,288	\$ 1,338,750	\$ 64,473,825	\$ 33,938,377
Percent Applicable to Customer Accounts Services (903 and 905)		59.0%	74.0%	90.8%	83.0%
Customer Account Services Portion of Total Payroll		\$ 3,374,808	\$ 247,918	\$ 23,151,530	\$ 13,172,176
Pension & Benefits Pertaining to Customer Accounts Services		\$ 932,359	\$ 109,417	\$ 3,743,004	\$ 4,374,673
Note B: Calculation of Employer's FICA Pertaining to Customer Accounts Services					
Customer Account Services Portion of Total Payroll		\$ 3,374,808	\$ 247,918	\$ 23,151,530	\$ 13,172,176
Employer's Portion of FICA (6.20%) and Medicare (1.45%)		7.65%	7.65%	7.65%	7.65%
Estimated Employer's Portion of FICA		\$ 258,173	\$ 18,966	\$ 1,771,092	\$ 1,007,671

Virginia Natural Gas, Inc.
Comparison Group 2009 Actual Customer Accounts Expense Per Customer

	Maryland			Tennessee
	Baltimore Gas & Electric	Delmarva Power & Light	Potomac Electric	Kingsport Power
Customer Account Services Cost Pool				
FERC Account Balances:				
Account 903 - Customer Records & Collection (page 322, line 161)	\$ 27,866,774	\$ 32,434,776	\$ 45,896,046	\$ 1,458,469
Account 905 - Misc Customer Accounts (page 322, line 163)	\$ 3,630,336	\$ -	\$ -	\$ 1,697
Subtotal	\$ 31,497,110	\$ 32,434,776	\$ 45,896,046	\$ 1,460,166
Add: Employee Benefits & Employer FICA (not included in above amounts)				
Account 926 - Employee Pension & Benefits	\$ 7,086,906	\$ 3,183,229	\$ 7,120,702	\$ 63,259
Account 408 - Taxes Other Than Income (Employer's Portion of FICA)	\$ 2,449,386	\$ 528,359	\$ 870,314	\$ 18,076
Total Cost Pool	\$ 41,033,402	\$ 36,146,364	\$ 53,887,062	\$ 1,541,501
Total Customers (page 304, line 43)	1,234,644	498,046	769,966	47,027
Customer Account Services Expense per Customer	\$ 33.24	\$ 72.58	\$ 69.99	\$ 32.78
Note A: Calculation of Pension & Benefits Pertaining to Customer Account Mgmt				
Account 926 - Employee Pension & Benefits (page 323, line 187)	\$ 39,876,147	\$ 18,030,414	\$ 35,071,199	\$ 526,873
Total O&M Payroll (page 355, line 65)	\$180,157,469	\$ 39,120,620	\$ 56,032,805	\$ 1,967,933
Benefits as Percent of Payroll	22.1%	46.1%	62.6%	26.8%
Payroll Applicable to Customer Account Services				
Total Payroll Charged to Customer Accounts Function				
Electric (page 354, line 7)	\$ 24,805,988	\$ 7,101,649	\$ 12,971,565	\$ 261,311
Gas (page 354, line 37)	\$ 12,759,646	\$ 1,558,899	\$ -	\$ -
Total Payroll Charged to Customer Accounts	\$ 37,565,634	\$ 8,660,548	\$ 12,971,565	\$ 261,311
Percent Applicable to Customer Accounts Services (903 and 905):				
Account 903 - Customer Records & Collection (page 322, line 161)	\$ 27,866,774	\$ 32,434,776	\$ 45,896,046	\$ 1,458,469
Account 905 - Misc Customer Accounts (page 322, line 163)	\$ 3,630,336	\$ -	\$ -	\$ 1,697
Subtotal - Total Charges Applicable to Customer Accounts Services	\$ 31,497,110	\$ 32,434,776	\$ 45,896,046	\$ 1,460,166
Account 902 - Meter Reading Expenses (page 322, line 160)	\$ 5,457,249	\$ 8,236,558	\$ 6,434,241	\$ 154,677
Total Charges Applicable to Customer Accounts Svcs & Meter Reading	\$ 36,954,359	\$ 40,671,334	\$ 52,330,287	\$ 1,614,843
Percent Applicable to Customer Accounts Services (903 and 905)	85.2%	79.7%	87.7%	90.4%
Customer Account Services Portion of Total Payroll	\$ 32,018,115	\$ 6,906,657	\$ 11,376,654	\$ 236,281
Pension & Benefits Pertaining to Customer Accounts Services	\$ 7,086,906	\$ 3,183,229	\$ 7,120,702	\$ 63,259
Note B: Calculation of Employer's FICA Pertaining to Customer Accounts Services				
Customer Account Services Portion of Total Payroll	\$ 32,018,115	\$ 6,906,657	\$ 11,376,654	\$ 236,281
Employer's Portion of FICA (6.20%) and Medicare (1.45%)	7.65%	7.65%	7.65%	7.65%
Estimated Employer's Portion of FICA	\$ 2,449,386	\$ 528,359	\$ 870,314	\$ 18,076

Group Average
\$348,982,272
11,417,884
\$ 30.56

Analysis of Services

The services that AGSC provides VNG, summarized in Schedule 14, are necessary and would be required even if VNG were a stand-alone utility. In addition, there is no redundancy or overlap in the services provided by AGSC to VNG. Based on an analysis of the structures and employee positions of AGSC and VNG it is clear that functions are distinctly organized with no duplication of activities.

Governance Practices Associated With AGSC Charges

A number of management practices exist to ensure that AGSC charges to operating companies are appropriate. Specifically, certain review, approval and monitoring activities are performed by AGSC and VNG personnel that work to control the on-going level of AGSC charges to VNG. Examples of such governance activities include the following.

- AGSC Oversight – Every operating company president is an officer of AGLR. This gives them a say in major business decisions and the ability to monitor service quality and spending levels.
- AGSC Budget Review/Approval – Each year, AGLR presents its consolidated budget to its Board of Directors for approval. Every operating company president must formally approve its individual budget, which includes AGSC charges for the next year. Additionally, the AGSC budget is reviewed annually through a peer review process of key managers from the operating companies.
- Project Review And Approval – Major projects undertaken by AGSC must first be reviewed and approved by the operating companies that will pay for the initiatives. Consultants used on these projects who are hired by AGSC must also be approved by operating companies.
- AGSC Budget Variance Reporting – A summary and explanation of year-to-date budget variances is prepared for the entire AGSC on a monthly basis. In addition, a monthly variance report is produced by AGSC budget managers and shows budget versus actual spending for the month and year-to-date by cost category.
- VNG Budget Variance Reporting – VNG's monthly budget variance report contains a line item for AGSC charges. In this way, AGSC budget versus actual charges can be monitored by VNG personnel for the month and year-to-date.

Virginia Natural Gas, Inc.
Summary of Services Provided by AGSC to VNG

Construction and Engineering	Gas Supply and Capacity Management
Utility Locating	Gas Operations
Pipeline Integrity and Cathodic Protection	LNG Plant Operations
Construction Operations	Measurement Operations
Leak Investigation and Repair	SCADA Operations
Engineering Design	Capacity Planning
Mapping Services	Information Systems Services
Safety and Compliance	Mainframe Support
Environmental	Applications Support
Asset Protection	Network Services
Customer Services	Network Engineering
Customer Logistics Services	Desktop Support
Emergency Response Team	Network Security
Call Center	Help Desk
Customer Verification	Internal Auditing
Customer Relations	Investor Relations
Credit & Collections	Legal
Customer Services Technology Support	Legal Services
Employee Services	Risk Management
Benefits	Marketing
Labor Relations	Business Development
Payroll Services	Wholesale Services
Talent Acquisition	Sales Services and Administration
Talent Management	Channel Development
Training	Marketing Services and Administration
Compensation	Other
Executive/Management	Corporate Compliance
External Relations	Corporate Secretary
Governmental Affairs	Corporate Communications --
Economic Development	Community Affairs
Facilities	Customer Communications
Financial Services	Employee Communications
Corporate Tax	Public Affairs
Customer and Vendor Accounting	Rates and Regulatory
External Reporting	Regulatory Accounting and Analysis
Financial Accounting	Regulatory Planning
Financial Planning and Analysis	Regulatory Affairs
Fixed Asset Accounting	Supply Chain Management
Gas Accounting	Bid Solicitation
Treasury	Contract Administration
Fleet	Materials Management
	Ordering

**DIRECT TESTIMONY
OF
PATRICK L. BARYENBRUCH
ON BEHALF OF
VIRGINIA NATURAL GAS, INC.
BEFORE THE
STATE CORPORATION COMMISSION OF VIRGINIA
CASE NO. PUE-2010-00142**

1 **Q. Please state your name and business address.**

2 A. My name is Patrick L. Baryenbruch and my business address is 2832 Claremont Road,
3 Raleigh, North Carolina 27608.

4 **Q. Please describe your educational and professional background.**

5 A. I received a Bachelor's degree in accounting from the University of Wisconsin-Oshkosh
6 in 1974 and a Masters in Business Administration degree from the University of
7 Michigan in 1979.

8 I am a financial consultant and a certified public accountant. I am a member of the
9 American Institute of Certified Public Accountants and the North Carolina Association of
10 Certified Public Accountants.

11 I began my career as a staff accountant with Arthur Andersen & Company, where I
12 performed financial audits of utilities, banks and finance companies. After three years, I
13 left to pursue an M.B.A. degree. Upon graduation from business school, I worked with
14 the consulting firms of Theodore Barry & Associates and Scott, Madden & Associates.

15 During my consulting career, I have performed consulting assignments for approximately
16 50 utilities and 10 public service commissions. I have participated as project manager,
17 lead or staff consultant for 24 commission-ordered management and prudence audits of

1 public utilities. Of these, I was responsible for evaluating the area of affiliate charges and
2 allocation of corporate expenses in the state commission-ordered audits of Connecticut
3 Light and Power, Connecticut Natural Gas, General Water Corporation (Pennsylvania
4 Operations), Philadelphia Suburban Water Company (now Aqua America) and Pacific
5 Gas & Electric Company.

6 My firm performed the commission-ordered audit of Southern California Edison's 2002,
7 2003, 2004 and 2005 transactions with its non-regulated affiliate companies.

8 **Q. What are your duties and responsibilities in your current position?**

9 A. I am the President of my own consulting practice, Baryenbruch & Company, LLC, which
10 was established in 1985. In that capacity, I provide consulting services to utilities and
11 their regulators.

12 **Q. What is the purpose of your testimony in this case?**

13 A. I have been asked by Virginia Natural Gas, Inc. ("VNG" or the "Company") to present
14 the results of my study, which evaluated the services provided by AGL Services
15 Company ("AGSC") during the 12 months ended September 30, 2010 to VNG.

16 **Q. Are you sponsoring an exhibit in this proceeding?**

17 A. Yes. Company Exhibit No. __, PLB, consisting of Schedule 1, has been prepared under
18 my direction and supervision and is accurate and complete to the best of my knowledge
19 and belief. Specifically, Schedule 1 contains the results of my study in this proceeding.

20 **Q. What were the objectives of your study?**

21 A. I undertook this study to answer four questions concerning the services provided by

1 AGSC to VNG, each of which bears on the reasonableness of those charges as incurred
2 during the 12 months ended September 30, 2010:

3 1. Were AGSC's charges to VNG during the 12 months ended September 30,
4 2010 reasonable compared to other utility service companies?

5 2. Was VNG charged the lower of cost or market for managerial and
6 professional services provided by AGSC during the 12 months ended
7 September 30, 2010?

8 3. Were the 12 months ended September 30, 2010 costs of AGSC's customer
9 accounts services comparable to those of other utilities?

10 4. Are the services VNG receives from AGSC necessary?

11 **Q. What conclusion were you able to draw concerning Question 1, as to whether the**
12 **AGSC charges to VNG were reasonable?**

13 A. I was able to conclude that AGSC's 12 months ended September 30, 2010 cost per VNG
14 customer was reasonable compared to cost per customer for electric and combination
15 electric/gas service companies. During that period, VNG was charged \$67 per customer
16 for administrative and general ("A&G")-related services provided by AGSC. This
17 compares to an average of \$95 per customer for service companies reporting to the
18 Federal Energy Regulatory Commission ("FERC").

19 **Q. What conclusions were you able to draw concerning Question 2, regarding whether**
20 **VNG was charged the lower of cost or market for services provided by AGSC?**

21 A. I was able to draw the following conclusions:

- 1 1. VNG was charged the lower of cost or market for managerial and professional
2 services during the 12 months ended September 30, 2010.
- 3 2. On average, the hourly rates for outside service providers are approximately
4 84% higher than the AGSC's hourly rates.
- 5 3. If all the managerial and professional services now provided by AGSC had
6 been outsourced during the 12 months ended September 30, 2010, VNG and
7 its ratepayers would have incurred almost \$13 million in additional expenses.
- 8 4. AGSC fees do not include any profit markup. Only its actual cost of service is
9 being recovered from VNG ratepayers.

10 **Q. What conclusion did you draw regarding Question 3 concerning the comparability**
11 **of AGSC's test year customer account services costs to other utilities?**

12 A. I determined that the cost of AGSC's customer accounts services is within the range of
13 the average of the neighboring energy utility comparison group. This group of
14 companies provides a reasonable proxy group for comparison to a regulated utility of the
15 size and scope of AGSC and VNG. During the 12 months ended September 30, 2010,
16 the customer accounts cost for VNG customers was \$28.96 compared to the 2009 average
17 of \$30.56 for neighboring utilities. The highest comparison group per customer cost was
18 \$72.58 and the lowest \$15.58.

19 **Q. What conclusions were you able to draw concerning Question 4, as to whether the**
20 **services VNG receives from AGSC are necessary?**

21 A. I was able to draw the following conclusions:

1 1. The services that AGSC provides are necessary and would be required even if
2 VNG were a stand-alone utility.

3 2. In addition, there is no redundancy or overlap in the services provided by
4 AGSC to VNG. Based on an analysis of the structures and employee
5 positions of AGSC and VNG, it is clear that functions are distinctly organized
6 with no duplication of activities.

7 **Q. Mr. Baryenbruch, does this conclude your pre-filed direct testimony?**

8 **A. Yes, it does.**

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF WATER SERVICE)
CORPORATION OF KENTUCKY FOR AN) CASE NO. 2010-00476
ADJUSTMENT OF RATES)

O R D E R

Water Service Corporation of Kentucky ("WSKY") has applied to adjust its rates for water service to produce additional revenues from water sales of \$448,723, or 22 percent above normalized revenues from such sales. By this Order, the Commission establishes rates that will produce additional annual revenues of \$68,898. For a customer who uses 5,000 gallons of water monthly, these rates will result in an increase of \$0.70 in his monthly bill if he resides in Bell County or \$1.15 if he resides in Hickman County.

BACKGROUND

WSKY, a Kentucky corporation, owns and operates facilities that treat and distribute water to approximately 7,376 customers in Hickman and Bell Counties, Kentucky.¹ WSKY is a wholly-owned subsidiary of Utilities, Inc. ("UI"), an Illinois corporation that indirectly owns over 70 water and wastewater systems in 15 states throughout the United States. Water Service Corporation, an Illinois corporation that is also a wholly-owned subsidiary of UI, provides various management, administrative,

¹ *Annual Report of WSKY Corporation of Kentucky to the Public Service Commission of the Commonwealth of Kentucky for the Calendar Year Ended December 31, 2010 ("2010 Annual Report")* at 5 and 30.

and technical services for WSKY as well as all other UI water and wastewater systems. Water Service Corporation, not WSKY, employs all persons who are responsible for the WSKY's provision of water service in Kentucky.² WSKY has no employees. WSKY's most recent rate adjustment occurred on November 9, 2009.³

PROCEDURE

On December 3, 2010, WSKY notified the Commission in writing of its intent to apply for an adjustment of rates using a historical test period. On January 24, 2011, it filed its application with the Commission. In its application, WSKY submitted tariff sheets containing a proposed effective date of February 24, 2011. The Commission subsequently advised WSKY that, because the submitted tariff sheets failed to comply with 807 KAR 5:011, Section 4, its notice was defective and the rates could not become effective on the proposed date. The Commission subsequently established a procedural schedule for this proceeding.

The Commission has granted the Attorney General of Kentucky ("AG") and Hickman County Fiscal Court leave to intervene in this matter. Following discovery by Commission Staff and the parties, the Commission conducted an evidentiary hearing in this matter on July 14, 2011. Testifying at this hearing were: Patrick L. Baryenbruch, President, Baryenbruch & Company, LLC; Bruce T. Haas, Regional Director of Operations for UI's Midwest Region; Steven M. Lubertozzi, UI's Executive Director of Regulatory Accounting and Affairs; and Brian Shrake, Senior Regulatory Accountant at

² WSKY's Response to Attorney General's Request for Information, Item 16(c). In its annual report, WSKY reports having 11 full-time employees. See *2010 Annual Report* at 5. The Commission assumes that the references in WSKY's annual report are to Water Service Corporation employees who are stationed or residing in Kentucky and working directly on WSKY facilities or operations.

³ Case No. 2008-00563, *Application of Water Service Corporation of Kentucky for an Adjustment of Rates* (Ky. PSC Nov. 9, 2009).

UI. We also held public hearings to receive public comment on the proposed rate adjustment in Middlesboro, Kentucky on June 8, 2011 and in Clinton, Kentucky on June 22, 2011. On August 22, 2011, this matter stood submitted for decision following the parties' submission of written briefs.

TEST PERIOD

WSKY proposes to use the 12-month period ending September 30, 2010 as the test period to determine the reasonableness of its proposed rates. The Commission finds the use of this period reasonable. In using a historical test period, we give full consideration to appropriate, known, and measurable changes.

INCOME STATEMENT

For the test period, WSKY reports actual operating revenues and expenses of \$1,907,162 and \$1,667,143, respectively.⁴ WSKY proposes several adjustments to revenues and expenses to reflect current and anticipated operating conditions, resulting in pro forma operating revenue of \$2,009,847 and pro forma operating expenses of \$1,832,663.⁵ The Commission's review of these proposed adjustments is set forth below.

Operating Revenues from Water Sales

WSKY reports test-period operating revenues from water sales of \$1,980,475.⁶ Because its current rates became effective after the start of the test period and thus were not assessed throughout the test period, WSKY proposes to increase its revenues

⁴ Application, Exhibit 4, Schedule B at 1.

⁵ *Id.*

⁶ *Id.*

from water sales by \$68,214 to reflect the annualization of its current rates.⁷ Finding that WSKY's proposal to annualize its rates is reasonable and meets the ratemaking criteria of known and measurable, we accept the proposed adjustment and have increased operating revenues from water sales by \$68,214.

Uncollectibles

WSKY reports a test-period uncollectible expense of \$126,200 as a credit to operating revenues and proposes to decrease this amount by \$34,473 to a pro forma level of \$91,727.⁸ This adjustment reportedly reflects the percentage of the uncollectible accounts to the test-period revenues applied to the normalized revenues from water sales.⁹

In calculating its uncollectible expense, WSKY uses an uncollectible rate of 4.48 percent, which is significantly higher than the rate of 1.11 percent that the utility used in its previous general rate adjustment application. This increase is due in part to the use of a different methodology to calculate the rate. WSKY Witness Shrake testified that WSKY's previous methodology only included the "availability customers" in its aging schedule to calculate the uncollectible allowance.¹⁰ The new methodology includes all customers WSKY bills and, therefore, "more accurately reflects [the] actual amount of

⁷ Application, Exhibit 4, Schedule B at 1 (filed Jan. 24, 2011). See also WSKY's Response to Commission Staff's First Information Request, Item 1 (filed Mar. 8, 2011).

⁸ WSKY's Response to Commission Staff's First Information Request, Item 1 (filed Mar 8, 2011).

⁹ *Id.*, Direct Testimony of Brian Shrake at 5 (filed Jan. 24, 2011).

¹⁰ WSKY's Response to Commission Staff's Third Information Request, Item 10(a) (filed May 20, 2011).

collectibles.”¹¹ WSKY also contends the uncollectible rate of 1.11 percent is less accurate because it is a three-year average.¹²

The Commission finds insufficient evidence in the record to support WSKY's use of an uncollectible rate of 4.48 percent for ratemaking purposes. For the calendar year ending December 31, 2010, WSKY's uncollectible rate was 2.55 percent.¹³ During the same period, the uncollectible rate for UI's water and wastewater system was 1.12 percent.¹⁴ Because WSKY implemented its new methodology in December 2009, the 2010 uncollectible rate of 2.55 percent is the most current rate. The most current rate is the more reasonable uncollectible rate to use for establishing rates.

Using that rate and the normalized operating revenues from water sales of \$2,048,689, the Commission calculates an uncollectible expense of \$52,243, which is \$73,957 below the amount reported. Accordingly, we increase operating revenues by \$126,200 and operating expenses by \$52,243 to reflect application of the 2010 uncollectible rate.

¹¹ *Id.*

¹² *Id.* Item 10(b).

¹³ WSKY's Response to Hearing Data Request, Tab 3 (filed Aug. 5, 2011); WSKY's Response to Commission Staff's Third Information Request, Item 11. Although WSKY stated in its response to Commission Staff's Hearing Data Request that the uncollectible rate of 2.55 percent applies for the calendar year ending December 31, 2009, this rate appears to apply to the calendar year ending December 31, 2010. WSKY reports total uncollectibles of \$51,666 for the calendar year ending December 31, 2010. It reported service revenues of \$2,022,768 for the same period. As shown below, this information results in an uncollectible rate of 2.55 percent.

$$\$51,666 \text{ (2010 Uncollectibles)} \div \$2,022,768 \text{ (2010 Service Revenues)} = 2.55 \text{ percent.}$$

¹⁴ WSKY's Response to Hearing Information Requests, Tab 3.

Salaries and Wages – Employee

WSKY proposes to increase test-period operating expenses by \$34,608¹⁵ to annualize employee wages¹⁶ as of the end of the test period.¹⁷ The proposed adjustment, however, is based projected employee wage increases that became effective April 1, 2011, seven months after the end of the test-period.¹⁸ WSKY applied the 2011 wage rates to the end-of-period employee level and the actual test-period overtime hours worked to arrive at its pro forma Salaries and Wages – Employees expense of \$667,529.¹⁹ It projects a 3.5 percent wage increase for each employee, but the actual wage increases varied from 0.0 percent to 12.5 percent²⁰ due to individual performance, promotions, and other factors.²¹

In support of the reasonableness of its current employee wage levels, WSKY states that it must offer competitive compensation and provide merit pay increases to

¹⁵ \$73,324 (Salaries and Wages – Operations) - \$38,716 (Salaries and Wages – Non-Operations) = \$34,608.

¹⁶ WSKY has no employees. The wages and salaries at issue are those of employees of Water Service Corporation who perform services for WSKY. *See, e.g.*, WSKY's Response to AG's Request for Information, Item 16. Water Service Corporation employs 11 persons within the state of Kentucky to operate and administer its facilities in Bell and Hickman Counties. It charges WSKY the total amount of these persons' salaries and wages. Additionally, employees at Water Service Corporation's offices outside of Kentucky provide administrative and management services to WSKY. Water Service Corporation has allocated 2.63 percent of their salaries and wages to WSKY. The allocation factor of 2.63 is based upon the proportion of WSKY's equivalent customer connections to UI's total equivalent customer connections.

¹⁷ Direct Testimony of Brian Shrake at 5.

¹⁸ WSKY's Response to Commission Staff's Third Information Request, Item 5(a) (filed May 20, 2011).

¹⁹ \$516,265 (Salaries and Wages – Operations) + \$151,264 (Salaries and Wages – Non-Operations) = \$667,529.

²⁰ WSKY's Response to Commission Staff's Second Information Request, Item 7 (filed Apr. 20, 2011).

²¹ WSKY's Response to Commission Staff's Third Information Request, Item 5(a) (filed May 20, 2011).

compete with municipalities and other utilities. Its studies of its own compensation packages and those offered by other utilities suggest that the current level of compensation for its employees is comparable to or below industry benchmarks.²²

The Commission finds insufficient evidence to support the reasonableness of the proposed adjustment to the test-year expense. Although WSKY asserts that local wage information was incorporated into the benchmarks used to develop its 2010 and 2011 wage increases,²³ it failed to produce any studies or documentary evidence to support its assertion.²⁴ It has offered no evidence to compare the 2011 wage increases with local, regional or state wage trends or to suggest that the 2011 increase was necessary or reasonable. Accordingly, we deny WSKY's proposed adjustment to Salaries and Wages – Employees expense and allow an increase of only \$11,209²⁵ for a pro forma level of \$644,130.²⁶

Operating Expenses Charged to Plant

WSKY proposes to increase its operating expenses charged to plant of (\$50,427) by (\$44,689). Having reviewed WSKY's supporting calculations, the Commission finds that they are reasonable and has increased expenses charged to plant by (\$44,689).

²² *Id.*

²³ WSKY's Response to Hearing Data Request, Tab 2.

²⁴ See, e.g., WSKY's Response to Commission Staff's Third Information Request, Item 6(a) (filed May 20, 2011); WSKY's Response to Hearing Information Requests, Tab 2 (filed Aug. 5, 2011).

²⁵ \$55,865 (Salaries and Wages – Operations) - \$44,656 (Salaries and Wages – Non Operations) = \$11,209.

²⁶ \$498,806 (Salaries and Wages – Operations) + \$145,324 (Salaries and Wages – Non Operations) = \$644,130.

Rate Case Expense

WSKY proposes to increase test-period rate case amortization of \$55,885 by \$26,960 to reflect the amortization over three years of the estimated cost of this current case of \$147,422 and the unamortized rate case expense from its prior rate proceeding of \$101,114. Based upon our review of submitted invoices, we find that WSKY incurred rate case expense of \$141,408 in this proceeding. We further find that \$56,624 of WSKY's rate case expenses from its last rate case proceeding have yet to be amortized. Amortizing the sum of these expenses²⁷ over three years results in a pro forma rate case amortization expense of \$66,011, which is \$10,126 above the actual test-period expense. Accordingly, the Commission finds that WSKY's proposed adjustment should be denied and that Rate Case Amortization expense should be increased by \$10,126.

Employee Pensions and Other Benefits

WSKY proposes to increase Employee Pension and Benefit expense by \$39,523 to a pro forma level of \$162,867 to reflect the effect of the April 2011 wage increases on WSKY's contributions for employee retirement and current employee insurance premiums. Eliminating the effects of the April 2011 wage increases and including the current premiums results in a pro forma Employee Pension and Benefit expense of \$161,338, which is \$37,994 above actual test-period expense. Accordingly, the Commission denies WSKY's proposed adjustment and increases Employee Pension and Benefit expense by \$37,994 for ratemaking purposes.

²⁷ \$141,408 (Actual Rate Case Cost Current Case) + \$56,624 (Unamortized Cost of Case No. 2008-00563) = \$198,032.

Indirect Expense Allocations

Water Service Corporation, a UI subsidiary, manages WSKY's water operations. Those costs that Water Service Corporation incurs and that cannot be directly assignable to a specific UI subsidiary are booked to Water Service Corporation and then allocated to UI subsidiaries at year-end, based on the proportion of active Equivalent Residential Customers ("ERCs") served by an operating company to the total number of active ERCs the UI affiliates serve. Water Service Corporation charged approximately \$169,886 of these allocated indirect charges to WSKY during the test period. These charges are part of its pro forma operating expenses.

The AG requests the disallowance and removal of these charges from pro forma operating expenses. He argues that WSKY bears the burden of demonstrating not only the reasonableness of its proposed rates, but also the reasonableness of each component upon which those rates are based. He asserts that WSKY has failed to demonstrate their reasonableness.

The AG's position centers upon the lack of any independent review of allocated indirect expenses. The agreement between Water Service Corporation and WSKY contains no provisions for WSKY to monitor and challenge assignments of indirect expenses. Moreover, the members of WSKY's Board of Directors also serve as directors of other UI subsidiaries, including Water Service Corporation. On its face, this arrangement presents an apparent conflict of interest and raises questions about WSKY's willingness to question transactions with Water Service Corporation. "In that Water Service Corporation has virtually no compunction when it comes to allocating amounts to Kentucky which have no discernable connection with the provision of

reasonable utility service,” the AG argues, “the lack of independence works to the material detriment of . . . [WSKY’s] ratepayers.”²⁸

Responding to these arguments, WSKY notes that Water Service Corporation actually provided services for the expenses in question. “Rather than depriving . . . [Water Service Corporation of Kentucky] of an actual expense reasonably incurred, actually used for the benefit of the customers, and actually used to comply with Commission regulations as to certain service standards such as billing, record keeping, regulatory reporting and other aspects of utility operations,” WSKY asserts, “the Commission is obligated to allow . . . [Water Service Corporation of Kentucky] to recover its costs of operations.”²⁹

WSKY also presented testimony on the reasonableness of the proposed charges. WSKY Witness Baryenbruch conducted a study of the services that Water Service Corporation provided to WSKY. He concluded that, based upon comparisons with costs of electric utility service companies, the cost of Water Service Corporation’s services were reasonable. He further concluded that Water Service Corporation’s charges for these services were at the lower of cost or market and that the services provided were necessary.³⁰

The AG asserts that no weight should be afforded to Mr. Baryenbruch’s study. He contends that Mr. Baryenbruch’s comparison group does not involve comparable utilities. The study group did not contain any water utility and the utilities studied were

²⁸ AG Brief at 5 (filed Aug. 22, 2011).

²⁹ WSKY Brief at 17 (filed Aug. 22, 2011).

³⁰ Supplemental Testimony of Patrick L. Baryenbruch at 3-4 (filed Jan. 31, 2011).

much larger than IU and its subsidiaries. He describes the study as merely a “device by which . . . [Mr. Baryenbruch] seeks to discuss whether . . . [Water Service Corporation’s] costs allocations are in ‘the ballpark’ with amounts on the FERC Form 60.”³¹ The AG asserts that the standard of reasonableness requires a “far more exacting and demanding than an ‘in the ballpark’ standard.”³²

An applicant for a rate adjustment generally has the burden to demonstrate the reasonableness of its proposed rates.³³ Management decisions are generally presumed to be reasonable.³⁴ When costs, however, are not the product of an arms-length transaction, the presumption of reasonableness does not follow.³⁵ The applicant must demonstrate the reasonableness of the charges for the services provided by the affiliate. “[I]f there is an absence of data and information from which the reasonableness and propriety of the services rendered and the reasonable cost of rendering such services can be ascertained by the Commission, allowance is properly refused.”³⁶

Based upon our review of the record, we find that WSKY has failed to demonstrate the reasonableness of the charges for indirect services. We agree with the AG’s criticism of Mr. Baryenbruch’s study as failing to involve similar type and sized

³¹ AG Brief at 6.

³² *Id.*

³³ KRS 278.190(3).

³⁴ *Pa. Pub. Util. Comm’n v. Phila. Elec. Co.*, 561 A.2d 1224 (Pa. 1989); *West Ohio Gas Co. v. Ohio Pub. Util. Comm’n*, 294 U.S. 63 (1935).

³⁵ See, e.g., *Hilton Head Plantation Utilities, Inc. v. Pub. Serv. Com’n*, 441 S.E.2d 321 (S.C. 1994); *Boise Water Corp. v. Idaho Pub. Util. Com’n*, 555 P.2d 163 (Idaho 1976); *State ex rel. Util. Com’n v. General Tel. Co.*, 189 S.E.2d 705 (N.C. 1972).

³⁶ *Hilton Head Plantation Utilities, Inc.*, 441 S.E.2d at 323.

utilities and, therefore, decline to afford it any weight. Moreover, the record indicates an absence of any independent review of the cost allocations by WSKY's management. In the absence of adequate support for the charges, the Commission disallows allocated indirect costs of \$169,886 from pro forma operating expenses.³⁷

Depreciation

WSKY proposes to decrease depreciation expense by \$14,075³⁸ to reflect the gross depreciable plant at the end of the test period multiplied by the appropriate depreciation rates.³⁹ WSKY's proposed pro forma depreciation expense includes depreciation on accounting and financial systems that UI placed into service as a result of its Project Phoenix study.⁴⁰

Asserting that WSKY has failed to demonstrate the purchase and implementation of the Project Phoenix systems was reasonable or that the project costs were reasonable, the AG urges the Commission to exclude any depreciation expense associated with the Project from rate recovery.⁴¹ He argues that WSKY has failed to demonstrate that a "reasonable utility of comparable size would spend in excess of a half-million dollars on software similar to that contained in Project Phoenix." He refers

³⁷ For a listing of these expenses, see Appendix B to this Order.

³⁸ Application, Exhibit 4, Schedule B at 1.

³⁹ Direct Testimony of Brian Shrake at 5.

⁴⁰ In 2006, UI began Project Phoenix, an internal and external evaluation of its accounting and billing software and computer system. After evaluating the potential solutions, UI selected J.D. Edwards Enterprise One as the financial system and Oracle's Customer Care and Billing System as the customer information system. On December 3, 2007, UI placed the J.D. Edwards system into service at a total cost of \$13,955,789. It placed the Oracle system into operation on June 2, 2008, at a total cost of \$7,126,679. Using an allocation factor based upon the equivalent residential connections, UI allocated \$368,069 of the total cost of the JD Edwards system and \$178,432 of the Oracle cost to WSKY. See Direct Testimony of Steven M. Lubertozi at 5-11.

⁴¹ AG Brief at 3.

to the Commission's decision in WSKY's last rate case proceeding⁴² to deny rate recovery to such an expense as a basis for similar action in the present proceeding. Responding to these arguments, WSKY contends that the testimony of WSKY Witnesses Lubertozzi and Baryenbruch provided ample support to demonstrate the reasonableness of Project Phoenix.

Our review of the record in this proceeding and in WSKY's last rate proceeding indicates no new evidence that requires us to alter our earlier findings. In the last proceeding, we expressly noted the failure of UI to perform an analysis to show that Project Phoenix benefited WSKY's ratepayers.⁴³ While Mr. Baryenbruch did not testify in the earlier proceeding, we note that his written testimony did not address Project Phoenix and his testimony at hearing did not expressly address the prudence of Project Phoenix.

We find WSKY's depreciation calculations are reasonable and accept them. We further accept WSKY's proposed adjustment to decrease Depreciation expense by \$14,075. In light of WSKY's failure to provide convincing evidence as to the reasonableness or need of Project Phoenix, however, we have decreased Depreciation expense by an additional \$69,565⁴⁴ to eliminate the Depreciation expense associated with Project Phoenix.

⁴² Case No. 2008-00563, *Application of Water Service Corporation of Kentucky for an Adjustment of Rates* (Ky. PSC Nov. 9, 2009) at 3-6.

⁴³ *Id.* at 6.

⁴⁴ \$368,089 (Allocated – JD Edward Costs) + \$188,432 (Allocated – Oracle Costs) = \$556,521 x 12.5% (Depreciation Rate – Computers) = \$69,565.

Amortization of Contributions In Aid of Construction ("CIAC")

WSKY proposes to increase Amortization of CIAC expense of (\$1,536) by (\$2,814)⁴⁵ to reflect CIAC at the end of the test period multiplied by the appropriate depreciation rates.⁴⁶ Based upon our review of WSKY's calculations and workpapers, we find that the proposed adjustment is reasonable and we accept it.

Plant Acquisition Adjustment ("PAA")

WSKY proposes to increase pro forma operating expenses by \$3,660 to reflect removal of the Amortization PAA.⁴⁷ Based upon our review of WSKY's calculations and workpapers, we find that the proposed adjustment is reasonable and we accept it.

General Taxes

WSKY proposes to increase test-period General Tax expense of \$145,450 by \$3,255 to annualize payroll taxes and utility commission taxes.⁴⁸ Eliminating the effect on payroll taxes of the April 2011 wage increases results in a pro forma General Tax expense of \$146,279. This amount is \$829 greater than actual test-period General Tax expense. Accordingly, we deny WSKY's proposed adjustment and increase General Tax expense by \$829.

Expense Reduction – Clinton Sewer

WSKY proposes to decrease its sewer expense allocation by \$34,206 from (\$137,459) to (\$103,253). This adjustment reflects the requested pro forma operating expenses' effect on the allocation of costs to the city of Clinton's sewer operations. The

⁴⁵ Application, Exhibit 4, Schedule B at 1.

⁴⁶ Direct Testimony of Brian Shrake at 5.

⁴⁷ Application, Exhibit 4, Schedule B at 1.

⁴⁸ Direct Testimony of Brian Shrake at 5.

Commission calculates a revised decrease of \$35,243 based upon the pro forma operating expenses determined reasonable herein, which results in expense allocation of (\$102,216).

Interest Expense

WSKY proposes to increase Interest expense of \$179,640 to \$191,934, an increase of \$12,294. WSKY is adjusting interest expense using a debt-to-equity ratio of 50.11 percent to 48.89 percent and a cost of debt of 6.58 percent. The elimination of interest expense associated with the debt incurred to finance Project Phoenix results in a decrease of \$1,471 to Interest Expense. The Commission denies WSKY's proposed adjustment and decreases interest expense by \$1,471 to eliminate interest on debt related to Project Phoenix.

Income Tax

Based upon its pro forma operating revenues and expenses, WSKY calculates an income tax expense credit of (\$8,350). Using the pro forma operating revenues and expenses determined reasonable herein, the Commission calculates a pro forma income tax expense of \$120,027 as shown in Table I. The Commission finds that Income Tax expense should be increased by \$217,463 to reflect its pro forma level.

Table I: Income Tax		
Account Titles	Revenues & Expenses	Taxes
<u>OPERATING REVENUES</u>		
Operating Revenues	\$ 2,101,576	
<u>OPERATING EXPENSES</u>		
Maintenance Expenses	\$ 1,368,284	
Depreciation	206,857	
General Taxes	146,279	
Exp. Reduction - Clinton Sewer	(102,216)	
Amortization CIAC & AIAC	+ (4,350)	
Total Operating Expenses	\$ 1,614,854	
State Taxable Income before Interest Exp.	\$ 486,722	
Less: Interest Expense	- 178,169	
State Taxable Income	\$ 308,553	
Multiplied by: State Income Rate	x 6%	
Total State Income Tax Exp.		\$ 18,513
State Taxable Income	\$ 308,553	
Less: State Income Tax Exp.	- 18,513	
Federal Taxable Income	\$ 290,040	
Federal Tax Rate	x 35.00%	
Total Federal Tax Exp.		+ 101,514
Total Income Tax		\$ 120,027

Based on the accepted adjustments to operating revenues and expenses, the Commission finds WSKY's net operating income at present rates to be \$366,695 as shown in Table II.

Table II: Income Statement Comparison

Account Titles	Test Period Operations	Pro Forma Adjustments	Pro Forma Operations
<u>OPERATING REVENUES</u>			
Service Revenues - Water	\$ 1,980,475	\$ 68,214	\$ 2,048,689
Miscellaneous Revenues	52,887	0	52,887
Uncollectible Accounts	(126,200)	126,200	0
Operating Revenues	<u>\$ 1,907,162</u>	<u>\$ 194,414</u>	<u>\$ 2,101,576</u>
<u>OPERATING EXPENSES</u>			
<u>Maintenance Expenses:</u>			
Salaries & Wages	\$ 442,941	\$ 55,865	\$ 498,806
Purchased Power	78,100	0	78,100
Purchased Water	79,635	0	79,635
Maintenance & Repair	87,087	0	87,087
Maintenance Testing	24,880	0	24,880
Meter Reading	345	0	345
Chemicals	101,313	0	101,313
Transportation	47,173	0	47,173
Operating Exp. Charged to Plant	(50,427)	(44,689)	(95,116)
Outside Services - Other	30,721	0	30,721
Total Maintenance Exp.	<u>\$ 841,768</u>	<u>\$ 11,176</u>	<u>\$ 852,944</u>
<u>General Expenses:</u>			
Salaries & Wages	\$ 189,980	\$ (44,656)	\$ 145,324
Office Supplies & Other Exp.	102,242	0	102,242
Regulatory Commission Exp.	55,885	10,126	66,011
Pension & Other Benefits	123,344	37,994	161,338
Rent	18,906	0	18,906
Insurance	59,054	0	59,054
Office Utilities	53,825	0	53,825
Bad Debt Expense	0	52,243	52,243
Service Company - Allocated Exp.	0	(169,886)	(169,886)
Miscellaneous	26,283	0	26,283
Total General Exp.	<u>\$ 629,519</u>	<u>\$ (114,179)</u>	<u>\$ 515,340</u>
Total Operation & Maint. Exp	<u>\$ 1,471,287</u>	<u>\$ (103,003)</u>	<u>\$ 1,368,284</u>
Depreciation	290,497	(83,640)	206,857
Amortization PAA	(3,660)	3,660	0
General Taxes	145,450	829	146,279
Exp Reduction - Clinton Sewer	(137,459)	35,243	(102,216)
Amortization CIAC & AIAC	(1,536)	(2,814)	(4,350)
Income Tax Exp - Federal	(97,436)	217,463	120,027
Total Operating Expenses	<u>\$ 1,667,143</u>	<u>\$ 67,738</u>	<u>\$ 1,734,881</u>
Net Operating Income	<u>\$ 240,019</u>	<u>\$ 126,676</u>	<u>\$ 366,695</u>

OPERATING RATIO

WSKY proposes the use of an operating ratio methodology to determine its revenue requirement. Its proposal follows our comments in WSKY's last rate adjustment proceeding that suggested that the use of return-on-equity approaches is problematic and that an operating ratio methodology is more appropriate.⁴⁹ We noted several problems associated with the use of return-on-equity approaches. The Commission has historically used an operating ratio approach⁵⁰ to determine the revenue requirement for small, privately-owned utilities. This approach is used primarily when no basis exists for a rate-of-return determination or the cost of the utility has fully or largely been funded through contributions. For these reasons, the Commission finds that the operating ratio method should be used to determine WSKY's revenue requirement and that an operating ratio of 88 percent will allow WSKY sufficient revenues to cover its reasonable operating expenses and to provide for reasonable equity growth.

AUTHORIZED INCREASE

The Commission finds that WSKY's net operating income for ratemaking purposes is \$366,695. We further find that this level of net operating income and an 88

⁴⁹ Case No. 2008-00563, *Application of Water Service Corporation of Kentucky for an Adjustment of Rates* (Ky. PSC Nov. 9, 2009) at 23-24 ("the operating ratio is the most commonly used methodology in determining the return of a company the size of Water Service, and is highly preferable to a full ROE analysis such as the company has presented").

⁵⁰ Operating Ratio is the ratio of expenses, including depreciation and taxes, to gross revenues. It is expressed mathematically by the following formula:

$$\text{Operating Ratio} = \frac{\text{Operating Expenses} + \text{Depreciation} + \text{Taxes}}{\text{Gross Revenues}}$$

percent operating ratio requires an increase in present rate revenues of \$61,898, as shown in Table III.

Table III: Revenue Requirement	
Operating Expenses	\$ 1,734,881
Less: State & Federal Income Taxes	- 120,027
Operating Expenses Net of Income Taxes	\$ 1,614,854
Divide by: Operating Ratio	÷ 88.00%
Revenue to Cover Operating Ratio	\$ 1,835,062
Less: Operating Expenses Net of Income Taxes	- 1,614,854
Net Operating Income After Income Taxes	\$ 220,208
Multiplied by: Gross-up Factor	x 1.6822813
Net Operating Income Before Income Taxes	\$ 370,451
Add: Operating Expenses Net of Income Taxes	1,614,854
Interest on Long-Term Debt	+ 178,169
Total Revenue Requirement	\$ 2,163,474
Less: Other Operating Revenues	- 52,887
Revenue Requirement from Water Sales	\$ 2,110,587
Less: Normalized Revenue - Water Sales	- 2,048,689
Revenue Requirement Increase	\$ 61,898
Percentage Increase	3.021%

RATE DETERMINATION

WSKY has requested that its monthly water service rates be increased across-the-board by approximately 21.9 percent. The Commission has generally accepted this method for allocating required revenue increases. Nothing in the record of this proceeding indicates that such methodology would be inappropriate in the current case. The revenue requirement determined reasonable herein is an approximate 3.021 percent increase over WSKY's normalized operating revenues. The Commission uses this percentage increase to calculate WSKY's monthly water service rates.

SUMMARY

Having considered the evidence of record and being sufficiently advised, the Commission finds that:

1. The 12-month period ending September 30, 2010 should be used as the test period to determine the reasonableness of WSKY's current and proposed rates.

2. Based upon pro forma test-period operations, WSKY's pro forma total operating expenses, after adjusting for known and measurable changes, are \$1,734,881.

3. The use of an operating ratio is the most appropriate means to determine WSKY's total revenue requirement.

4. An operating ratio of 0.88 will permit WSKY to meet its reasonable operating expenses and provide a fair and reasonable return for equity growth and should be used to determine WSKY's total revenue requirements.

5. Applying an operating ratio of 0.88 to WSKY's pro forma total operating expenses of \$1,734,881 and adjusting for the effects of state and federal taxes produces a total revenue requirement from water sales of \$2,110,587, or \$61,898 greater than the annual revenue from water sales that WSKY's current rates produce.

6. WSKY's proposed rates would produce revenue from water sales in excess of \$2,110,587 and should be denied.

7. The rates set forth in Appendix A to this Order will produce revenue from water sales of \$2,110,587.

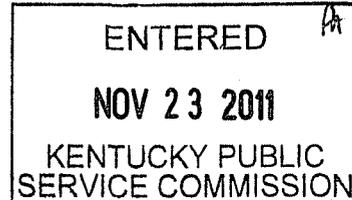
IT IS THEREFORE ORDERED that:

1. WSKY's proposed rates are denied.

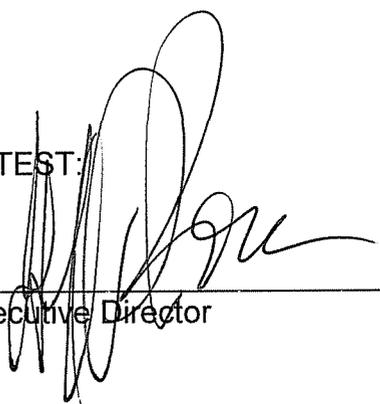
2. The rates set forth in Appendix A to this Order are approved for service rendered by WSKY on and after the date of this Order.

3. Within 20 days of the date of this Order, WSKY shall file revised tariff sheets setting forth the rates approved herein and reflecting their effective date as authorized by this Order.

By the Commission



ATTEST:



Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2010-00476 DATED **NOV 23 2011**

The following rates and charges are prescribed for the customers in the area served by Water Service Corporation of Kentucky. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of the Commission prior to the effective date of this Order.

Monthly Water Rates

CLINTON

5/8-inch x 3/4-inch Meter:

First	1,000 gallons	\$ 11.99	Minimum bill
Next	9,000 gallons	6.79	per 1,000 gallons
Next	15,000 gallons	6.23	per 1,000 gallons
Next	25,000 gallons	5.68	per 1,000 gallons
Next	50,000 gallons	5.04	per 1,000 gallons
All Over	100,000 gallons	4.40	per 1,000 gallons

1-inch Meter:

First	5,300 gallons	\$ 41.19	Minimum bill
Next	3,700 gallons	6.79	per 1,000 gallons
Next	15,000 gallons	6.23	per 1,000 gallons
Next	25,000 gallons	5.68	per 1,000 gallons
Next	50,000 gallons	5.04	per 1,000 gallons
All Over	100,000 gallons	4.40	per 1,000 gallons

1 1/2-inch Meter:

First	11,200 gallons	\$ 80.59	Minimum bill
Next	13,800 gallons	6.23	per 1,000 gallons
Next	25,000 gallons	5.68	per 1,000 gallons
Next	50,000 gallons	5.04	per 1,000 gallons
All Over	100,000 gallons	4.40	per 1,000 gallons

2-inch Meter:

First	17,600 gallons	\$ 120.48	Minimum bill
Next	7,400 gallons	6.23	per 1,000 gallons
Next	25,000 gallons	5.68	per 1,000 gallons
Next	50,000 gallons	5.04	per 1,000 gallons
All Over	100,000 gallons	4.40	per 1,000 gallons

6-inch Meter:

First	250,500 gallons	\$ 1222.45	Minimum bill
All Over	250,500 gallons	4.40	per 1,000 gallons

MIDDLESBORO

5/8-inch x 3/4-inch Meter:

First	1,000	gallons	\$ 8.96	Minimum bill
Next	9,000	gallons	3.61	per 1,000 gallons
Next	15,000	gallons	3.29	per 1,000 gallons
Next	25,000	gallons	3.12	per 1,000 gallons
Next	50,000	gallons	2.79	per 1,000 gallons
All Over	100,000	gallons	2.55	per 1,000 gallons

1-inch Meter:

First	6,000	gallons	\$ 26.97	Minimum bill
Next	4,000	gallons	3.61	per 1,000 gallons
Next	15,000	gallons	3.29	per 1,000 gallons
Next	25,000	gallons	3.12	per 1,000 gallons
Next	50,000	gallons	2.79	per 1,000 gallons
All Over	100,000	gallons	2.55	per 1,000 gallons

1 1/2-inch Meter:

First	13,000	gallons	\$ 51.22	Minimum bill
Next	12,000	gallons	3.29	per 1,000 gallons
Next	25,000	gallons	3.12	per 1,000 gallons
Next	50,000	gallons	2.79	per 1,000 gallons
All Over	100,000	gallons	2.55	per 1,000 gallons

2-inch Meter:

First	21,400	gallons	\$ 78.80	Minimum bill
Next	3,600	gallons	3.29	per 1,000 gallons
Next	25,000	gallons	3.12	per 1,000 gallons
Next	50,000	gallons	2.79	per 1,000 gallons
All Over	100,000	gallons	2.55	per 1,000 gallons

3-inch Meter:

First	68,400	gallons	\$ 220.05	Minimum bill
Next	31,600	gallons	2.79	per 1,000 gallons
All Over	100,000	gallons	2.55	per 1,000 gallons

4-inch Meter:

First	127,500	gallons	\$ 378.43	Minimum bill
All Over	127,500	gallons	2.55	per 1,000 gallons

6-inch Meter:

First	281,500	gallons	\$ 771.41	Minimum bill
All Over	281,500	gallons	2.55	per 1,000 gallons

Monthly Fire Protection Rates

Private Sprinkler	\$ 19.93	per sprinkler
Private Hydrant	\$ 19.93	per hydrant
Municipal Hydrant	\$ 4.43	per hydrant

APPENDIX B

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
 COMMISSION IN CASE NO. 2010-00476 DATED **NOV 23 2011**

DISALLOWED ALLOCATED INDIRECT EXPENSES

<u>Account</u>	<u>Schedule B Category</u>	<u>Adjustment</u>
<u>Direct Expenses:</u>		
5810 MEMBERSHIPS	Miscellaneous	\$ (5,630.68)
5890 PUBL SUBSCRIPTI	Office Supplies & Other Office Exp.	(395.66)
6185 TRAVEL LODGING	Miscellaneous	(1,480.85)
6190 TRAVEL AIRFARE	Miscellaneous	(408.40)
6195 TRAVEL TRANSPOR	Miscellaneous	(140.00)
6200 TRAVEL MEALS	Miscellaneous	(949.11)
<u>Allocated Expenses:</u>		
5810 MEMBERSHIPS	Miscellaneous	(225.00)
5815 PENALTIES/FINES	Miscellaneous	(27.00)
5825 OTHER MISC EXPE	Miscellaneous	(6,816.00)
5870 HOLIDAY EVENTS/	Office Supplies & Other Office Exp.	(78.00)
5890 PUBL SUBSCRIPTI	Office Supplies & Other Office Exp.	(787.00)
6015 EMPLOY FINDER F	Outside Services - Other	(2,323.00)
6045 TEMP EMPLOY - C	Outside Services - Other	(4,272.00)
6185 TRAVEL LODGING	Miscellaneous	(1,871.00)
6190 TRAVEL AIRFARE	Miscellaneous	(961.00)
6195 TRAVEL TRANSPOR	Miscellaneous	(229.00)
6200 TRAVEL MEALS	Miscellaneous	(609.00)
6205 TRAVEL ENTERTAI	Miscellaneous	(237.00)
6207 TRAVEL OTHER	Miscellaneous	-
Subtotal		\$ (27,439.70)
Add: Corporate Salaries		(142,446.00)
Total Adjustment		\$ (169,885.70)

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**Market Cost Comparison of Affiliate Company Charges
to Water Service Corporation of Kentucky**

12 Months Ended September 30, 2010



**Water Service Corporation of Kentucky
Market Cost Comparison of Affiliate Company Charges
12 Months Ended September 30, 2010**

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Purpose of This Study

This study was undertaken to answer three questions concerning the services provided by Water Service Corporation (WSC) to Water Service Corporation of Kentucky (WSCK):

- Are the costs of administrative and general (A&G) services provided by WSC to WSCK reasonable?
- Was WSCK charged the lower of cost or market for managerial and professional services provided by the Service Company during the 12 months ended September 30, 2010?
- Are the services WSCK receives from WSC necessary?

The results of this study will be used in WSCK's rate case before the Kentucky Public Service Commission.

Study Results

The following conclusions can be drawn from this study:

- The cost of A&G services provided by WSC to WSCK are reasonable compared to the costs of services of other utility service companies.
 - WSC's A&G services cost \$72 per WSCK customer per year as compared to an average of \$95 per customer for other utility service companies.
- WSC provided WSCK with managerial and professional services during the 12 months ended September 30, 2010 at the lower of cost or market.
 - On average, the hourly rates for outside service providers were 123% higher than the WSC's hourly rates during the 12 months ended September 30, 2010.
 - If all the managerial and professional services provided by WSC had been out-sourced during the 12 months ended September 30, 2010, WSCK and its ratepayers would have incurred an additional \$506,000 in expenses.
- The services that WSC provides are necessary and would be required even if WSCK were a stand-alone water utility. Furthermore, there is no redundancy or overlap in the services provided by WSC to WSCK. For all of the services listed in Exhibit 9, there was only one entity primarily responsible for the service.

Overview of WSCK and Its Principal Affiliate Entities

WSCK is a wholly-owned subsidiary of Utilities, Inc., which is one of the largest privately-owned water and wastewater companies in the US. Utilities, Inc. holds around 85 subsidiaries that operate around 800 systems in 15 states, mainly in the eastern US and it serves more than 300,000 customers. About half of Utilities, Inc.'s revenue comes from water services and the other half from wastewater services; residential customers account for approximately 90% of sales. Utilities, Inc. also provides reuse water for irrigation purposes and for golf courses and car washes.

WSCK has no employees of its own. All personnel serving WSCK are WSC employees. Employees located in Kentucky are involved in operating and maintaining the water and waste water utility facilities and equipment. Other WSC employees serving WSCK are located in two regional offices and in the corporate headquarters in Northbrook, Illinois. Regional offices provide operations, engineering and customer services. Headquarters personnel provide the following services to the operating utilities:

- Executive Management
- Engineering
- Operations
- Accounting
- Legal
- Billing and Customer Relations
- Construction
- Regulatory
- Information Technology
- Human Resources

Utilities, Inc. regulated utilities are served by WSC's three national call centers located in Charlotte, North Carolina, Altamonte Springs Florida and Parump, Nevada.

Test Year Affiliate Charges to WSCK

During the 12 months ended September 30, 2010, WSC per books O&M expenses charged to WSCK were approximately \$1,930,800. These transactions are covered by a service agreement between WSC and WSCK dated December 19, 2007. The agreement describes the allocation methods for those expenses/costs that cannot be charged directly to WSCK. It specifies that services are to be rendered at cost and without profit to WSC.

III – Reasonableness of Service Company Charges

Cost Comparison Methodology

The determination as to whether WSC's charges to WSCK are reasonable was made by comparing the cost of WSC's A&G-related services provided to WSCK to the cost of similar services provided by other service companies to their regulated utility affiliates. Comparison group service company information was obtained from the FERC Form 60 – Annual Report of Service Companies. WSCK's per customer cost is compared to Form 60 data from 2009, the latest year available.

WSCK's Service Company Cost per Customer

As calculated in the table below, WSCK's rate case requests the equivalent of \$72 per customer for general expenses (i.e., A&G-related services). All of these costs are charged to WSCK by WSC.

General Expenses	Rate Case Amounts		
	Pro Forma Proposed	Adjustment (A)	A&G-Related WSC Charges
Salaries and Wages	\$ 151,264		\$ 151,264
Office Supplies and Other Office Exp.	\$ 102,242		\$ 102,242
Regulatory Commission Expense	\$ 82,845		\$ 82,845
Pension and Other Benefits	\$ 162,868	\$ (126,040)	\$ 36,828
Rent	\$ 18,906		\$ 18,906
Insurance	\$ 59,054		\$ 59,054
Office Utilities	\$ 53,825		\$ 53,825
Miscellaneous	\$ 26,283		\$ 26,283
Total	\$ 657,286		\$ 531,246
Total WSCK Customers			7,349
A&G Expenses Per Customer			\$ 72

Note A: The Pro Forma Proposed balance represents pension and benefits for all WSC employees who support WSCK. Thus, it is necessary to eliminate pension and benefits on maintenance (i.e., on-site Kentucky operations) personnel to arrive at A&G-related pension and benefits. The elimination is calculated below.

Total Pension and Other Benefits	\$ 162,868
Less: Maintenance portion	77%
Adjustment	\$ 126,040

Comparison Group Cost per Customer

Every centralized service company in a holding company system must file a Form 60, unless exempt, in accordance with the Public Utility Holding Company Act of 2005, Section 1270, Section 390 of the Federal Power Act and 18 C.F.R. paragraph 366.23. This report is designed to collect financial information from service companies that are subject to regulation by the FERC.

III – Reasonableness of Service Company Charges

For 2009, a Form 60 was filed by 24 utility service companies, all of which serve utilities that provide regulated electric and, in some cases, gas service to retail customers. In order to make a valid comparison of this group's costs to those of WSC, it was necessary to isolate expenses that they have in common. These include A&G-related charges associated with the following FERC accounts:

901 – Supervision	921 – Office supplies and expenses
903 – Customer records and collection expenses	923 – Outside services employed
905 – Miscellaneous customer accounts expenses	928 – Regulatory commission expenses
907 – Supervision	930.2 – Miscellaneous general expenses
910 – Misc customer service and info expenses	931 – Rents
911 – Supervision	935 – Maintenance of structures and equipment
920 - Administrative and general salaries	

O&M expenses charged to utility affiliates for the comparison group service companies were obtained from Schedule XVI – Analysis of Charges for Service Associate and Non-Associate Companies (p. 303 to 306) of each entity's FERC Form 60. This schedule shows charges by FERC Account.

Comparison group service company 2009 expenses were also adjusted to remove charges to non-regulated affiliates from the cost pool used to calculate the cost per regulated service customer. This determination was made using information from the FERC Form 60 schedule: Account 457 – Analysis of Billing – Associate Companies.

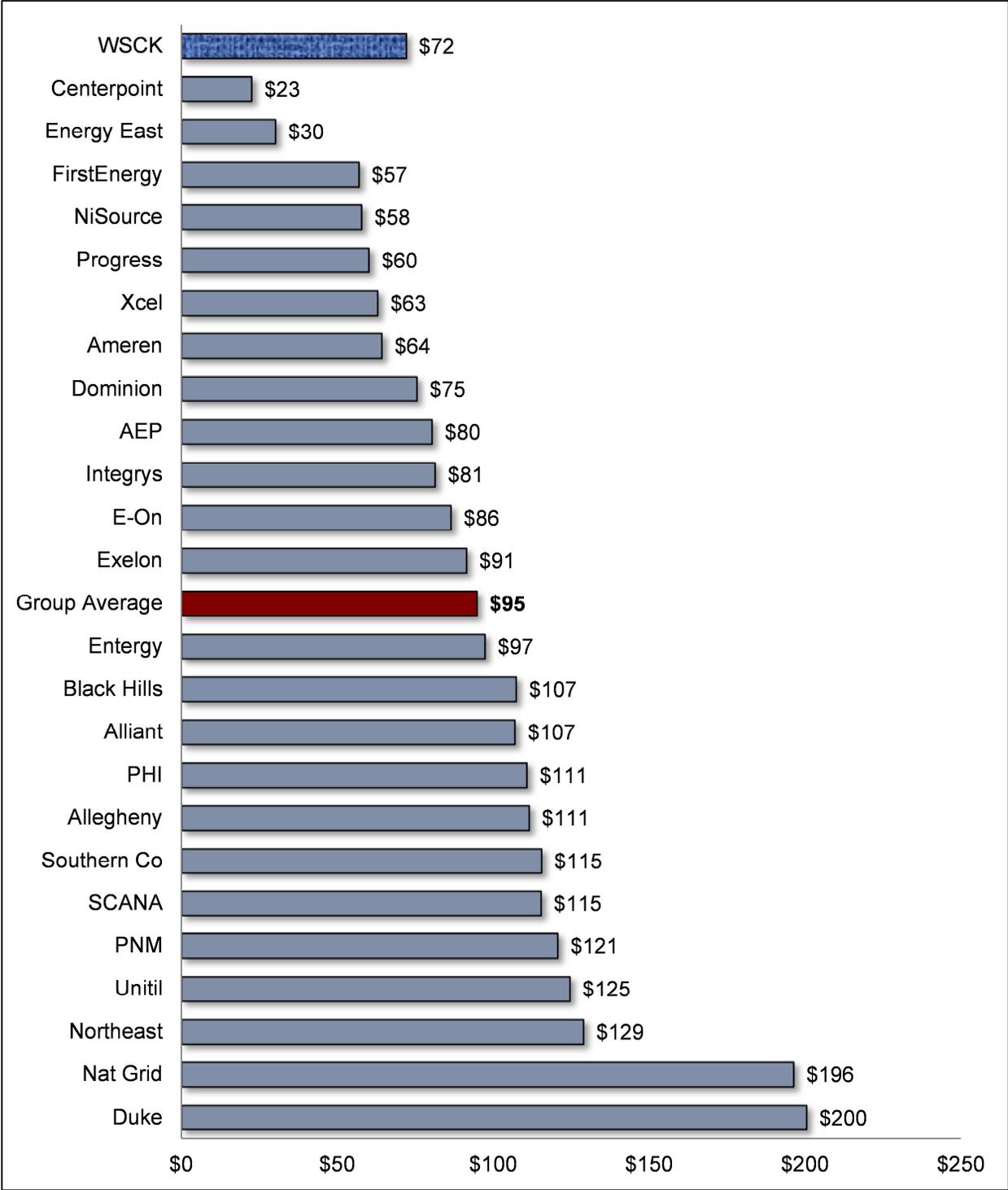
A&G expenses per regulated utility customer for the 24 utility companies that file Form 60 for 2009 are calculated in Schedule 1.

Schedule 2 shows WSCK's proposed rate case A&G costs per customer of \$72 is below the average of \$95 per customer for the comparison group service companies. Based on this result, it is possible to conclude that WSC's A&G charges to WSCK are reasonable.

Water Service Corporation of Kentucky
Comparison Group Service Company A&G Costs Per Customer

Utility Company	2009 Regulated		Cost per Customer
	Retail Service Company A&G Expenses	Regulated Retail Customers	
AEP	\$418,484,117	5,213,000	\$ 80
Allegheny	\$176,685,245	1,585,700	\$ 111
Alliant	\$149,116,475	1,395,189	\$ 107
Ameren	\$212,036,412	3,300,000	\$ 64
Black Hills	\$81,484,333	759,400	\$ 107
Centerpoint	\$119,304,604	5,300,000	\$ 23
Dominion	\$279,128,940	3,700,000	\$ 75
Duke	\$901,762,388	4,500,000	\$ 200
Energy East	\$89,580,962	2,973,000	\$ 30
Entergy	\$262,596,172	2,700,000	\$ 97
E-On	\$105,893,093	1,226,000	\$ 86
Exelon	\$537,633,122	5,886,000	\$ 91
FirstEnergy	\$255,874,712	4,500,000	\$ 57
Integrus	\$175,423,352	2,157,700	\$ 81
Nat Grid	\$1,314,902,105	6,700,000	\$ 196
NiSource	\$216,480,637	3,750,000	\$ 58
Northeast	\$269,948,801	2,095,000	\$ 129
PHI	\$215,465,623	1,946,000	\$ 111
Progress	\$186,256,921	3,100,000	\$ 60
PNM	\$87,998,259	729,700	\$ 121
SCANA	\$166,555,883	1,445,000	\$ 115
Southern Co	\$508,130,523	4,402,000	\$ 115
Unitil	\$21,115,280	169,600	\$ 125
Xcel	\$333,389,459	5,300,000	\$ 63
Group Total	\$7,085,247,416	74,833,289	\$ 95

**Water Service Corporation of Kentucky
Comparison of Service Company A&G Costs Per Customer**



Scope

The scope of this aspect of the study is focused on services provided by WSC management and professional personnel. WSC hourly workers are excluded because market information is not available for local contractors. Also excluded are WSCK customer service representatives since market costs for providers of call center services is not publicly available information.

Cost Comparison Methodology

WSC's charges assigned to WSCK were tested to determine if they were priced at the lower of cost or market. This was accomplished by comparing the cost per hour for WSC managerial and professional services to those of outside service providers to whom this work could be outsourced. Based on the nature of the WSC services, it was determined that the following outside providers could perform the categories of services indicated below:

- Management Consultants – executive and administrative management and human resources services
- Certified Public Accountants – accounting, information technology and rates/regulatory services
- Professional Engineers – operations, engineering, construction management
- Attorneys – legal

WSC's hourly rates were calculated for each service provider category, based on the dollars and hours charged to WSCK during the 12 months ended September 30, 2010. Hourly billing rates for outside service providers were developed using third party surveys or directly from information furnished by outside providers themselves.

WSC Hourly Rates

WSC's expenses assigned to WSCK were first analyzed to determine which are associated with the provision of management and professional services. This process is directed at creating a cost pool that contains the same type of expenses outside providers recover in the hourly billing rates. Exhibit 4 shows the results of this analysis. As summarized below, \$413,312 of WSC expenses are associated with the provision of management and professional services to WSCK and subject to a lower of cost or market comparison.

Testable WSC Charges	Amount
Salaries	\$ 290,849
Benefits	\$ 80,128
Other Expenses	\$ 42,335
Testable Total	\$ 413,312

Water Service Corporation of Kentucky
Analysis of Y/E 9/30/2010 Operating and Maintenance Expenses by Account

Allocated WSC Expenses			Excluded From Market Cost Study							
Account		9/30/2010	Included in Cost/Hour Calculation			Sal/Ben for Excluded Employees	Capital Costs	Outside Services	Travel Expenses	Non-Service Expenses
Number	Description	Trial Balance	Labor	Benefits	Other Exp					
5435	Purchased Water-Water Sys	\$ 78,100							\$ 78,100	
5460	Purchased Sewer-Billings	\$ -							\$ -	
	Total Purchased Water And Sewer	\$ 78,100								
5465	Elect Pwr-Wtr System Src	\$ 70,484							\$ 70,484	
5470	Elect Pwr-Swr System Coll	\$ 9,151							\$ 9,151	
	Total Electric Power	\$ 79,635								
5480	Chlorine	\$ 30,493							\$ 30,493	
5490	Other Treatment Chemicals	\$ 70,821							\$ 70,821	
	Total Chemicals	\$ 101,313								
5495	Meter Reading	\$ 345							\$ 345	
	Total Meter Reading	\$ 345								
5505	Agency Expense	\$ 23							\$ 23	
5510	Uncollectible Accounts	\$ 89,708							\$ 89,708	
5515	Uncoll Accounts Accrual	\$ 36,469							\$ 36,469	
	Total Bad Debt Expense	\$ 126,200								
5525	Bill Stock	\$ 2,732							\$ 2,732	
5530	Billing Computer Supplies	\$ 452							\$ 452	
5535	Billing Envelopes	\$ 1,638							\$ 1,638	
5540	Billing Postage	\$ 23,937							\$ 23,937	
5545	Customer Service Printing	\$ 1,808							\$ 1,808	
	Total Billing & Customer Service Expense	\$ 30,567								
5625	401k/ESOP Contributions	\$ 21,246		\$ 9,763		\$ 11,482				
5630	Health & Dental Premiums	\$ 14,617		\$ 6,717		\$ 7,900				
5635	Dental Ins. Reimbursements	\$ (5)		\$ (3)		\$ (3)				
5645	Employee Ins. Deductions	\$ (31,269)		\$ (14,369)		\$ (16,900)				
5650	Health Costs & Other	\$ 867		\$ 398		\$ 468				
5655	Health Ins Reimbursements	\$ 102,809		\$ 47,244		\$ 55,565				
5660	Other Emp Pension/Benefits	\$ 1,444		\$ 664		\$ 781				
5665	Pension Contributions	\$ 8,277		\$ 3,804		\$ 4,473				
5670	Term Life Ins	\$ 4,843		\$ 2,225		\$ 2,617				
5675	Term Life Ins - OPT	\$ (681)		\$ (313)		\$ (368)				
5680	Depend Life Ins-Opt	\$ (90)		\$ (41)		\$ (49)				
5690	Tuition	\$ 1,289		\$ 592		\$ 696				
	Total Employee Pension & Benefits Exp	\$ 123,344								
5715	Insurance-Other	\$ 59,054							\$ 59,054	
	Total Insurance Expense	\$ 59,054								
5735	Computer Maintenance	\$ 49,314			\$ 3,800				\$ 45,514	
5740	Computer Supplies	\$ 2,784			\$ 2,784					
5745	Computer-Amort & Prog. Cost	\$ (91)			\$ (91)					
5750	Internet Supplier	\$ 506			\$ 506					
5755	Microfilming	\$ (0)			\$ (0)					
	Total It Department	\$ 52,512								
5785	Advertising/Marketing	\$ 395			\$ 395					
5790	Bank Service Charges	\$ 3,988							\$ 3,988	
5800	Letter of Credit Fee	\$ -							\$ -	
5805	License Fees	\$ 1			\$ 1					
5810	Memberships	\$ 5,856			\$ 225				\$ 5,631	
5815	Penalties/Fines	\$ 27			\$ 27					
5820	Training Expense	\$ 1,506			\$ 156				\$ 1,350	
5825	Other Misc Expense	\$ 7,623			\$ 6,816				\$ 807	
	Total Miscellaneous Expense	\$ 19,397								
5855	Answering Service	\$ 698							\$ 698	
5860	Cleaning Supplies	\$ 610			\$ 29				\$ 582	
5865	Copy Machine	\$ 231			\$ 47				\$ 184	
5870	Holiday Events/Picnics	\$ 78			\$ 78					
5875	Kitchen Supplies	\$ 113			\$ 113					
5880	Office Supply Stores	\$ 5,272			\$ 728				\$ 4,544	
5885	Printing/Blueprints	\$ 82			\$ 82					
5890	Publ Subscriptions/Tapes	\$ 1,183			\$ 787				\$ 396	
5895	Shipping Charges	\$ 4,891			\$ 785				\$ 4,106	
5900	Other Office Expense	\$ 6,005			\$ 1,532				\$ 4,473	
	Total Office Expense	\$ 19,163								
5930	Office Electric	\$ 3,586			\$ 614				\$ 2,972	
5935	Office Gas	\$ 1,983			\$ 170				\$ 1,813	
5940	Office Water	\$ 810			\$ 22				\$ 787	
5945	Office Telecom	\$ 30,489			\$ 3,049				\$ 27,440	
5950	Office Garbage Removal	\$ 1,030			\$ 175				\$ 855	
5955	Office Landscape / Mow / P	\$ 3,767			\$ 457				\$ 3,310	
5960	Office Alarm Sys Phone Exp	\$ 4,390			\$ 150				\$ 4,240	
5965	Office Maintenance	\$ 1,985			\$ 1,069				\$ 916	
5970	Office Cleaning Service	\$ 5,541			\$ 776				\$ 4,765	
5975	Office Machine/Heat&Cool	\$ 207			\$ 207					
5980	Other Office Utilities	\$ 38			\$ 2				\$ 36	
5985	Telemetering Phone Expense	\$ -			\$ -				\$ -	
	Total Office Utilities/Maintenance	\$ 53,825								

Water Service Corporation of Kentucky
Analysis of Y/E 9/30/2010 Operating and Maintenance Expenses by Account

Allocated WSC Expenses			Excluded From Market Cost Study							
Account		9/30/2010	Included in Cost/Hour Calculation			Sal/Ben for Excluded Employees	Capital Costs	Outside Services	Travel Expenses	Non-Service Expenses
Number	Description	Trial Balance	Labor	Benefits	Other Exp					
6010	Audit Fees	\$ 8,277						\$ 8,277		
6015	Employ Finder Fees	\$ 2,323			\$ 2,323					
6020	Engineering Fees	\$ -						\$ -		
6025	Legal Fees	\$ 2,541						\$ 2,541		
6035	Payroll Services	\$ 2,922						\$ 2,922		
6040	Tax Return Review	\$ 2,128						\$ 2,128		
6045	Tax Return Review	\$ 4,272						\$ 4,272		
6050	Temp Employ - Clerical	\$ 8,259						\$ 8,259		
	Total Outside Service Expense	\$ 30,721								
6065	Rate Case Amort Expense	\$ 55,885								\$ 55,885
	Total Rate Case Expense	\$ 55,885								
6090	Rent	\$ 18,906			\$ 14,522					\$ 4,384
	Total Rent Expense	\$ 18,906								
6110	Salaries-Acctg/Finance	\$ 33,780								
6120	Salaries-Officers/Stkhdr	\$ 41,790								
6125	Salaries-Hr	\$ 5,050								
6130	Salaries-Mis	\$ 8,070								
6135	Salaries-Leadership Ops	\$ 40,112								
6140	Salaries-Regulatory	\$ 26,858	\$ 290,849			\$ 342,072				
6145	Salaries-Customer Service	\$ 36,958								
6146	Salaries-Billing	\$ 6,842								
6147	Salaries-Corp Service Admi	\$ 1,372								
6150	Salaries-Operations Field	\$ 402,829								
6155	Salaries-Operations Office	\$ 29,259								
6165	Capitalized Time Adjustment	\$ (50,427)					\$ (50,427)			
	Total Salaries & Wages	\$ 582,494.10								
6185	Travel Lodging	\$ 3,351							\$ 3,351	
6190	Travel Airfare	\$ 1,370							\$ 1,370	
6195	Travel Transportation	\$ 369							\$ 369	
6200	Travel Meals	\$ 1,558							\$ 1,558	
6205	Travel Entertainment	\$ 237							\$ 237	
6207	Travel Other	\$ 0							\$ 0	
	Total Travel Expense	\$ 6,886								
6215	Fuel	\$ 24,269								\$ 24,269
6220	Auto Repair/Tires	\$ 22,896								\$ 22,896
6225	Auto Licenses	\$ 34								\$ 34
6230	Other Trans Expenses	\$ (25)								\$ (25)
	Total Fleet Transportation Expense	\$ 47,173								
6255	Test-Water	\$ 16,937								\$ 16,937
6260	Test-Equip/Chemical	\$ 3,449								\$ 3,449
6265	Test-Safe Water Drinking	\$ -								\$ -
6270	Test-Sewer	\$ 4,494								\$ 4,494
	Total Maintenance Testing	\$ 24,880								
6285	Water-Main Supplies	\$ 8,234								\$ 8,234
6290	Water-Maint Repairs	\$ 26,860								\$ 26,860
6295	Water-Main Breaks	\$ 636								\$ 636
6300	Water-Elec Equipt Repair	\$ 899								\$ 899
6310	Other Trans Expenses	\$ 5,514								\$ 5,514
6320	Water-Other Maint Exp	\$ 1,421								\$ 1,421
6325	Sewer-Maint Repairs	\$ 1,721								\$ 1,721
6330	Sewer-Main Breaks	\$ -								\$ -
6335	Sewer-Elec Equipt Repair	\$ -								\$ -
6340	Sewer-Permits	\$ -								\$ -
6345	Sewer-Maint Supplies	\$ 130								\$ 130
6355	Sewer-Other Maint Exp	\$ 23,805								\$ 23,805
6360	Deferred Maint Expense	\$ 10,112								\$ 10,112
6370	Oper Contracted Workers	\$ 25								\$ 25
6380	Communication Expense	\$ 0								\$ 0
6385	Repairs & Maint-Maint, Land	\$ 2,122								\$ 2,122
6390	Uniforms	\$ 1,309								\$ 1,309
6400	Sewer Rodding	\$ 4,300								\$ 4,300
6410	Sludge Hauling	\$ -								\$ -
	Total Maintenance Expense	\$ 87,087								
6445	Deprec-Organization	\$ 2,562								\$ 2,562
6455	Deprec-Struct & Imprv Src	\$ 2,258								\$ 2,258
6460	Deprec-Struct & Imprv Wtp	\$ 9,034								\$ 9,034
6465	Deprec-Struct & Imprv Dist	\$ -								\$ -
6470	Deprec-Struct & Imprv Gen	\$ 2,592								\$ 2,592
6485	Deprec-Wells & Springs	\$ 9,501								\$ 9,501
6495	Deprec-Supply Mains	\$ 130								\$ 130
6505	Deprec-Elec Pump Eq Src P	\$ -								\$ -
6510	Deprec-Elec Pump Eq Wtp	\$ 11,916								\$ 11,916
6515	Deprec-Elec Pump Eq Trans	\$ 112								\$ 112
6520	Deprec-Water Treatment Eq	\$ 11,408								\$ 11,408
6525	Deprec-Dist Resv & Standpi	\$ 10,456								\$ 10,456

Water Service Corporation of Kentucky
Analysis of Y/E 9/30/2010 Operating and Maintenance Expenses by Account

Allocated WSC Expenses			Excluded From Market Cost Study							
Account		9/30/2010	Included in Cost/Hour Calculation			Sal/Ben for Excluded Employees	Capital Costs	Outside Services	Travel Expenses	Non-Service Expenses
Number	Description	Trial Balance	Labor	Benefits	Other Exp					
6530	Deprec-Trans & Distr Mains	\$ 59,097							\$ 59,097	
6535	Deprec-Service Lines	\$ 13,574							\$ 13,574	
6540	Deprec-Meters	\$ 13,757							\$ 13,757	
6545	Deprec-Meter Installs	\$ 6,744							\$ 6,744	
6550	Deprec-Hydrants	\$ 7,638							\$ 7,638	
6555	Deprec-Backflow Prevent De	\$ -							\$ -	
6575	Deprec-Oth Plt&Misc Eqp Di	\$ -							\$ -	
6580	Weather/Hurricane Costs	\$ 3,278							\$ 3,278	
6585	Deprec-Office Structure	\$ 2,181							\$ 2,181	
6595	Deprec-Office Furn/Eqmt	\$ 5,179							\$ 5,179	
6600	Deprec-Laboratory Equipmen	\$ 896							\$ 896	
6610	Deprec-Tool Shop & Misc Eqm	\$ 2,086							\$ 2,086	
6615	Deprec-Misc Equipment	\$ -							\$ -	
6620	Deprec-Other Tang Plt Wate	\$ 1,400							\$ 1,400	
6655	Deprec-Struct/Imprv Coll P	\$ -							\$ -	
6660	Deprec-Struct/Imprv Pump	\$ -							\$ -	
6670	Deprec-Struct/Imprv Rclm W	\$ -							\$ -	
6680	Deprec-Struct/Imprv Gen Pl	\$ -							\$ -	
6695	Deprec-Power Gen Equip Tre	\$ -							\$ -	
6710	Deprec-Sewer Force Main/Sr	\$ 5							\$ 5	
6715	Deprec-Sewer Gravity Main/	\$ 23							\$ 23	
6725	Deprec-Services To Custome	\$ 0							\$ 0	
6730	Deprec-Flow Measure Device	\$ -							\$ -	
6735	Deprec-Flow Measure Instal	\$ -							\$ -	
6745	Deprec-Pump Eqp Pump Plt	\$ 2							\$ 2	
6750	Deprec-Pump Eqp Rclm Wtp	\$ -							\$ -	
6760	Deprec-Treat/Disp Equip La	\$ 5							\$ 5	
6765	Deprec-Treat/Disp Eq Trt P	\$ -							\$ -	
6775	Deprec-Plant Sewers Trtmt	\$ -							\$ -	
6800	Deprec-Other Plt Pump	\$ -							\$ -	
6830	Deprec-Stores Equipment	\$ -							\$ -	
6835	Deprec-Tool Shop & Misc Eq	\$ -							\$ -	
6840	Deprec-Laboratory Eqpt	\$ -							\$ -	
6845	Deprec-Power Operated Equi	\$ -							\$ -	
6850	Deprec-Communication Eqpt	\$ -							\$ -	
6855	Deprec-Misc Equip Sewer	\$ -							\$ -	
6885	Deprec-Reuse Dist Reservoi	\$ -							\$ -	
6890	Deprec-Reuse Transm / Dist	\$ -							\$ -	
	Total Depreciation	\$ 175,832								
6905	Deprec-Auto Trans	\$ 28,595							\$ 28,595	
	Total Deprec-Auto Trans	\$ 28,595								
6920	Deprec-Computer	\$ 86,070							\$ 86,070	
	Total Deprec-Computer	\$ 86,070								
6960	Amort Of Util Paa-Water	\$ (3,660)							\$ (3,660)	
	Total Amort of Utility Paa-Water	\$ (3,660)								
7160	Amort-Other Tangible Plt W	\$ (1,491)							\$ (1,491)	
7165	Amort-Water-Tap	\$ (46)							\$ (46)	
7185	Amort-Wtr Plt Mtr Fee	\$ -							\$ -	
7225	Amort-Struct/Imprv Pump Pl	\$ -							\$ -	
7245	Amort-Struct/Imprv Gen Plt	\$ -							\$ -	
7275	Amort-Sewer Force Main/Srv	\$ -							\$ -	
7280	Amort-Sewer Gravity Main	\$ -							\$ -	
	Total Amortization	\$ (1,536)								
7510	FICA Expense	\$ 44,786		\$ 20,581		\$ 24,205				
7515	Federal Unemployment Tax	\$ 820		\$ 377		\$ 443				
7520	State Unemployment Tax	\$ 5,417		\$ 2,489		\$ 2,927				
	Total Payroll Taxes	\$ 51,023								
7535	Franchise Tax	\$ 7,189							\$ 7,189	
7540	Gross Receipts Tax	\$ -							\$ -	
7545	Personal Property/Ict Tax	\$ 27,376							\$ 27,376	
7550	Property/Other General Tax	\$ 33,411							\$ 33,411	
7555	Real Estate Tax	\$ 23,827							\$ 23,827	
7570	Utility/Commission Tax	\$ 2,624							\$ 2,624	
	Total Property And Other Tax Expense	\$ 94,427								
7595	Def Income Tax-Federal	\$ 71,135							\$ 71,135	
7600	Def Income Taxes-State	\$ 15,747							\$ 15,747	
7605	Income Taxes-Federal	\$ (176,483)							\$ (176,483)	
7610	Income Taxes-State	\$ (7,835)							\$ (7,835)	
	Total Income Tax Expense	\$ (97,436)								
	Total O&M Expenses	\$ 1,930,803	\$ 290,849	\$ 80,128	\$ 42,335	\$ 436,311	\$ (50,427)	\$ 28,399	\$ 6,886	\$ 1,096,322
						\$1,930,803				

IV – Lower of Cost or Market Pricing

The following WSC expenses were excluded from the market cost comparison because they are not related to services provided by Northbrook and regional office personnel:

- Salaries, Benefits and Payroll Taxes of Hourly Employees – These charges represent personnel costs associated with local WSCK operations and maintenance staff and customer service representatives in the Middlesboro, Kentucky regional office.
- Capital Costs – Are not related to the provision of services to WSCK.
- Outside Services – These expenses are not associated with the cost of WSC personnel performing services for WSCK. Charges from outside professional firms to perform certain corporate-wide services (e.g., legal, financial audit, tax return review) represent services that have, in effect, already been outsourced by WSC.
- Travel Expenses - In general, client-related travel expenses are not recovered by outside service providers through their hourly billing rates. Rather, actual out-of-pocket travel expenses are billed to clients in addition to fees for professional services. Thus, it is appropriate to remove these charges from the WSC hourly rate calculation.
- Non-Services Expenses – The remaining excluded expenses are associated with: (1) materials and postage associated with printing and mailing of customer bills, (2) Kentucky operations-related expenses (3) general ledger hardware and software expenses, (3) depreciation expenses and (4) taxes.

Each WSC position was next assigned to the outside service provider to whom their work could be outsourced. Exhibit 4 shows the results of this analysis. This designation was used to assign each position's salary and hours to the four outside provider cost pools.

Exhibit 4 shows four WSC positions designated as administrative support personnel. Outside service providers typically recover the cost of these personnel through the hourly rates of professional staff. For purposes of the WSC hourly rate calculation, administrative staff salaries are considered an overhead that are "loaded" onto management and professional hourly rates.



Water Service Corporation of Kentucky Assignment of WSC Positions To Outside Provider Categories

Location	Group	WSC Position Whose Salary Is Charged to WSCK	Assignment to Outside Provider Category				Admin Support
			Management Consultant	Certified Public Accountant	Professional Engineer	Attorney	
Northbrook	Regulatory	Regulatory Staff Accountant II		X			
Northbrook	Billing	Billing Manager		X			
Northbrook	Regulatory	Regulatory Staff Accountant I		X			
Northbrook	Regulatory	Regulatory Staff Accountant I		X			
Northbrook	Officer	President & CEO	X				
Northbrook	Finance / Accounting	Senior Fixed Asset Accountant		X			
Northbrook	Finance / Accounting	AP Supervisor		X			
Northbrook	Regulatory	Regulatory Accounting Manager		X			
Northbrook	Regulatory	Director, Governmental Affairs	X				
Northbrook	Finance / Accounting	Director, Tax & Accounting Operations		X			
Northbrook	Finance / Accounting	Chief Operating Officer	X				
Northbrook	Finance / Accounting	Corporate Staff Accountant I		X			
Northbrook	Finance / Accounting	Corporate Accounting Manager		X			
Northbrook	Billing	Asst. Manager of Billing		X			
Northbrook	Officer	Chief Financial Officer	X				
Northbrook	Finance / Accounting	Payroll Supervisor		X			
Northbrook	Regulatory	Regulatory Staff Accountant I		X			
Northbrook	Regulatory	Regulatory Staff Accountant II		X			
Northbrook	IT	IT Manager		X			
Northbrook	Finance / Accounting	Senior Corporate Accountant		X			
Northbrook	Finance / Accounting	Senior Regulatory Accountant		X			
Northbrook	Finance / Accounting	Financial Planning & Analysis Manager	X				
Northbrook	Administration	Executive Assistant					X
Northbrook	Finance / Accounting	Tax Specialist		X			
Northbrook	Billing	Billing Specialist		X			
Northbrook	Regulatory	Senior Regulatory Accountant		X			
Northbrook	IT	Network Administrator		X			
Northbrook	Officer	VP, General Counsel				X	
Northbrook	Regulatory	Regulatory Accounting Manager		X			
Northbrook	Regulatory	Regulatory Staff Accountant I		X			
Northbrook	HR	Human Resources Generalist	X				
Northbrook	Administration	Operations Administration Manager			X		
Northbrook	HR/ Payroll	Payroll/HR Administrator	X				
Northbrook	IT	Desktop Support Analyst II		X			
Northbrook	Administration	Operations Administrator			X		
Northbrook	Administration	Regulatory Assistant		X			
Northbrook	Administration	Receptionist					X
Northbrook	Finance / Accounting	Senior Corporate Accountant		X			
Northbrook	Administration	Compliance & Safety Coordinator			X		
Northbrook	IT	Desktop Support Analyst II		X			
Northbrook	Finance / Accounting	Senior Financial Analyst		X			
Northbrook	Finance / Accounting	Capital Projects Analyst		X			
Northbrook	Officer	VP, Corporate Development	X				
Northbrook	Regulatory	Executive Director, Regulatory Affairs	X				
Northbrook	Finance / Accounting	Corporate Services Manager	X				
Northbrook	HR	Benefits Administrator	X				
Northbrook	Regulatory	Regulatory Staff Accountant I		X			
Northbrook	Administration	Process & Performance Manager	X				
Northbrook	HR	HR Manager	X				
Northbrook	Administration	Mail Clerk					X
Kentucky Operations	Operations	Regional Manager			X		
Kentucky Operations	Operations	Area Manager - JCT			X		
Regional Offices	Operations	Regional Director	X				
Regional Offices	Officer	Regional Vice President	X				
Regional Offices	Administration	Executive Assistant					X
Regional Offices	Finance / Accounting	Regional Finance Manager		X			
Regional Offices	Administration	Regional Compliance & Safety Manager			X		

IV – Lower of Cost or Market Pricing

Shown below is the calculation of the overheads that are applied to management and professional salaries for purposes of calculating WSC's hourly rates.

	Amount	% of Mgmt & Prof Salaries
Salaries		
Management & Professional	\$ 281,689	
Administrative Support	\$ 9,160	3.3%
Total Salaries	\$ 290,849	
Benefits	\$ 80,128	28.4%
Other Expenses	\$ 42,335	15.0%
Total Testable Expenses	\$ 413,312	

Based on the assignment of market testable WSC expenses and hours to the four outside provider categories, WSC's hourly rates for the 12 months ended September 30, 2010 are calculated below.

	Management Consultant	Certified Public Accountant	Professional Engineer	Attorney	Total
Management/Professional Salaries	\$ 93,134	\$ 64,282	\$ 117,576	\$ 6,697	\$ 281,689
Overhead Items:					
Benefits (28.4%)	\$ 26,492	\$ 18,285	\$ 33,445	\$ 1,905	\$ 80,128
Other Expenses (15.0%)	\$ 13,997	\$ 9,661	\$ 17,671	\$ 1,007	\$ 42,335
Administrative Staff Salaries (3.3%)	\$ 3,029	\$ 2,090	\$ 3,823	\$ 218	\$ 9,160
Total Cost Pool	\$ 136,652	\$ 94,318	\$ 172,515	\$ 9,827	\$ 413,312
Management and Professional Hours	1,180	1,783	3,735	55	6,753
Average Hourly Rate	\$ 116	\$ 53	\$ 46	\$ 180	

Outside Service Provider Hourly Rates

The next step in the cost comparison was to obtain the average billing rates for each outside service provider. The source of this information and the determination of the average rates are described in the paragraphs that follow.

Management Consultants

The cost per hour for management consultants was developed from the 2010 annual survey performed by the Association of Management Consulting Firms—an industry trade organization. The first step in the calculation, presented in Exhibit 6, was to determine an average rate by consultant position. From these rates, a single weighted average hourly rate was calculated based upon the percent of time that is typically applied to a consulting assignment by each consultant position. Consultants typically do not limit their practice to any one region and must travel to a client's location. Thus, the U.S. national average is appropriate for comparison. This survey includes rates that were in effect at December 31, 2009 for firms in the United States. This 2009 average rate was escalated to March 31, 2010—the midpoint of the 12 months ended September 30, 2010 test year.

Certified Public Accountants

The average hourly rate for Kentucky certified public accountants was developed from a 2010 survey conducted by the American Institute of Certified Public Accountants (AICPA) every two years. Hourly rates in the AICPA survey are the average of firms in Kentucky. The average hourly rate was calculated for a range of accountant positions, as shown in Exhibit 7. Based on a typical staff assignment by each accountant position, a weighted average hourly rate was calculated. This survey covered hourly rates in effect during 2009. Thus, the 2009 average rate was escalated to March 31, 2010—the midpoint of the 12 months ended September 30, 2010 test year.

Professional Engineer

The association for professional civil engineers, the American Society of Civil Engineers, does not survey its members' billing rates. Neither does the National Society of Professional Engineers, the association for the entire engineering profession. Thus, 2010 hourly rates for Kentucky professional engineers were obtained Baryenbruch & Company, LLC's database. As shown in Exhibit 8, an average rate was developed for each engineering position. Then, using a typical percentage mix by position for a typical engineering project, a weighted average cost per hour was calculated.

Attorneys

The Kentucky Bar Association does not survey its members as to their hourly billing rates. In addition, publicly available billing rate information could not be found for Kentucky attorneys. Therefore, an estimate of Kentucky attorney rates was developed from surveys of Missouri and Michigan lawyers conducted annually by the publications, Missouri Lawyers Weekly and Michigan Lawyers Weekly. As presented in Exhibit 9, the average rate for each Missouri and Michigan firm respondent was adjusted for the cost of living differential between their location and Middlesboro, Kentucky. The survey includes hourly rates that were in effect at December 31, 2009. Thus, the 2009 average rate was escalated to March 31, 2010—the midpoint of the 12 months ended September 30, 2010.



**Water Service Corporation of Kentucky
2010 Billing Rates of U.S. Management Consultants**

Survey billing rates in effect in 2009 (Note A)					
A. Calculation of Average Hourly Billing Rate by Consultant Position					
	Average Hourly Rates (Note A)				
	Entry-Level Consultant	Associate Consultant	Senior Consultant	Junior Partner	Senior Partner
Average	\$ 155	\$ 215	\$ 279	\$ 328	\$ 413
B. Calculation of Overall Average Hourly Billing Rate Based on a Typical Distribution of Time on an Engagement					
	Entry-Level Consultant	Associate Consultant	Senior Consultant	Junior Partner	Senior Partner
Average Hourly Billing Rate (from above)	\$ 155	\$215	\$279	\$328	\$413
Percent of Consulting Assignment	30%	30%	20%	10%	10%
	\$ 46	\$ 64	\$ 56	\$ 33	\$ 41
					Weighted Average \$ 240
<u>Escalation to Test Period Midpoint (March 31, 2010) (Note B)</u>					
				CPI at December 31, 2009	216.0
				CPI at March 31, 2010	217.6
				Inflation/Escalation	0.7%
Average Hourly Billing Rate For Management Consultants At March 31, 2010					\$ 242

Note A: Source is "Operating Ratios For Management Consulting Firms, 2010 Edition," Association of Management Consulting Firms

Note B: Source is U.S. Bureau of Labor Statistics (<ftp://ftp.bls.gov/pub/special.requests/cpi/cpi.ai.txt>)

**Water Service Corporation of Kentucky
2010 Billing Rates Of Kentucky Certified Public Accountants**

Survey billing rates were those in effect in 2009 (Note A)

Type of Firm	Average Hourly Billing Rate (Note A)			
	Staff Accountant	Senior Accountant	Manager	Partner
Average Hourly Rate	\$ 83	\$ 101	\$ 144	\$ 172

B. Calculation of Overall Average Accountant Billing Rate Based Upon Typical Distribution of Time on an Engagement

Average Hourly Billing Rate (From Above)	Staff Accountant	Senior Accountant	Manager	Partner	Weighted Average
	\$ 83	\$ 101	\$ 144	\$ 172	
Typical Percent of Time Spent on an Accounting Assignment	30%	30%	20%	20%	
	\$ 25	\$ 30	\$ 29	\$ 34	\$ 118

Escalation to Midpoint of March 31, 2010 Test Period (Note B)

CPI at December 31, 2009	215.9
CPI at March 31, 2010	217.6
Inflation/Escalation	0.8%
Average Hourly Billing Rate For CPAs At March 31, 2010	\$ 119

Note A: Source is AICPA's 2010 National PCPS/TSCPA Management of an Accounting Practice Survey (Kentucky edition)

Note B: source is US Bureau of Labor Statistics (<ftp://ftp.bls.gov/pub/special.requests/cpi/cpiat.t>)

**Water Service Corporation of Kentucky
2010 Billing Rates Of Kentucky Professional Engineers**

A. Calculation of Average Hourly Rate by Engineer Position				
Name of Firm	Average Hourly Billing Rates			
	Technician Senior Technician	Engineer Design Engineer Project Engineer	Project Manager Sr. Mgr. Engineer	Officer Principal Engineer
Firm #1	\$80	\$89	\$112	\$181
Firm #2	\$79	\$86	\$140	\$170
Firm #3	\$83	\$105	\$167	\$214
Firm #4	\$57	\$89	\$144	\$197
B. Calculation of Overall Average Engineering Hourly Billing Rate				
Average Hourly Billing Rate (From Above)	Technician Senior Technician	Engineer Design Engineer Project Engineer	Project Manager Sr. Mgr. Engineer	Officer Principal Engineer
	\$75	\$92	\$141	\$190
Typical Percent of Time on an Engineering Assignment	30%	35%	25%	10%
	\$22	\$32	\$35	\$19
				Weighted Average \$109

Source: Baryenbruch & Company, LLC database

**Water Service Corporation of Kentucky
2010 Estimated Billing Rates Of Kentucky Attorneys**

Billing rates during 2009		Billing Rate Range (A)					Average	Cost of Living Adjust (B)	Adjusted Rate
Firm	Location	Associate		Partner					
		Low	High	Low	High				
Dickinson Wright	Detroit, Mi	\$ 195	\$ 275	\$ 355	\$ 575	\$ 350	116%	\$ 302	
Dykema	Detroit, Mi	\$ 185	\$ 425	\$ 295	\$ 615	\$ 380	116%	\$ 328	
Butzel Long	Detroit, Mi	\$ 175	\$ 325	\$ 250	\$ 600	\$ 338	116%	\$ 291	
Jaffe Raitt Heuer & Weiss	Southfield, Mi	\$ 175	\$ 250	\$ 225	\$ 550	\$ 300	116%	\$ 259	
Brooks Kushman	Southfield, Mi	\$ 180	\$ 275	\$ 300	\$ 425	\$ 295	116%	\$ 254	
Kemp, Klein, Umphrey, Edelman & Ma	Troy, Mi	\$ 145	\$ 260	\$ 200	\$ 350	\$ 239	116%	\$ 206	
Rader, Fishman & Grauer	Bloomfield Hills, Mi	\$ 130	\$ 250	\$ 275	\$ 550	\$ 301	116%	\$ 260	
Williams, Williams, Rattner & Plunkett	Birmingham, Mi	\$ 150	\$ 250	\$ 275	\$ 450	\$ 281	116%	\$ 243	
Abbott, Nicholson, Quilter, Esshaki,	Detroit, Mi	\$ 150	\$ 220	\$ 300	\$ 375	\$ 261	116%	\$ 225	
Parmenter O'Toole	Muskegon, Mi			\$ 125	\$ 275	\$ 200	105%	\$ 191	
Lipson, Neilson, Cole, Seltzer & Garin	Bloomfield Hills, Mi	\$ 185	\$ 235	\$ 225	\$ 300	\$ 236	116%	\$ 204	
Berman DeLeve Kuchan & Chapman	Kansas City, Mo			\$ 250	\$ 250	\$ 250	110%	\$ 227	
Boggs, Avellino, Lach & Boggs	St. Louis, Mo			\$ 160	\$ 160	\$ 160	102%	\$ 157	
Bryan Cave	Kansas City, Mo	\$ 200	\$ 200	\$ 385	\$ 435	\$ 305	110%	\$ 277	
Danna McKittrick	St. Louis, Mo			\$ 300	\$ 300	\$ 300	102%	\$ 295	
David Shroeder Law Offices	Springfield, Mo			\$ 260	\$ 260	\$ 260	100%	\$ 259	
Dobson, Goldberg, Berns & Rich	St. Louis, Mo			\$ 300	\$ 425	\$ 363	102%	\$ 356	
Dunn & Davison	Kansas City, Mo			\$ 225	\$ 225	\$ 225	110%	\$ 204	
Evans Partnership	St. Louis, Mo			\$ 175	\$ 175	\$ 175	102%	\$ 172	
Greensfelder Hemker & Gale	St. Louis, Mo			\$ 235	\$ 300	\$ 268	102%	\$ 263	
Husch Blackwell Sanders	Kansas City, Mo	\$ 204	\$ 345	\$ 356	\$ 472	\$ 344	110%	\$ 312	
Karfeld Law Firm	St. Louis, Mo			\$ 265	\$ 265	\$ 265	102%	\$ 260	
Krigel & Krigel	Kansas City, Mo	\$ 175	\$ 225	\$ 200	\$ 250	\$ 213	110%	\$ 193	
Law Office of Brad Goss	St. Charles, Mo			\$ 175	\$ 175	\$ 175	102%	\$ 172	
Law Offices of George A. Barton	Kansas City, Mo	\$ 300	\$ 400	\$ 400	\$ 600	\$ 425	110%	\$ 385	
McDowell, Rice, Smith & Buchann	Kansas City, Mo			\$ 425	\$ 425	\$ 425	110%	\$ 385	
Neil Weintraub, Attorney at Law	St. Louis, Mo			\$ 260	\$ 260	\$ 260	102%	\$ 255	
Pennington Shea	St. Louis, Mo			\$ 190	\$ 260	\$ 225	102%	\$ 221	
Pletz and Reed	Jefferson City, Mo	\$ 150	\$ 150	\$ 180	\$ 180	\$ 165	104%	\$ 158	
Polsinelli Shughart	Kansas City, Mo	\$ 210	\$ 350	\$ 380	\$ 600	\$ 385	110%	\$ 349	
Raymond I. Plaster	Springfield, Mo			\$ 275	\$ 275	\$ 275	100%	\$ 274	
Shook, Hardy & Bacon	Kansas City, Mo	\$ 265	\$ 265	\$ 425	\$ 425	\$ 345	110%	\$ 313	
Speer Law Firm	Kansas City, Mo	\$ 400	\$ 400	\$ 500	\$ 500	\$ 450	110%	\$ 408	
Spencer Fane Britt & Browne	Kansas City, Mo	\$ 150	\$ 325	\$ 310	\$ 470	\$ 314	110%	\$ 284	
Stanton & Redlingshafer	Kansas City, Mo			\$ 195	\$ 195	\$ 195	110%	\$ 177	
Stinson Morrison Hecker	Kansas City, Mo	\$ 195	\$ 195	\$ 350	\$ 445	\$ 296	110%	\$ 269	
The Sader Law Firm	Kansas City, Mo	\$ 225	\$ 235	\$ 265	\$ 265	\$ 248	110%	\$ 224	
Thompson Coburn	St. Louis, Mo	\$ 200	\$ 200	\$ 480	\$ 480	\$ 340	102%	\$ 334	
Overall Cost-of-Living Adjusted Average 2009 Billing Rate								\$ 262	
<u>Escalation to Test Period Midpoint (March 31, 2010) (Notes B, C)</u>									
							CPI at December 31, 2009	216.0	
							CPI at March 31, 2010	217.6	
							Inflation/Escalation	0.7%	
Average Hourly Billing Rate For Attorneys At March 31, 2010								\$ 264	

Note A: Source is Michigan Lawyers Weekly and Missouri Lawyers Weekly

Note B: Source is Council for Community and Economic Research. This percentage represents the cost of living difference between the Michigan and Missouri cities and Middlesboro, Ky. A number over 100% indicates the Michigan or Missouri city's cost of living is higher than Middlesboro. A number less than 100% indicates Middlesboro's cost of living is higher.

Note C: source is US Bureau of Labor Statistics (<ftp://ftp.bls.gov/pub/special.requests/cpi/cpiiai.txt>)

IV – Lower of Cost or Market Pricing

WSC – Outside Provider Cost Comparison

As shown in the table below, WSC costs per hour are significantly lower than those of outside providers during the 12 months ended September 30, 2010.

Service Provider	WSC	Outside Provider	Difference-- WSC Greater(Less) Than Outside
Management Consultant	\$ 116	\$ 242	\$ (126)
Certified Public Accountant	\$ 53	\$ 119	\$ (66)
Professional Engineer	\$ 46	\$ 109	\$ (63)
Attorney	\$ 180	\$ 264	\$ (84)

Based on these cost per hour differentials and the number of hours billed to WSCK, outside service providers would have cost WSCK and its rate payers \$506,835 or 123% (\$506,835 / \$413,312) more than the cost of WSC's services during the 12 months ended September 30, 2010.

Service Provider	Hourly Rate Difference-- WSC Greater(Less) Than Outside	WSC Hours Charged	Dollar Difference
Management Consultant	\$ (126)	1,180	\$ (149,291)
Certified Public Accountant	\$ (66)	1,783	\$ (118,447)
Professional Engineer	\$ (63)	3,735	\$ (234,502)
Attorney	\$ (84)	55	\$ (4,595)
WSC Less Than Outside Providers			\$ (506,835)

Analysis of Services

The final aspect of this study was an assessment of whether the services that are provided to WSCK by WSC would be necessary if WSCK were a stand-alone water utility. The first step in this evaluation was to determine specifically what the WSC does for WSCK. Based on discussions with WSC personnel, the matrix in Exhibit 9 was created showing which entity—WSCK or a WSC location—is responsible for each of the functions WSCK requires to ultimately provide service to its customers. This matrix was reviewed to determine: (1) if there was redundancy or overlap in the services being provided by WSC and (2) if WSC services are typical of those needed by a stand-alone water utility.

Upon review of Exhibit 9, the following conclusions can be drawn:

- The services that WSC provides are necessary and would be required even if WSCK were a stand-alone water utility.
- There is no redundancy or overlap in the services provided by WSC to WSCK. For all of the services listed in Exhibit 9, there was only one entity that was primarily responsible for the service.



Water Service Corporation of Kentucky Designation Of Responsibility For Water And Waste Water Utility Functions

Primarily Responsible P Provides Support S	Water Services Corporation Location Performing Work			
	Kentucky Offices	Charlotte, NC Regional Office	Cust Service Offices	Northbrook, IL Headquarters
Water and Waste Water Function				
Engineering and Construction Management				
Long Term System Planning	S	P	S	S
Engineering Standards & Policies Development	S	S		P
Project Design				
Major Projects (e.g., new treatment plant)	S	P	S	S
Minor Projects (e.g., pipelines)	P	S	S	
Construction Project Management				
Major Projects	P	S	S	S
Minor Projects	P	S	S	
Hydraulics Review	P	S	S	
Developers Extensions	S	P	S	S
Tank Painting	P	S	S	
Water Quality and Purification				
Water Quality Standards Development	P	S	S	S
Research Studies				P
Water Quality Program Implementation	P	S		S
Water Treatment Operations & Maintenance	P	S		
Compliance Sampling	P	S		
Testing/Other Sampling	P	S		
Transmission and Distribution				
Preventive Maintenance Program Development	P	S		S
System Maintenance	P	S		
Leak Detection	P	S		
Customer Service				
Community Relations	P	S	S	
Customer Contact	P (direct)		P (phone)	S
Call Processing	S		P	
Service Order Creation	S		P	
Service Order Processing	S		P	
Customer Credit			P	
Meter Reading	P		S	
Customer Bill Preparation			S	P
Bill Collection	S		P	
Customer Payment Processing		P	S	
Meter Standards Development	S	P	S	
Meter Testing, Maintenance & Replacement	P	S	S	
Financial Management				
Financial Planning				P
Financings—Equity				P
Financings--Long Term Debt & Preferred				P
Short Term Lines of Credit Arrangements				P
Insurance Program Administration				P
Loss Control/Safety Program Administration				P
Pension Fund Asset Management				P
Cash Management/Disbursements				P
Rates				
Rate Studies & Tariff Change Administration		S	S	P
Rate Case Planning and Preparation	S	S	S	P
Rate Case Administration	S	S	S	P
Commission Inquiry Response	S	S	S	P

Water Service Corporation of Kentucky Designation Of Responsibility For Water And Waste Water Utility Functions

Primarily Responsible P Provides Support S	Water Services Corporation Location Performing Work			
	Kentucky Offices	Charlotte, NC Regional Office	Cust Service Offices	Northbrook, IL Headquarters
Water and Waste Water Function				
Budgeting and Variance Reporting				
Corporate Guidelines & Instructions				P S
Regional Guidelines & Instructions		P		
Operating Budget Preparation				
Revenue		S		P
O&M	S	S		P
Service Company Charges				P
Depreciation and Interest Expense				P
Capital Budget Preparation	S	S		P
Project Work	S	P	S	S
Non-Project Work	P	S	S	
Operating Budget Variance Report Preparation		S		P
Capital Budget Variance Report Preparation		S		P
Year-End Projections		S		P
Accounting and Taxes				
Accounts Payable Accounting				P
Payroll Accounting				P
Work Order Accounting				P
Fixed Asset Accounting				P
Journal Entry Preparation--Billing Corrections				P
Journal Entry Preparation--All Others				P
Financial Statement Preparation				P
State Commission Reporting				P
Income Taxes--State				P
Income Taxes--Federal				P
Property Taxes	S	S	S	P
Gross Receipts Taxes				P
Legal				P
Purchasing and Materials Management				
Specification Development	S	P	S	
Bid Solicitation	P	S	S	
Contract Administration	P	S	S	
Ordering	P	S	S	
Inventory Management	P	S	S	
Human Resources Management				
Benefit Program Development				P
Benefits Program Administration				P
Management Compensation Administration				P
Wage & Salary Program Design				P
Wage & Salary Administration	S	S	S	P
Labor Negotiations--Wages				P
Labor Negotiations--Benefits				P
Labor Negotiations--Work Rules		S		P
Training Program Development	S	S	S	P
Training--Course Delivery	P	S		S
Affirmative Action/EEO--Plan Development				P
Affirmative Action/EEO--Implementation	S	S	S	P
Information Technology Services				
Service Company Data Centers				P
System Operations & Maintenance				P
Software Maintenance				P
Network Administration				P
PC Acquisition & Support				P
Help Desk				P

SUPPLEMENTAL TESTIMONY
OF
PATRICK L. BARYENBRUCH
ON BEHALF OF
WATER SERVICE CORPORATION OF KENTUCKY

CASE NO. 2010-00476

Q. Please state your name and business address.

A. Patrick L. Baryenbruch, 2832 Claremont Road, Raleigh, North Carolina 27608.

Q. Please describe your educational and professional background.

A. I received a Bachelors degree in accounting from the University of Wisconsin-Oshkosh in 1974 and a Masters in Business Administration degree from the University of Michigan in 1979.

I am a certified public accountant and am a member of the American Institute of Certified Public Accountants and the North Carolina Association of Certified Public Accountants.

I began my career as a staff accountant with Arthur Andersen & Company where I performed financial audits of utilities, banks and finance companies. After three years I left to pursue an M.B.A. degree. Upon graduation from business school, I worked with the consulting firms of Theodore Barry & Associates and Scott, Madden & Associates.

During my consulting career, I have performed consulting assignments for approximately 50 utilities and 10 public service commissions. I have participated as project manager, lead or staff consultant for 24 commission-ordered management and prudence audits of public utilities. Of these, I have been responsible for evaluating the area of affiliate charges and allocation of corporate expenses in the Commission-ordered audits of Connecticut Light and Power, Connecticut Natural Gas, General Waterworks Corporation (Pennsylvania Operations), Philadelphia Suburban Water Company, Pacific Gas & Electric Company and Southern California Edison.

My firm performed the commission-ordered audits of Southern California Edison's transactions with its non-regulated affiliate companies for the years 2002 through 2005.

Q. What are your duties and responsibilities in your current position?

A. I am the President of my own consulting practice, Baryenbruch & Company, LLC, which was established in 1985. In that capacity, I provide financial and management and consulting services to utilities and their regulators.

Q. Please describe the reason for your testimony in this case.

A. I am presenting the results of my study which evaluated the services provided by Water Service Corporation (WSC) to Water Service Corporation of Kentucky (WSCK). This study was undertaken in conjunction with Massanutten PSC's rate case for the test year

ending September 30, 2010 and is true to the best of my knowledge and belief. The study is attached as Exhibit PLB-1.

Q. What were the objectives of your study?

A. This study was undertaken to answer three questions concerning the services provided by Water Service Corporation (WSC) to Water Service Corporation of Kentucky (WSCK):

1. Are the costs of administrative and general (A&G) services provided by WSC to WSCK reasonable?
2. Was WSCK charged the lower of cost or market for managerial and professional services provided by WSC during the 12 months ended September 30, 2010?
3. Are the services WSCK receives from WSC necessary?

Q. WHAT CONCLUSIONS WERE YOU ABLE TO DRAW CONCERNING QUESTION NUMBER 1, WHETHER THE WSC CHARGES TO WSCK WERE REASONABLE?

A. I was able to draw the following conclusions about the reasonableness of those charges:
The cost of A&G services provided by WSC to WSCK are reasonable compared to the costs of those services as provided by other utility service companies. WSC's A&G services cost \$72 per WSCK customer per year as compared to an average of \$95 per customer for other utility service companies.

Q. WHAT CONCLUSIONS WERE YOU ABLE TO DRAW CONCERNING QUESTION NUMBER 2, WHETHER WSCK WAS CHARGED THE LOWER OF COST OR MARKET SERVICES PROVIDED BY WSC?

A. I was able to draw the following conclusions:

(1) WSC provided WSCK with managerial and professional services during the 12 months ended September 30, 2010 at the lower of cost or market.

(2) On average, the hourly rates for outside service providers were 123% higher than the WSC's hourly rates during the 12 months ended September 30, 2010.

(3) If all the managerial and professional services provided by WSC had been outsourced during the 12 months ended September 30, 2010, WSCK and its ratepayers would have incurred an additional \$506,000 in expenses.

Q. WHAT CONCLUSIONS WERE YOU ABLE TO DRAW CONCERNING QUESTION 3 REGARDING THE NECESSITY OF THE SERVICES WSCK RECEIVES FROM WSC?

A. I was able to draw the following conclusions:

The services that WSC provides are necessary and would be required even if WSCK were a stand-alone water utility. Furthermore, there is no redundancy or overlap in the services provided by WSC to WSCK. For all of the services listed in Exhibit 9 of my study, there was only one entity primarily responsible for the service.

Q. Does this complete your testimony?

A. Yes.

**Market Cost Comparison of Service Company Charges to
West Virginia American Water Company**

12-Months Ended June 30, 2012



**West Virginia American Water Company
Market Cost Comparison of Service Company Charges
12-Months Ended June 30, 2012**

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Purpose of This Study

This study was undertaken to answer four questions concerning the services provided by American Water Works Service Company, Inc. (Service Company) to West Virginia American Water Company (WV American):

1. Were the Service Company's charges to WV American during the 12 months ended June 30, 2012 reasonable?
2. Was WV American charged the lower of cost or market for managerial and professional services provided by the Service Company during the 12 months ended June 30, 2012?
3. Were the 12 months ended June 30, 2012 costs of the Service Company's customer accounts services, including those of the National Call Centers, comparable to those of other utilities?
4. Are the services WV American receives from the Service Company necessary?

Study Results

Concerning question 1, the following conclusion was reached:

- The Service Company's 12 months ended June 30, 2012 cost per WV American customer are very reasonable. During the test period, WV American was charged \$59 per customer for administrative and general ("A&G")-related services provided by the Service Company. This compares favorably to A&G costs per customer for electric and combination electric/gas service companies that average \$121 for service companies reporting to the Federal Energy Regulatory Commission ("FERC"). Only three of the comparison group service companies had a lower A&G cost per customer than WV American. Based on this result, it is possible to conclude that the Service Company's 12 months ended June 30, 2012 charges to WV American were reasonable.

Concerning question 2, the following conclusions were drawn from this study:

- WV American was charged the lower of cost or market for managerial and professional services during the 12 months ended June 30, 2012.
- On average, the hourly rates for outside service providers are 11% higher than the Service Company's hourly rates.
- The managerial and professional services provided by the Service Company are vital and could only be procured effectively by WV American from outside professionals if it provided careful supervision to those service providers. If these services were contracted entirely from outside providers, WV American would have to add at least one position to manage activities of outside firms. This position would be necessary to ensure the quality and timeliness of services provided.
- If all the managerial and professional services now provided by the Service Company had been outsourced during the 12 months ended June 30, 2012, WV American and its ratepayers would have incurred more than \$1.9 million in additional expenses. This amount includes the higher cost of outside providers and the cost of one new WV American position needed to direct the outsourced work.

I – Introduction

- This study's hourly rate comparison actually understates the cost advantages that accrue to WV American from its use of the Service Company. Outside service providers generally bill for every hour worked. Service Company exempt personnel, on the other hand, charge a maximum of 8 hours per day even when they work more hours. If all overtime hours of Service Company personnel were factored into the hourly rate calculation, the Service Company would have had an even greater annual dollar advantage than the \$1.9 million cited above.
- It would be difficult for WV American to find local service providers with the same specialized water industry expertise as that possessed by the Service Company staff. Service Company personnel spend substantially all their time serving operating water companies. This specialization brings with it a unique knowledge of water utility operations and regulation that is most likely unavailable from local service providers.
- Service Company fees do not include any profit markup. Only its actual cost of service is being recovered from WV American customers.

Concerning question 3, the following conclusion was reached:

- The cost of the Service Company's customer accounts services, including those provided by the National Call Center, is below the average of the neighboring electric utility comparison group. As will be explained further, this group of companies provides a reasonable proxy group for comparison to a regulated utility of the size and scope of the Service Company and WV American. During the 12 months ended June 30, 2012, the customer accounts cost for WV American customers was \$30.04 compared to the 2011 average of \$33.04 for neighboring electric utilities. The highest comparison group per customer cost was \$88.76 and the lowest \$13.67.

Concerning question 4, the following conclusions was drawn:

- The services that the Service Company provides are necessary and would be required even if WV American were a stand-alone water utility.
- Furthermore, there is no redundancy or overlap in the services provided by the Service Company to WV American. For all of the services listed in Exhibit 12, there was only one entity primarily responsible for the service and thus no duplication of efforts between the Service Company and WV American.



II – Background

Overview of American Water Works Service Company

American Water's Service Company exists to provide certain shared services to American Water subsidiaries. It follows a service company model used by many utility holding companies that own multiple regulated utilities. By consolidating executive and professional services into a single service company, utility holding companies are able to realize the following benefits for ratepayers:

- Purchasing Economies – Common expenses (e.g., insurance, chemicals, piping) can be procured on a much larger scale thereby providing greater bargaining power for the combined entity compared to individual utility operating companies. A service company facilitates corporate-wide purchasing programs through its procurement and contract administration functions.
- Operating Economies of Scale – A service company is able to deliver services more efficiently because workloads can be balanced across more persons and facilities. For instance, American Water's Service Company is able to maintain one principal data center for the entire corporation. This is much more cost-efficient than each operating utility funding its own data center with its large fixed hardware, software and staffing costs.
- Continuity of Service – Centralizing service company personnel who perform similar services facilitates job cross-training and sharing of knowledge and expertise. This makes it easier to deal with staff turnover and absences and to sustain high levels of service to operating utilities. An individual operating utility might experience considerable disruption if a key professional left and it was necessary to hire outside to fill the vacancy.
- Maintenance of Corporate-Wide Standards – Personnel in American Water's Service Company establish standards for many functions (e.g., engineering designs, operating procedures and maintenance practices). It is easier to ensure these standards are followed by every operating utility because their implementation is overseen by the Service Company.
- Improved Governance – American Water's Service Company provides another dimension of management and financial oversight that supplements local operating utility management. The Service Company facilitates standard planning and reporting that help ensure operating utilities meet the requirements of their customers in a cost effective manner.
- Retention of Personnel – A service company organization provides operating utility personnel with another career path beyond what may be available on a local level. These opportunities tend to improve employee retention.

American Water follows the model for other utility service companies in another important regard. Its services are provided to affiliate operating utilities, like WV American, at cost. American Water's Service Company is not a profit-making entity. It assigns only its actual expenses to the American Water subsidiaries it services.

The Service Company provides services to American Water operating companies from the following locations:



II – Background

- Corporate Office – Includes American Water's executive management and personnel from the various corporate support services. American Water's corporate office is located in Voorhees, New Jersey.
- National Call Centers – Perform customer service functions, including: customer call processing, service order origination, correspondence processing, credit and collections. American Water maintains two call centers. One in Alton, Illinois that went into operation in 2001 and a second in Pensacola, Florida that went into operation in 2005. Prior to the establishment of these national call centers, customer service functions were performed by employees of WV American, which incurred the expense on its books.
- National Shared Services Center – The Shared Services Center, located in Cherry Hill, New Jersey, provides various financial, accounting and treasury functions that had been performed by individual operating companies. This arrangement has improved and streamlined the Company's financial processes and allowed operating companies to focus on providing utility service.
- Regional Offices – Regional offices provide operating companies with certain support services that can be performed more effectively on a regional basis because individual operating company/center workloads are not sufficient to warrant a full-time staff for these activities. At the same time, these services require closer proximity to operating companies served so they are not provided by the National Shared Services Center. Examples of regional office services include legal, communication, human resources and maintenance.
- Belleville Lab – The national trace substance laboratory is located in Belleville, Illinois and performs testing for all American Water operating companies.
- Information Technology Service Centers – American Water's principal data center, located in Charleston, West Virginia, supports the IT infrastructure required to run corporate and operating company business applications and the communications systems. IT personnel rotate, as needed, throughout the regional offices and operating companies.

Service Company Expense Categories

The Service Company renders a monthly bill to operating companies. Charges are broken down into the following expense categories:

- Labor – base pay (salaries) of managerial and professional employees
- Labor-Related Overheads - employee benefit costs (payroll taxes, medical coverage, pensions, disability insurance) and other general expenses
- Support - wages and salaries of office support personnel, including secretaries, clerical personnel, telephone operators and mail clerks
- Office Expenses - office rent, equipment leases, telephone, electric, office supplies, property taxes, office maintenance
- Vouchers/Journal Entries – (1) travel expenses incurred by Service Company personnel, (2) other items submitted for reimbursement by employees, including professional association dues, (3) outside service contracts for such things as actuarial



II – Background

services, and (4) various other expenditures, including data center expenses for software licenses and hardware maintenance.

Service Company expenses are either assigned directly or allocated to operating companies, as shown in the table below.

Expense Category	Direct		Comments
	Charged	Allocated	
Labor	X	X	Professional personnel working for one or several operating companies
Labor-Related Overheads	X	X	These are primarily employee benefit costs that relate directly to labor
Support		X	Administrative personnel support the professional staff, thus support costs are allocated on the basis of professional labor
Office Expense		X	Are all allocated on the basis of professional labor
Vouchers/Journals	X	X	May be either directly in support of one operating company (e.g., an engineer traveling from the Corporate Office to the operating company) or allocated to several operating companies

A direct charge occurs when Service Company work or expenses are incurred in support of only one operating company. Direct charge examples include work in support of an operating company's rate case, engineering design work on an operating company's project and the preparation of an operating company's financial statements.

Service Company expenses are allocated when more than one operating company benefits from the underlying work. Examples include assessments of new Federal water quality regulations, development of the company-wide materials procurement contracts and creation of company-wide engineering design standards.

Charging and Assignment Of Service Company Time and Expenses

Service Company transactions are assigned with the following information so there is a proper accounting and eventual charging to an operating company:

- Operating company
- Formula number
- Work order (where applicable)
- Authorization number (where applicable)

Charges can originate from the following systems:

- Payroll System
- RVI System (outside vendor payments)
- PCard System (credit card payments)
- Internal Purchase Order System
- Journal entries

II – Background

The Service Company's time reporting process enables labor and support charges to be assigned to the proper operating company. Labor charges are based on the time reported by managerial and professional Service Company employees. Every week, Service Company professional employees complete an electronic time sheet that shows:

- Formula number (this is linked to operating company within American Water's financial system)
- Employee hours worked
- Account number for non-labor charges

At month-end, time report information is processed and direct and allocated professional labor hours tabulated for each operating company. Dollar charges are then calculated using the hourly rate of each Service Company professional employee based upon their base salary (i.e., an employee's hours times their hourly rate of pay).

Support (administrative) personnel charge their time to the activity "General Admin." As described in the table on page 5, their labor charges are allocated to operating companies based upon how their office's professional personnel labor charges are assigned. For instance, if 2% of American Water's Shared Services' professional labor is assigned to WV American during a month, then 2% of that office's monthly administrative labor charges also are assigned to the operating company.

The overhead cost category is next assigned based on professional and administrative labor costs. Thus, if 2% of the Shared Services' accumulated professional and support labor is charged to WV American during the month, then 2% of that month's overhead expenses will be assigned to WV American.

Each Service Company location's office expenses are allocated to operating companies based on how professional labor charges for that office have been assigned. For instance, if 2% of professional labor from one Service Company office is assigned to WV American, then 2% of that office's office expenses would be assigned to WV American. Thus, office expenses are allocated in the very same way as administrative labor.

Vouchers/journal entries may be charged directly or allocated, depending on who benefits from the expenditure. For instance, the cost of a continuing professional education course taken by a professional in a regional office is allocated to the operating companies served by that office. Travel expenses by that same professional to a rate case proceeding are charged directly to the operating company whose case is being heard.

III – Service Company Cost Comparison Approach

During the 12 months ended June 30, 2012, the Service Company billed WV American approximately \$18.7 million. As shown in the table below, approximately \$11.3 million of this total were O&M charges and \$7.4 million capital charges.

	12 Months Ended Jun. 30, 2012
Management Fees - O&M	\$ 11,352,048
Management Fees - Capital	\$ 7,353,806
Total AWWSC Charges	\$ 18,705,854

Total 12 months ended June 30, 2012 capital charges from the Service Company are much higher than normal historical levels due to the assignment to WV American of Business Transformation (BT) costs. BT is a major initiative that replaces several enterprise-wide applications with a single enterprise resource planning system (SAP) and redesigns business processes.

For purposes of comparing these charges to certain outside benchmarks, Service Company services were placed into two categories:

- Managerial and Professional Services – Includes such services as management, accounting, legal, human resources, information technology, and engineering
- Customer Accounts Services – Includes customer-related services, such as call center, credit, billing, collection and payment processing

Total test period Service Company charges break down between management/professional services and customer account services as follows:

	12 Months Ended Jun. 30, 2012	
	Amount	Hours
Management and Professional Services	\$ 16,086,123	56,399
Customer Account Services	\$ 2,619,731	44,746
Total Service Company Charges	\$ 18,705,854	101,145

This study's first question—whether Service Company charges during the 12 months ended June 30, 2012 were reasonable—was determined by comparing WV American's A&G-related Service Company charges per customer to the same charges for utility companies that must file the FERC Form 60 – Annual Report of Service Companies.

The second question—whether Service Company charges during the 12 months ended June 30, 2012 were at the lower of cost or market—was evaluated by comparing the cost per hour for managerial and professional services provided by Service Company personnel to hourly billing rates that would be charged by outside providers of equivalent services. Service Company costs per hour were based on actual charges to WV American during the 12 months ended June 30, 2012. Outside providers' billing rates came from surveys or other information from professionals that could perform the services now provided by the Service Company.



III – Service Company Cost Comparison Approach

The third question—whether Service Company's the 12 months ended June 30, 2012 customer account services charges, including those of the National Call Center costs, were comparable to other utilities—was addressed by comparing WV American's customer accounts services expenses to those of neighboring electric utilities. This utility comparison group was selected because the cost of outside providers of customer accounts services is proprietary and not publicly available. Comparison to electric utilities is appropriate because all utilities, regardless of service type, must perform customer account services activities, including updating customer records for meter reads, printing and mailing bills, and the collection and processing of customer payments. Electric utility costs are available from the Federal Energy Regulatory Commission (FERC) Form 1, thus there is appropriate data transparency. The selection of electric utilities from West Virginia and neighboring states provides a sufficiently sized comparison group.

The fourth question—the necessity of Service Company services—was investigated by defining the services provided to WV American and determining if these services would be required if WV American were a stand-alone utility.

IV – Question 1 – Reasonableness of Service Company Charges

WV American’s Service Company Cost per Customer

During the 12 months ended June 30, 2012, WV American was charged \$59 per customer by the Service Company for A&G/O&M-related services. The calculation of this amount, shown in the table below, starts with total net testable Service Company charges and adjusts for capital and non-A&G functions (engineering, operations and water quality) charges. These adjustments are necessary to develop a per customer cost that is comparable to cost of utility service companies.

	12 Months ended Jun. 30, 2012 Svc. Co. Charges
Testable Service Company charges	\$ 18,705,854
Less: Capital charges	\$ (7,353,806)
Less: Non-A&G function O&M charges	
Engineering	\$ (11,209)
Operations	\$ (848,332)
Water Quality	\$ (309,559)
Net A&G/O&M-related charges	\$ 10,182,948
WV American customers	171,898
WV American Cost Per Customer	\$ 59

Comparison Group Cost Per Customer

Every centralized service company in a holding company system subject to regulation by the FERC must file a Form 60 in accordance with the Public Utility Holding Company Act of 2005, Section 1270, Section 390 of the Federal Power Act and 18 C.F.R. paragraph 366.23. This report is designed to collect financial information from service companies that are subject to regulation by the FERC.

For 2011, a Form 60 was filed by 25 utility service companies, all of which serve utilities that provide regulated electric and, in some cases, gas service to retail customers. In order to make a valid comparison of this group’s costs to those of American Water Works Service Company, it was necessary to isolate expenses that they have in common. These include A&G-related charges associated with the following FERC accounts:

901 – Supervision	921 – Office supplies and expenses
903 – Customer records and collection expenses	923 – Outside services employed
905 – Miscellaneous customer accounts expenses	926 – Employee pensions and benefits
907 – Supervision	928 – Regulatory commission expenses
910 – Misc customer service and info expenses	930.2 – Miscellaneous general expenses
911 – Supervision	931 – Rents
920 - Administrative and general salaries	935 – Maintenance of structures and equipment

Charges to utility affiliates for the comparison group service companies were obtained from Schedule XVI – Analysis of Charges for Service Associate and Non-Associate Companies (p. 303 to 306) of each entity’s FERC Form 60. This schedule shows charges by FERC Account.

Comparison group service company 2011 expenses were also adjusted to remove charges to non-regulated affiliates from the cost pool used to calculate the cost per regulated service customer. This determination was made using information from the FERC Form 60 schedule: Account 457 – Analysis of Billing – Associate Companies.

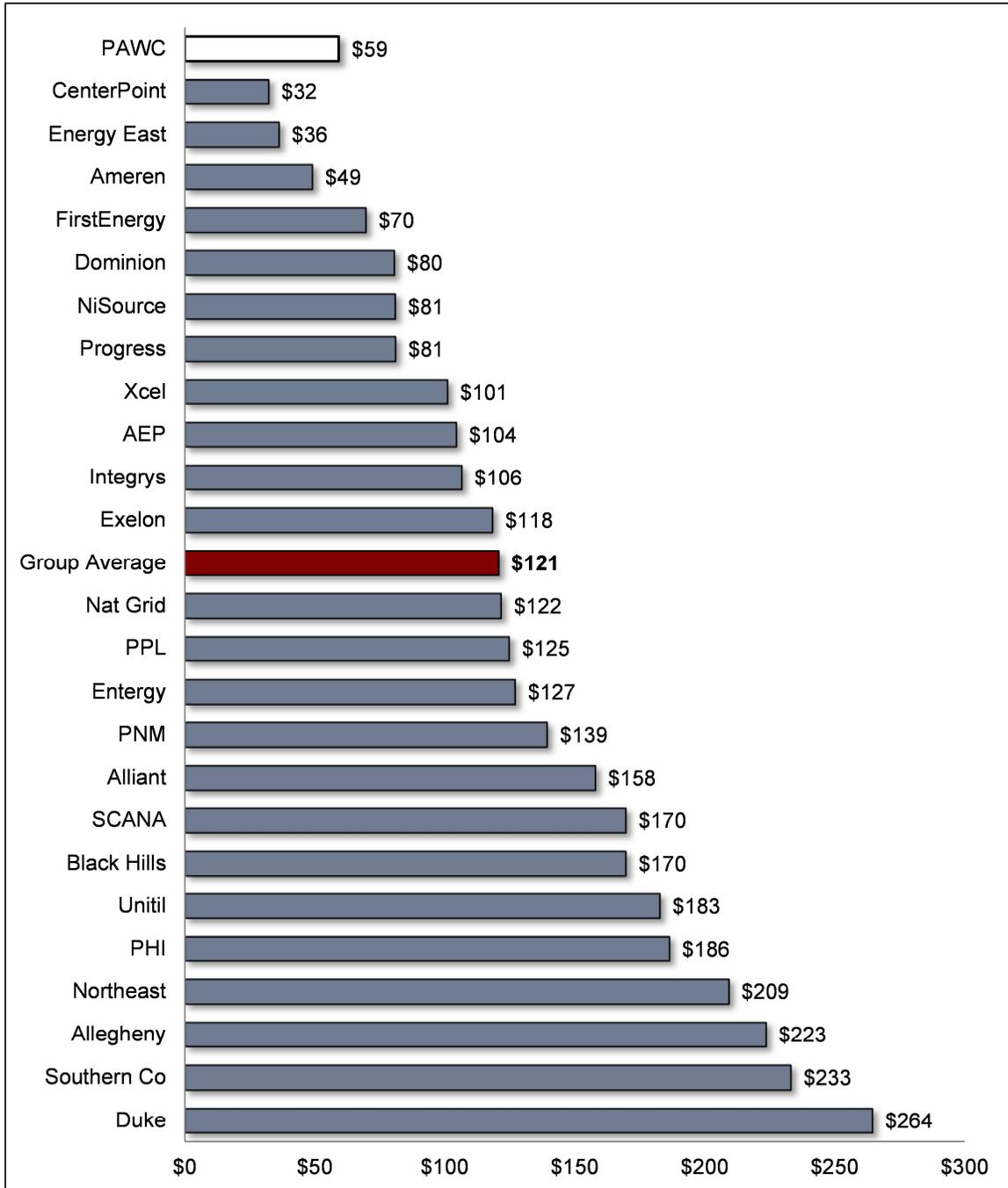
IV – Question 1 – Reasonableness of Service Company Charges

One service company that filed a Form 60 was excluded from the comparison group because its Form 60 contained no data for 2011. That service company, Great Plains Energy Services Incorporated, became inactive since 2010 and had no charges to its regulated utility affiliate. The A&G expenses per regulated utility customer for the other 24 utility companies that filed a Form 60 for 2011 are calculated below.

Utility Company	2011 Regulated Retail Service Company A&G Expenses	Regulated Retail Customers	Cost per Customer
AEP	\$552,869,918	5,300,000	\$ 104
Allegheny	\$335,224,868	1,500,000	\$ 223
Alliant	\$220,963,294	1,399,705	\$ 158
Ameren	\$161,679,247	3,300,000	\$ 49
Black Hills	\$129,300,718	762,500	\$ 170
CenterPoint	\$173,167,918	5,382,487	\$ 32
Dominion	\$300,693,353	3,738,000	\$ 80
Duke	\$1,192,583,827	4,510,000	\$ 264
Energy East	\$98,954,004	2,734,000	\$ 36
Entergy	\$379,796,584	2,991,000	\$ 127
Exelon	\$696,273,856	5,890,000	\$ 118
FirstEnergy	\$312,882,782	4,500,000	\$ 70
Integrus	\$234,096,627	2,200,000	\$ 106
Nat Grid	\$838,867,286	6,900,000	\$ 122
NiSource	\$303,783,709	3,755,000	\$ 81
Northeast	\$441,777,008	2,112,000	\$ 209
PHI	\$365,137,583	1,960,000	\$ 186
PNM	\$101,488,176	728,700	\$ 139
PPL	\$331,526,788	2,659,000	\$ 125
Progress	\$251,067,778	3,100,000	\$ 81
SCANA	\$248,225,942	1,464,000	\$ 170
Southern Co	\$1,025,362,066	4,400,000	\$ 233
Unitil	\$31,359,988	171,700	\$ 183
Xcel	\$534,839,915	5,300,000	\$ 101
Group Total	\$9,261,923,233	76,758,092	\$ 121

Exhibit 1 shows WV American's 12 months ended June 30, 2012 Service Company cost per customer of \$59 to be considerably lower than the average of \$121 per customer for the comparison group service companies. Only two of the comparison group service companies had a lower cost per customer than WV American. Based on this result, it is possible to conclude that the Service Company's 12 months ended June 30, 2012 charges to WV American were reasonable.

**West Virginia American Water Company
Comparison of Service Company Annual Costs Per Customer**



Methodology

The lower-of-cost-or-market comparison is accomplished by comparing the cost per hour for Service Company managerial and professional services to those of outside service providers to whom these duties could be assigned. Based on the nature of the Service Company services it was determined that the following outside providers could perform the categories of services indicated below:

- Management Consultants – executive and administrative management, risk management services, human resources and communications services
- Attorneys – legal services
- Certified Public Accountants – accounting, financial and rates and revenues services
- Information Technology Professional – information technology services
- Professional Engineers – engineering, operations and water quality services.

The services provided by the Belleville lab are assumed to be transferable to professional engineers for purposes of this cost comparison. This was done for two reasons. First, there is no readily available survey of hourly billing rates for testing services such as those performed by Belleville. Second, Belleville personnel have similar, scientific educational backgrounds as Service Company engineering personnel. Thus, it is valid to compare the hourly rates of Belleville services to those of outside engineering firms.

Service Company's hourly rates were calculated for each of the five outside service provider categories, based on the dollars and hours charged to WV American during the 12 months ended June 30, 2012. Hourly billing rates for outside service providers were developed using third party surveys or directly from information furnished by outside providers themselves.

It should be noted that by using the Service Company's hours charged WV American during the 12 months ended June 30, 2012, its hourly rates are actually overstated because some Service Company personnel charge a maximum 8 per day even when they work more. Outside service providers generally bill for every hour worked. If all overtime hours of Service Company personnel had been factored into the hourly rate calculation, Service Company hourly rates would have been lower.

The last step in the market cost comparison was to compare the Service Company's average cost per hour to the average cost per hour for outside providers.

Service Company Hourly Rates

Exhibit 2 (page 14) details the assignment of 12 months ended June 30, 2012 management and professional Service Company charges by outsider provider category. Exhibit 3 (page 15) shows the same assignment for Service Company management and professional hours charged to WV American during the 12 months ended June 30, 2012.

Certain adjustments to these dollar amounts were necessary to calculate Service Company hourly rates that are directly comparable to those of outside providers. Adjustments were made to the following 12 months ended June 30, 2012 non-labor Service Company charges:

V – Question 2 – Provision of Services at the Lower of Cost or Market

- Contract Services – 12 months ended June 30, 2012 Service Company charges to WV American include expenses associated with the use of outside professional firms to perform certain corporate-wide services (e.g., legal, financial audit, actuarial services). These professional fees are excluded from the Service Company hourly rate calculation because the related services have effectively been out-sourced already.
- Travel Expenses – In general, client-related travel expenses are not recovered by outside service providers through their hourly billing rate. Rather, actual out-of-pocket travel expenses are billed to clients in addition to fees for professional services. Thus, it is appropriate to remove these Service Company charges from the hourly rate calculation.
- Information Technology Infrastructure Expenses – Included in the 12 months ended June 30, 2012 Service Company charges to WV American are leases, maintenance fees and depreciation related to American Water's enterprise mainframe, server and network infrastructure and corporate business applications. An outside provider that would take over operation of this infrastructure would recover these expenses over and above the labor necessary to operate the data center.

Exhibit 4 (page 16) shows how contract services, travel expenses and computer hardware/software-related Service Company charges are assigned among the four outside provider categories.

Based on the assignment of expenses and hours shown in Exhibits 2 and 3 and the excludable items shown in Exhibit 4, the Service Company's equivalent costs per hour for the 12 months ended June 30, 2012 are calculated below.

	Attorney	Management Consultant	Certified Public Accountant	IT Professional	Professional Engineer	Total
Total management, professional & technical services charges	\$ 475,089	\$ 8,650,456	\$ 2,470,162	\$ 3,169,925	\$ 1,320,492	\$ 16,086,123
Less:						
Contract services	\$ 54,310	\$ 5,228,384	\$ 642,474	\$ 397,365	\$ 10,266	\$ 6,332,799
Travel expenses	\$ 8,786	\$ 180,924	\$ 35,485	\$ 30,983	\$ 30,909	\$ 287,087
IT infrastructure expenses	\$ 1,250	\$ 419,577	\$ 23,274	\$ 1,079,087	\$ 21,882	\$ 1,545,071
Net Service Charges (A)	\$ 410,742	\$ 2,821,571	\$ 1,768,929	\$ 1,662,489	\$ 1,257,434	\$ 7,921,166
Total Professional Hours (B)	2,101	14,846	17,109	9,778	12,565	56,399
Average Hourly Rate (A / B)	\$ 196	\$ 190	\$ 103	\$ 170	\$ 100	

West Virginia American Water Company
Analysis Of 12 Months Ended June 30, 2012 Service Company Charges By Location And Function

		12 Months Ended June 30, 2012 Service Company Charges						
Location	Function	Attorney	Management Consultant	Certified Public Accountant	IT Professional	Professional Engineer	Total	
Belleville Lab	Water Quality					\$ 230,975	\$ 230,975	
Call Center	Human Resources		\$ 50,630				\$ 50,630	
Corporate	Accounting			\$ 551,199			\$ 551,199	
	Administration		\$ 1,471,569				\$ 1,471,569	
	Audit			\$ 87,830			\$ 87,830	
	Communications		\$ 138,141				\$ 138,141	
	Engineering					\$ 21,654	\$ 21,654	
	Finance		\$ 5,661,024	\$ 512,040			\$ 6,173,064	
	Human Resources		\$ 450,406				\$ 450,406	
	Information Technology				\$ 113,120		\$ 113,120	
	Legal		\$ 227,454				\$ 227,454	
	Operations			\$ 120,859			\$ 444,143	\$ 565,003
	Procurement				\$ 260,919			\$ 260,919
	Rates & Revenue				\$ 81,435			\$ 81,435
	Risk Management			\$ 72,823				\$ 72,823
	Water Quality						\$ 109,648	\$ 109,648
Division/Region Offices	Administration		\$ 320,735				\$ 320,735	
	Business Development		\$ 70,761				\$ 70,761	
	Communications		\$ 47,458				\$ 47,458	
	Engineering					\$ 11,299	\$ 11,299	
	Finance			\$ 423,477			\$ 423,477	
	Human Resources		\$ 54,073				\$ 54,073	
	Legal		\$ 247,635				\$ 247,635	
	Operations			\$ -			\$ 502,773	\$ 502,773
	Procurement				\$ 18,217			
Risk Management			\$ 10				\$ 10	
Information Technology	Information Technology				\$ 3,056,805		\$ 3,056,805	
Shared Services	Accounting			\$ 515,075			\$ 515,075	
	Administration		\$ 190,980				\$ 190,980	
	Human Resources		\$ 986					
	Rates & Revenue			\$ 19,970			\$ 19,970	
Total Dollars Charged		\$ 475,089	\$ 8,650,456	\$ 2,470,162	\$ 3,169,925	\$ 1,320,492	\$ 16,066,920	

West Virginia American Water Company
Analysis Of 12 Months Ended June 30, 2012 Service Company Hours By Location And Function

Location	Function	12 Months Ended June 30, 2012 Service Company Hours					Total
		Attorney	Management Consultant	Certified Public Accountant	IT Professional	Professional Engineer	
Belleville Lab	Water Quality					1,718	1,718
Call Center	Human Resources		491				491
Corporate	Accounting			3,248			3,248
	Administration		782				782
	Audit			432			432
	Communications		427				427
	Engineering						-
	Finance		8,223	3,384			11,607
	Human Resources		1,951				1,951
	Information Technology				526		526
	Legal	357					357
	Operations		286			1,577	1,863
	Procurement						-
	Rates & Revenue			524			524
	Risk Management			372			372
	Water Quality					1,040	1,040
Division/Region Offices	Administration		114				114
	Business Development		650				650
	Communications		276				276
	Engineering					-	-
	Finance			2,636			2,636
	Human Resources		3				3
	Legal	1,744					1,744
	Operations					8,229	8,229
	Procurement			180			
	Risk Management			-			-
Information Technology	Information Technology				9,252		9,252
Shared Services	Accounting			6,707			6,707
	Administration		1,252				1,252
	Human Resources		19				
	Rates & Revenue		-				-
Total Hours Charged		2,101	14,846	17,109	9,778	12,565	56,201

West Virginia American Water Company
12 Months Ended June 30, 2012 Service Company Charges Excludable From The Hourly Rate Calculation

Charges By Function	Exclusions From Hourly Rate Calculation			
	Contract Services	IT HW/SW	Travel Expenses	Total
Accounting	\$ 437,795	\$ 623	\$ 4,761	\$ 443,179
Administration	\$ 778,265	\$ 49,845	\$ 44,453	\$ 872,563
Audit	\$ 17,521	\$ 78	\$ 8,381	\$ 25,980
Business Development			\$ 902	\$ 902
Communications	\$ 40,891	\$ 1,698	\$ 2,900	\$ 45,489
Engineering	\$ 3	\$ 13	\$ 704	\$ 720
Finance	\$ 4,276,324	\$ 353,527	\$ 102,322	\$ 4,732,173
	\$ 7,719	\$ 22,573	\$ 18,089	\$ 48,381
Human Resources	\$ 125,890	\$ 13,006	\$ 18,297	\$ 157,194
Information Technology	\$ 397,365	\$ 1,079,087	\$ 30,983	\$ 1,507,435
Legal	\$ 54,310	\$ 1,250	\$ 8,786	\$ 64,346
Operations	\$ 5,487		\$ 5,219	\$ 10,705
	\$ 634	\$ 12,364	\$ 24,887	\$ 37,885
Procurement	\$ 169,249		\$ 2,452	\$ 171,701
Rates & Revenue	\$ 10,190		\$ 1,802	\$ 11,992
Risk Management	\$ 1,527	\$ 1,501	\$ 6,833	\$ 9,860
Water Quality	\$ 9,629	\$ 9,506	\$ 5,318	\$ 24,453
Total	\$ 6,332,799	\$ 1,545,071	\$ 287,087	\$ 8,164,957

Outside Service Provider Category
Certified Public Accountant
Management Consultant
Certified Public Accountant
Management Consultant
Management Consultant
Professional Engineer
Management Consultant
Certified Public Accountant
Management Consultant
IT Professional
Attorney
Management Consultant
Professional Engineer
Certified Public Accountant
Certified Public Accountant
Management Consultant
Professional Engineer

Recap By Outside Provider	Exclusions From Hourly Rate Calculation			
	Contract Services	IT HW/SW	Travel Expenses	Total
Attorney	\$ 54,310	\$ 1,250	\$ 8,786	\$ 64,346
Management Consultant	\$ 5,228,384	\$ 419,577	\$ 180,924	\$ 5,828,885
Certified Public Accountant	\$ 642,474	\$ 23,274	\$ 35,485	\$ 701,233
IT Professional	\$ 397,365	\$ 1,079,087	\$ 30,983	\$ 1,507,435
Professional Engineer	\$ 10,266	\$ 21,882	\$ 30,909	\$ 63,057
Total	\$ 6,332,799	\$ 1,545,071	\$ 287,087	\$ 8,164,957

Outside Service Provider Hourly Rates

The next step in the cost comparison was to obtain the average billing rates for each outside service provider. The source of this information and the determination of the average rates are described in the paragraphs that follow.

It should be noted that professionals working for three of the five outside provider categories may be licensed to practice by state regulatory bodies. However, not every professional working for these firms is licensed. For instance, among West Virginia certified public accounting firms, only the more experienced staff are predominantly CPAs (see table below). Some Service Company employees also have professional licenses. Thus, it is valid to compare the Service Company's hourly rates to those of the outside professional service providers included in this study.

Position	WVa Average
Partners/Owners	98%
Directors (11+ years experience)	81%
Managers (6-10 years experience)	66%
Sr Associates (4-5 years experience)	44%
Associates (1-3 years experience)	16%
New Professionals	7%

Source: AICPA's National PCPS/TSCPA Management of an Accounting Practice Survey (2008)

Attorneys

The West Virginia State Bar does not survey its members as to their hourly billing rates. In addition, publicly available billing rate information could not be found for West Virginia attorneys. Therefore, an estimate of West Virginia attorney rates was developed from surveys conducted by Lawyers Weekly in the states of Michigan, Missouri and Massachusetts. As presented in Exhibit 5 (page 19), the average rate for each firm was adjusted for the cost of living differential between its location and Charleston, West Virginia. The Lawyers Weekly surveys include rates in effect at December 31, 2010 (Missouri) and December 31, 2011 (Michigan and Massachusetts).

Management Consultants

The cost per hour for management consultants was developed from a 2012 survey performed by the Association of Management Consulting Firms—an industry trade organization. The survey includes rates that were in effect during 2011 for firms throughout the United States. Consultants typically do not limit their practice to any one region and must travel to a client's location. Thus, the U.S. national average is appropriate for comparison.

The first step in the calculation, presented in Exhibit 6 (page 20), was to determine an average rate by consultant position level. From these rates, a single weighted average hourly rate was calculated based upon the percent of time that is typically applied to a consulting assignment by each consultant position level.

V – Question 2 – Provision of Services at the Lower of Cost or Market

Certified Public Accountants

The average hourly rate for West Virginia CPAs was developed from a 2012 survey performed by the American Institute of Certified Public Accountants (AICPA). The West Virginia version of this survey was used to develop hourly rates for member firms in West Virginia.

As shown in Exhibit 7 (page 21), a weighted average hourly rate was developed based on a set of accountant positions and a percent of time that is typically applied to an accounting assignment. This survey includes rate information in effect during 2011.

Information Technology Professionals

The average hourly rate for information technology consultants and contractors was developed from Baryenbruch & Company, LLC IT industry hourly billing rate data. As shown in Exhibit 8 (page 22), that data was compiled and a weighted average was calculated based on a percent of time that is typically applied to an IT consulting assignment based on Baryenbruch & Company, LLC's experience.

Professional Engineers

The Company provided hourly rate information for outside engineering firms that could have been used by WV American in 2012. As presented in Exhibit 9 (page 23), an average rate was developed for each engineering position level. Then, using a typical percentage mix of project time by engineering position, a weighted average cost per hour was calculated.



**West Virginia American Water Company
Estimated Billing Rates For West Virginia Attorneys Based On
Michigan, Missouri and Massachusetts Attorney Billing Rates**

Billing rates as of December 31, 2010/2011 (Note A)		Billing Rate Range					Average	Cost of Living Adjust (B)	Adjusted Rate
Firm	Location	Associate		Partner					
		Low	High	Low	High				
Dickinson Wright	Detroit, Mi	\$ 210	\$ 295	\$ 365	\$ 585	\$ 364	111%	\$ 328	
Butzel Long	Detroit, Mi	\$ 235	\$ 335	\$ 330	\$ 590	\$ 373	111%	\$ 336	
Harness, Dickey & Pierce	Troy, Mi	\$ 281	\$ 281	\$ 468	\$ 468	\$ 375	111%	\$ 338	
Kemp Klein Law Firm	Troy, Mi	\$ 185	\$ 285	\$ 200	\$ 375	\$ 261	111%	\$ 236	
Rader, Fishman & Grauer	Bloomfield Hills, Mi	\$ 130	\$ 250	\$ 275	\$ 550	\$ 301	111%	\$ 272	
Thrun Law Firm	East Lansing, Mi	\$ 210	\$ 210	\$ 235	\$ 235	\$ 223	100%	\$ 222	
Williams, Williams, Rattner & Plunk	Birmingham, Mi	\$ 200	\$ 225	\$ 225	\$ 400	\$ 263	111%	\$ 237	
O'Reilly Rancilio	Sterling Heights, Mi	\$ 150	\$ 200	\$ 225	\$ 300	\$ 219	111%	\$ 197	
Parmenter O'Toole	Muskegon, Mi	\$ 175	\$ 225	\$ 225	\$ 275	\$ 225	100%	\$ 225	
Abbott, Nicholson	Detroit, Mi	\$ 200	\$ 200	\$ 350	\$ 350	\$ 275	111%	\$ 248	
Greensfelder Hemker & Gale	St. Louis, Mo	\$ 175	\$ 240	\$ 285	\$ 435	\$ 284	97%	\$ 291	
Thompson Coburn	St. Louis, Mo	\$ 225	\$ 310	\$ 480	\$ 480	\$ 374	97%	\$ 384	
Armstrong Teasdale	St. Louis, Mo	\$ 200	\$ 325	\$ 335	\$ 475	\$ 334	97%	\$ 343	
HeplerBroom	St. Louis, Mo	\$ 150	\$ 150	\$ 275	\$ 275	\$ 213	97%	\$ 218	
Husch Blackwell	Kansas City, Mo	\$ 206	\$ 326	\$ 342	\$ 483	\$ 339	106%	\$ 322	
Lathrop & Gage	Kansas City, Mo	\$ 195	\$ 240	\$ 325	\$ 420	\$ 295	106%	\$ 280	
Polsinelli, Shughart	Kansas City, Mo	\$ 260	\$ 260	\$ 400	\$ 400	\$ 330	106%	\$ 313	
Spencer, Fane, Britt & Browne	St. Louis, Mo	\$ 220	\$ 230	\$ 280	\$ 390	\$ 280	97%	\$ 287	
Stinson, Morrison, Hecker	St. Louis, Mo	\$ 205	\$ 255	\$ 285	\$ 445	\$ 298	97%	\$ 305	
Burns & Levinson	Boston, Ma	\$ 225	\$ 410	\$ 385	\$ 630	\$ 413	142%	\$ 291	
Hinckley, Allen & Snyder	Boston, Ma	\$ 245	\$ 465	\$ 365	\$ 660	\$ 434	142%	\$ 306	
Fletcher Tilton	Worcester, Ma	\$ 175	\$ 275	\$ 275	\$ 375	\$ 275	142%	\$ 194	
Robinson & Cole	Boston, Ma	\$ 330	\$ 330	\$ 480	\$ 480	\$ 405	142%	\$ 286	
Lawson & Weitzen	Boston, Ma	\$ 150	\$ 300	\$ 250	\$ 500	\$ 300	142%	\$ 212	
Hemenway & Barnes	Boston, Ma	\$ 275	\$ 410	\$ 410	\$ 550	\$ 411	142%	\$ 290	
Anderson Kreiger	Cambridge, Ma	\$ 220	\$ 440	\$ 375	\$ 625	\$ 415	142%	\$ 293	
Seegel Lipshutz & Wilchins	Wellesley, Ma	\$ 180	\$ 300	\$ 250	\$ 400	\$ 283	142%	\$ 199	
Bernkopf Goodman	Boston, Ma	\$ 250	\$ 325	\$ 355	\$ 600	\$ 383	142%	\$ 270	
Tarlow Breed Hart & Rodgers	Boston, Ma	\$ 175	\$ 375	\$ 395	\$ 525	\$ 368	142%	\$ 259	
Cushing & Dolan	Waltham, Ma	\$ 225	\$ 250	\$ 275	\$ 350	\$ 275	142%	\$ 194	
Average Hourly Billing Rate For Attorneys At December 31, 2011								\$ 272	

Note A: Source is Michigan Lawyers Weekly (April 2012), Missouri Lawyers Weekly (April 2011) and Massachusetts Lawyers Weekly (April 2012)

Note B: Source is Council for Community and Economic Research. This percentage represents the cost of living difference between the Michigan and Massachusetts cities and Charleston, WV. A number over 100% indicates the Michigan/Missouri/Massachusetts city's cost of living is higher than Charleston. A number less than 100% indicates Hershey's cost of living is higher.

**West Virginia American Water Company
Billing Rates For U.S. Management Consultants**

Survey billing rates in effect in 2011 (Note A)

A. Calculation of Average Hourly Billing Rate by Consultant Position

Average Hourly Rates (Note A)				
Entry-Level Consultant	Associate Consultant	Senior Consultant	Junior Partner	Senior Partner
\$ 176	\$ 251	\$ 308	\$ 327	\$ 429

Average

B. Calculation of Overall Average Hourly Billing Rate Based on a Typical Distribution of Time on an Engagement

	Entry-Level Consultant	Associate Consultant	Senior Consultant	Junior Partner	Senior Partner	
Average Hourly Billing Rate (from above)	\$ 176	\$251	\$308	\$327	\$429	
Percent of Consulting Assignment	30%	30%	20%	10%	10%	Weighted Average
	\$ 53	\$ 75	\$ 62	\$ 33	\$ 43	\$ 265

Average Hourly Billing Rate For Management Consultants At December 31, 2011 **\$ 265**

Note A: Source is "Operating Ratios For Management Consulting Firms, 2012 Edition," Association of Management Consulting Firms

**West Virginia American Water Company
Billing Rates For West Virginia Certified Public Accountants**

A. Calculation of Average Hourly Billing Rate by Public Accounting Position
Survey billing rates were those in effect in 2011 (Note A)

Average Hourly Billing Rate (Note A)					
	Staff Accountant	Senior Accountant	Manager	Partner	
Average Hourly Billing Rate by CPA Firm Position	\$ 79	\$ 102	\$ 141	\$ 193	
Percent of Accounting Assignment	30%	30%	20%	20%	Weighted Average
	\$ 24	\$ 31	\$ 28	\$ 39	\$ 121
Average Hourly Billing Rate For Certified Public Accountants At December 31, 2011					\$ 121

Note A: Source is AICPA's 2012 National PCPS/TSCPA Management of an Accounting Practice Survey (West Virginia edition)

**West Virginia American Water Company
Billing Rates For West Virginia Information Technology Professionals**

IT Resource Level	2011-12 Hourly Rate (A)
Consultant Positions	
Senior Manager/Partner Consultant	\$ 378
Staff/Manager Consultant	\$ 261
Contractor Positions	
Senior Contractor	\$ 155
Contractor	\$ 65

Overall Average	2011-12 Rate	% of Project/ Assignment	
Senior Manager/Partner Consultant	\$ 378	10%	\$ 38
Staff/Manager Consultant	\$ 261	30%	\$ 78
Senior Contractor	\$ 155	30%	\$ 46
Contractor	\$ 65	30%	\$ 19
Weighted Average			\$ 182

Note A: Sources are Baryenbruch & Company, LLC

**West Virginia American Water Company
Estimated Billing Rates For West Virginia Professional Engineers**

Billing rates in effect in 2012				
A. Calculation of Average Hourly Rate by Engineer Position				
Name of Firm	Average Hourly Billing Rates			
	Technician Senior Technician	Engineer Design Engineer Project Engineer	Project Manager Sr. Mgr. Engineer	Officer Principal Engineer
Firm #1	\$68	\$98	\$134	\$200
Firm #2	\$38	\$91	\$166	\$200
Firm #3	\$68	\$80	\$133	\$225
B. Calculation of Overall Average Engineering Hourly Billing Rate				
Average Hourly Billing Rate (From Above)	Technician Senior Technician	Engineer Design Engineer Project Engineer	Project Manager Sr. Mgr. Engineer	Officer Principal Engineer
	\$58	\$90	\$144	\$208
Typical Percent of Time on an Engineering Assignment	30%	35%	25%	10%
	\$17	\$31	\$36	\$21
				Weighted Average \$105

Source: Information provided by American Water Works Service Company

V – Question 2 – Provision of Services at the Lower of Cost or Market

Service Company versus Outside Provider Cost Comparison

As shown in the table below, Service Company costs per hour are considerably lower than those of outside providers.

Service Provider	12 Months Ended June 30, 2012		
	Service Company	Outside Provider	Difference-- Service Co. Greater(Less) Than Outside
Attorney	\$ 196	\$ 272	\$ (76)
Management Consultant	\$ 190	\$ 265	\$ (75)
Certified Public Accountant	\$ 103	\$ 121	\$ (18)
IT Professional	\$ 170	\$ 182	\$ (12)
Professional Engineer	\$ 100	\$ 105	\$ (5)

Based on these cost per hour differentials and the number of managerial and professional services hours billed to WV American during the 12-months ended June 30, 2012, outside service providers would have cost \$1,765,044 more than the Service Company (see table below). Thus, on average, outside provider's hourly rates are 11% higher than those of the Service Company (\$1,765,044 / \$16,086,123).

Service Provider	12 Months Ended June 30, 2012		
	Hourly Rate Difference-- Service Co. Greater(Less) Than Outside	Service Company Hours Charged	Dollar Difference
Attorney	\$ (76)	2,101	\$ (160,715)
Management Consultant	\$ (75)	14,846	\$ (1,117,307)
Certified Public Accountant	\$ (18)	17,109	\$ (303,397)
IT Professional	\$ (12)	9,778	\$ (115,758)
Professional Engineer	\$ (5)	12,565	\$ (67,867)
Service Company Less Than Outside Providers			\$ (1,765,044)

It should be noted that the cost differential associated with using outside providers is even greater because exempt Service Company personnel do not charge more than 8 hours per day even when they work more. Outside providers generally charge clients for all hours worked. Thus, WV American would have been charged by outside providers for overtime worked by Service Company personnel who are not paid for that time.

If WV American were to use outside service providers rather than the Service Company for managerial and professional services, it would incur other additional expenses besides those associated with higher hourly rates. Managing outside firms who would perform over 56,200 hours of work (more than 37 full-time equivalents at 1,500 "billable" hours per FTE per year) would add a significant workload to the existing WV American management team. Thus, it would be necessary for WV American to add at least one position to supervise the outside firms and ensure they delivered quality and timely services. The individual that would fill this position would need a good understanding of each profession being managed. They must also have management experience and the authority necessary to give them credibility with the outside

V – Question 2 – Provision of Services at the Lower of Cost or Market

firms. As calculated in the table below, this position would add almost \$150,000 per year to WV American's personnel expenses.

<u>Cost of Adding 1 Professional Positions To</u>	
<u>WV American's Staff</u>	
	<u>Total</u>
New Positions' Salary	\$ 100,000
Benefits (at 49.4%)	\$ 49,400
Office Expenses (15.2%)	\$ 15,200
Total Cost of Full Time Position	\$ 149,400

Thus, the total effect on the ratepayers of WV American of contracting all services now provided by Service Company would be an increase in their costs of \$1,914,444 (\$1,765,044 + \$149,400). Based on the results of this comparison, it is possible to conclude that the Service Company charged WV American at the lower of cost or market for services provided during the 12 months ended June 30, 2012.

VI - Question 3 - Reasonableness of Customer Accounts Services Costs

Background

Customer Accounts Services covers the following utility functions:

- Customer Call Center – customer calls/contact, credit, order taking/disposition, bill collection efforts, outage calls
- Customer Call Center Maintenance – support of phone banks, voice recognition units, call center software applications and telecommunications
- Customer billing – bill printing, stuffing, and mailing
- Remittance processing – processing customer payments received in the mail
- Bill payment centers – processing customer payments at locations where customers can pay their bills in person

It is difficult to compare the cost of the Service Company's customer accounts services-related charges to WV American with outside providers of the same services because survey data is proprietary and expensive to obtain. For this reason, WV American's charges from the Service Company for customer accounts services are compared to those of neighboring electric utilities because the data necessary to make such comparison is available to the public.

Neighboring electric utility cost information comes from the FERC Form 1 that each utility must file. FERC's chart of accounts is defined in Chapter 18, Part 101 of the Code of Federal Regulations. FERC accounts that contain customer accounts services-related expenses are Account 903 Customer Accounts Expense – Records and Collection Expense and Account 905 Customer Accounts Expense – Miscellaneous Customer Accounts Expense. Exhibit 10 provides FERC's definition of the type of expenses that should be recorded in these accounts.

In addition to the charges in these FERC accounts, labor-related overheads charged to the following FERC accounts must be added to the labor components of Accounts 903 and 905:

- Account 926 Employee Pension and Benefits
- Account 408 Taxes Other Than Income (employer's portion of FICA)

Comparison Group

Electric utilities included in the comparison group are shown in the table below. These are companies whose FERC Form 1 show amounts for accounts 903 and 905.

West Virginia	<ul style="list-style-type: none"> • Appalachian Power • Monongahela Power 	<ul style="list-style-type: none"> • Potomac Edison • Wheeling Power
Kentucky	<ul style="list-style-type: none"> • Duke Energy Kentucky • Kentucky Power 	<ul style="list-style-type: none"> • Kentucky Utilities • Louisville Gas & Electric
Ohio	<ul style="list-style-type: none"> • Cleveland Elect Illuminating • Dayton Power & Light • Duke Energy Ohio 	<ul style="list-style-type: none"> • Ohio Edison • Ohio Power • Toledo Edison
Virginia	<ul style="list-style-type: none"> • Appalachian Power 	<ul style="list-style-type: none"> • Virginia Electric Power
Pennsylvania	<ul style="list-style-type: none"> • Duquesne Light • Metropolitan Edison • PECO Energy • Pennsylvania Electric 	<ul style="list-style-type: none"> • Pennsylvania Power • PPL Electric • West Penn Power
Maryland	<ul style="list-style-type: none"> • Baltimore Gas & Electric • Delmarva Power & Light 	<ul style="list-style-type: none"> • Potomac Electric

West Virginia American Water Company FERC Account Descriptions

903 – Customer Records and Collection Expenses

This account shall include the cost of labor, materials used and expenses incurred in work on customer applications, contracts, orders, credit investigations, billing and accounting, collections and complaints.

Labor

1. Receiving, preparing, recording and handling routine orders for service, disconnections, transfers or meter tests initiated by the customer, excluding the cost of carrying out such orders, which is chargeable to the account appropriate for the work called for by such orders.
2. Investigations of customers' credit and keeping of records pertaining thereto, including records of uncollectible accounts written off.
3. Receiving, refunding or applying customer deposits and maintaining customer deposit, line extension, and other miscellaneous records.
4. Checking consumption shown by meter readers' reports where incidental to preparation of billing data.
5. Preparing address plates and addressing bills and delinquent notices.
6. Preparing billing data.
7. Operating billing and bookkeeping machines.
8. Verifying billing records with contracts or rate schedules.
9. Preparing bills for delivery, and mailing or delivering bills.
10. Collecting revenues, including collection from prepayment meters unless incidental to meter reading operations.
11. Balancing collections, preparing collections for deposit, and preparing cash reports.
12. Posting collections and other credits or charges to customer accounts and extending unpaid balances.
13. Balancing customer accounts and controls.
14. Preparing, mailing, or delivering delinquent notices and preparing reports of delinquent accounts.
15. Final meter reading of delinquent accounts when done by collectors incidental to regular activities.
16. Disconnecting and reconnecting services because of nonpayment of bills.
17. Receiving, recording, and handling of inquiries, complaints, and requests for investigations from customers, including preparation of necessary orders, but excluding the cost of carrying out such orders, which is chargeable to the account appropriate for the work called for by such orders.
18. Statistical and tabulating work on customer accounts and revenues, but not including special analyses for sales department, rate department, or other general purposes, unless incidental to regular customer accounting routines.
19. Preparing and periodically rewriting meter reading sheets.
20. Determining consumption and computing estimated or average consumption when performed by employees other than those engaged in reading meters.

Materials and expenses

21. Address plates and supplies.
22. Cash overages and shortages.
23. Commissions or fees to others for collecting.
24. Payments to credit organizations for investigations and reports.
25. Postage.
26. Transportation expenses, including transportation of customer bills and meter books under centralized billing procedure.
27. Transportation, meals, and incidental expenses.
28. Bank charges, exchange, and other fees for cashing and depositing customers' checks.
29. Forms for recording orders for services, removals, etc.
30. Rent of mechanical equipment.

**West Virginia American Water Company
FERC Account Descriptions**

905 – Miscellaneous Customer Accounts Expenses

This account shall include the cost of labor, materials used and expenses incurred not provided for in other accounts.

Labor

1. General clerical and stenographic work.
2. Miscellaneous labor.

Materials and expenses

3. Communication service.
4. Miscellaneous office supplies and expenses and stationery and printing other than those specifically provided for in accounts 902 and 903.



VI - Question 3 - Reasonableness of Customer Accounts Services Costs

WV American Cost per Customer

As calculated below, WV American's 12 months ended June 30, 2012 customer account services expense per customer is \$30.04. The cost pool used to calculate this average includes charges for Service Company services (e.g., call center, billing, payment processing) and postage and forms expenses, which are incurred directly by WV American. It was necessary to adjust the National Call Center charges because electric utilities experience an average of 2.50 calls per customer compared to American Water's 1.26 calls per customer. Thus, National Call Center expenses have to be increased, for comparison purposes, to reflect its costs at a 2.50 calls per customer level.

West Virginia American Water Company		Service Co Charges	Adjustment Fewer Calls For Water Cos. (A)	Adjusted	
Service Company					
Call Centers	Call processing, order processing, credit, bill collection	\$ 2,592,450	\$ 1,192,892	\$ 3,785,343	
Service Company	Customer payment processing			\$ 215,148	Note B
Operating Company	Postage & forms			\$ 1,163,073	
			Cost Pool Total	\$ 5,163,563	
			Total Customers	171,898	
12 Months Ended December 31, 2009 Cost Per WV American Customer				\$ 30.04	

Note A: Adjustment for American Water's fewer calls per customer

This adjustment is necessary because water utilities experience fewer calls per customer than do electric utilities

Test year Call Handling charges	\$ 1,213,790
Electric utility industry's avg calls/customer	2.50
American Water's avg calls/customer	1.26
Percent different	98%
Total Adjustment B	\$ 1,192,892

Note B: Estimated customer payment processing expenses

Number of customers	171,898
Number of payments/customer/year	12.0
Total payments processed/year	2,062,776
Bank charge per item	\$ 0.1043
Total estimated annual expense	\$ 215,148

Electric Utility Group Cost per Customer

Exhibit 11 shows the actual 2011 customer accounts expense per customer calculation for the electric utility comparison group. All of the underlying data was taken from the utilities' FERC Form 1.

VI - Question 3 - Reasonableness of Customer Accounts Services Costs

Summary of Results

As shown in the table below, WV American's cost per customer is below the average cost of the neighboring electric utility comparison group. It can therefore be concluded that WV American's 2011 customer accounts-related expenses, including those of the Alton and Pensacola Call Centers, assigned by the Service Company to WV American were comparable to those of other utilities.

Average Customer Accounts Expense Per Customer		
Cleveland Electric Illum.	\$	13.67
Metropolitan Edison	\$	15.04
Virginia Electric Power	\$	15.77
Pennsylvania Electric	\$	16.37
Pennsylvania Power	\$	16.40
Ohio Edison	\$	16.58
Potomac Edison	\$	17.69
Monongahela Power	\$	19.32
Toledo Edison	\$	19.78
Louisville Gas & Electric	\$	20.26
Duquesne Light	\$	21.02
Dayton Power & Light	\$	23.17
West Penn Power	\$	24.53
Wheeling Power	\$	27.01
West Virginia American Water	\$	30.04
Appalachian Power	\$	32.03
PPL Electric Utilities	\$	32.93
Comparison Group Average	\$	33.04
Kentucky Utilities	\$	34.18
Ohio Power	\$	34.20
Kentucky Power	\$	36.64
Baltimore Gas & Electric	\$	38.64
Duke Energy Kentucky	\$	48.49
Duke Energy - Ohio	\$	51.73
PECO Energy	\$	60.59
Delmarva Power & Light	\$	76.56
Potomac Electric	\$	88.76

West Virginia-American Water Company
Comparison Group 2011 Actual Customer Accounts Expense Per Customer

	West Virginia			Virginia	
	Power	Power	Edison	Power	Power
Customer Account Services Cost Pool					
FERC Account Balances:					
Acct 903 - Customer Records & Collection (page 322, line 161)	\$ 28,641,441	\$ 4,959,667	\$ 4,495,504	\$ 1,012,892	\$ 32,812,881
Acct 905 - Misc Customer Accounts (page 322, line 163)	\$ 146,685	\$ -	\$ -	\$ 5,146	\$ -
Subtotal	\$ 28,788,126	\$ 4,959,667	\$ 4,495,504	\$ 1,018,038	\$ 32,812,881
Add: Employee Benefits & Employer FICA (not included in above amounts)					
Account 926 - Employee Pension & Benefits	\$ 1,550,885	\$ 2,264,766	\$ 2,155,297	\$ 72,273	\$ 4,182,674
Account 408 - Taxes Other Than Income (Employer's Portion of FICA)	\$ 443,489	\$ 249,835	\$ 226,964	\$ 19,751	\$ 1,455,883
Total Cost Pool	\$ 30,782,500	\$ 7,474,268	\$ 6,877,766	\$ 1,110,062	\$ 38,451,438
Total Customers (page 304, line 43)	961,129	386,819	388,814	41,099	2,438,226
Customer Account Services Expense per Customer	\$ 32.03	\$ 19.32	\$ 17.69	\$ 27.01	see WVa \$ 15.77
Note A: Calculation of <u>Pension & Benefits</u> Pertaining to Customer Acct Mgmt					
Account 926 - Employee Pension & Benefits (page 323, line 187)	\$ 26,385,423	\$ 45,790,854	\$ 18,445,546	\$ 518,375	\$ 135,517,624
Total O&M Payroll (page 355, line 65)	\$ 98,629,340	\$ 66,031,040	\$ 25,391,013	\$ 1,851,783	\$ 616,604,687
Benefits as Percent of Payroll	26.8%	69.3%	72.6%	28.0%	22.0%
Payroll Applicable to Customer Account Services					
Total Payroll Charged to Customer Accounts Function					
Electric (page 354, line 7)	\$ 6,618,102	\$ 6,164,039	\$ 5,133,095	\$ 331,381	\$ 23,387,494
Gas (page 354, line 37)	\$ -	\$ -	\$ -	\$ -	\$ -
Total Payroll Charged to Customer Accounts	\$ 6,618,102	\$ 6,164,039	\$ 5,133,095	\$ 331,381	\$ 23,387,494
Percent Applicable to Customer Accounts Services (903 and 905):					
Acct 903 - Customer Records & Collection (page 322, line 161)	\$ 28,641,441	\$ 4,959,667	\$ 4,495,504	\$ 1,012,892	\$ 32,812,881
Acct 905 - Misc Customer Accounts (page 322, line 163)	\$ 146,685	\$ -	\$ -	\$ 5,146	\$ -
Subtotal - Total Charges Applicable to Customer Accounts Services	\$ 28,788,126	\$ 4,959,667	\$ 4,495,504	\$ 1,018,038	\$ 32,812,881
Acct 902 - Meter Reading Expenses (page 322, line 160)	\$ 4,076,241	\$ 4,401,397	\$ 3,282,389	\$ 288,637	\$ 7,511,063
Total Charges Applicable to Customer Accounts Svcs & Meter Reading	\$ 32,864,367	\$ 9,361,064	\$ 7,777,893	\$ 1,306,675	\$ 40,323,944
Percent Applicable to Customer Accounts Services (903 and 905)	87.6%	53.0%	57.8%	77.9%	81.4%
Customer Account Services Portion of Total Payroll	\$ 5,797,244	\$ 3,265,823	\$ 2,966,851	\$ 258,181	\$ 19,031,151
Pension & Benefits Pertaining to Customer Accounts Services	\$ 1,550,885	\$ 2,264,766	\$ 2,155,297	\$ 72,273	\$ 4,182,674
Note B: Calculation of <u>Employer's FICA</u> Pertaining to Customer Accounts Services					
Customer Account Services Portion of Total Payroll	\$ 5,797,244	\$ 3,265,823	\$ 2,966,851	\$ 258,181	\$ 19,031,151
Employer's Portion of FICA (6.20%) and Medicare (1.45%)	7.65%	7.65%	7.65%	7.65%	7.65%
Estimated Employer's Portion of FICA	\$ 443,489	\$ 249,835	\$ 226,964	\$ 19,751	\$ 1,455,883

**West Virginia-American Water Company
Comparison Group 2011 Actual Customer Accounts Expense Per Customer**

		Kentucky				Maryland		
		Kentucky	Power	Utilities	& Electric	& Electric	& Light	Electric
Customer Account Services Cost Pool								
FERC Account Balances:								
Acct 903 - Customer Records & Collection (page 322, line 161)		\$ 5,385,435	\$ 5,926,504	\$ 14,012,026	\$ 5,174,872	\$ 34,333,558	\$ 35,438,737	\$ 60,313,434
Acct 905 - Misc Customer Accounts (page 322, line 163)		\$ -	\$ 87,535	\$ 753,506	\$ 445,330	\$ 3,555,098	\$ -	\$ -
	Subtotal	\$ 5,385,435	\$ 6,014,039	\$ 14,765,532	\$ 5,620,202	\$ 37,888,656	\$ 35,438,737	\$ 60,313,434
Add: Employee Benefits & Employer FICA (not included in above amounts)								
Account 926 - Employee Pension & Benefits	Note A	\$ 853,986	\$ 264,233	\$ 3,199,741	\$ 2,015,996	\$ 7,217,235	\$ 2,468,007	\$ 8,345,850
Account 408 - Taxes Other Than Income (Employer's Portion of FICA)	Note B	\$ 334,932	\$ 84,713	\$ 521,679	\$ 346,229	\$ 2,820,876	\$ 451,976	\$ 1,203,073
	Total Cost Pool	\$ 6,574,353	\$ 6,362,985	\$ 18,486,953	\$ 7,982,427	\$ 47,926,766	\$ 38,358,720	\$ 69,862,357
Total Customers (page 304, line 43)		135,574	173,641	540,839	394,063	1,240,291	500,998	787,137
	Customer Account Services Expense per Customer	\$ 48.49	\$ 36.64	\$ 34.18	\$ 20.26	\$ 38.64	\$ 76.56	\$ 88.76
Note A: Calculation of Pension & Benefits Pertaining to Customer Acct Mgmt								
Account 926 - Employee Pension & Benefits (page 323, line 187)		\$ 6,725,042	\$ 5,311,103	\$ 40,898,849	\$ 38,333,662	\$ 44,126,036	\$ 19,496,486	\$ 39,561,414
Total O&M Payroll (page 355, line 65)		\$ 34,477,756	\$ 22,258,075	\$ 87,164,271	\$ 86,058,359	\$225,448,119	\$ 46,672,791	\$ 74,547,274
	Benefits as Percent of Payroll	19.5%	23.9%	46.9%	44.5%	19.6%	41.8%	53.1%
Payroll Applicable to Customer Account Services								
Total Payroll Charged to Customer Accounts Function								
Electric (page 354, line 7)		\$ 3,181,805	\$ 1,234,698	\$ 9,052,948	\$ 3,440,063	\$ 28,391,332	\$ 7,041,290	\$ 17,382,773
Gas (page 354, line 37)		\$ 1,983,282	\$ -	\$ -	\$ 2,814,445	\$ 13,873,030	\$ 144,720	\$ -
	Total Payroll Charged to Customer Accounts	\$ 5,165,087	\$ 1,234,698	\$ 9,052,948	\$ 6,254,508	\$ 42,264,362	\$ 7,186,010	\$ 17,382,773
Percent Applicable to Customer Accounts Services (903 and 905):								
Acct 903 - Customer Records & Collection (page 322, line 161)		\$ 5,385,435	\$ 5,926,504	\$ 14,012,026	\$ 5,174,872	\$ 34,333,558	\$ 35,438,737	\$ 60,313,434
Acct 905 - Misc Customer Accounts (page 322, line 163)		\$ -	\$ 87,535	\$ 753,506	\$ 445,330	\$ 3,555,098	\$ -	\$ -
	Subtotal - Total Charges Applicable to Customer Accounts Services	\$ 5,385,435	\$ 6,014,039	\$ 14,765,532	\$ 5,620,202	\$ 37,888,656	\$ 35,438,737	\$ 60,313,434
Acct 902 - Meter Reading Expenses (page 322, line 160)		\$ 967,928	\$ 691,558	\$ 4,836,309	\$ 2,146,609	\$ 5,538,460	\$ 7,664,725	\$ 6,352,290
	Total Charges Applicable to Customer Accounts Svcs & Meter Reading	\$ 6,353,363	\$ 6,705,597	\$ 19,601,841	\$ 7,766,811	\$ 43,427,116	\$ 43,103,462	\$ 66,665,724
	Percent Applicable to Customer Accounts Services (903 and 905)	84.8%	89.7%	75.3%	72.4%	87.2%	82.2%	90.5%
	Customer Account Services Portion of Total Payroll	\$ 4,378,192	\$ 1,107,362	\$ 6,819,339	\$ 4,525,873	\$ 36,874,193	\$ 5,908,182	\$ 15,726,443
	Pension & Benefits Pertaining to Customer Accounts Services	\$ 853,986	\$ 264,233	\$ 3,199,741	\$ 2,015,996	\$ 7,217,235	\$ 2,468,007	\$ 8,345,850
Note B: Calculation of Employer's FICA Pertaining to Customer Accounts Services								
	Customer Account Services Portion of Total Payroll	\$ 4,378,192	\$ 1,107,362	\$ 6,819,339	\$ 4,525,873	\$ 36,874,193	\$ 5,908,182	\$ 15,726,443
	Employer's Portion of FICA (6.20%) and Medicare (1.45%)	7.65%	7.65%	7.65%	7.65%	7.65%	7.65%	7.65%
	Estimated Employer's Portion of FICA	\$ 334,932	\$ 84,713	\$ 521,679	\$ 346,229	\$ 2,820,876	\$ 451,976	\$ 1,203,073

West Virginia-American Water Company
Comparison Group 2011 Actual Customer Accounts Expense Per Customer

		Pennsylvania						
		Light	Edison	Energy	Electric	Power	Utilities	Power
Customer Account Services Cost Pool								
FERC Account Balances:								
Acct 903 - Customer Records & Collection (page 322, line 131)		\$ 8,240,831	\$ 6,478,417	\$ 57,731,950	\$ 6,603,775	\$ 1,825,059	\$ 36,945,110	\$ 13,077,267
Acct 905 - Misc Customer Accounts (page 322, line 133)		\$ -	\$ 64,637	\$ 34,645,819	\$ 185,630	\$ 47,061	\$ 1,277,524	\$ -
	Subtotal	\$ 8,240,831	\$ 6,543,054	\$ 92,377,769	\$ 6,789,405	\$ 1,872,120	\$ 38,222,634	\$ 13,077,267
Add: Employee Benefits & Employer FICA (not included in above amounts)								
Account 926 - Employee Pension & Benefits	Note A	\$ 3,653,759	\$ 1,567,034	\$ 5,986,300	\$ 2,625,837	\$ 691,630	\$ 6,274,768	\$ 4,079,846
Account 408 - Taxes Other Than Income (Employer's Portion of FICA)	Note B	\$ 455,410	\$ 204,097	\$ 2,109,517	\$ 236,399	\$ 64,258	\$ 1,729,458	\$ 435,580
	Total Cost Pool	\$ 12,350,000	\$ 8,314,186	\$100,473,587	\$ 9,651,641	\$ 2,628,008	\$ 46,226,859	\$ 17,592,693
Total Customers (page 304, line 43)		587,610	552,631	1,658,184	589,651	160,250	1,403,889	717,269
	Customer Account Services Expense per Customer	\$ 21.02	\$ 15.04	\$ 60.59	\$ 16.37	\$ 16.40	\$ 32.93	\$ 24.53
Note A: Calculation of <u>Pension & Benefits</u> Pertaining to Customer Acct Mgmt								
Account 926 - Employee Pension & Benefits (page 323, line 187)		\$ 31,937,033	\$ 17,129,280	\$ 37,433,682	\$ 24,209,982	\$ 4,527,270	\$ 27,029,308	\$ 29,057,464
Total O&M Payroll (page 355, line 65)		\$ 52,035,044	\$ 29,163,301	\$172,435,116	\$ 28,491,240	\$ 5,498,267	\$ 97,383,584	\$ 40,552,793
Benefits as Percent of Payroll		61.4%	58.7%	21.7%	85.0%	82.3%	27.8%	71.7%
Payroll Applicable to Customer Account Services								
Total Payroll Charged to Customer Accounts Function								
Electric (page 354, line 7)		\$ 9,724,042	\$ 4,719,136	\$ 26,445,113	\$ 5,454,906	\$ 1,489,216	\$ 23,668,855	\$ 8,505,318
Gas (page 354, line 37)		\$ -	\$ -	\$ 5,670,129	\$ -	\$ -	\$ -	\$ -
	Total Payroll Charged to Customer Accounts	\$ 9,724,042	\$ 4,719,136	\$ 32,115,242	\$ 5,454,906	\$ 1,489,216	\$ 23,668,855	\$ 8,505,318
Percent Applicable to Customer Accounts Services (903 and 905):								
Acct 903 - Customer Records & Collection (page 322, line 161)		\$ 8,240,831	\$ 6,478,417	\$ 57,731,950	\$ 6,603,775	\$ 1,825,059	\$ 36,945,110	\$ 13,077,267
Acct 905 - Misc Customer Accounts (page 322, line 163)		\$ -	\$ 64,637	\$ 34,645,819	\$ 185,630	\$ 47,061	\$ 1,277,524	\$ -
	Subtotal - Total Charges Applicable to Customer Accounts Services	\$ 8,240,831	\$ 6,543,054	\$ 92,377,769	\$ 6,789,405	\$ 1,872,120	\$ 38,222,634	\$ 13,077,267
Acct 902 - Meter Reading Expenses (page 322, line 160)		\$ 5,220,147	\$ 5,030,505	\$ 15,208,540	\$ 5,195,495	\$ 1,447,040	\$ 1,794,813	\$ 6,457,162
	Total Charges Applicable to Customer Accounts Svcs & Meter Reading	\$ 13,460,978	\$ 11,573,559	\$107,586,309	\$ 11,984,900	\$ 3,319,160	\$ 40,017,447	\$ 19,534,429
	Percent Applicable to Customer Accounts Services (903 and 905)	61.2%	56.5%	85.9%	56.6%	56.4%	95.5%	66.9%
	Customer Account Services Portion of Total Payroll	\$ 5,953,073	\$ 2,667,940	\$ 27,575,390	\$ 3,090,186	\$ 839,969	\$ 22,607,289	\$ 5,693,861
	Pension & Benefits Pertaining to Customer Accounts Services	\$ 3,653,759	\$ 1,567,034	\$ 5,986,300	\$ 2,625,837	\$ 691,630	\$ 6,274,768	\$ 4,079,846
Note B: Calculation of <u>Employer's FICA</u> Pertaining to Customer Accounts Services								
	Customer Account Services Portion of Total Payroll	\$ 5,953,073	\$ 2,667,940	\$ 27,575,390	\$ 3,090,186	\$ 839,969	\$ 22,607,289	\$ 5,693,861
	Employer's Portion of FICA (6.20%) and Medicare (1.45%)	7.65%	7.65%	7.65%	7.65%	7.65%	7.65%	7.65%
	Estimated Employer's Portion of FICA	\$ 455,410	\$ 204,097	\$ 2,109,517	\$ 236,399	\$ 64,258	\$ 1,729,458	\$ 435,580

West Virginia-American Water Company
Comparison Group 2011 Actual Customer Accounts Expense Per Customer

		Ohio						
		Electric Illum.	& Light	Ohio	Ohio Edison	Ohio Power	Toledo Edison	
Customer Account Services Cost Pool								
FERC Account Balances:								
Acct 903 - Customer Records & Collection (page 322, line 161)		\$ 8,478,640	\$ 10,438,841	\$ 29,061,485	\$ 12,525,713	\$ 46,627,577	\$ 4,450,729	
Acct 905 - Misc Customer Accounts (page 322, line 163)		\$ 350,354	\$ -	\$ 238	\$ 390,160	\$ 267,744	\$ 148,130	
	Subtotal	\$ 8,828,994	\$ 10,438,841	\$ 29,061,723	\$ 12,915,873	\$ 46,895,321	\$ 4,598,859	
Add: Employee Benefits & Employer FICA (not included in above amounts)								
Account 926 - Employee Pension & Benefits	Note A	\$ 1,206,387	\$ 1,056,621	\$ 4,754,999	\$ 3,860,431	\$ 2,326,236	\$ 1,376,718	Group Average
Account 408 - Taxes Other Than Income (Employer's Portion of FICA)	Note B	\$ 205,413	\$ 402,717	\$ 1,661,039	\$ 376,315	\$ 705,013	\$ 135,304	
	Total Cost Pool	\$ 10,240,794	\$ 11,898,179	\$ 35,477,762	\$ 17,152,620	\$ 49,926,570	\$ 6,110,881	\$608,294,374
Total Customers (page 304, line 43)		748,935	513,524	685,859	1,034,534	1,459,875	309,020	18,409,861
	Customer Account Services Expense per Customer	\$ 13.67	\$ 23.17	\$ 51.73	\$ 16.58	\$ 34.20	\$ 19.78	\$ 33.04
Note A: Calculation of Pension & Benefits Pertaining to Customer Acct Mgmt								
Account 926 - Employee Pension & Benefits (page 323, line 187)		\$ 14,411,809	\$ 21,509,888	\$ 39,844,399	\$ 32,150,620	\$ 41,913,468	\$ 12,046,966	
Total O&M Payroll (page 355, line 65)		\$ 32,077,339	\$107,166,207	\$181,942,977	\$ 40,967,942	\$166,048,740	\$ 15,476,786	
	Benefits as Percent of Payroll	44.9%	20.1%	21.9%	78.5%	25.2%	77.8%	
Payroll Applicable to Customer Account Services								
Total Payroll Charged to Customer Accounts Function								
Electric (page 354, line 7)		\$ 3,984,196	\$ 7,159,427	\$ 16,474,197	\$ 7,731,172	\$ 10,693,557	\$ 2,571,207	
Gas (page 354, line 37)		\$ -	\$ -	\$ 8,860,878	\$ -	\$ -	\$ -	
	Total Payroll Charged to Customer Accounts	\$ 3,984,196	\$ 7,159,427	\$ 25,335,075	\$ 7,731,172	\$ 10,693,557	\$ 2,571,207	
Percent Applicable to Customer Accounts Services (903 and 905):								
Acct 903 - Customer Records & Collection (page 322, line 161)		\$ 8,478,640	\$ 10,438,841	\$ 29,061,485	\$ 12,525,713	\$ 46,627,577	\$ 4,450,729	
Acct 905 - Misc Customer Accounts (page 322, line 163)		\$ 350,354	\$ -	\$ 238	\$ 390,160	\$ 267,744	\$ 148,130	
	Subtotal - Total Charges Applicable to Customer Accounts Services	\$ 8,828,994	\$ 10,438,841	\$ 29,061,723	\$ 12,915,873	\$ 46,895,321	\$ 4,598,859	
Acct 902 - Meter Reading Expenses (page 322, line 160)		\$ 4,271,429	\$ 3,757,999	\$ 4,848,064	\$ 7,383,306	\$ 7,519,338	\$ 2,086,719	
	Total Charges Applicable to Customer Accounts Svcs & Meter Reading	\$ 13,100,423	\$ 14,196,840	\$ 33,909,787	\$ 20,299,179	\$ 54,414,659	\$ 6,685,578	
	Percent Applicable to Customer Accounts Services (903 and 905)	67.4%	73.5%	85.7%	63.6%	86.2%	68.8%	
	Customer Account Services Portion of Total Payroll	\$ 2,685,138	\$ 5,264,279	\$ 21,712,933	\$ 4,919,156	\$ 9,215,858	\$ 1,768,676	
	Pension & Benefits Pertaining to Customer Accounts Services	\$ 1,206,387	\$ 1,056,621	\$ 4,754,999	\$ 3,860,431	\$ 2,326,236	\$ 1,376,718	
Note B: Calculation of Employer's FICA Pertaining to Customer Accounts Services								
	Customer Account Services Portion of Total Payroll	\$ 2,685,138	\$ 5,264,279	\$ 21,712,933	\$ 4,919,156	\$ 9,215,858	\$ 1,768,676	
	Employer's Portion of FICA (6.20%) and Medicare (1.45%)	7.65%	7.65%	7.65%	7.65%	7.65%	7.65%	
	Estimated Employer's Portion of FICA	\$ 205,413	\$ 402,717	\$ 1,661,039	\$ 376,315	\$ 705,013	\$ 135,304	

VI - Question 4 – Need for Service Company Services

Analysis of Services

The final aspect of this study was an assessment of whether the services that are provided to WV American by the Service Company would be necessary if WV American were a stand-alone water and wastewater utility. The first step in this evaluation was to determine specifically what the Service Company does for WV American. Based on discussions with Service Company personnel, the matrix in Exhibit 12 was created showing which entity—WV American or a Service Company location—is responsible for each of the functions WV American requires to ultimately provide service to its customers. This matrix was reviewed to determine: (1) if there was redundancy or overlap in the services being provided by the Service Company and (2) if Service Company services are typical of those needed by a stand-alone water utility.

Upon review of Exhibit 12, the following conclusions can be drawn:

- The services that the Service Company provides are necessary and would be required even if WV American were a stand-alone water utility.
- There is no redundancy or overlap in the services provided by the Service Company to WV American. For all of the services listed in Exhibit 12, there was only one entity that was primarily responsible for the service.

West Virginia American Water Company Designation Of Responsibility For Water Utility Functions

P - Primarily Responsible S - Provides Support	Performed By:							
	WV American	American Water Service Company						
		Customer Call Center	Eastern Division	Shared Services	Corporate Office	IT Service Centers	Supply Chain	Belleville Lab
Water Company Function								
Engineering and Construction Management								
CPS Preparation	P				S			
Five-Year System Planning	P							
Engineering Standards & Policies Development					P			
Project Design								
Major Projects (e.g., new treatment plant)	P				S			
Special Projects	P				S			
Minor Projects (e.g., pipelines)	P							
Construction Project Management								
Major Projects	P				S			
Special Projects	P				S			
Minor Projects	P							
Hydraulics Review	P							
Developers Extensions	P							
Tank Painting	P							
Water Quality and Purification								
Water Quality Standards Development	S				P			S
Research Studies	S				P			S
Water Quality Program Implementation	P				S			
Water Treatment Operations & Maintenance	P				S			
Compliance Sampling and Chemical Testing	S							P
Sample Collection and Other Testing	P				S			S
Transmission and Distribution								
Preventive Maintenance Program Development	P				S			
System Maintenance	P							
Leak Detection	P							
Customer Service								
Community Relations	S		P		S			
Customer Contact	S	P						
Call Processing		P						
Service Order Creation	S	P	S					
Service Order Processing	S	S	P					
Customer Credit	S	P						
Meter Reading	P					S		
Customer Bill Preparation		S				P		
Bill Collection	S	P	S			S		
Customer Payment Processing	S			P				
Meter Standards Development	S				P			
Meter Testing, Maintenance & Replacement	P							

West Virginia American Water Company Designation Of Responsibility For Water Utility Functions

P - Primarily Responsible S - Provides Support	Performed By:						
	WV American	American Water Service Company					
		Customer Call Center	Eastern Division	Shared Services	Corporate Office	IT Service Centers	Supply Chain
Financial Management							
Financial Planning	S		P	S	S		
Financings--Equity			S	S	P		
Financings--Long Term Debt & Preferred (Note A)	S		S	S	P		
Short Term Lines of Credit Arrangements(Note A)	S		S	S	P		
Investor Relations			S		P		
Insurance Program Administration	S				P		
Loss Control/Safety Program Administration	P				S		
Pension Fund Asset Management					P		
Cash Management/Disbursements	S			P			
Internal Auditing					P		
Budgeting and Variance Reporting							
Corporate Guidelines & Instructions					P		
Regional Guidelines & Instructions			P				
Budget Preparation							
Revenue and O&M	P		S				
Depreciation and Interest Expense	P		S	S			
Budget Preparation--Service Company Charges			S	P	S	S	S
Capital Budget Preparation—Projects	P						
Capital Budget Preparation—Non-Project Work	P						
Prepare Monthly Budget Variance Report ("Budget/Plan Analysis")	P		S				
Prepare Capital Project Budget Status Report	P						
Year-End Projections	P						
Accounting and Taxes							
Accounts Payable Accounting	S			P			
Payroll Accounting	S			P			
Work Order Accounting	S			P			
Fixed Asset Accounting	S			P			
Journal Entry Preparations--Billing Corrections	S			P			
Journal Entry Preparation--All Others	S			P			
Financial Statement Preparation	S			P			
State Commission Reporting	S			P			
Income Taxes--State				P			
Income Taxes--Federal				P			
Property Taxes	S		S	P			
Gross Receipts (Tow n) Taxes	S		S	P			

Note A: Lines of credit are the responsibility of American Water Capital Corporation ("AWCC"). AWCC is also responsible for Corporate financings which may be distributed to the regulated subsidiaries.

West Virginia American Water Company Designation Of Responsibility For Water Utility Functions

P - Primarily Responsible S - Provides Support	Performed By:							
	Water Company Function	WV American	American Water Service Company					Belleville Lab
			Customer Call Center	Eastern Division	Shared Services	Corporate Office	IT Service Centers	
Rates								
	Rate Studies & Tariff Change Administration	S		P				
	Rate Case Planning and Preparation	S		P				
	Rate Case Administration	S		P				
	Commission Inquiry Response	S		P				
Legal								
				P		S		
Purchasing and Materials Management – National (pipe, chemicals, meters, etc.)								
	Specification Development	S			S	P		S
	Bid Solicitation	S						P
	Contract Administration	S						P
Purchasing and Materials Management – State (state supplier service agreements)								
	Specification Development	P			S			
	Bid Solicitation	P						
	Contract Administration	P						
	Ordering	P						
	Inventory Management	P			S			
Human Resources Management								
	Benefit Program Development					P		
	Benefits Program Administration	S				P		
	Management Compensation Administration					P		
	Wage & Salary Program Design					P		
	Wage & Salary Administration	S		P				
	Labor Negotiations--Wages	P		S				
	Labor Negotiations--Benefits					P		
	Labor Negotiations--Work Rules	P		S				
	Training Program Development	S		S		P		
	Training--Course Delivery	S		P				
	Affirmative Action/EEO--Plan Development	S		P				
	Affirmative Action/EEO--Implementation	S		P				
Information Systems Services								
	Service Company Data Centers							
	System Operations & Maintenance					P		
	Software Maintenance					P		
	Network Administration	S				P		
	PC Acquisition & Support					P		
	Help Desk				S	P		

VI - Question 4 – Need for Service Company Services

Governance Practices Associated With Service Company Charges

There are several ways by which WV American exercises control over Service Company services and charges. The most important of these are described below.

- **President of Regulated Operations Oversight** – The President of Regulated Operations is on the Executive Management Team (EMT) of American Water. This position is responsible for the overall performance of each operating company in American Water. As part of the EMT, the President of Regulated Operations has equal say with other EMT members in major business decisions of American Water and has the ability to monitor Service Company performance quality and spending. The President of Regulated Operations also has dialogue with each operating company president to address local concerns.
- **Divisional Vice President & Treasurer** – The Divisional Vice President and Treasurer of the Mid-Atlantic Division states is responsible for the financial reporting, performance and internal controls of each of the operating companies in the division. The Vice President and Treasurer monitors the performance and reporting from the Service Company and follows up on instances where the quality and timeliness of services are not as expected. The operating company interacts with the Divisional VP & Treasurer to discuss any concerns with billings, etc.
- **Operating Company Board Oversight** – WV American’s board of directors includes members of American Water’s EMT, members of the divisional management team and business and community leaders from outside the Company. WV American’s president is Chairman of the WV American board. This helps ensure that WV American’s needs are a factor in the delivery of Service Company services.
- **Service Company Budget Review/Approval** – The President of Regulated Operations sits on the Service Company board and that board must formally approve the budget for Service Company charges for the next year. These budgeted charges are consolidated with the operating company’s own spending into an overall budget which must be approved by the operating company’s board of directors. WV American’s president also sits on the Service Company board.
- **Major Project Review And Approval** – Major projects undertaken by the Service Company must first be reviewed by American Water’s Executive Management Team, which includes the President of Regulated Operations. With input from the local presidents and Divisional Vice President & Treasurer, they have the ability to impact all new initiatives and projects before they are authorized.
- **Service Company Bill Scrutiny** – WV American Finance personnel review the monthly Service Company bill for accuracy and reasonableness on a monthly basis. WV American financial manager has dialogue with Shared Services Center office personnel concerning the monthly bill and any mistakes or overcharges are credited on a subsequent billing. The WV American Finance Manager prepares an actual to budget comparison of management fees each month for use in identifying unusual variances. Service Company actual to budget comparison is included in the monthly FRP. Unusual variances are researched, explanations are provided and any corrections are made, as necessary.
- **Service Company Budget Variance Reporting** – Each month, a summary variance analysis is prepared that explains differences between budgeted and actual Service Company spending. In addition, a more detailed monthly variance report, called the “Statement of Expenses and Billed Charges,” is produced by Service Company location and shows actual spending for the month.

VI - Question 4 – Need for Service Company Services

- **Operating Company Budget Variance Reporting** – The “Budget/Plan Analysis,” produced monthly, has a line item for Management Fees (i.e., Service Company charges). In this way, Service Company budget versus actual charges can be monitored for the month and year-to-date. Additional information exists that allows more detailed analysis of "Divisional" and "Corporate" Management Fees.
- **Capital Investment Management (“CIM”)** – CIM is one of American Water's primary business planning processes. It covers capital and asset planning and is employed throughout American Water. CIM provides a full range of governance practices, including a formal protocol for assessing system needs, prioritizing expenditures, managing the capital program, approving project spending, delivering projects and measuring outputs. CIM ensures that:
 - Capital expenditure plans are aligned with the strategic intent of the business
 - The impact of capital expenditure and income plans are fully reflected in operating expense plans
 - The impacts of these plans are understood and affordable, and
 - Effective controls are in place over budgets (through business plans) and individual capital projects (through appropriate authorization thresholds, management and reporting processes).

The CIM process was designed to optimize the effectiveness of asset investment. The process is managed at two levels for all American Water companies, including all WV American Operating Units. Monthly meetings of the CIM are held to review capital spending compared to plan, review new project requests, and review updates or modifications to existing projects. The President of WV American and others participate as necessary (e.g. WV American operations managers and Rates Manager) and provide the data used in the monthly review schedules.

**PUBLIC SERVICE COMMISSION
OF WEST VIRGINIA
CHARLESTON**

Case Nos. 12-1648-S-42T, 12-1649-W-42T

WEST VIRGINIA-AMERICAN WATER COMPANY

**Rule 42T Tariff Filing to Increase
Rates and Charges**

**DIRECT TESTIMONY OF
PATRICK L. BARYENBRUCH**

_____, 2013

1 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 A. Patrick L. Baryenbruch, 2832 Claremont Road, Raleigh, North Carolina 27608.

3

4 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL AND PROFESSIONAL**
5 **BACKGROUND.**

6 A. I received a Bachelors degree in accounting from the University of Wisconsin-
7 Oshkosh in 1974 and a Masters in Business Administration degree from the
8 University of Michigan in 1979.

9 I am a financial and management consultant. I am also a certified public
10 accountant and a member of the American Institute of Certified Public
11 Accountants and the North Carolina Association of Certified Public Accountants.

12 I began my career as a staff accountant with Arthur Andersen & Company where I
13 performed financial audits of utilities, banks and finance companies. After three
14 years I left to pursue an M.B.A. degree. Upon graduation from business school, I
15 worked with the consulting firms of Theodore Barry & Associates and Scott,
16 Madden & Associates.

17 During my consulting career, I have performed consulting assignments for
18 approximately 50 utilities and 10 public service commissions. I have participated
19 as project manager, lead or staff consultant for 24 commission-ordered
20 management and prudence audits of public utilities. Of these, I have been

1 responsible for evaluating the area of affiliate charges and allocation of corporate
2 expenses in the Commission-ordered audits of Connecticut Light and Power,
3 Connecticut Natural Gas, General Water Corporation (Pennsylvania Operations),
4 Philadelphia Suburban Water Company (now Aqua America), and Pacific Gas &
5 Electric Company.

6 My firm has performed the commission-ordered audit of Southern California
7 Edison's 2002, 2003, 2004 and 2005 transactions with its non-regulated affiliate
8 companies.

9

10 **Q. WHAT ARE YOUR DUTIES AND RESPONSIBILITIES IN YOUR**
11 **CURRENT POSITION?**

12 A. I am the President of my own consulting practice, Baryenbruch & Company, LLC,
13 which was established in 1985. In that capacity, I provide consulting services to
14 utilities and their regulators.

15

16 **Q. PLEASE DESCRIBE THE REASON FOR YOUR TESTIMONY IN THESE**
17 **CASES.**

18 A. I am presenting the results of my study which evaluated the services provided by
19 American Water Works Service Company ("Service Company") during the 12
20 months ended June 30, 2012 to West Virginia-American Water Company (WV

1 American). This study was undertaken in conjunction with WV American's rate
2 cases and is true to the best of my knowledge and belief. The study is attached as
3 Exhibit PLB-1.

4

5 **Q. WHAT WERE THE OBJECTIVES OF YOUR STUDY?**

6 A. This study was undertaken to answer four questions. First, were the Service Company's
7 charges to WV American during the 12 months ended June 30, 2012 reasonable?
8 Second, was WV American charged the lower of cost or market for managerial and
9 professional services provided by the Service Company during the 12 months ended June
10 30, 2012? Third, were the 12 months ended June 30, 2012 costs of the Service
11 Company's customer accounts services, including those of the National Call Centers,
12 comparable to those of other utilities? Fourth, are the services WV American receives
13 from the Service Company necessary?

14

15 **Q. WHAT CONCLUSIONS WERE YOU ABLE TO DRAW CONCERNING**
16 **QUESTION NUMBER 1, WHETHER THE SERVICE COMPANY**
17 **CHARGES TO WV AMERICAN DURING THE 12 MONTHS ENDED**
18 **JUNE 30, 2012 WERE REASONABLE?**

19 A. I was able to conclude that the Service Company's 12 months ended June 30, 2012 cost
20 per WV American customer are very reasonable. During the test period, WV American
21 was charged \$59 per customer for administrative and general ('A&G')-related services

1 provided by the Service Company. This compares favorably to A&G costs per customer
2 for electric and combination electric/gas service companies that average \$121 for service
3 companies reporting to the Federal Energy Regulatory Commission (“FERC”). Only
4 three of the comparison group service companies had a lower A&G cost per customer
5 than WV American. Based on this result, it is possible to conclude that the Service
6 Company’s 12 months ended June 30, 2012 charges to WV American were reasonable.

7
8 **Q. WHAT CONCLUSIONS WERE YOU ABLE TO DRAW CONCERNING**
9 **QUESTION NUMBER 2, WHETHER WV AMERICAN WAS CHARGED THE**
10 **LOWER OF COST OR MARKET SERVICES PROVIDED BY THE SERVICE**
11 **COMPANY?**

12 A. I was able to draw the following conclusions:

13 (1) WV American was charged the lower of cost or market for
14 managerial and professional services during the 12-months ended June 30 30,
15 2012.

16 (2) On average, the hourly rates for outside service providers are 11%
17 higher than the Service Company’s hourly rates.

18 (3) The managerial and professional services provided by the Service
19 Company are vital and could not be procured externally by WV American without
20 careful supervision on the part of WV American. If these services were
21 contracted entirely to outside providers, then WV American would have to add at
22 least one position to manage activities of outside firms in order to ensure the

1 quality and timeliness of services provided.

2 (4) If all the managerial and professional services now provided by the
3 Service Company had been out-sourced during the 12-months ended June 30,
4 2012, then WV American and its ratepayers would have incurred an additional
5 \$1.9 million in expenses. This amount includes the higher cost of outside
6 providers and the cost of a WV American position needed to direct the outsourced
7 work.

8 (5) This study's hourly rate comparison actually understates the cost
9 advantages that accrue to WV American from its use of the Service Company.
10 Outside service providers generally bill for every hour worked. Service Company
11 exempt personnel, on the other hand, charge a maximum of 8 hours per day even
12 when they work more hours. If all overtime hours of Service Company personnel
13 were factored into the hourly rate calculation, the Service Company would have
14 had an even greater annual dollar advantage than the \$1.9 million cited above.

15 (6) It would be difficult for WV American to find local service
16 providers with the same specialized water industry expertise as that possessed by
17 the Service Company staff. Service Company personnel spend substantially all
18 their time serving operating water companies. This specialization brings with it a
19 unique knowledge of water utility operations and regulation that is most likely
20 unavailable from local service providers.

21 (7) Service Company fees do not include any profit markup. Only its
22 actual cost of service is being recovered from WV American customers.

1

2 **Q. WHAT IS YOUR CONCLUSION REGARDING THE REASONABLENESS OF**
3 **THE COSTS OF THE NATIONAL CALL CENTER THAT PROVIDES SERVICE**
4 **TO WV AMERICAN?**

5 A. I was able to determine that the cost of the Service Company's customer accounts
6 services, including those provided by the National Call Center, is below the average of
7 the neighboring electric utility comparison group. As will be explained further, this
8 group of companies provides a reasonable proxy group for comparison to a regulated
9 utility of the size and scope of the Service Company and WV American. During the 12
10 months ended June 30, 2012, the customer accounts cost for WV American customers
11 was \$30.04 compared to the 2011 average of \$33.04 for neighboring electric utilities.
12 The highest comparison group per customer cost was \$88.76 and the lowest \$13.67.

13

14 **Q. WHAT CONCLUSIONS WERE YOU ABLE TO DRAW CONCERNING THE**
15 **NECESSITY OF THE SERVICES WV AMERICAN RECEIVES FROM THE**
16 **SERVICE COMPANY?**

17 A. I was able to draw the following conclusions:

18 (1) The services that the Service Company provides are necessary and
19 would be required even if WV American were a stand-alone water utility.

20 (2) There is no redundancy or overlap in the services provided by the
21 Service Company to WV American.

22

1 Q. DOES THIS COMPLETE YOUR TESTIMONY?

2 A. Yes.

PUBLIC SERVICE COMMISSION
OF WEST VIRGINIA
CHARLESTON

CASE NO. 12-1648-S-42T
CASE NO. 12-1649-W-42T

02:56 PM OCT 07 2013 PSC EXEC SEC DIV

WEST VIRGINIA-AMERICAN WATER COMPANY
Rule 42T Tariff Filings to Increase
Rates and Charges

RESPONDENT'S REPLY TO UWUA REQUEST FOR RECONSIDERATION

As the UWUA merely reargue their case, their petition should be refused. *See, e.g.,* Trans-Allegheny Interstate Line Company, Case No. 07-0508-E-CN, Commission Order, February 13, 2009, page 11 (petition “does not present any information that has not been previously addressed by the Commission.”); Short Creek Landfill, Case No. 08-0698-SWF-T, Commission Order, July 30, 2008, Conclusion of Law, page 2 (“As the issues raised ... were previously addressed by the Commission’s July 10, 2008 order, it is reasonable to deny the petition and dismiss this proceeding.”); General Order No. 185.17, Commission Order, July 28, 1983, page 4 (“no new evidence has been referenced, no new issues have been raised and no new theories generated by Columbia Gas which have not been fully reviewed, considered and decided by the Commission”).¹

The UWUA argue (page 2) that “[t]he September 26 Order fails to confront the Union’s evidence, labeling it as ‘primarily hearsay and supposition.’” But they cite no authority (page 7) that the Commission had to use more than “a single finding of fact or law” in the September 26 Order to state its conclusion that the UWUA’s evidence “did not support a conclusion that management decisions of WVAWC regarding the (i) main repair and replacement program and practices, (ii) field service order scheduling, or (iii) staffing levels are unreasonable.”

¹ The UWUA (pages 3-4) only cite judicial opinions about appellate review.

The UWUA continue to attempt to use this general rate case to enforce a self-serving interpretation of Commission Orders in Case No. 11-0740-W-GI, a docket in which the UWUA participated and the outcome of which, at the time, they found acceptable. Tr. I (Lanham) at 37. The UWUA now go so far as to maintain (page 8) that the Commission is bound in 2013 to the view of the need for managerial oversight that it had in 2011:

The September 26 Order inexplicably fails to consider relevant evidence on these issues and appears to abandon prior Commission orders, while failing to provide the basis for such actions. The Commission's rulings in the September 26 Order therefore constitute arbitrary and capricious agency decisionmaking.

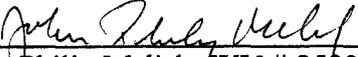
No authority is cited, and to our knowledge no such authority exists.² Case No. 11-0740-W-GI was a general investigation, not a quasi-legislative rate case or rulemaking; whether the Commission's concerns addressed in that docket have now been satisfactorily addressed is for the Commission, not the UWUA, to determine.

The evidence and argument about the number of employees, how best to balance regulation with managerial discretion, etc., were addressed in the Company's previous briefs. For those same reasons, the Commission should reject the UWUA's petition to reconsider the September 26, 2013 Commission Order.

² Cf., C & P Telephone Co. of W. Va. v. Public Service Com'n of W. Va., 171 W. Va. 708, 714, 301 S.E.2d 798, 804 (1983) ("Utilities have no vested right to any particular approach, but they have a right to application of the current, effective rules to their rate filing, absent reasonable notice ... When an administrative agency reverses course from its precedents, it must give reasonable notice and supporting rationale before it changes its standards, or its actions appear arbitrary and capricious.").

Respectfully submitted this 7th day of October, 2013.

WEST VIRGINIA-AMERICAN WATER COMPANY
By Counsel



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CERTIFICATE OF SERVICE

I certify service of this RESPONDENT'S REPLY TO UWUA REQUEST FOR
RECONSIDERATION by U. S. Mail on October 7, 2013, upon:

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