

**BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO**

In the Matter of the Application of Aqua)	
Ohio, Inc. to Increase Its Rates and Charges)	Case No. 16-0907-WW-AIR
for Its Waterworks Service.)	

**SUPPLEMENTAL DIRECT TESTIMONY OF
RICHARD A. HIDEG
ON BEHALF OF AQUA OHIO, INC.**

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

1 **Supplemental Direct Testimony of**
2 **Richard A. Hideg**

3 **I. INTRODUCTION AND SUMMARY**

4 **Q1. Please introduce yourself.**

5 A. My name is Richard A. Hideg, and I am Aqua Ohio, Inc.'s (Aqua or the Company)
6 Controller. My business address is 6550 South Ave., Boardman, Ohio 44512.

7 **Q2. Are you the same Richard A. Hideg who filed Direct Testimony on behalf of Aqua in**
8 **this proceeding on June 14, 2016?**

9 A. Yes.

10 **Q3. What is the purpose of your supplemental direct testimony?**

11 A. This testimony is intended to support the Company's objections to the recommendations
12 made by the Staff of the Public Utilities Commission of Ohio (Staff) in its Report of
13 Investigation (Staff Report).

14 **Q4. Please summarize your supplemental testimony.**

15 A. I am testifying in support of the Company's objections to Staff's adjustments and
16 recommendations regarding Operating Income and Rate Base.

17 **II. OPERATING INCOME AND RATE BASE**

18 **Objection No. 1: Projected plant adjustments**

19 **Q5. What does Staff recommend regarding Aqua's projected plant adjustments?**

20 A. Staff recommended the removal of projected plant adjustments associated with the
21 Norlick Water Treatment Plant and an HS starter with VFD in the amount of \$900,000
22 and \$117,000. The basis for the adjustment is that the plant will not be placed in service
23 by the end of the test year.

Q6. Does Aqua agree with this adjustment?

A. No. Aqua objects to this adjustment because the Norlick plant will be complete and in service by December 31, 2016, and the VFD project was placed in service in November 2016.

Q7. What adjustment to the associated reserve does Aqua recommend?

A. Aqua recommends that the amounts removed by Staff (respectively \$900,000 and \$117,000) should be included in plant in service, with corresponding adjustments to the associated reserve (respectively \$73,270 and \$10,341).

Objection Nos. 2, 3, 11 & 12: Tank-painting expense

Q8. What does Staff recommend regarding tank-painting expense?

A. Staff rejected Aqua's proposed treatment of tank painting as a capital expenditure; with the exception of tanks involving lead-based paint, Staff recommends treating tank painting as a normal maintenance expense.

Q9. Why does Aqua object to this adjustment?

A. First, tank painting should be considered a capital expenditure. This activity provides benefits over a long period of time, as Staff recognizes for at least 20 years, and constitutes an asset betterment that allows the tank to reach or exceed its expected life. Therefore, tank painting should be considered and treated as a capital expenditure.

Q10. Are there any other objections to the Staff Report's treatment?

A. Yes. The Staff Report also recommended rejecting Route 84 tank painting as a capital expenditure. Although it removed these costs from capital, it failed to include the Route 84 tank under the tank-painting schedule found at Staff Schedule C-3.7. This is inconsistent with the treatment proposed by Staff. The amount to be added to the schedule is \$277,210.

Q11. Are there are any other objections regarding tank painting?

A. Yes. Aqua also objects to the Staff Report’s failure to include the correct amount associated with painting the Tiffin Washwater tank in the proposed tank-painting schedule. The correct amount is \$204,428.

Objection No. 4: Lake White metering pump

Q12. What does Staff recommend regarding the Lake White metering pump?

A. Staff recommended removing from plant \$1,231 associated with the Lake White metering pump.

Q13. Why does Aqua object?

A. Aqua objects to the Staff Report’s adjustment of the associated reserve for only \$146 instead of the entire \$1,231. By doing so, the adjustment treated the \$1,231 as though it were a projected item when it should have been treated as a normal retirement. Under the NARUC Utility Plant Instructions, “When a retirement unit is retired from utility plant, with or without replacement, the book cost thereof shall be credited to the utility plant account in which it is included . . . [and] the book cost of the unit retired and credited to utility plant shall be charged to the accumulated provision for depreciation applicable to such property.”

Objection Nos. 5 & 6: Labor expense: post-test-year adjustments

Q14. What does Staff recommend regarding post-test-year adjustments?

A. The Staff Report excludes post-test-year labor expense adjustments.

Q15. Why does Aqua object to this recommendation?

A. It is my understanding that Ohio law specifically allows for the inclusion of post-test-year expenses. R.C. 4909.15(D) states that a water-works company may “propose adjustments to the revenues and expenses . . . for any changes that are, during the test period or the

1 twelve-month period immediately following the test period, reasonably expected to
2 occur.” The proposed post-test-year adjustments are just and reasonable and reasonably
3 expected to occur. Aqua has routinely experienced increases in labor expense from year
4 to year, and the proposed post-test-year adjustment was consistent both with this
5 experience and the guidance provided by various salary-market research authorities (on
6 which Aqua relies in determining salary targets). Additionally, to be conservative, Aqua’s
7 proposed adjustment was actually substantially lower than the projected increase.
8 Therefore, these expenses should be recovered in rates. Aqua also objects to this
9 recommendation to the extent it causes the understatement of employee contribution
10 thrift expense and payroll taxes included in rates.

11 **Objection Nos. 7 & 8: Labor expense – stock compensation incentives**

12 **Q16. What does Staff recommend regarding stock compensation incentives?**

13 A. Staff recommends that this form of compensation be excluded from the labor expense.

14 **Q17. Does Staff explain why this form of compensation should be excluded?**

15 A. No. The Staff Report merely claims that shareholders should be responsible for this kind
16 of compensation, but does not explain why.

17 **Q18. Why does Aqua object to this recommendation?**

18 A. Aqua objects because stock compensation is an important piece of the Company’s overall
19 compensation package. These types of incentives are an economically efficient way to
20 attract and reward employees. Other forms of compensation, such as traditional fixed
21 pension benefit plans, have not been offered to new employees since 2003. The Company
22 uses stock compensation to attract and retain highly qualified individuals, which
23 ultimately benefits ratepayers with exceptional performance. Stock compensation is
24 therefore an important labor-recruitment tool for the Company and should be permitted as

1 a labor expense. Aqua also objects to the extent this adjustment causes the
2 understatement of payroll taxes included in rates.

3 **Objection Nos. 9 & 10: Consumption adjustment**

4 **Q19. What does Staff recommend regarding test-year consumption?**

5 A. Staff recommends adjusting test-year consumption in the Lake Erie West jurisdiction to
6 assume increased consumption.

7 **Q20. Why does Aqua object to this recommendation?**

8 A. As the Staff Report recognizes, Aqua has been experiencing a significant and continuing
9 downward trend in consumption. In view of these known trends, adjustments to actual
10 consumption should not be made to impute an increase in water usage. This adjustment
11 should be rejected.

12 **Q21. Does Aqua have any other objection to this recommendation?**

13 A. Yes. Even if the adjustment imputing increased consumption is accepted, the Staff Report
14 failed to recognize or account for the additional variable costs associated with the
15 production of such water. These costs include chemicals and electricity.

16 **Objection No. 13: Well-cleaning expense**

17 **Q22. What does Staff recommend regarding well-cleaning expense?**

18 A. The Staff Report recommended reclassifying the expenses associated with well cleaning
19 in Aqua's Tiffin district. (*See* Staff Report at 10.)

20 **Q23. Why does Aqua object to this recommendation?**

21 A. Aqua does not object to the reclassification of the expense, only to the amount of the
22 adjustment. Staff's adjustment removed the entire *actual* amount that had been
23 capitalized, or \$27,074. But Aqua had only included in the original maintenance
24 operations adjustment a *projected* expense of \$20,000 associated with this well cleaning.

Thus, the Staff Report removed more than Aqua had included. The adjusted miscellaneous expense on Staff Schedule C-3.16 should be \$174,922, and the adjustment only (\$20,000).

Objection No. 14: Property tax

Q24. What does Staff recommend regarding Aqua's property tax?

A. Staff recommends a reduction of \$436,568 to Aqua's annual property-tax expense.

Q25. Why does Aqua object to this recommendation?

A. The Staff Report included sewer property among Aqua's 2014 year-end plant-in-service and taxable property even though this property was excluded from the corresponding 2015 tax filing. Only water property was included in the State of Ohio's December 31, 2014 Assessed Valuation. Aqua's 2015 Annual Report filed with the Department of Taxation states that Aqua "exclude[d] the value of Aqua's waste water system in Franklin County as it is tax exempt per Ohio Revised Code 6111.01."

Q26. Was Aqua assessed property tax on sewer property for the 2015 tax year?

A. No.

Q27. Did Aqua pay property tax on sewer property for the 2015 tax year?

A. No.

Q28. What was the effect of the Staff Report's inclusion of sewer property for the 2015 tax year?

A. The inclusion of sewer property as taxable property resulted in an understatement of the assessed-value percentage, which in turn resulted in an understatement of Aqua's jurisdictional Ohio property tax.

Q29. What do you recommend?

A. Remove the sewer property from the assessed-valuation-percentage calculation in Staff Schedule C-3.28 to allow the proper calculation of the property-tax adjustment.

Objection No. 15: Excise tax

Q30. What does Staff recommend regarding the excise tax?

A. Staff adjusted the excise tax by making a \$1,528,725 adjustment to operating revenue to reflect sales for resale.

Q31. Why does the Company object to Staff's adjustment to the excise tax?

A. Under the state's instructions regarding the calculation of excise taxes, which are attached to my testimony as Attachment A, sales for resale are only exempt if made to water utilities that pay the excise tax. Aqua, however, had no such sales in the test year. The only applicable excise-tax exemption in the test year was for sales to federal government agencies, which totaled \$10,386, and only that portion of the excise-tax adjustment is proper.

Aqua also objects to Staff's adjustment for the \$25,000 exemption. Staff should only have adjusted for the jurisdictional portion of this exemption, which is \$15,650.

Objection Nos. 16–22: Payroll taxes

Q32. Does Aqua object to the Staff Report's payroll-tax adjustments?

A. Yes. There are several objections. Several objections (Nos. 17, 19, and 22) pertain to Staff's failure to determine the amount of certain taxes based on Aqua's total labor expense. Three taxes—the Federal Insurance Contributions Act (FICA) and State and Federal Unemployment Taxes (SUTA and FUTA)—are all charged to Aqua based on Aqua's total labor expense. The Staff Report, however, reduced tax expense by assuming these taxes applied only to the O&M portion of labor and not to capitalized labor

1 expense. This understates Aqua's test-year tax liability: these taxes are not reduced or
2 avoided for capitalized labor expense and are normal and recurring costs of doing
3 business. They should not have been excluded from the total taxes.

4 **Q33. Did Aqua pay these taxes based on total labor during the test year?**

5 A. Yes. Aqua's tax liability was not reduced to exclude capital labor expense.

6 **Q34. What other objections does Aqua have to payroll-tax adjustments?**

7 A. With respect to FICA, the Staff Report failed to adjust wages not subject to FICA in
8 accordance with the recommended exclusions related to incentive compensation. The
9 effect of this was to understate taxable wages.

10 **Q35. Are there any other objections regarding the treatment of FICA?**

11 A. Yes. The Staff Report failed to account for the IRS's release of the revised wage base
12 limit for Social Security tax. At the time of the wage update, the limit was for 2016 and
13 was \$118,500. The new limit that will begin January 1 is \$127,200. This revised amount
14 should be considered when calculating the wages not subject to the tax.

15 **Q36. Does Aqua have additional objections to Staff Report's SUTA and FUTA**
16 **adjustments?**

17 A. Yes. With respect to SUTA and FUTA, the Staff Report also excluded summer
18 employees from its calculation of Aqua's tax liability. Again, this is an incorrect
19 exclusion: Aqua pays these taxes on all employees and thus its summer employees' share
20 of these taxes should not have been excluded from test-year expense.

21 **Q37. Did Aqua pay the SUTA and FUTA taxes on summer employees during the test**
22 **year?**

23 A. Yes. Aqua's tax liability was not reduced to exclude summer employees.

1 **Q38. Are there other objections?**

2 A. Yes. The Staff Report's SUTA and FUTA adjustments also double-counted the allocation
3 percentages applicable to jurisdictional employees performing tasks under the operating
4 contract and thus overstated the reduction attributable to allocation. The calculation
5 contained in the Staff Report both used a jurisdictional allocation of operating-contract
6 employees (*i.e.*, it reduced the actual head count based on the allocation of labor costs to
7 Aqua) and applied an operating-contract adjustment. But the latter adjustment *also*
8 reflects jurisdictional allocation percentages and thus should not have been applied when
9 an allocated headcount was already being used.

10 **Q39. Has Aqua quantified the impact of reversing these adjustments?**

11 A. Not at this time. There are many moving pieces associated with calculating payroll taxes,
12 and the amount of the payroll-tax adjustments would vary depending on how other labor-
13 expense adjustments are treated. After the related adjustments have been settled, the
14 treatment of payroll taxes can then be determined with precision.

15 **Objection No. 23–25: Flow-through adjustments**

16 **Q40. Does Aqua have any other objections regarding Staff's recommendations to**
17 **operating expense and rate base?**

18 A. Yes. Aqua objects to the extent Staff's adjustments described above affect the calculation
19 of federal income tax, depreciation expense, and property tax included in rates. However
20 the foregoing issues are resolved, it is important to ensure that they are properly flowed
21 through to other rate components.

1 **III. RATES AND TARIFFS**

2 **Objection Nos. 29–32: Contract revenue**

3 **Q41. What does the Staff Report recommend regarding operating revenue?**

4 A. Two recommendations suggest that revenues need to be increased from a specific
5 customer and a specific class of customer. The Staff Report recommends that Aqua’s
6 contract with Whirlpool Corporation “be revised to be based on the CPI – Water and
7 Sewerage Maintenance.” (Staff Report at 16.) The Staff Report also recommends that the
8 Sales for Resale class “should be incurring more of the costs,” *i.e.*, contributing more
9 revenue to Aqua.

10 **Q42. Why does Aqua object to the recommendation regarding Whirlpool Corporation?**

11 A. Aqua objects to this recommendation on several grounds. First, the Staff Report failed to
12 recognize that the contract is bilateral and cannot be revised without the consent of both
13 parties. While I am not testifying on questions of law, I have been informed by counsel
14 that an attempt by the state to revise a contract may be prohibited by the state and federal
15 Constitutions. Additionally, my understanding is that this contract was reviewed and
16 approved as just and reasonable by the Commission only a few years ago. I am not aware
17 of any changed circumstance that would call that conclusion into question.

18 Finally, the Staff Report did not mention that Whirlpool is one of the largest
19 customers on Aqua’s system. I am very concerned that an increase in the rates charged to
20 Whirlpool could cause it to explore alternate options to Aqua. If Whirlpool were lost, it
21 would have a major impact on Aqua’s revenues and would require a marked increase in
22 the rates charged to remaining customers.

1 **Q43. Why does Aqua object to the recommendation to increase Sales for Resale revenue?**

2 A. Aqua objects for similar reasons it objects to the Whirlpool recommendation. Like
3 Whirlpool, many sales-for-resale customers receive service under contract, and the same
4 concerns about revising contracts apply here as well.

5 **Objection Nos. 33 & 34: Meter Installation**

6 **Q44. What do Aqua's proposed tariffs provide regarding meter installation?**

7 A. Several of Aqua's rate schedules include charges for both metered and unmetered rates.
8 Those schedules contain the following provision: "The Company, at its discretion, may
9 install meters for customers on the unmetered rates. Once meters are installed, the
10 Customers will be charged the appropriate metered rates."

11 **Q45. What does the Staff recommend regarding meter installation?**

12 A. The Staff Report recommends that Aqua's "proposal to install meters at its discretion is
13 unreasonable." (Staff Report at 24.)

14 **Q46. Why does Aqua object to this recommendation?**

15 A. The language cited by the Staff Report as unreasonable was taken verbatim from Ohio
16 American Water Company's prior tariff. The same language is also contained in Aqua's
17 current tariff. The fact that these provisions have been reviewed and approved by the
18 Commission in several cases over a period of years confirms that neither the concept nor
19 the implementing language should be considered unjust or unreasonable.

20 **Q47. The Staff Report states that this language provides for "a very open-ended plan**
21 **with no certainty for the customer" and that "further discussion" and "additional**
22 **data" should be considered. Do you agree that this supports the recommendation?**

23 A. In my view, it does not. First, it is not clear to me that Aqua's tariffs are the proper place
24 to provide guidance regarding the timing of meter installation. And there is nothing
25 inconsistent between the language in Aqua's tariffs and a definite plan for installing

1 meters—the point of the language is to clarify that meter installation is a process
2 designed and managed by Aqua. Finally, whether or not it is necessary to have
3 discussions regarding meter-installation plans, there is nothing in the tariff language that
4 would prevent or hinder such discussions.

5 **Q48. What do you recommend?**

6 A. This tariff language should be approved.

7 **Objection No. 35: Sprinkler head rate**

8 **Q49. What did the Staff Report recommend regarding the grandfathered sprinkler head**
9 **rate?**

10 A. In this case, Aqua inadvertently failed to update a grandfathered sprinkler rate of \$1.24
11 per sprinkler head per month. Staff recommended that the “grandfathered sprinkler head
12 rate issue should be addressed in this proceeding,” as opposed to a future proceeding.

13 **Q50. Why does Aqua object?**

14 A. Aqua believes that this issue should be addressed in a future proceeding in conjunction
15 with the preparation of a new cost of service study that takes the issue and surrounding
16 circumstances into account. The issue affects only a small number of customers and
17 dollars, and Aqua does not believe it is necessary to revisit the cost-of-service study
18 (which Staff otherwise accepted) based on such a small issue.

19 **IV. CONCLUSION**

20 **Q51. Does this conclude your supplemental direct testimony?**

21 A. Yes.

✓ INSTRUCTIONS FOR COMPLETING PAGES 2 AND 3

WATER-WORKS COMPANY ANNUAL STATEMENT OF GROSS RECEIPTS

Please note that this statement is to be used to report all water-works activities gross receipts (activities of supplying to customers via pipes or tubing) and all other activities (nonutility). The gross receipts should be reported on what you actually received, i.e. cash or equivalent, for the period May 1, 2013 through April 30, 2014. Amounts should be rounded to the nearest dollar.

If you have a source of gross receipts that is not listed on the statement, you must list those receipts in the blank spaces provided. If you need additional space you may attach a supplemental schedule. Whether taxable or not, all business gross receipts must be listed on this schedule.

Explanation of the Columns of the Report

(A) **Total Gross Receipts:** Enter the total gross receipts for all business done, including nonutility activities.

(B) **Interstate Business:** Enter all gross receipts derived wholly from interstate business. IF OVER \$10,000, ATTACH A BREAKDOWN LISTING EACH ENTITY AND THE AMOUNT PER ENTITY THAT AN EXEMPTION IS CLAIMED.

(C) **Business Done in Other States:** Enter all gross receipts from intrastate business provided entirely in a state other than Ohio. IF OVER \$10,000, ATTACH A BREAKDOWN LISTING THE STATES AND THE AMOUNT PER STATE THAT AN EXEMPTION IS CLAIMED.

(D) **Total Ohio Intrastate Receipts:** Subtract Columns B and C from Column A - Only business done in Ohio should be claimed on the columns below.

(E) **Business Done For or With the Federal Government:** Enter all gross receipts for business done in Ohio for or with the federal government. Federal government does not include state and local agencies such as the Ohio National Guard, schools, colleges, and non-federal organizations wholly or partially funded by the federal government. IF OVER \$10,000, ATTACH A BREAKDOWN LISTING EACH FEDERAL AGENCY AND THE AMOUNT PER AGENCY THAT AN EXEMPTION IS CLAIMED.

(F) **Sales to Other Public Utilities for Resale:** Enter all gross receipts from sales to other public utilities in Ohio (taxable as public utilities under Chapter 5727 of the Revised Code) for resale, excluding telephone companies, railroads, electrics, rural electrics and interexchange telecommunications companies. Do not include a public utility located in or outside of Ohio that is not subject to the gross receipts excise tax (5727.24 or 5727.30 R.C.) under this column. If exempt, sales located outside of Ohio should be reported under Column B. IF OVER \$10,000, ATTACH A BREAKDOWN LISTING EACH PUBLIC UTILITY AND THE AMOUNT PER PUBLIC UTILITY THAT AN EXEMPTION IS CLAIMED.

(G) **Sale of Merchandise:** Enter all gross receipts from the sale of merchandise in Ohio. Merchandise includes items of tangible personal property such as equipment, appliances, and also includes food and beverages, that is sold in the ordinary course of business. It does not include the sale of services or the gross receipts derived from the rental or lease of property. Items subject to Ohio's sales tax do not automatically come within this deduction. YOU MAY BE ASKED TO PROVIDE ADDITIONAL DETAIL ON THE MERCHANDISE CLAIMED AS AN EXEMPTION.

(H) **Total Intrastate Deductions:** Add Columns E, F and G.

(I) **Ohio Taxable Gross Receipts:** Subtract Column H from Column D.

The total on line 26, Column I, (Ohio Taxable Gross Receipts) should be entered in the tax calculation portion of this statement.

If you have questions?

Please contact the Public Utility Tax Section at (614) 466-7371 or Fax (614) 752-2496.

This statement and all accompanying schedules should be sent to:

Address for U.S. Postal Service:

Ohio Department of Taxation
Public Utility Tax Section
P.O. Box 530
Columbus, OH 43216-0530

Address for other delivery services:

Ohio Department of Taxation
Public Utility Tax Section
30 East Broad Street, 19th Floor
Columbus, OH 43215

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing Supplemental Direct Testimony was served by electronic mail this 19th day of December, 2016 to the following:

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Summary: Text Supplemental Direct Testimony of Richard A. Hideg electronically filed by Ms. Rebekah J. Glover on behalf of Aqua Ohio, Inc.