

BEFORE THE  
STATE OF NEW YORK  
PUBLIC SERVICE COMMISSION

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In the Matter of  
Long Island American Water  
Cases 11-W-0200  
September 2011

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Prepared Testimony of:

Basil Bailey  
Public Utilities Auditor II  
State of New York  
Department of Public Service  
90 Church Street  
New York, NY 10007

- 1 Q. Please state your name and business address.
- 2 A. Basil Bailey, 90 Church Street, New York, NY.
- 3 Q. By whom and in what capacity are you employed?
- 4 A. I am employed by the New York State Department  
5 of Public Service as a Public Utilities Auditor  
6 II in the Office of Accounting and Finance.
- 7 Q. Please state briefly your educational background  
8 and professional experience.
- 9 A. I graduated from Baruch College in 1987 where I  
10 earned a Bachelor of Arts degree in Business  
11 Administration with a concentration in  
12 accounting. I have been employed by the  
13 Department of Public Service since 1988.
- 14 Q. Have you testified previously in a proceeding  
15 before the Commission?
- 16 A. Yes, I have testified numerous times.
- 17 Q. What is the purpose of your testimony in this  
18 case?
- 19 A. I will address certain operation and maintenance  
20 (O&M) expenses projected by Long Island American  
21 Water (LIAW). I will also address LIAW's  
22 property tax projection and LIAW's request for a  
23 property tax reconciliation. My testimony also

1 addresses American Water Works purchase of Aqua  
2 America Inc.'s regulated operations in New York.

3 Q. Are you proposing any adjustments to these  
4 areas?

5 A. Yes. For the rate year ending the March 31, 2013  
6 I am proposing the following adjustments:

7	Service Company Charges	(\$ 940,929)
8	Invoices	(\$ 183,231)
9	Property Taxes	(\$3,504,649)
10	Actuary Study Amortization	(\$ 96,444)

11 Q. Will you be addressing any other O&M expenses?

12 A. Yes, I will also address the company's  
13 projections for pensions and Other Post-  
14 Employment Benefits (OPEB).

15 Q. Have you prepared any exhibits for this  
16 proceeding?

17 A. Yes. I have prepared Exhibit\_\_(BLB-1), which  
18 consist of three schedules.

19 Q. Briefly describe each schedule in Exhibit\_\_\_\_  
20 (BLB-1).

21 A. Schedule 1 shows my Service Company adjustments.  
22 Schedule 2 shows my Invoices adjustment.  
23 Schedule 3 shows my property taxes adjustments.

1 I have also prepared Exhibit \_\_\_\_ (BLB-2), which  
2 consists of the company's responses to Staff's  
3 interrogatories to which I refer in my  
4 testimony.

5 Service Company Charges

6 Q. Please briefly explain the nature of the charges  
7 from American Water Works Service Company  
8 (AWWSC).

9 A. Both LIAW and AWWSC are subsidiaries of American  
10 Water Works (AWW). AWWSC provides services to  
11 LIAW and other affiliated companies of AWW.

12 Q. What kind of services does AWWSC provide to  
13 LIAW?

14 A. As listed on page 3 of the testimony of LIAW  
15 witness, Mr. Conroy, the services include  
16 accounting, administration, communication,  
17 engineering, financial, information system,  
18 human resources, water quality, operations,  
19 customer services, and corporate secretarial and  
20 other general services

21 Q. How are costs allocated from AWWSC to LIAW?

22 A. LIAW is charged directly for the cost of  
23 services provided specifically to it and also

1           pays its proportional share of common costs.  
2           Direct charges are based on actual hours charged  
3           to LIAW from service company employee timesheets  
4           and common charges are based on various other  
5           methods as discuss on page 4, of Mr. Conroy's  
6           testimony of LIAW.

7    Q.    How much did LIAW project for rate year service  
8           company charges?

9    A.    \$5,374,394.

10   Q.    How much of an increase is this over the amount  
11          reflected in current rates for the year ended  
12          March 31, 2011 and the historic year (HTY)?

13   A.    Its an increase of \$1,371,700 or 34.27% over the  
14          amount reflected in current rates. The increase  
15          over the HTY is \$783,699 or 17.07%

16   Q.    Did the company provide an explanation for such  
17          a significant increase over current rates?

18   A.    In response to question 3 of Staff IR-93, LIAW  
19          provided an explanation and analysis of the cost  
20          elements that contributed to the increase.  
21          Specifically, the company stated that  
22          Information Technology Services (ITS) account  
23          for 57% of the \$1,371,700 increase, raises and

1 inflation account for 15% of the increase and a  
2 significant portion of the remaining 28% is  
3 attributed to pension, OPEB and group insurance  
4 costs.

5 Q. Please briefly explain how LIAW projected rate  
6 year service company charges?

7 A. As shown on LIAW's Exhibit 12, Tab 16, pages 1  
8 and 2, LIAW first adjusted the historic test  
9 year (HTY) amount by a net increase of \$378,244.  
10 In response to Staff IR-32 LIAW explained the  
11 reason for the labor and related expense  
12 adjustments. LIAW also adjusted the HTY amount  
13 for a part-time human resources support person  
14 and for depreciation and maintenance in the  
15 amounts of \$10,000 and \$127,922, respectively.

16 Q. After these adjustments to the HTY amount, how  
17 did LIAW projected the rate year amount?

18 A. LIAW reflected average salary and benefit  
19 increases of 2.72%, 2.75% and 2.75% for the  
20 years 2011, 2012 and 2013, respectively to the  
21 adjusted HTY labor and related expenses. For its  
22 other expenses, LIAW made inflation adjustments  
23 of 1.59% and specific adjustments for business

1 transformation costs as shown on LIAW Exhibit  
2 12, Tab 16, page 2.

3 Q. How do you propose LIAW's rate year forecast for  
4 service company charges be determined?

5 A. I propose the adjusted base year amount first be  
6 reduced by \$724,764 as shown on Exhibit BLB-1,  
7 schedule 1. A composite inflation rate of 4.46%  
8 from the HTY to the rate year should then be  
9 applied to the remainder. This results in  
10 recommend allowance of \$4,433,465 and an overall  
11 reduction of \$940,929 to LIAW's projection.

12 Q. Please explain your adjustments to the HTY  
13 service company expenses as provided on schedule  
14 1 of Exhibit\_\_ (BLB-1).

15 A. Schedule-1 shows costs for incentive pay, other  
16 stock related incentive pay compensation and  
17 relocation costs. These costs are projected into  
18 the rate year by LIAW. However, LIAW did not  
19 demonstrate how the benefits associated with  
20 these incentive pay compensation have been  
21 reflected in its revenue projection.

22 Q. Did LIAW explain the reasoning for incentive pay  
23 and the other compensation included in service

1 company expenses?

2 A. The testimony of LIAW's Mr. Varley provides  
3 explanation and reasoning for the incentive  
4 programs. However those explanation and  
5 reasoning did not explain or show how LIAW  
6 projected and captured related benefits for  
7 customers from these incentive costs. For the  
8 same reasons as set forth in the testimony of  
9 staff witness, Mr. Leung, these components of  
10 service company expenses should be eliminated  
11 from rate year forecast.

12 Q. Why did you eliminate the relocation cost?

13 A. These are costs incurred to transfer employees  
14 to other company locations. Since ratepayers are  
15 already paying for the services of these  
16 employees any additional cost should provide  
17 quantifiable benefits to ratepayers. In response  
18 to IR-99, LIAW did not provide any quantifiable  
19 benefits or savings reflected in the rate year.

20 Q. Why did you eliminate LIAW'S base year increase  
21 adjustment of \$378,244 in your projection?

22 A. Service company charges from 2007 to 2010  
23 reflect both increases and decreases with an

1 average increase of 3.24%. The increase from  
2 2009 to the HTY without the adjustment is 8.55%.  
3 With the adjustment it is 17%. As this greatly  
4 exceeds the average increase of 3.24%, LIAW  
5 should not be allowed to increase the base year  
6 amount without reflecting quantifiable benefits  
7 in the rate year resulting from the increased  
8 costs.

9

10 Invoices

11 Q. Please provide an overview of invoices.

12 A. The invoices are broken down into four major  
13 categories, which are Customer Accounting;  
14 General Office Expense; Miscellaneous and  
15 Maintenance Expenses. The descriptions of the  
16 type of charges are provided in LIAW's Exhibit  
17 12, pages 1-2.

18 Q. How did LIAW forecast invoices expense for the  
19 rate year of \$2,563,952?

20 A. LIAW increased the HTY amount by an inflation  
21 factor of 1.59% per year. LIAW also made three  
22 separate adjustments for 2011 totaling  
23 (\$78,534). The adjustments include an increase

1 to annualize public relation costs; an increase  
2 for software maintenance and a decrease for the  
3 costs that it already recovered in the Revenue  
4 Adjustment Clause (RAC) mechanism. In the year  
5 2012 and the three months ended March 31, 2013,  
6 LIAW also increased the cost by \$15,738 for  
7 software maintenance.

8 Q. Do you agree with the amount forecasted by LIAW?

9 A. No. I recommend a rate year allowance of  
10 \$2,380,721. This is a reduction of \$183,231 to  
11 LIAW's forecast. My recommended amount is based  
12 on a four year average from 2007 to 2010.

13 Q. Why do you believe an average is more  
14 appropriate than LIAW's approach?

15 A. The charges for invoices vary significantly from  
16 year to year as shown on schedule 2 of Exhibit \_  
17 BLB-1. Therefore to forecast the rate year  
18 basically on the HTY amount as LIAW done, does  
19 not account for the varying pattern of these  
20 costs. An average captures the varying nature  
21 of these LIAW's invoice charges from year to  
22 year and provides for a more normalized level.  
23 LIAW should only be allowed this normalized

1 level for the rate year.

2

3 Property Tax Expense

4 Q. Briefly describe how LIAW forecasted its  
5 property taxes.

6 A. The property taxes consist of town taxes, school  
7 taxes and village taxes. LIAW first developed  
8 ratios by dividing property expense for each  
9 category by the Tentative Full value (TFV). TFV  
10 is derived from total utility plant in service  
11 (UPIS) plus construction work in process (CWIP).  
12 LIAW then apply the ratios to projected TFV to  
13 forecast its rate year property taxes expense.  
14 LIAW's Exhibit 12, on page 2 of tab 28 shows how  
15 the ratios were developed and applied. LIAW's  
16 response to Staff's IR-14, provide further  
17 explanation of the development of the ratios and  
18 how they were used in the forecast.

19 Q. How much property taxes expense LIAW is  
20 forecasting for the rate Year?

21 A. LIAW's forecast for the rate is \$14,365,278.  
22 This is an increase of \$3,543,021 or 32.74% over  
23 the HTY.

1 Q. What justification the company gave for such a  
2 significant increase?

3 A. According to LIAW, the increase is due to the  
4 additional investment of utility plant.

5 Q. Do you agree with LIAW's forecast?

6 A. No. The historic data from the LIAW's books  
7 shows a decreasing trend for property taxes  
8 expense from 2005 to 2010. The five year average  
9 is a decrease in property taxes expense of 5.6%.

10 Q. Did LIAW provide information for UPIS and CWIP  
11 and related TFV during the decline in property  
12 taxes expense for the 5 year period?

13 A. Yes. That information was provided in response  
14 to Staff IR-63. Based on that information it is  
15 clear that an increase in utility plant does not  
16 automatically result in an increase in the TFV  
17 or property taxes expense. To the contrary,  
18 during the period 2005 to 2010, UPIS and CWIP  
19 cumulative cost increased by 51.68% while  
20 property tax expense decreased by an average of  
21 5.6%. Therefore it would be unreasonable to  
22 accept LIAW methodology for forecasting property  
23 taxes expenses that resulted in such a drastic

1           increase when its own historic records do not  
2           support it.

3    Q.    What is your recommended level of rate year  
4           property taxes expense?

5    A.    I recommend a rate year property tax expense of  
6           \$10,860,629. This is a reduction of \$3,504,649  
7           to LIAW'S projection of \$14,365,278.

8    Q.    Please describe how you derived the rate year  
9           projection?

10   A.    I applied the applicable GDP inflation rate to  
11          the latest known actual property taxes expense  
12          for town taxes, school taxes and village taxes  
13          as shown on schedule-3 of Exhibit \_\_ (BLB-1).  
14          Specifically; I used the company's actual 2011  
15          town taxes, 2011/2012 village taxes and the  
16          2010/2011 school taxes.

17   Q.    Why do you believe that using the GDP inflation  
18          rate and the latest known property taxes expense  
19          is reasonable compared to LIAW's methodology?

20   A.    Property taxes expense is a product of the  
21          property's assessment value and tax rate.  
22          Therefore changes in these components cause  
23          property taxes expense to fluctuate from year to

1 year. LIAW can challenge the assessment value  
2 but has no control over the tax rate. As a  
3 result of the uncontrollable components, LIAW  
4 may experience property tax increases in any  
5 given year despite its recent history. However,  
6 as LIAW has not experienced property tax expense  
7 increases in recent years despite increases in  
8 plant value, it would be unreasonable to base an  
9 increase for LIAW on any other factors beside  
10 the latest known property taxes expense and the  
11 GDP inflation rate.

12 Q. Do you propose updates be made to the rate year  
13 school taxes you propose?

14 A. Yes, an update should be made to reflect the  
15 company's actual 2011/2012 school taxes.  
16 However, the company must provide copies of the  
17 actual tax bills to Staff no later than filing  
18 of Briefs on Exception, consistent with the  
19 Commission's "Statement of Policy on Test  
20 Periods in Major Rate Proceedings (issued  
21 November 23, 1997).

22 Q. Is LIAW requesting a property tax expense  
23 reconciliation clause?

1 A. Yes. LIAW proposes to recover or refund 100% of  
2 the difference between actual property taxes and  
3 the amount reflected in rates.

4 Q. Do you agree with LIAW's proposal?

5 A. No. Property tax expense reconciliation is not  
6 necessary in the context of establishing rates  
7 for a single year. The Commission's general  
8 practice has been to only grant property tax  
9 reconciliation in cases where rates have been  
10 agreed upon for multi-years, and the company has  
11 not provided any rationale as to why this  
12 general practice should be altered for this  
13 single year rate case.

14

15 Pension and OPEB Expense

16 Q. Has LIAW's accounting for pension and OPEB  
17 expense ever been called into question by the  
18 Commission?

19 A. Yes, on March 21, 2005 the Commission issued an  
20 Order Instituting Proceeding in Case 05-W-0339,  
21 Proceeding on Motion of the Commission to  
22 Examine the Accounting Practices of Long Island  
23 Water Corporation with Respect to its Pension

1           and Other Post-Employment Benefit Plans. The  
2           objective of Case 05-W-0339 was to examine  
3           LIAW's accounting pursuant to the Commission's  
4           Statement of Policy and Order Concerning the  
5           Accounting and Ratemaking Treatment for Pensions  
6           and Post-Retirement Benefits Other Than Pensions  
7           issued on September 7, 1993 pursuant to Case 91-  
8           M-0890 (Pension/OPEB Policy Statement).

9    Q.    What were the results of Case 05-W-0339?

10   A.    The Joint Proposal adopted by the Commission in  
11           LIAW's last rate case (Case 07-W-0508, Long  
12           Island Water Corporation - Rates, Order Adopting  
13           Three-Year Rate Plan (issued March 5, 2008))  
14           fully resolved Case 05-W-0339.

15   Q.    Please describe the provision in the Case 07-W-  
16           0508 Joint Proposal that resolved Case 05-W-  
17           0339.

18   A.    In Case 05-W-0339 Staff conducted an audit of  
19           LIAW's accounting for pensions and OPEBs for the  
20           period January 1993 through December 2003. The  
21           Audit Report and associated materials, including  
22           the Company's response to the audit were  
23           attached to the Joint Proposal in Appendix F.

1           LIAW agreed to make certain journal entries and  
2           fully comply with the Pension/OPEB Policy  
3           Statement, specifically noting that it would  
4           record pension expense on a stand-alone-basis.

5    Q.    What do you mean when you say "record pension  
6           expense on a stand-alone-basis"?

7    A.    LIAW's employees are covered by the pension/OPEB  
8           plans of its parent, AWW. Prior to Case 05-W-  
9           0339 LIAW recorded pension expense using the  
10          total pension/OPEB costs of the parent times an  
11          allocation factor. This methodology was  
12          specifically rejected on pages 31-34 of the  
13          Pension/OPEB Policy Statement. Instead,  
14          utilities must calculate pension/OPEB costs for  
15          the entity regulated by the Commission separate  
16          from the other entities covered by the  
17          pension/OPEB plan or on a stand-alone-basis.

18   Q.    Has the company recorded pension or OPEB expense  
19          on its books on a stand-alone-basis since the  
20          issuance of the Order adopting the Joint  
21          Proposal in Case 07-W-0508?

22   A.    No.

23   Q.    Did LIAW develop its rate year pension and OPEB

1 expense forecast on a stand-alone basis?

2 A. No.

3 Q. Did any company witness explain why LIAW's rate  
4 year pension and OPEB expenses weren't forecast  
5 on a stand-alone basis?

6 Q. The only LIAW testimony addressing pensions or  
7 OPEBs is on pages 4-7 of Mr. Casillo's  
8 testimony. However, the proposals in that  
9 testimony only impact the accrual of interest on  
10 LIAW's pension/OPEB internal reserves and not  
11 the cumulative amount of pension/OPEB expenses  
12 allowed in rates. Thus, it is discussed  
13 separately in the next section of this  
14 testimony.

15 Q. Did you ask Mr. Casillo why the company's rate  
16 year projection is based on an allocation from  
17 the parent company instead of on a stand-alone-  
18 basis as ordered by the Pension/OPEB Policy  
19 Statement?

20 A. Yes, I asked that question in Staff IT-70 and  
21 Mr. Casillo responded "The Company is proposing  
22 to match the funding level allowed in rates with  
23 the actual funding of the Plan. If the Company

1 requests expense recovery on a stand-alone basis  
2 it will cause rate shock as the stand-alone  
3 expense is higher than the American FAS 87  
4 projections for LIAW in 2011. Since the funding  
5 of the plan is made at the ERISA level for  
6 Pension from the American plan, the Company is  
7 requesting to use the expense from the American  
8 plan which is better aligned to the funding of  
9 the plan than the stand-alone amount. The  
10 Company is also attempting to smooth rate  
11 recovery of the Pension expense by not  
12 requesting a higher stand-alone expense. This  
13 filing is consistent with the filing for Pension  
14 expense in Case 07-W-0508."

15 Q. Did Mr. Casillo provide a comparison of  
16 pension/OPEB expense calculated on a stand-alone  
17 versus consolidated basis?

18 A. Staff IR 172 requested the company provided a  
19 comparison by major component between pension  
20 and OPEB expense calculated on stand-alone and  
21 allocation basis. The response only provided a  
22 comparison for pension expense showing that for  
23 2010 total pension costs calculated on a stand-

1 alone basis was \$2,304,809 versus \$1,210,497 on  
2 an allocated basis. For 2011, the response  
3 showed that total pension costs calculated on a  
4 stand-alone basis was \$2,776,859 versus  
5 \$1,022,052 on an allocated basis.

6 Q. What is LIAW's rate year forecast for pension  
7 expense?

8 A. The company's rate year forecast for pension  
9 expense is based on the allocated \$1,022,052  
10 plus disability payments of \$43,563 total 2011  
11 pension cost. However, the company projects  
12 16.98% of that amount will be capitalized, thus  
13 only \$884,674 is left in O&M expenses.

14 Q. What is LIAW's rate year forecast for OPEB  
15 expense?

16 A. The company's total rate year forecast for OPEB  
17 costs is \$600,791. However, like pensions, the  
18 company projects 16.98% of that amount will be  
19 capitalized, thus only \$498,777 is left in O&M  
20 expenses. According to the supporting workpaper  
21 included in Exhibit 12, Tab 11, page 3 this is  
22 the expected 2011 cost using data collected as  
23 of July 1, 2010.

- 1 Q. How much do you recommend be included in the  
2 rate year O&M expenses for pensions and OPEBs?
- 3 A. LIAW has not provided adequate detail for Staff  
4 to fully evaluate the stand-alone pension/OPEB  
5 forecasts provided by company and this  
6 information should be provided by the company in  
7 its rebuttal testimony. For the interim, the  
8 revenue requirement forecasts in Exhibit\_\_(ACL-  
9 1) are based on the LIAW's total pension/OPEB  
10 cost forecasts only adjusted for the 16.59%  
11 capitalization percentage recommended by Mr.  
12 Leung.
- 13 Q. Does this mean you agree with the company's  
14 proposal to compute pension/OPEB expense on an  
15 allocated versus stand-alone basis.
- 16 A. Absolutely not. The reasons given by the  
17 Commission in the Pension/OPEB Policy Statement  
18 for requiring pension/OPEB costs be calculated  
19 on a stand-alone basis are rooted in sound, long  
20 standing regulatory principles that the company  
21 has not even attempted to refute or explain why  
22 they are not applicable to LIAW.
- 23 Q. Then why isn't Staff adjusting the company's

1 rate year O&M expense forecasts for pensions to  
2 reflect those costs on a stand-alone basis.

3 A. Staff's review, based on the limited related  
4 information provided by LIAW to date, indicate  
5 the two major drivers of the higher stand-alone  
6 cost are the amortizations of prior service  
7 costs and the unrecognized net actuarial loss.  
8 These discrepancies are counter intuitive and  
9 Staff is not comfortable acknowledging them in  
10 any way at this time.

11 Q. Please explain what you mean by the amortization  
12 of prior service costs.

13 A. Prior Service costs are costs that arise from  
14 amendments to defined benefit pension plans that  
15 retroactively increase benefits. The rules for  
16 accounting for pensions adopted by the  
17 Commission are provided in Statement of  
18 Financial Accounting Standards (FAS) 87 (See  
19 Pension/OPEB Policy Statement pp. 1-2). Under  
20 FAS 87, prior service costs are reflected in net  
21 periodic pension costs over the projected  
22 remaining service lives for the employees  
23 expected to receive benefits.

1 Q. Please explain why the discrepancy between the  
2 allocated and stand-alone amortization of prior  
3 service costs is counterintuitive.

4 A. LIAW's response to Staff IR 172 shows total  
5 unrecognized prior service costs of \$3,497,775  
6 for 2010 almost doubling in 2011 to \$6,411,797  
7 on a allocated basis and increasing from  
8 \$2,040,605 in 2010 to \$5,484,254 on a stand-  
9 alone basis. The company has provided no  
10 explanation for the large increase and it is  
11 counterintuitive that the allocation to LIAW  
12 from AWW is so much lower than on a stand-alone  
13 basis given the employees are part of the same  
14 pension plan. Moreover, at the same time the  
15 response to Staff IR 172 shows the amortization  
16 of prior service on an allocated basis actually  
17 decreasing from \$15,724 in 2010 to \$13,858 in  
18 2011 while the same amortization increases from  
19 \$318,380 to \$723,422 on a stand-alone basis.  
20 These amounts should not be moving in the  
21 opposite direction.

22 Q. Please explain what you mean by the amortization  
23 of the unrecognized net actuarial loss.

- 1 A. Recording pension expense under the accrual  
2 basis of accounting as required by FAS 87  
3 requires the use of numerous assumptions and  
4 estimates. As actual results will vary, FAS 87  
5 requires the variances to be amortized into net  
6 periodic pension costs and the methodology  
7 adopted by the Commission's Pension/OPEB Policy  
8 Statement (pp. 14-18) is for the amortization to  
9 be over a ten year period on a vintage year  
10 basis.
- 11 Q. Please explain why the discrepancy in the  
12 amortizations of the unrecognized net actuarial  
13 loss is counterintuitive.
- 14 A. The response to Staff IR 172 shows the total  
15 unrecognized net actuarial loss for 2010 was  
16 \$6,372,577 on an allocated basis versus  
17 \$7,256,401 on a stand-alone basis, a difference  
18 of \$883,824. Yet the amount reflected in net  
19 periodic pension cost for 2010 was \$477,747 on  
20 an allocated basis versus \$1,239,967, on a  
21 stand-alone basis, a difference of \$762,220.  
22 This result is counterintuitive since both  
23 amounts are amortized over 10 years. Absent, the

1 supporting calculations Staff cannot assess  
2 these results.

3 Q. What about 2011?

4 A. The discrepancy exacerbates in 2011. The  
5 response to Staff IR 172 shows the total  
6 unrecognized net actuarial loss for 2011 to be  
7 \$6,797,717 on an allocated basis versus  
8 \$6,584,425 on a stand-alone basis. Yet the  
9 amount reflected in net periodic pension cost  
10 for 2011 is \$476,647 on an allocated basis  
11 versus \$1,225,829 on a stand-alone basis. Thus,  
12 although the total unrecognized actuarial loss  
13 on an allocated basis is \$213,292 higher than on  
14 a stand-alone basis, the amount amortized to net  
15 periodic pension cost is actually lower by  
16 \$749,182!

17 Q. Should LIAW fully explain these discrepancies in  
18 its rebuttal filing?

19 A. Yes and all of the supporting working papers and  
20 actuarial reports used to determine the amounts  
21 in Staff IR 172 should be provided to Staff.

22

23 Pension and OPEB Internal Reserve

1 Q. What is the internal reserve for pensions and  
2 OPEBs?

3 A. Pensions and OPEBs are employee benefits that  
4 are earned while an employee works for an entity  
5 but are not paid until after the employee  
6 retires. Under the accounting and ratemaking  
7 treatment adopted in the Pension/OPEB Policy  
8 Statement, customers pay for a utility's  
9 pension/OPEB costs as employees earn them.  
10 Funding for pensions and OPEBs in advance of the  
11 employee retiring, on the other hand, are  
12 primarily guided by federal regulations that  
13 differ from the accounting and ratemaking  
14 adopted in the Pension/OPEB Policy Statement  
15 which requires the differences between the  
16 amount of Pension/OPEB costs collected in rates  
17 and funded be accounted for in an internal  
18 reserve.

19 Q. How are customers compensated for providing the  
20 utility cash for Pension/OPEB costs that it does  
21 not pay until many years in the future?

22 A. The cash collected from customers for  
23 pensions/OPEBs is credited to the internal

1           reserve and the amounts deposited by the utility  
2           in external pension/OPEB trusts are debited to  
3           the internal reserve. The Pension/OPEB Policy  
4           Statement requires jurisdictional utilities to  
5           accrue a noncash return when the internal  
6           reserve as a credit balance at the company's  
7           latest authorized pretax rate of return.

8    Q.    Can the utility accrue a noncash return on the  
9           internal reserve when it has a debit balance?

10   A.    No but footnote 3 on Attachment A, p. 6 of the  
11          Pension/OPEB Policy Statement says "A Debit  
12          balance can occur only when management, at its  
13          discretion, decides to make contributions in  
14          excess of the rate allowance or if it accrues a  
15          negative pension expense. In rate proceedings  
16          companies may seek prospective interest accruals  
17          or rate base treatment for debit balances."

18   Q.    Please elaborate on your statement above that  
19          Mr. Casillo's testimony contains proposals  
20          related to LIAW's internal reserve.

21   A.    Mr. Casillo initially proposes that LIAW's  
22          pension and OPEB expense be combined for  
23          accounting and ratemaking purposes stating that

1           LIAW "is seeking to align future pension & OPEB  
2           recovery with future funding of separate pension  
3           and OPEB trusts in order to curtail future  
4           interest expense for internal reserve  
5           calculations." Mr. Casillo further states that  
6           without accumulated interest both the pension  
7           and OPEB internal reserve are in a debit balance  
8           for the HTY. Based on current projections, LIAW  
9           believes that future funding of pension trust  
10          will increase above the pension expense and  
11          future funding of OPEB will equal to the  
12          projected OPEB expense.

13    Q.    How does the LIAW believe its future funding  
14          plan will affect the internal reserve?

15    A.    Mr. Casillo testifies that with separate rate  
16          allowances for pension and OPEB expense, the  
17          pension internal reserve will be in a debit  
18          balance and the OPEB internal reserve will  
19          continue to be in a credit balance. The credit  
20          balance in the OPEB reserve is due to the  
21          compounding interest calculation. This results  
22          in LIAW having the burden of continuing to  
23          calculate interest on OPEB Internal reserve

1           although it is fully-funded.

2    Q.    According to Mr. Casillo, would the Pension  
3           Policy allow for the debit balance in internal  
4           reserve for pension to offset the credit balance  
5           in the internal reserve for OPEB?

6    A.    No. Therefore, LIAW proposes the rate allowance  
7           for pension and OPEB expense be combined as only  
8           pension expense which to align it with future  
9           funding of the pension and OPEB trust.

10   Q.    Does Mr. Casillo have an alternative proposal to  
11          the combining of pension and OPEB expense and  
12          the treatment of carrying charges on these  
13          pension and OPEB internal reserve fund?

14   A.    Yes. He requests that LIAW be permitted to  
15          accrue carrying charges on the projected debit  
16          balances of the pension and OPEB internal  
17          reserve funds. By doing so LIAW could achieve  
18          the same result by proposing rate allowance of  
19          pension and OPEB expense separately.

20   Q.    Does Mr. Casillo have a proposal related to the  
21          rate that should be applied to the internal  
22          reserve to accrue a noncash return?

23   A.    Yes, he requests that LIAW be allowed to accrue

1 interest on credit balances of pension and OPEB  
2 internal reserve fund at the other customer  
3 capital rate rather than the pretax authorized  
4 rate of return as required by the Pension/OPEB  
5 Policy Statement. Mr. Casillo maintains that  
6 using the other customer deposit capital rate is  
7 consistent with the interest rate used on other  
8 deferrals such as the Revenue Adjustment Clause  
9 (RAC) and Property Tax Reconciliation Clause  
10 (PTC). He also maintains that it is consistent  
11 with the rate used to calculate interest on the  
12 Company's various tax refund cases.

13 Q. Do you agree with the proposal to combine  
14 pension and OPEB expenses as pension expense?

15 A. No. Adopting this proposal would circumvent the  
16 Pension/OPEB Policy Statement's barring of  
17 accruing balances on internal reserve debit  
18 balances without basis. As noted above, a  
19 utility may request to accrue a noncash return  
20 on internal reserve debit balances in rate  
21 proceedings and LIAW's proposal to combine  
22 pension and OPEB expense in effect does that.  
23 However, to be granted that request the utility

1           has the burden showing why such treatment is  
2           proper and LIAW has not explained or provided  
3           the necessary backup as to why a debit internal  
4           reserve balance is appropriate.

5       Q.   Has the Commission ever allowed a utility to  
6           accrue a noncash return on an internal reserve  
7           debit balance?

8       A.   Yes but only once, in Case 04-G-1047, Proceeding  
9           on Motion of the Commission as to the Rates  
10          Charges, Rules and Regulations of Natural Fuel  
11          Gas Distribution Corporation for Gas Service,  
12          Order Establishing Rates and Terms of Two Year  
13          Rate Plan, Attachment 1, PP. 11-12 (issued July  
14          22,2005)

15       Q.   Do you agree with LIAW's proposal to record  
16           interest at the other customer deposit rate on  
17           credit balance in the internal reserve fund?

18       A.   No. The mechanisms Mr. Casillo refers to that  
19           apply the Other Capital rate are short term in  
20           nature where applying that rate is appropriate.  
21           The Pension/OPEB internal reserve, however, is  
22           very long term in nature which is why the  
23           Pension/OPEB Policy Statement requires the pre-

1 tax authorized rate of return be used. LIAW has  
2 provided no reasons to deviate from that policy  
3 and its proposal to use the Other Customer  
4 Capital rate should be rejected.

5

6 Amortization of Actuarial Study Costs

7 Q. Briefly describe the actuarial study cost of  
8 \$289,334 that LIAW is seeking to amortize over 3  
9 years.

10 A. These are costs for work performed by an  
11 actuarial firm to calculate pension and OPEB  
12 expense on a stand-alone-basis for LIAW.

13 Q. Did the company provide an explanation as to why  
14 this amortization should be allowed in rates?

15 A. Yes. LIAW's explanation is presented in its  
16 response to question 1 of Staff IR-126. The  
17 Company states that it requested recovery of  
18 this expense in its last rate case (07-W-0508)  
19 as part of Rate Case Expense but Staff's direct  
20 testimony proposed it be eliminated on the  
21 grounds they were part of Case 05-W-0339 and  
22 recovery of those costs should be decided in  
23 that case. In response to IR-126, LIAW maintains

1 the recovery of these costs would produce a  
2 revenue requirement and therefore were not  
3 formally addressed in Case 05-W-0339 but instead  
4 were discussed between the Company and Staff to  
5 defer the costs and seek recovery in the next  
6 rate case proceeding. These actuarial costs were  
7 therefore deferred over the period 2007 through  
8 2011.

9 Q. Did the Joint Proposal adopted by the Commission  
10 in LIAW's last rate case discuss the costs to  
11 perform the actuarial studies needed to  
12 determine Pension/OPEB expense on a stand-alone  
13 basis?

14 A. No, they are not mentioned at all.

15 Q. Does the Commission have a policy for  
16 determining if an expense qualifies for deferred  
17 accounting treatment?

18 A. Yes. To qualify for deferred accounting  
19 treatment, an expense must meet the following  
20 three-prong criteria generally applied by the  
21 Commission:

22 A) The expense is incremental to the amount  
23 allowed in rates;

1 B) The incremental amount is material and  
2 extraordinary in nature; and,  
3 C) Earnings are below the authorized rate of  
4 return on common equity.

5 The Commission recently confirmed this standard  
6 in Case 10-M-0473, Central Hudson Gas & Electric  
7 Corporation, Order Regarding Request to Defer  
8 Storm Restoration Expenses, Bad Debt Net Write-  
9 off Expenses, and Property Taxes for the Rate  
10 Year Ended June 30, 2010, as well as, Authority  
11 to Offset These Expenses with Certain Income Tax  
12 benefits (issued: March 30, 2011) (Central  
13 Hudson Deferral Order).

14 Q. Do LIAW's deferred actuarial costs satisfy the  
15 three prong criteria?

16 A. No. In response to staff's IR-126, LIAW provided  
17 the costs it deferred from 2007 to 2011. Except  
18 for the year 2007, when the Company incurred a  
19 loss, LIAW does not satisfy the condition that  
20 the net cost must be material. Specifically, as  
21 re-affirmed by the Commission on page 5 of the  
22 Central Hudson Deferral Order, to be material  
23 the expense must be in excess of 5% of net

1 income for the year in which the expense is  
2 incurred. Another reason to disallow this  
3 request is that it wasn't made on a timely basis  
4 as required under the USOA. LIAW's response to  
5 IR-126 states "The recovery of these costs would  
6 produce a revenue requirement and therefore were  
7 not formally addressed in Case 05-W-0339 but  
8 instead were discussed between the Company and  
9 Staff to defer the costs and seek recovery in  
10 the next rate case proceeding." However, as  
11 indicated above, the Joint Proposal approved by  
12 the Commission did not address the costs.  
13 Therefore LIAW's statement is irrelevant.

14 Q. What adjustment is required to reflect this  
15 determination?

16 A. The \$96,444 included by LIAW in rate year O&M  
17 expenses for Amortization of Actuarial Studies  
18 should be eliminated

19

20 Acquisition of Aqua of New York

21 Q. Please summarize American Water Works Company,  
22 Inc.'s (AWW) purchase of Aqua America Inc.'s  
23 regulated operations in New York (Aqua).

- 1 A. On July 11, 2011 AWW, the parent company of  
2 LIAW, issued a press release announcing the  
3 purchase of Aqua's seven regulated water  
4 companies in New York. Aqua's seven New York  
5 regulated companies have approximately 50,000  
6 customers, with the majority located in Nassau  
7 County. The two largest companies are Aqua-New  
8 York (d/b/a New York Water Service) with 45,000  
9 customers and Aqua Sea Cliff with 4,500  
10 customers. If this transaction is approved, AWW  
11 will serve approximately 124,000 customers in  
12 New York State, with nearly 123,000 in Nassau  
13 County. The agreement is a stock purchase  
14 valued at approximately \$71 million.
- 15 Q. What is the expected closing date for this  
16 transaction?
- 17 A. According to AWW's press release, the closing is  
18 expected to occur during the first quarter of  
19 2012.
- 20 Q. How does this date coincide with LIAW's rate  
21 year?
- 22 A. The transaction should be consummated by the  
23 beginning of LIAW's rate year April 1, 2012.

1 Q. Did LIAWC address this acquisition in its  
2 current rate filing?

3 A. No. The company has submitted no testimony or  
4 other information regarding the acquisition in  
5 its May 2011 rate filing.

6 Q. Have the companies requested Commission approval  
7 of the acquisition?

8 A. Yes. The petition was filed on September 1,  
9 2011, in case 11-W-0472.

10 Q. Did Staff ask LIAW to identify the RY synergy  
11 savings resulting from the acquisition?

12 A. Yes. In IR-142 RMD-1, Staff asked the company  
13 to identify all financial, operational and  
14 synergy savings and or benefits that should be  
15 reflected in LIAW's revenue requirement for the  
16 RYE 3/31/2013.

17 Q. Please summarize the company's response.

18 A. The company believes that the acquisition will,  
19 over time, produce more efficient operations.  
20 However, at this time, there have been no  
21 studies made by AWW as to the potential for  
22 savings that might actually exist by combining  
23 the operations of American Water and Aqua of NY.

1           As such, the company believes there is no basis  
2           for any imputation of savings in LIAW's revenue  
3           requirement.

4   Q.   Do you agree with the company?

5   A.   No.  Considering the magnitude of the  
6           transaction (\$71 million) and the close  
7           proximity of the impacted companies (LIAW and  
8           Aqua-New York are contiguous and Aqua-Sea Cliff  
9           is about 12 miles away), we find it hard to  
10          believe that the company did not attempt to  
11          quantify synergy savings.

12  Q.   What is Staff's litigated position regarding  
13          rate year synergies to LIAW?

14  A.   Since the company has not provided any  
15          documentation for Staff to review, an estimate  
16          or imputation of the RY savings would be  
17          inappropriate at this time.  As an alternative,  
18          we recommend that the Commission reserve the  
19          right to record a regulatory liability (i.e.,  
20          ratepayer IOU) on the books of LIAW for the  
21          agreed upon ratepayer synergy savings as  
22          stipulated in the Acquisition petition Case 11-  
23          W-0472.  This amount (net of income taxes) should

1           accrue interest at the company's authorized pre-  
2           tax rate of return until final disposition.

3   Q.   Does this conclude your testimony at this time?

4   A.   Yes.

5