

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

CASE 11-W-0200

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

Rebuttal Testimony of John M. Watkins

REDACTED

October 3, 2011

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

2 A. My name is John M. Watkins, and my business address is 131 Woodcrest Road,
3 Cherry Hill, New Jersey 08034.

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

5 A. I am employed by American Water Works Service Company, Inc. (hereinafter
6 referred to as “AWWSC” or the “Service Company”) as Senior Manager – Rates &
7 Regulation.

8 **3. Q. Did you file direct testimony in this proceeding?**

9 A. Yes.

10 **4. Q. What are the areas you will address in your rebuttal testimony?**

11 A. First, I will address the Company’s position on Staff’s model and exhibits; I will
12 then summarize and identify those Staff adjustments that the Company accepts;
13 those adjustments that the Company does not agree with, but will not contest for
14 purposes of this proceeding; those adjustments that the Company agrees with in
15 principle, but need to be recalculated based on the most current data or adjustments
16 that may have surfaced as a result of the discovery process; and finally, those
17 adjustments which the Company disagrees with. My next section will address the
18 DSIC, SIC, RAC/PTC and then synergy savings associated with the proposed
19 acquisition of Aqua New York by American Water Works. I am also attaching the
20 revised exhibits for LIAW as Exhibit_(JMW-1).

1 **Staff's Model**

2 **5. Q. Were there any corrections made to the model that Staff provided with their**
3 **direct testimony on September 12, 2011?**

4 A. Yes. After their prefiled direct testimony was filed, Staff adjusted their model.
5 Please see the responses to LIAW-1 through LIAW-4 attached to my testimony as
6 Exhibit (JMW-2). Staff revised their position from \$495,311 to \$1,086,436 in the
7 response to LIAW-4, please see the attachments for LIAW-4 contained in
8 Exhibit_(JMW-1).

9 **6. Q. Are there other adjustments that need to be made?**

10 A. Yes, as stated in the question and response to LIAW-4, part d, the Company and
11 Staff agree that there is a need to realign some of the numbers based on changes
12 that have occurred through testimony and discovery.

13 **Staff adjustments that the Company accepts**

14 **7. Q. With which adjustments and schedules in Staff's prefiled direct testimony and**
15 **exhibits does the Company agree?**

16 A. The Company agrees with Present Rate Revenues, Postage, Tank Painting and
17 Depreciation.

18 **Staff adjustments that the Company does not agree with, but will not contest for**
19 **purposes of this proceeding only**

20 **8. Q. Which adjustments does the Company not agree with, but will not contest for**
21 **purposes of this proceeding only?**

1 A. The Company does not agree with the adjustments to overtime and capitalization
2 but will not contest them for purposes of this proceeding only.

3 **Staff adjustments that the Company agrees with in principle but that need to be**
4 **updated**

5 **9. Q. Which adjustments and schedules does the Company agree with Staff's**
6 **position in principle but need to be revised/updated?**

7 A. The Company agrees with the following topics in principle but due to updates and
8 revisions that were received or determined after Staff filed its direct testimony, each
9 topic listed below needs to be adjusted per the parenthetical reason, please see
10 Exhibit (JMW-1) for the revisions to the Company's Exhibits:

- 11 • Productivity Adjustment (adjusted per labor and related)
- 12 • Power (Inflation rate for 2011, 2012 and 3 months of 2013)
- 13 • Fuel (Inflation rate for 2011, 2012 and 3 months of 2013)
- 14 • Chemical (Inflation rate for 2012 and 3 months of 2013)
- 15 • Rents (Inflation rate for 2011, 2012 and 3 months of 2013)
- 16 • 401(k) (adjustment for flow through of Payroll adjustments)
- 17 • Defined Contribution Plan (adjustment for flow through of Payroll adjustments)
- 18 • Insurance Other Than Group (Inflation rate for 2012 and 3 months of 2013)
- 19 • Uncollectible (adjustment for final revenue increase)
- 20 • PSC Assessment (adjustment for final revenue increase)
- 21 • Retiree Medical (Adjustment for lower capitalization percentage)
- 22 • Customer Outreach and Education Program (Inflation rate for 2011, 2012 and 3
- 23 months of 2013)
- 24 • Audit Fees (Inflation rate for 2011, 2012 and 3 months of 2013)
- 25 • Payroll Taxes (adjustment for flow through of Payroll adjustments)
- 26 • SIT & FIT (Flow through effects of any adjustments)
- 27 • Rate Base (Adjustments for Cash Allowance, Regulatory Deferrals, Accumulated
- 28 Deferred Income Taxes to align Staff's and the Company's positions) see
- 29 Exhibit_(JMW-4)
- 30

1 **Staff Adjustments that the Company is addressing in Rebuttal**

2 **10. Q. Which adjustments and schedules is the Company addressing in Rebuttal?**

3 A. Mr. Engle will address the rebuttal for Payroll, Group Insurance and Employee
4 Stock Purchase Plan. Mr. Bozman will address the rebuttal for Invoices and Rate
5 Case Expense. Mr. Conroy will address the rebuttal for Leased Vehicles and
6 Service Company expenses. Mr. Casillo and Ms. King, from Towers Watson, will
7 address the Pension and OPEB position of the Company. The Company is not
8 contesting the rate making treatment for Pensions/OPEBs from Staff; it is, however,
9 providing additional rebuttal testimony to support its request to move to a
10 consolidated plan. Mr. Casillo will also address the Amortization of Actuarial
11 Studies and Property Tax Expense. Ms. Ahern will be addressing common equity
12 and overall rate of return in her rebuttal.

13 **DSIC Surcharge Mechanism**

14 **11. Q. Do you concur with Staff's recommendation of discontinuing the DSIC and**
15 **allowing such forecasted capital investment in the area of mains, valves,**
16 **services and hydrants for the rate year?**

17 A. Yes, the Company concurs with this methodology and will clarify some of the
18 aspects of this recommendation below.

19 **12. Q. Does the Company believe this recommendation to allow forecasted capital**
20 **described above for the rate year is made within the context of a multi-year**
21 **rate plan or a single year rate plan?**

1 A. While Staff has recommended a single year in their testimony, the plan presented
2 by them does not fit a single year rate plan, as there is no recognition of an increase
3 outside the first rate year. The Company believes that this proposal is for a multi-
4 year rate plan, and if this belief is correct, then the Company would agree with
5 Staff's proposal. If it is not correct, then the Company believes that the DSIC is the
6 appropriate mechanism to allow the Company to recover the costs for mains,
7 valves, services and hydrants.

8 **13. Q. How much does the Company propose to invest under the DSIC program in**
9 **each rate year after the rate year ending March 31, 2013?**

10 A. The Company proposes to invest \$7,750,000 in each rate year to replace water
11 mains, fire hydrants, valves and services throughout its service territory.

12 **14. Q. What is the value of assets you plan to retire through the DSIC program**
13 **during each rate year?**

14 A. The Company anticipates retiring \$125,000 worth of mains, fire hydrants and
15 services per year. The \$125,000 is based on the average value retired per year
16 under the current DSIC program during the last five years.

17 **15. Q. What is the composite depreciation rate and the estimate of depreciation**
18 **under the Company's proposal?**

19 A. The composite depreciation rate should be 1.26% with an annual depreciation of
20 \$97,926 per rate year.

21

1 **16. Q. What is the tax depreciation life and the annual amount of tax depreciation?**

2 A. The tax depreciation life is 25 years and the tax depreciation would be \$305,000
3 (\$7,750,000 – \$125,000 = \$7,625,000 / 25).

4 **17. Q. What is the effective tax rate and the deferred taxes?**

5 A. The effective tax rate is 39.79%. The deferred taxes are \$82,395, based on the
6 calculation of (\$305,000 - \$97,926) x 39.79%.

7 **18. Q. How is the revenue requirement calculated for each rate year based on the**
8 **information above?**

9 A. The revenue requirement calculation has been calculated as total spend less
10 retirements less depreciation less deferred taxes, with this resulting subtotal then
11 multiplied by the return on equity.

12 **SIC Surcharge Mechanism**

13 **19. Q. Do you concur with Staff’s recommendation for the System Improvement**
14 **Charge (SIC)?**

15 A. Yes, the Company agrees with this recommendation as presented within Staff’s
16 prefiled direct testimony.

17 **20. Q. What should the cap be on each project?**

18 A. The maximum SIC-recovery amount allowed per SIC-eligible project should be as
19 follows:

- 20 • Plant 15 - \$8,450,000
- 21 • Plant 13 - \$1,900,000
- 22 • Plant 5 - \$525,000

- 1 • Business Transformation - \$4,926,481

2

3 **RAC and Property Tax Reconciliation Clause (PTC)**

4 **21. Q. What is Staff's recommendation for the RAC/PTC?**

5 A. Staff has recommended the PTC be discontinued as their current position
6 contemplates a one-year rate plan for LIAW. Staff did not submit prefiled direct
7 testimony about the RAC.

8 **22. Q. Does the Company agree with Staff's recommendation?**

9 A. No. The Company believes the PTC benefits the customers, and therefore the
10 Company takes the position that the PTC be continued regardless of the length of
11 the rate plan (i.e. single year of multi-year) that results from this proceeding. The
12 Company also believes that due to the aggressive challenges and the overall
13 reduction in property taxes along with over \$16.2 million in refunds through the
14 current filed Village refund petition, Case 11-W-0484, it should recover 100% of
15 taxes above the threshold set by Staff and refund 100% below the threshold.
16 Clearly, the record demonstrates that LIAW has been very diligent in pursuing tax
17 challenges. Under the circumstances, it would not be either fair or appropriate
18 ratemaking to place the Company at risk for non-recovery of any of its property tax
19 expense. At the same time, ratepayers will be protected completely as any savings
20 would be passed through to them.

21 Please see Mr. Casillo's rebuttal testimony for more information.

22 Furthermore, the Company takes the position that the RAC/PTC should also be

1 continued because it benefits the customers with new levels set for revenues,
2 power, fuel, chemicals and property taxes for each rate year. This ensures the
3 customers pay the actual costs the Company incurs and therefore do not overpay the
4 Company with regard to these expenses.

5 **Synergy Savings Related to the Proposed Acquisition of Aqua NY by AWW**

6 **23. Q. Has the Company adjusted its filing to reflect any synergies related to the**
7 **acquisition of Aqua NY by its parent company, AWW?**

8 A. Yes, the Company has adjusted its labor and related and Service Company expenses
9 based on the assumption that the Aqua NY acquisition by AWW will produce
10 certain savings in the future. Despite these particular elements of individual
11 savings, actual net savings associated with the acquisition may not occur for some
12 time, or at all, as (1) the Company has not studied the Aqua systems in any detail,
13 (2) the companies are not currently being merged and (3) Aqua NY is made up of
14 three separate legal entities (Aqua NY, Aqua NY of Sea Cliff and New York Water
15 Service Company) so there will need to be effort expended to consolidate and
16 harmonize those operations.

17 **24. Q. What will be the effect if the acquisition does not occur?**

18 A. There is a possibility that the acquisition will not occur because it is contingent on
19 both the Ohio and New York commissions approving the acquisition petitions that
20 have been filed in each of these jurisdictions and any terms imposed being
21 acceptable to both parties to the acquisition.

1 **25. Q. What would you recommend if synergy savings are taken into account in this**
2 **rate case and then the proposed acquisition does not occur?**

3 A. If the acquisition is abandoned prior to the disposition of this case, the synergy
4 savings can be reversed. If the acquisition were to be abandoned after the
5 disposition of this case, the Company should be allowed to defer all of the costs
6 given up as synergy savings for subsequent recovery in a future proceeding.

7 **26. Q. What synergies is the Company reflecting in its rebuttal position for labor and**
8 **related costs to reflect the proposed acquisition?**

9 A. As LIAW has stated previously, we have not done any studies of the possible
10 synergies related to the Aqua NY acquisition. On the other hand, it seems
11 reasonable to expect that there will be some opportunities for synergies as the
12 operations of the companies are studied and harmonized. For example, please see
13 Mr. Engle's rebuttal testimony, where he has prorated the salaries and related
14 benefits for Mr. Varley and his supporting operations specialist to allocate a portion
15 of their salaries and benefits for the proposed acquisition of Aqua NY by AWW.
16 As currently contemplated Mr. Varley would be president of both LIAW and the
17 three acquired Aqua entities located in New York. His salary, in addition to the
18 salary of the operations specialist who provides support to him in carrying out his
19 duties, would be allocated by customers between LIAW and the acquired Aqua
20 entity. The total allocated portion of the labor and related based on allocating the
21 costs to Aqua NY by dividing Total Aqua NY customers (50,384) by total

1 customers in NY of the 4 companies (124,391) is \$133,777. This amount has been
2 removed from LIAW rate case in labor and related.

3 **27. Q. Are there any synergies related to Service Company expense?**

4 A. Yes, the Company is removing the 3 employees from the SSC Rates & Regulation
5 group which provide support for this filing and many other petitions for LIAW.

6 The savings of \$241,325 must be reduced, however, by an additional FTE in LIAW
7 payroll line. Please refer to Mr. Conroy's rebuttal testimony for further
8 information. Mr. Engle states in his rebuttal testimony that a new position of Rates
9 Manager will be added to LIAW at a salary of [BEGIN CONFIDENTIAL]

10 [END CONFIDENTIAL] with benefits of [BEGIN CONFIDENTIAL]

11 [END CONFIDENTIAL] prior to capitalization.

12 **Rate Design**

13 **28. Q. Did Staff address Rate Design?**

14 A. No, Staff did not submit prefiled direct testimony for revenues or rate design.

15 **29. Q. Does the Company have any update to its Rate Design as it was presented in its
16 prefiled direct testimony?**

17 A. Yes, instead of billing in thousand gallons increments as it does currently the
18 Company will adjust its usage to be billed in hundred gallons increments. Please
19 see Exhibit (JMW-5) for the attached tariff sheets.

20

1 **30. Q. Why is the Company proposing this change?**

2 A. As a result of the Business Transformation upgrades discussed within the
3 Company's direct testimony, LIAW will now be able to bill its customers in 100
4 gallon increments, which will provide LIAW's customers with more accurate
5 billing information about their water consumption on a monthly basis.

6 **31. Q. Will this change result in any increased costs to LIAW's customers?**

7 A. No, it will not.

8 **LIAW Managed as a Separate Entity**

9 **32. Q. Is LIAW managed as an independent entity from AWW?**

10 A. Yes. LIAW maintains a separate corporate charter, a separate corporate structure
11 and separate Board of Directors. Its capital structure, risk management, are also
12 managed separately, and such management also includes the arrangement of a
13 conservative debt maturity profile, provision for adequate financial liquidity,
14 corporate financial strength, dividend declarations, and formation of equity capital
15 in its ongoing financial planning. LIAW does not provide any financial guarantees,
16 support or letters of intent for the financial obligations of AWW, AWCC or any
17 other affiliate. Nor does LIAW provide collateral, negative pledges or other
18 encumbrances on its assets to support the financial obligations of AWW, AWCC or
19 any other affiliate.

20

1 **33. Q. If Staff is going to impute a consolidated capital structure for the Company, is**
2 **it appropriate to utilize a 34% federal income tax rate?**

3 A. No. If the Staff is recommending the utilization of a consolidated capital structure,
4 it should also utilize the 35% federal income tax rate that would be applicable to a
5 consolidated filing as compared to the 34% for a stand-alone filing.

6 **Long-Term Debt**

7 **34. Q. Please summarize Staff's position on long-term debt.**

8 A. Staff is utilizing the consolidated capital structure of a hypothetical company to
9 assign the cost of long-term debt and preferred stock for LIAW.

10 **35. Q. Do you agree with Staff's utilization of the hypothetical consolidated capital**
11 **structure of American Water?**

12 A. No, I do not. The determination should be based on LIAW's actual capital
13 structure, not an imputed cost based on debt and preferred stock that may be on the
14 books of sister companies in this hypothetical company. The cost of debt for LIAW
15 is known, and real. The Company should be regulated on the weighted average cost
16 of debt to which its assets are pledged as collateral. Staff has lowered the
17 Company's cost of long-term debt from 6.00% to 5.68%, a reduction in revenue
18 requirement of approximately \$213,000. This reduction is significant from the
19 standpoint of the Company, but not material as the adjustments to return of equity
20 of approximately \$2.4 million. In this particular proceeding the cost of debt on a

1 consolidated basis of 5.68% and 6.00% on a stand-alone bases are not significantly
2 different.

3 **36. Q. Does this conclude your rebuttal testimony?**

4 A. Yes, it does.