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BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Ohio)
American Water Company to Increase Its) Case No. 11-4161-WS-AIR
Rates for Water Service and Sewer Service.)

DIRECT TESTIMONY
OF
MELISSA L. SCHWARZELL
ON BEHALF OF
OHIO AMERICAN WATER COMPANY

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PUCO

- ☐ Management policies, practice and organization
- ☒ Operating income
- ☐ Rate base
- ☐ Allocations
- ☐ Rate of return
- ☐ Rates and tariffs
- ☐ Other

951-001/289950

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1 **Direct Testimony of**

2 **Melissa L. Schwarzell**

3 **I. WITNESS INTRODUCTION**

4 **Q1. Please introduce yourself.**

5 A1. My name is Melissa L. Schwarzell. I am employed by American Water Works Service
6 Company ("Service Company") as a Financial Analyst I Rates, supporting Ohio
7 American Water Company. The Service Company is a subsidiary of American Water
8 Works Company, Inc. ("American Water") that provides support services to American
9 Water's subsidiaries. My business address is 2300 Richmond Road, Lexington,
10 Kentucky 40502.

11 **Q2. Please summarize your education and business experience.**

12 A2. I graduated Magna Cum Laude from The Ohio State University in 2001, with a Bachelor
13 of Science degree. I was a member of Golden Key and Phi Kappa Phi. I began my
14 employment in 2001 when I was hired by the Bluegrass Area Agency on Aging as a
15 Financial / Administrative Assistant. My responsibilities in that role included
16 bookkeeping, computer system training and implementation, administrative support, and
17 the development and maintenance of data tools to track service delivery, administration,
18 and funding allocations for various social service programs. I joined American Water in
19 2009 as an Executive Assistant to the Vice President of Finance, Eastern Division. In
20 addition to providing administrative support, my job responsibilities included labor
21 budgeting and analysis, development and maintenance of service company review tools,
22 and revenue analytic development. I was promoted to Financial Analyst I Rates in

1 February 2011. In my current position, I work with rates and rate issues for regulated
2 subsidiaries of American, including Ohio American Water Company ("Ohio American"
3 or "Company"). I attended the American Water Rate School in 2010.

4 **Q3. What is the purpose of your testimony in this proceeding?**

5 A3. The purpose of my testimony is to address various adjustments to Operating Expenses,
6 including Labor, Pension, Group Insurance including Other Post Employment Benefits
7 ("OPEB"), Incentive Plan, Payroll Tax, Property Taxes, and some labor related
8 adjustments within Miscellaneous Expense (401k and Defined Contribution Pension).
9 These adjustments are shown in Schedules C-3.4, C-3.10, C-3.11, C-3.17, C-3.21, C-
10 3.23, C-9, and C-9.1. Each schedule was prepared by me or under my supervision.

11 **II. OPERATING INCOME AND EXPENSES**

12 **Q4. Please explain the adjustments to Operating Expenses shown in Schedule C-3.4.**

13 A4. Schedule C-3.4 is the Company's pro forma labor expense adjustment. Pro forma labor
14 expense was calculated based upon a level of 106 full time associates. Each associate's
15 pro forma salary and wage was calculated and applied to his or her test year hours, as
16 adjusted where applicable. For Corporate and non-union associates, the pro forma wages
17 are the same as the test year wages, as there are no merit increases within the adjustment
18 period. For union employees operating under a collective bargaining agreement
19 extending through the adjustment period, employee wages are based upon the applicable
20 contract rates in effect on December 31, 2011. For union employees operating under a
21 collective bargaining agreement that will expire and need to be renegotiated during the
22 test year, a three percent wage increase was assumed. These union merit increases are
23 annualized and are thus a positive adjustment to test year labor expense.

Overtime hours reflected in Labor Expense are based on 2011 budgeted overtime hours and rates.

Labor costs associated with twenty-four hour service, such as Shift Premiums, Holiday Premiums and Service Watch were based upon historical charges and were assigned by district / job title. These costs were not captured in Ohio American's labor budget and are thus a positive adjustment to the test year.

License Premiums, which are specific to the certifications of individual employees, were assigned by employee, based on historical payments. For employees who joined the company after January of 2010, and thus for whom we lack a full year of premium payment history, premiums from the first quarter of 2011 were annualized. License premiums were not captured in Ohio American's labor budget and are thus an adjustment to the test year.

The Operations and Maintenance ("O&M") percentage for Ohio Pro Forma Labor costs were also assigned based on the 2011 budget. There were adjustments made to the O&M percentage of 14 employees for whom more accurate capitalization forecasts were completed in early 2011 but not reflected in the original budget. All O&M percentages were assigned on an employee-by-employee basis, unless there had been a personnel change since the budget was built, in which case an average O&M percent for the position's district / job title combination was used. The overall O&M for direct labor expense is 84.08%.

Labor expense also includes payments made and accrued to eligible employees for the annual incentive plan ("AIP") and long-term incentive plan ("LTIP"). These were based on the annual pro forma salary for eligible employees.

1 Another adjustment was to allocate the pro forma labor expenses of Franklin County
2 employees between Franklin County Water and Franklin County Wastewater. This was
3 done according to 2010 historical charges to these districts.

4 **Q5. Please discuss the adjustments to Operating Expenses under Schedule C-3.10.**

5 A5. Schedule C-3.10 is the adjustment to group insurance which is comprised of two
6 components. The first component is the life, disability, VEBA, health, dental, and vision
7 insurance coverage Ohio American provides for each associate. The pro forma costs of
8 life and disability insurance were assigned to each employee based on the premiums that
9 were in effect as of January 1, 2011. In cases where there was a difference between the
10 premium for bargaining-unit (union) and non-bargaining unit (non-union) employees,
11 then those premiums were applied accordingly. Voluntary Employee Benefit Association
12 (VEBA) payments were assigned according to actual obligations, on an employee-by-
13 employee basis. The pro forma costs of health, dental and vision insurances were
14 assigned based on both the rates and employee contribution policies in effect as of
15 January 1, 2011, as well as on the coverage selections of each employee. For the two
16 union positions which were vacant when pro forma labor was developed, the average
17 union premium and union employee contribution levels were used. Although these costs
18 are very comparable to what was budgeted, they have an O&M percentage applied to
19 them, which was missed in the budgeting process. Pro forma life, disability, health,
20 dental and vision costs thus represent a negative adjustment to test year group insurance
21 expense of (\$117,245).

22 The second component of group insurance adjustment relates to the accrual cost
23 of Other Post Employment Benefits ("OPEBs") other than pensions under SFAS 106.

1 Pro forma OPEBs costs were based on the \$402,401 allowed amount specified in the
2 PUCO Order in Case No. 09-391-WS-AIR. This amount is less than the test year cost of
3 OPEB and thus results in a negative adjustment of (\$117,957).

4 **Q6. Please describe the OPEBs available to associates of Ohio American Water**
5 **Company that are not included in Schedule C-3.10.**

6 A6. Depending on their start date, some Ohio American associates are eligible for OPEBs
7 upon their retirement. Union associates hired after January 1, 2006 and non-union
8 associates hired after Associates hired after January 1, 2002 are not eligible for post
9 retirement benefits. For those associates who are eligible, the company offers various
10 levels of coverage for medical, dental, and prescription drug benefits, depending upon
11 retirement date and age.

12 **Q7. Please explain the Pension Expense Schedule C-3.11.**

13 A7. Schedule C-3.11 reflects the \$692,164 of pension expense allowed per the PUCO Order
14 in Case No. 09-391-WS-AIR. A small adjustment of \$2,170 was required to reflect this,
15 primarily to offset a \$2,191 true-up entry from March 2011.

16 **Q8. Please discuss the 401k and Defined Contribution Pension adjustments on Schedule**
17 **C-3.17.**

18 A8. Schedule C-3.17 contains the adjustments for Miscellaneous Expense. Two elements of
19 the Miscellaneous Expense adjustment are 401k Expense and Defined Contribution
20 Pension Expense. Ohio American matches employee contributions to 401k accounts,
21 according to each employee's benefit group category. For employees whose benefit
22 group falls into an "Original" category, the company matches 50% of the first 5% of the
23 employee's contributions (for a maximum of 2.5%). For employees whose benefit group

1 falls into an "Enhanced" category, the company matches 100% of the first 3% and 50% of
2 the next 2% of the employee's contributions (for a maximum of 4%) Pro Forma 401k
3 expense was calculated based on actual employee contribution levels and benefit group
4 categories. An O&M percentage was then applied to each employee's company match.
5 Because actual 401k employee contribution levels are lower than budgeted, there is a
6 resultant negative adjustment to test year 401k expense of (\$11,445).

7 The second Miscellaneous Expense adjustment discussed here is the Defined
8 Contribution Pension ("DCP") adjustment. DCP is a retirement savings program for
9 employees not eligible for the Defined Benefit Pension. The DCP program entails Ohio
10 American contributing an amount equal to 5.25% of an employee's base pay into a
11 retirement account. The pro forma calculation for DCP involved multiplying pro forma
12 base pay times 5.25% for each DCP eligible employee and for the two vacant positions.
13 An O&M percentage was applied. Pro forma DCP totals result in a positive adjustment
14 to Miscellaneous Expense of \$22,195. This is because a simple spreadsheet error in the
15 original labor budget resulted in DCP being calculated for too few employees.

16 **Q9. Please discuss the adjustments to real and personal property taxes included in**
17 **Schedule C-3.21.**

18 A9. Schedule C-3.21 identifies the variance between the test year expense and anticipated
19 liability for real and personal property taxes. The pro forma expense for the period was
20 calculated by taking the 2010 actual Ohio property taxes owed and adding to this the
21 estimated real and personal property tax on recent additions to Utility Plant in Service
22 ("UPIS"). This addition is derived by calculating a ratio of property tax dollars to UPIS
23 dollars. Property Taxes for 2010 are divided by UPIS as of December 31, 2010. The

1 resulting ratio (0.040954) is multiplied by the UPIS added between January 1, 2011 and
2 April 30, 2011. The total figure represents an adjustment to Real and Personal Property
3 Tax of \$951,644.

4 **Q10. Please explain the adjustments to payroll tax expense in Schedule C-3.23.**

5 A10. Schedule C-3.23 contains the adjustment for annual payroll tax expense based upon the
6 pro forma labor expenses as shown on Schedule C-3.4. Federal and state unemployment
7 tax, and Social Security taxes (FICA and Medicare) were all calculated at current taxable
8 rates. The pro forma calculation resulted in an adjustment to test year Payroll Taxes of
9 \$15,956. This positive adjustment to payroll tax is a result of positive adjustments to
10 labor expense.

11 **Q11. Please discuss Schedule C-9 and C-9.1.**

12 A11. Schedule C-9 is a summation of Operation and Maintenance Payroll Costs for the test
13 year ending December 31, 2011. Operations and Maintenance Labor, Employee Benefits,
14 and Payroll taxes are broken down by the three rate groups of Water A, Water C, and
15 Wastewater, and include unadjusted and pro forma adjustments for each category.
16 Schedule C-9.1 is a comparison of payroll hours and dollars by various categories for the
17 pro forma test year ending December 31, 2011 and the calendar years ended December
18 31, 2005 through December 31, 2010. The comparison includes ratios of various
19 categories as well.

20 **Q12. Does this conclude your direct testimony?**

21 A12. Yes.