

**BEFORE  
THE PUBLIC UTILITIES COMMISSION OF OHIO**

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

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**DIRECT TESTIMONY  
OF  
GARY M. VERDOUW  
ON BEHALF OF  
OHIO AMERICAN WATER COMPANY**

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

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1 **Direct Testimony of**

2 **Gary M. VerDouw**

3 **I. WITNESS INTRODUCTION**

4 **Q1. Please introduce yourself.**

5 A1. My name is Gary M. VerDouw. I am employed by American Water Works Service  
6 Company ("Service Company") as its Director of Rates - Eastern Division. The Service  
7 Company is a subsidiary of American Water Works Company, Inc. ("American Water")  
8 and provides support services to American's subsidiaries, including Ohio American  
9 Water Company, Inc. ("Ohio American" or "Company"). My business address is 727  
10 Craig Road, Saint Louis, Missouri 63141.

11 **Q2. What are your job responsibilities as Director of Rates - Eastern Division?**

12 A2. I provide regulatory support to the American Water utilities in the Eastern Division,  
13 which comprises nine states, including Ohio. In this capacity, I lead and support rate  
14 cases filed with state commissions throughout the Eastern Division. I also interface with  
15 state commissions in ongoing regulatory matters affecting American Water utilities in the  
16 Eastern Division. My job requires me to know and understand the books, records and  
17 general financial condition of Ohio American.

18 **Q3. Please summarize your education and work experience**

19 A3. I graduated from the University of Mary in Bismarck, North Dakota in 1981 with a  
20 Bachelor of Science degree in Business Administration. I returned to the University of  
21 Mary and completed a second major in Accounting in May of 1988. I have attended the

1 Utility Rate Seminar sponsored by the National Association of Regulatory Utility  
2 Commissioners ("NARUC") Water Committee and have participated in various  
3 continuing education programs sponsored by my former employers and by the Service  
4 Company. I am a member of the American Water Works Association ("AWWA") and  
5 am currently a member of the Indiana Utility Regulatory Commission ("IURC") Water  
6 Rate Design Committee.

7 I began my professional employment in February of 1981 when I was hired as  
8 Reconciliation and Funds Administrator for the North Dakota State Treasurer's Office. I  
9 was hired as a Field Accountant for ANG Coal Gasification Company in Beulah, North  
10 Dakota in December of 1981. While employed with ANG, I was promoted to Accounts  
11 Payable Supervisor in 1982 and Cash Manager in 1984, where I oversaw daily cash  
12 management of over \$1.5 billion in secured debt and over \$400 million in daily cash  
13 balances. In January, 1988, I was hired as Business Manager for Capital Electric  
14 Cooperative, Inc. of Bismarck, North Dakota. My responsibilities there included the  
15 supervision and oversight of all accounting, finance, billing, budget, insurance, human  
16 resources, cash management, rate studies, and other functions for a growing electric  
17 distribution cooperative serving over 13,000 consumers. I was employed at Capital  
18 Electric until October of 2004, at which time I moved to the Saint Louis area. In  
19 February, 2005, I accepted the position of Senior Financial Analyst – Rates and  
20 Regulations with the Service Company. I was promoted to Manager of Rates and  
21 Regulation in April of 2008, where I was responsible for all rate and regulatory issues for  
22 American Water operations in the states of Indiana, Ohio, and Michigan. I was promoted

1 to Director of Rates – Eastern Division in January 2011.

2 **Q4. Have you testified before any regulatory agencies?**

3 A4. Yes. I have provided testimony before the Public Utilities Commission of Ohio  
4 (“PUCO” or “Commission”). The scope of my testimony included discussion on the  
5 details of Ohio American Water Company’s Rate Cases 06-433-WS-AIR, 07-1112-WS-  
6 AIR, and 09-0391-WS-AIR, as well as the System Infrastructure Improvement Charge  
7 filed for Ohio American as Case Numbers 09-092-WW-SIC and 11-151-WW-SIC. I also  
8 testified before the IURC in Indiana American Water Company’s Rate Case Cause Nos.  
9 43187, 43680, and 44022. In addition, I provided direct testimony regarding the  
10 implementation of Distribution System Improvement Charges (“DSIC”), the  
11 authorization of post-in-service AFUDC and deferred depreciation, and the approval of a  
12 Wise Water Use Plan Conservation Study for Indiana American Water Company.  
13 Finally, I have presented testimony before the Illinois Commerce Commission concerning  
14 the annual purchased water and sewer reconciliation that is required under Illinois  
15 Administrative Code 655.

16 **Q5. What is the purpose of your testimony in this case?**

17 A5. The purpose of my testimony is to address Rate Base, various Operating Expenses, and  
18 miscellaneous schedules that are required as part of Ohio American's application. I also  
19 discuss the services provided by the Service Company to Ohio American. All of the  
20 schedules discussed in my testimony were prepared by me or under my supervision.

## II. REASONS FOR RATE REQUEST

**Q6. When were Ohio American Water Company's current base rates established?**

A6. Ohio American filed its last Application for Increase of Rates on May 7, 2009, docketed as Case No. 09-0391-WS-AIR. On May 5, 2010, the PUCO addressed the Company's base rates in its Order and Opinion issued in that case. The Commission's Order approved an increase in base rates of \$2.6 million, or 7.12%.

**Q7. Since base rates were addressed in Case No. 09-03910WS-AIR, have there been adjustments to Ohio American Water's rates?**

A7. Yes. On January 12, 2011, the Company filed Case No. 11-0151-WW-SIC to request recovery of System Infrastructure Improvement Charge ("SIIC") eligible projects placed in service between January 1, 2009 and November 30, 2010. On June 1, 2011, the PUCO issued an Order authorizing the Company to establish a SIIC Surcharge to recover annual pre-tax revenues of \$858,683 or 2.15%. The new SIIC surcharge applies to Water A tariff group customers only, with an effective date of June 1, 2011.

**Q8. Why does the Company seek a rate increase?**

A8. The test year in this case, consisting of the twelve months ended December 31, 2011, shows a pro forma earned rate of return of 3.53%. This overall return is well below the current cost of capital proposed by Company witness Ms. Pauline Ahern. This case has been filed to provide the Company with an opportunity to earn a more appropriate return. The Company's ability to provide water service is dependent on a consistent level of adequate earnings. Adequate earnings are those necessary to compensate current investors and attract future investment. Revenues must be sufficient to cover operating

1 expenses, such as employee payroll and benefits, insurance, taxes, depreciation, and costs  
2 associated with maintenance and operations, and, additionally, to provide for the payment  
3 of capital costs which include interest and dividends. Revenues generated by the current  
4 rates the Company is authorized to charge for water and sewer service will not adequately  
5 accomplish this result.

6 **Q9. What factors are driving the need for an increase in rates?**

7 A9. The rate increase request is primarily due to the following factors:

8 **Infrastructure investments** - Across the state, the Company will have invested  
9 almost \$25 million in the communities it serves from the rate base date certain  
10 cut-off date of December 31, 2008 used in the Company's last rate case  
11 proceeding (Case No. 09-0391-WS-AIR) to the rate base date certain cut-off date  
12 of April 30, 2011 in this rate case. These investments include replacing and  
13 installing water lines, meters, hydrants and improvements at water treatment,  
14 pumping and storage facilities and wastewater treatment plants. These  
15 investments are necessary to meet regulatory requirements and enhance customer  
16 service, and they also benefit local economic development. Ohio American  
17 witness Mr. Thomas Schwing provides more detail regarding these investments.

18 **Wastewater Investments** – Ohio American as invested more than \$1 million in  
19 wastewater facilities to better improve operation as well as maintain compliance  
20 with existing Ohio EPA regulations.

21 **Property Taxes and Depreciation** – Increases in utility plant also result in higher  
22 property tax and depreciation expenses.

**Rate of Return** - Like all water utilities, Ohio American Water must continually invest in the water plants, towers and pipelines that serve our communities. In order to attract the capital needed to fund these improvements, the Company must earn a fair rate of return. This rate increase will allow Ohio American to earn a fair rate of return which will allow us to continue with infrastructure investment needs across the state.

**Reduced Sales** - The Company continues to see a decline in overall sales levels, both in terms of number of customers and in usage per customer. Pro forma present rate revenues have declined almost \$1 million from the revenue levels authorized by this Commission in the Company's last rate case, notwithstanding the approval of the Company's SIIC surcharge in June of 2011.

### III. OHIO AMERICAN RISK FACTORS

**Q10. Are the factors driving your rate increase request a result of issues unique to the water industry?**

A10. Yes, many are. Reduced sales, for example, have been caused by a number of factors, some of which may impact other industries and others that are unique to water operations.

The decline in demand has resulted from extremely wet summers in the past three years, persistent conservation messages communicated to water customers, and the impact of the economic downturn. Many industries have been affected by the overall economy.

Some industries, including gas and electric utilities, may be impacted by conservation, but not to the same extent as the water industry. The water industry is more negatively impacted by increased efficiency of water using fixtures and appliances, a lack of growth



1 in new water consuming products and wet weather. There has been no proliferation of  
2 new devices and appliances entering the market place that increase the use of water, as  
3 has been the case for the electric utility industry with the introduction of products such as  
4 I-Pads, cellular telephone devices, electric cars, and GPS devices to name a few.  
5 Moreover, weather impacts water consumption not only as a result of cooling degree day  
6 variations, but also because of ground moisture, rain and even the threat of rain.

7 **Q11. Are there other risks that have a greater impact on the financial results of water**  
8 **companies as opposed to electric and gas utility operations?**

9 A11. Yes. The water industry is extremely capital intensive, much more so than electric, gas or  
10 any other utility regulated by this Commission. For example, a 2008 study by AUS  
11 Consultants indicated that the ratio of dollars invested in utility plant per dollar of  
12 revenue for the water industry is slightly more than double that of the comparable ratio  
13 for the electric utility industry, nearly three times that of the gas distribution utility  
14 industry and more than ten times that of the S&P 500. This fact often goes  
15 unacknowledged because much of the water industry infrastructure is out of public view.  
16 Because of the larger amount of capital required to develop water infrastructure and the  
17 need to replace existing infrastructure, issues related to capital utilization and financing  
18 are more significant for water utilities than other utilities. The immediacy of the problem  
19 of aging water infrastructure is not well understood but is becoming better known. It is  
20 clear that the general public does not understand the immediacy of the problem or the  
21 substantial cost to fix the problem. This lack of understanding adds to the risk faced by  
22 those companies in need of funds to meet the challenge of maintaining and replacing an

1 aging system. Much of this country's investment in water and wastewater systems was  
2 made near the beginning of the twentieth century and is in dire need of replacement. The  
3 EPA Office of Water, Drinking Water Infrastructure Needs Survey issued in 2009 found  
4 that the total nationwide infrastructure need is \$334.8 billion over the subsequent 20-year  
5 period. The EPA Office of Clean Water Needs Survey issued in 2008 reported that \$190  
6 billion was needed for wastewater treatment, collection systems, and sewer overflow  
7 corrections. The American Society of Civil Engineers in 2009 gave water infrastructure in  
8 America a grade of D- and stated that the nation's drinking water and wastewater systems  
9 require a \$255 billion dollar investment in the next five years. Along with the sheer risk  
10 associated with replacing existing infrastructure, the water industry faces increasing  
11 maintenance costs, not recovered by rates due to regulatory lag. Main breaks from aging  
12 infrastructure can cause fish kills from discharge into ponds and streams resulting in fines  
13 and lawsuits. Moreover, greater capital expenditures result in greater business risk  
14 associated with contracts and vendors.

15 In addition to infrastructure concerns, the water industry provides a product that is  
16 critical for the health and safety of every person. As a result, the standards of availability  
17 and provision of water resources are established by governmental entities. Water and  
18 wastewater operations are subject to federal, state and local laws and regulations which  
19 control environmental protection, health and safety, water quality, and collection,  
20 *treatment and discharge of wastewater.* Under the Safe Drinking Water Act, the  
21 requirements for monitoring and/or treatment of additional contaminants continue to  
22 increase over time and are subject to some uncertainty. Today the Safe Drinking Water

1 Act requires the monitoring and/or treatment of 98 potential contaminants. The U.S.  
2 EPA has recently issued a list of 105 new contaminants from which candidates for new  
3 monitoring and/or treatment may be developed. With respect to wastewater constituent  
4 limits placed on new or renewed National Pollution Discharge Elimination System  
5 (“NPDES”), permits issued by the U.S. EPA and the Ohio EPA are becoming  
6 increasingly stringent, requiring investment in new technology and infrastructure for the  
7 treatment of wastewater prior to its discharge into receiving streams. Security of water  
8 facilities is critical for the health and safety of customers and therefore a failure in  
9 security systems is more substantial than in other industries. Increased oversight results  
10 in protection for consumers but also in increased risks of fines and litigation in the event  
11 of system failures or even perceived failures. For example, changes in system pressure as  
12 a result of a power outage outside the control or influence of the water company can, as a  
13 result of existing regulations, result in costly boil advisories, even though the water  
14 treatment and delivery system was in no way compromised and no health risk was  
15 involved.

16 **Q12. Are there risks that are specific to Ohio American Water as compared to the water**  
17 **industry as a whole?**

18 A12. Yes. Specific Company risks are generally those associated with Ohio American’s  
19 sources of supply and the make-up of its service territory. The availability and quality of  
20 source water impacts the Company’s ability to serve the current and future needs of its  
21 customers. Ohio American does not own the water it treats and supplies for distribution.  
22 In addition, the availability of Ohio American’s water supply is established through

1 requirements set by governmental entities and other provisions of law.

2 The surface water supplies that Ohio American Water accesses for some of its  
3 water requirements are exposed to increased treatment cost requirements and potential  
4 interruption of water supplies from water transportation related accidents, especially in its  
5 Lake Erie source of supply in Ashtabula. Lake Erie barge traffic transporting non-  
6 hazardous materials often carry thousands of gallons of diesel fuel. Hazardous cargos  
7 transported may be in the quantity of hundreds of thousands of gallons per tow.  
8 Additionally, the water quality and quantity risks associated with surface water supplies  
9 generally include the raw water quality, especially with respect to Crypto sporidium and  
10 Giardia. Some of the surface water accessed by Ohio American as its source of supply is  
11 agricultural watershed with grazing livestock and bringing with it Crypto sporidium and  
12 Giardia, along with herbicides and pesticides. Water quality risks associated with rapid  
13 changes in turbidity affect river and stream sources of supply as well.

14 **Q13. Is flooding a risk to the Company's facilities?**

15 A13. Yes. Unlike groundwater supplies or surface water supplies from impoundments, surface  
16 water supplies from rivers are often susceptible to flood damage. Ohio American Water's  
17 pumping and treatment facilities in Marion and Tiffin are located within the floodplains  
18 of the Little Scioto River and the Sandusky River. Although physically protected to 100  
19 year flood elevations, these facilities are exposed to potential flooding impacts ranging  
20 from interruption of service to structural and electrical damage from severe floods. As  
21 recently as the Spring of 2011, floodwaters from the Little Scioto River rose to a point  
22 that the Marion water treatment plant could only be accessed by boat. And, in 2008,

1 flooding on the Sandusky River forced sandbagging at the Tiffin water treatment plant to  
2 divert flood water.

3 **Q14. What additional risk does the Company face as a result of its physical make-up and**  
4 **service territory?**

5 A14. Ohio American has facilities reaching from the far southern point of Ohio to the far  
6 northeastern tip of the state. This make-up creates unique risks for Ohio American.  
7 Given the fact that the Company's operations are geographically dispersed throughout the  
8 state and vary in operational parameters, it must comply with a wide range of regulatory  
9 requirements in multiple locations. Regulatory variations include groundwater and  
10 surface water sources, expansive water main distribution systems and multiple discharge  
11 points. The higher variability in regulatory requirements necessitates increased  
12 management focus and creates greater risk of failure, resulting in potential penalties and  
13 fines, due to non-compliance.

14 **Q15. Does the Company have specific regulatory risks?**

15 A15. Yes. Currently about 80 percent of the typical Ohio American water bill issued to its  
16 customers is volumetric and therefore more subject to fluctuation, uncertainty and impact  
17 from some of the potential events previously described. Straight fixed-variable rate  
18 designs are not in place for Ohio American, nor are pass-through surcharges for expenses  
19 such fuel and purchased water that would reduce regulatory lag. The geographical reach  
20 of the Company results in greater complexity of rates and results in greater rate case  
21 intervention and cost. Finally, the Company has consistently been unable to approach  
22 earning its authorized rate of return over at least the past decade.

1 IV. OVERALL FINANCIAL SUMMARY

2 **Q16. What test year is Ohio American Water using in this case?**

3 A16. The Commission has approved a test year for the twelve month period ending December  
4 31, 2011. This test year reflects actual revenue and expenses for the months of January  
5 through April 2011, and projected revenue and expenses for the months of May through  
6 December 2011. Thus, the test year reflects four months of actual and eight months of  
7 projected data. The test year has been adjusted for known and measurable changes that  
8 will occur during the test year.

9 **Q17. What is the date certain in this case?**

10 A17. The Commission has approved a date certain of April 30, 2011. All plant in service and  
11 rate base reflects the Company's records as of April 30, 2011.

12 **Q18. Please describe the A Schedules you are sponsoring.**

13 A18. Schedule A-1 describes the overall financial summary of Ohio American Water  
14 Company. The Summary is shown in the three main rate categories: Water A, which are  
15 the districts that comprised Ohio American prior to the purchase of Citizens' Utilities  
16 Company of Ohio ("Citizens") assets in 2002; Water C, which reflect water operations in  
17 the former Citizens' properties purchased in 2002; and Wastewater, which includes all  
18 wastewater operations in the Ohio American service area. The revenue increase  
19 requested in rate increase by Ohio American is shown on Line 18 of Schedule A-1 and  
20 totals \$8,272,169.

21 Schedule A-2 details the computation of the Gross Revenue Conversion Factor for the  
22 Water A, Water C, and Wastewater tariff groups. The most current tax and assessment

1 rates known were used in the calculation. In addition, the uncollectible rate used is the  
2 rate reflected in this case. The average Gross Revenue Conversion Factor reflected in this  
3 case is 1.64599 as shown on Line 20 of Schedule A-2.

4 Schedule A-3, Calculation of Mirrored CWIP Revenue Surcharge – Credit Rider, in not  
5 applicable to Ohio American Water Company in this case.

## 6 V. RATE BASE

### 7 **Q19. Are you sponsoring any B Schedules?**

8 A19. Yes, I am sponsoring all of the schedules in Section B, which contain the rate base data of  
9 the Company. The Company's pro forma rate base is prepared as of the date certain.

### 10 **Q20. Please describe Schedule B-1.**

11 A20. Schedule B-1 summarizes the rate base components as of the date certain of April 30,  
12 2011. Support for the various items that comprise the calculation of rate base are  
13 explained in detail below. The Company's rate base as of the date certain is \$92,328,214,  
14 which is an increase of \$22,256,090, or 31.76%, over the rate base authorized in the  
15 Company's most recent rate filing, Case No. 09-0391-WS-AIR. The increase in rate base  
16 is the main driver of this rate filing.

### 17 **Q21. Please describe the B-2 Schedules.**

18 A21. Schedule B-2 details the Utility Plant In Service ("UPIS") component of rate base by  
19 major property grouping for each of the Water A, Water C, and Wastewater tariff groups.

20 The schedules reflect total utility plant in service for Water A of \$122,192,211; total  
21 utility plant in service for Water C of \$19,800,100; and total utility plant in service for  
22 Wastewater of \$17,493,057, for total Company Utility Plant In Service as of the date

certain of \$159,485,369. Total plant in service as of April 30, 2011 reflects an increase of \$27,487,188 over utility plant in service authorized in Case No. 09-0391-WS-AIR.

Schedule B-2.1 details the information for each of Water A, Water C, and Wastewater on Schedule B-2 by account balances.

Schedule B-2.2 details adjustments to Plant in Service by major grouping (Water A, Water C, and Wastewater). No adjustments are included for Water A, Water C, and Wastewater in this case.

Schedule B-2.3 details the additions, retirements and transfers/reclassifications that have been made to UPIS from the date certain in the last rate case (December 31, 2008) to the date certain in this rate case (April 30, 2011). As recommended by PUCO Staff in the Company's last rate proceeding, Corporate Plant has been separated into its own category and from there allocated back to Water A, Water C, and Wastewater, with customer count by tariff group used as the allocation methodology.

**Q22. Did Ohio American remove certain utility plant from its books as ordered in the Opinion and Order in Case No. 09-0391-WS-AIR?**

A22. Yes. Following issuance of the Opinion and Order in Case No. 09-0391-WS-AIR, Ohio American reviewed of all utility plant that the PUCO ordered removed from Utility Plant in Service. Based on that review, the utility plant in question was r either retired or, if deemed used and useful, reclassified as Non-Utility Plant. For instance, the Commission previously disallowed 15% of the Marion Corporate Office from rate base. Physically removing 15% of the Marion Corporate Office is impracticable without possibly rendering the remaining 85% of the office unusable. Since the 15% disallowed



1 portion of the office cannot be severed from the remaining part of the office, but remains  
2 used and useful to Ohio American, the disallowed portion, as well as the associated  
3 accumulated depreciation, has been reclassified as Non Utility Plant. Ohio American has  
4 fully complied with the Opinion and Order in Case No. 09-0391-WS-AIR regarding the  
5 removal of certain plant in service from rate base.

6 **Q23. Please describe the remaining B-2 Schedules.**

7 A23. Schedule B-2.4 is not applicable to Ohio American since there is no leased property that  
8 is classified as an asset on the Company's property records.

9 Schedule B-2.5 is not applicable to Ohio American since no property included in the total  
10 company plant in service has been excluded from rate base.

11 **Q24. Please describe the B-3 Schedules.**

12 A24. Schedule B-3 details the accumulated reserve for depreciation and amortization of Utility  
13 Plant in Service by utility plant account number and major property grouping for each of  
14 Water A, Water C, and Wastewater, as well as a summary of Total Water, as of the date  
15 certain.

16 Schedule B-3.1 details the adjustment made to the reserve at the date certain for each of  
17 Water A, Water C, and Wastewater. In this case, no adjustments were made to any  
18 accounts in Water A, Water C, or Wastewater.

19 Schedule B-3.2 lists the Company's depreciable Utility Plant In Service and  
20 corresponding depreciation reserve, at date certain, by utility plant account number for  
21 each of Water A, Water C, and Wastewater.

22 Schedule B-3.3 details the activity in the reserve from the date certain in the last rate case

(December 31, 2008) to the date certain in this case (April 30, 2011). Explanations of transfers and adjustments can be found on pages 2, 4, 6, and 8 of the schedules. This schedule breaks Corporate into its own separate category as discussed above regarding the B-2.3 schedule, with the accumulated depreciation balances relative to Corporate then allocated back to Water A, Water C, and Wastewater accounts based on a customer count allocation. The schedule also reflects the removal of accumulated depreciation relative to the removal of plant assets as directed in the Opinion and Order in Case No. 09-0391-WS-AIR.

Schedule B-3.4 is not applicable, as the Company has no capital leases that are being amortized at this time.

**Q25. Please describe the B-4 and B-5 Schedules.**

A25. Schedules B-4, B-4.1 and B-4.2 are not applicable to Ohio American. The Company is not requesting construction work in progress ("CWIP") in its rate base.

Schedule B-5 and B-5.1 summarize the components of the Company's working capital request. The Company believes at this time that a zero level of working capital is still appropriate.

**Q26. Please describe Schedule B-6.**

A26. Schedule B-6 details the other rate base items. Page 1 of 2 of Schedule B-6 includes rate base accounting of customer advances for construction, Contributions in Aid of Construction ("CIAC"), investment tax credits, deferred income taxes, Investment Tax Credit Gross-up, and AFUDC equity and debt. Page 2 of 2 includes deferred debits and credits for tank painting and additions for deferred depreciation incurred by the Company

and amortized in the cost of service.

**Q27. Why is it appropriate to include deferred depreciation in Schedule B-6?**

A27. Including deferred depreciation in rate base avoids a mismatch of rate base and capital structure and the resulting understatement of rate base. The entry to record the deferral of depreciation is to credit account 108.0 (accumulated depreciation) and to debit account 186.302 (deferred depreciation), instead of depreciation expense, thereby delaying the income statement effect and ultimately the effect on retained earnings in the capital structure. If the unamortized deferred depreciation balance is not included in rate base, the relationship between the rate base and capital structure will be upset because the Company's rate base will be improperly reduced by an amount which has not yet flowed to the income statement/retained earnings. If rate base treatment is not afforded for deferred depreciation item, the Company will not recover the full cost of providing service to its customers.

**Q28. What is the "full cost" of the deferred depreciation regulatory asset?**

A28. The Company has invested capital to provide safe and adequate service. Until this capital is recovered in rates, the Company will be incurring capital costs related to the unrecovered balances. Therefore, in order to recover the "full cost" of the deferrals, the Company must recover in rates both a "return of" (annual amortization of assets) and a "return on" (rate base treatment for the unamortized balance).

1 **Q29. If the Commission denies rate base treatment for the deferred depreciation**  
2 **regulatory assets, should there be an adjustment to the level of deferred taxes being**  
3 **deducted from rate base?**

4 A29. Yes. The Company's rate case application includes the total level of deferred taxes as of  
5 the date certain. The amount of deferred taxes associated with the deferral of  
6 depreciation are \$45,481, which is calculated by taking the deferred depreciation  
7 regulatory asset balance of \$129,945 times the federal tax rate of 35%. If the  
8 Commission denies rate base treatment for this item, in part or in whole, deferred taxes in  
9 rate base should be reduced, thus increasing rate base by \$45,481.

10 **Q30. Please describe the remaining B Schedules.**

11 A30. Schedule B-6.1 is not applicable as the Company is not proposing any adjustments to  
12 other rate base items.  
13 Schedule B-6.2 details the Contributions in Aid of Construction related to the Citizens'  
14 acquisition. These amounts are not on the books of the Company. For ratemaking  
15 purposes, they are being used to reduce rate base. The schedule has been updated to  
16 recognize the fact that CIAC for certain plant categories have been fully amortized and as  
17 such should not be included in the CIAC calculation. The reduction to rate base for  
18 Citizens' CIAC has been calculated at \$713,905 for Water C and \$872,367 for  
19 Wastewater, for a total of \$1,586,272.  
20 Schedule B-7 and B-7.1 details allocation factors for rate base and operating income by  
21 Water A, Water C, and Wastewater. In most cases, the Company has elected to allocate  
22 based on customer count by tariff group, as this is the most equitable way to allocate rate

1 base, operating income, and expenses.

2 Schedule B-7.2 explains changes to various allocation procedures used in the case.

3 Schedule B-8 details water data for the system, and includes output of the system, sales,  
4 other uses, and unaccounted for water for the test year.

5 Schedule B-9 is not applicable to Ohio American, as there is no request to include CWIP  
6 in the rate case.

## 7 VI. OPERATING INCOME AND EXPENSES

### 8 Q31. Are you sponsoring any Section C Schedules?

9 A31. Yes, I am sponsoring the following schedules that are a part of Section C: Schedules C-1  
10 through C-3, Schedule C-3.9, Schedule C-3.12, Schedules C-3.19 and C-3.20, Schedules  
11 C-3.26 through C-3.28, Schedules C-4 and C-4.1, Schedule C-8, and Schedules C-10.1  
12 and C-10.2. Other schedules in Section C will be sponsored by Company witnesses  
13 Donald Petry, Lewis Keathley and Melissa Schwarzell.

### 14 Q32. Please describe Schedules C-1, C-2, C-2.1, and C-3.

15 A32. Schedule C-1 shows the Company's pro forma income statement and overall rate of  
16 return under current and proposed rates, and are broken down by the major rate categories  
17 of Water A, Water C, total Water, Waste Water, and Total Company.

18 Schedule C-2 is a two-page schedule which provides a more detailed income statement  
19 which shows the transition from unadjusted test year data to pro forma data under current  
20 rates.

21 Schedule C-2.1 is a one-page schedule of the detail of the unadjusted test year income  
22 statement of revenue and expenses. All of the Company's service territory is in the same

1 jurisdiction so that no allocations were necessary.

2 Schedule C-3 lists the individual adjustments which were made to test year revenue and  
3 expenses for Water A, Water C, and Waste Water. The individual adjustments that will I  
4 will be covering in testimony include Schedule C-3.9, Schedule C-3.12, Schedules C-3.19  
5 and C-3.20, Schedules C-3.26 through C-3.28. Company witnesses Donald Petry, Lew  
6 Keathley, and Melissa Schwarzell provide testimony to the other adjustment schedules.  
7 A detailed explanation of each adjustment can be found on each individual adjustment  
8 schedule.

9 **Q33. Please discuss the adjustments for Support Services expense under Schedules C-3.9.**

10 A33. Schedule C-3.9 reflects the pro forma Support Services expense for the test period.

11 Support Services Expense, more commonly known as "Management Fees," relate to  
12 services provided to Ohio American by the Service Company, and include such services  
13 as billing, customer service, engineering, accounting, finance, legal, rates and regulation,  
14 human resources, and environmental. Services provided by the Service Company are  
15 billed either directly to Ohio American or on a per customer allocation across the various  
16 American Water companies. Three pro forma adjustments, totaling \$40,583, were made  
17 to Support Services Expense Fees.

18 The first entry eliminates known one-time costs from Support Services Expense.  
19 Since these items are non-recurring they have been adjusted out of the rate case. The  
20 total expense reduction to the test year for these one-time expenses is \$10,505.

21 The second adjustment was to eliminate items that may be considered disputable  
22 in regards to recovery in a rate case. Rather than argue the recovery of these items, the

1 Company made the determination to eliminate the items. The total reduction to the test  
2 year for these items is \$362.

3 The third adjustment increases labor and related expenses by \$51,449 to reflect  
4 costs for a former Ohio American employee who is now a Service Company employee.  
5 The employee, Charles Dean Van Horne, was the Senior Finance Manager at Ohio  
6 American Water. Mr. Van Horne was recently promoted to Senior Finance Manager for  
7 the Service Company, with accounting responsibilities for both Ohio American Water  
8 and West Virginia American Water. As such, the payroll expense for Ohio American  
9 does not include any expense for Mr. Van Horne. A Financial Analyst will be hired to  
10 assist Mr. Van Horne in the management of Ohio American's finances, and that position  
11 is included as a pro forma adjustment to Ohio American payroll expense in Schedule C-  
12 3.4. Mr. Van Horne will be spending 2/3 of his time on West Virginia American matters  
13 and 1/3 of his time on Ohio American matters. Accordingly, 1/3 of Mr. Van Horne's  
14 salary and related payroll expenses have been included as an adjustment to Support  
15 Services Expense.

16 In total, the three adjustments result in total Management Fee Pro Forma Expense  
17 of \$3,863,805.

18 **Q34. Please discuss the adjustment for Regulatory Expense as shown in Schedule C-3.12.**

19 A34. Schedule C-3.12 states the adjustment for regulatory expense that the Company expects  
20 to incur in this case. The Company estimates total Regulatory Expense of \$1,033,615,  
21 assuming this case is fully litigated. These expenses include fees for outside consultants  
22 and legal services. Three outside consultants were hired for this case. As recommended

1 in the Staff Report in Case No. 09-0391-WS-AIR, a depreciation study was conducted as  
2 part of this case. Outside expertise was also retained to prepare a cost of service study  
3 and to provide testimony on rate of return. The payroll expense incurred by Service  
4 Company employees that prepare the case, answer discovery and testify is also included.  
5 Also included are costs for customer notices, printing and binding of exhibits and  
6 testimony, and for other miscellaneous fees. The Company will submit a late-filed  
7 exhibit after the hearing to provide actual data for Regulatory Expense, and proposes to  
8 amortize this expense over two years, which is the length of time new rates are expected  
9 to remain in effect. The annual amortization of the current rate case expense is \$516,807.  
10 The adjustment to pro forma regulatory expense is \$137,777.

11 **Q35. How does the level of Regulatory Expense requested in this case compare to**  
12 **Regulatory Expense actually incurred in Case No. 09-0391-WS-AIR?**

13 A35. It is quite comparable. In Case No. 09-0391-WS-AIR, the Company and other parties  
14 endured 13 days of evidentiary hearings, resulting in total rate case expense of \$960,107.  
15 The Commission limited recovery to \$692,790 because this was the amount included in  
16 the original filing, and the Company did not timely submit a late-filed exhibit with actual  
17 data. The amount of rate case expense included in the filing in the last case assumed that  
18 the case would be settled, not fully litigated. The Company does not anticipate that this  
19 case will be settled. Therefore, the Company expects to incur rate case expense at a level  
20 comparable to what it incurred in the last case. Having said this, the Company is  
21 certainly willing to entertain settlement discussions at the appropriate time.



1 **Q36. Please discuss the depreciation expense included in Schedule C-3.19.**

2 A36. Schedule C-3.19 contains an adjustment for depreciation expense to reflect the  
3 calculation of depreciation based on pro forma Utility Plant in Service as of April 30,  
4 2011, multiplied by the pro forma depreciation rates included in the Depreciation Study  
5 conducted by Mr. John Spanos of AUS Consultants. Also included is the pro forma  
6 annual amortization of deferred depreciation expense. Total depreciation expense  
7 included in this case is \$3,795,311.

8 **Q37. Please discuss the adjustments to Amortization Expense in Schedule C-3.20.**

9 A37. Schedule C-3.20 represents adjustments to Amortization Expense. Schedule C-3.20 is  
10 listed at the bottom of Schedule C-3.19, Depreciation Expense. Schedule C-3.20 contains  
11 the adjustment for the Amortization of Limited Term Utility Plant Expense, as well as  
12 amortization of regulatory assets and the annual pro forma amortization of Intangibles.  
13 The pro forma amortization is \$32,816.

14 **Q38. Please discuss the tax adjustments in Schedules C-3.25 and C-3.26.**

15 A38. Schedule C-3.25 reflects an adjustment for current federal income taxes. This adjustment  
16 is necessary to reflect the impact of the Company's proposed pro forma adjustments to  
17 revenues, expenses, depreciation, general taxes, and the impact of interest  
18 synchronization in the tax calculation as shown on Schedule C-4. The Company is  
19 proposing the use of the statutory current federal income tax rate of 35%.

20 Schedule C-3.26 reflects an adjustment for deferred federal income taxes as a result of  
21 either temporary or permanent timing differences that have an impact on the revenue  
22 requirement. For Ohio American, the temporary timing difference that relates to tax

1 depreciation has a revenue requirement impact because Ohio American did not normalize  
2 depreciation for ratemaking purposes prior to 1981, thus passing through all the benefits  
3 to ratepayers of accelerated depreciation. For years prior to 1981, the book depreciation  
4 now exceeds the tax depreciation. Therefore, due to the implementation of SFAS 109 –  
5 Accounting for income taxes after 1993, the inclusion of an amortization of a regulatory  
6 asset associated with the pre-1981 flow through depreciation needs to be included in the  
7 tax calculation.

8 **Q39. Are there any permanent differences included in the tax calculation?**

9 A39. Yes. A portion of employee meals are not deductible for tax purposes and thus are added  
10 back in the tax calculation.

11 **Q40. Does the Company reflect the normalization of tax timing differences associated**  
12 **with maintenance, waste disposal, rate case expenses and other addbacks and**  
13 **deductions?**

14 A40. No, for two reasons. First, the inclusion of these items in the tax calculation would have  
15 no impact on the revenue requirement. A “pure” timing difference simply moves the tax  
16 impact between either current or deferred tax expense and thus does not impact the total  
17 revenue requirement. Second, the Company utilizes an effective tax rate methodology in  
18 calculating budgeted income taxes. Since the Company used eight months of budget data  
19 to prepare its test year, the identification of all addbacks and deducts for “pure” timing  
20 difference was not available.

21 **Q41. Please explain Schedule C-3.28.**

22 A41. Schedule C-3.28 reflects an adjustment to the Amortization of Investment Tax Credit.

1 This adjustment takes the pro forma Investment Tax Credit and moves the entire credit to  
2 the Water A revenues, which created the deferred credits and thus should benefit from the  
3 amortization.

4 **Q42. Please discuss Schedules C-4 and C-4.1.**

5 A42. Schedule C-4 reflects the adjusted jurisdictional Federal Income Taxes for the twelve  
6 months ended December 31, 2011. Calculations for this schedule were developed from  
7 various C-3 schedules that have been described above and in the testimony of others. All  
8 calculations have been done based on current pro forma rates.

9 Schedule C-4.1 contains the development of Jurisdictional Federal Income Taxes for the  
10 twelve months ended December 31, 2011. Once again, calculations for this schedule  
11 were developed using various C-3 schedules that have been described above.

12 **Q43. Please explain Schedule C-8.**

13 A43. Schedule C-8 contains information to compare the estimated and actual expenses from  
14 the two prior rate cases with the estimated expense for this rate case. The two most  
15 recent rate cases prior to this case were Case Nos. 09-0391-WS-AIR and 07-1112-WS-  
16 AIR.

17 **Q44. Please explain Schedules C-10.1 and C-10.2.**

18 A44. Schedule C-10.1 is a comparative balance sheet for the four months ending April 30,  
19 2011, which is the rate base cut-off date for this case, as well as for the five years ending  
20 December 31, 2006 through December 31, 2010.

21 Schedule C-10.2 is a comparative income statement for the four months ending April 30,  
22 2011, as well as for the five years ending December 31, 2006 through December 31,

1 2010.

2 **VII. SECTION D SCHEDULES**

3 **Q45. Are you sponsoring the Schedules in Section D of the Standard Filing**  
4 **Requirements?**

5 A45. Yes. I am sponsoring all of the D Schedules. These schedules are: Schedule D-1, Rate  
6 of Return Summary; Schedule D-2, Embedded Cost of Short-Term Debt; Schedule D-3,  
7 Embedded Cost of Long-Term Debt; Schedule D-4, Embedded Cost of Preferred Stock;  
8 and Schedule D-5, Comparative Financial Data.

9 **Q46. What capital structure do you recommend for computing the Company's weighted**  
10 **average cost of capital?**

11 A46. I recommend using the Company's actual capital structure as of April 30, 2011, which is  
12 the date certain in this proceeding. That capital structure consists of 48.24% long-term  
13 debt, 1.07% preferred stock and 50.69% common equity, as shown in the Rate of Return  
14 Summary on Schedule D-1.

15 **Q47. Please briefly describe Schedule D-1.**

16 A47. Schedule D-1 summarizes the amounts and cost rates for each capital component. The  
17 cost rate for each capital component is multiplied by its percentage proportion in the  
18 capital structure, which results in a weighted cost. The weighted costs for each capital  
19 component are then summed to produce a weighted cost of capital. Schedule D-1 shows  
20 that Ohio American's weighted cost of capital is 8.97% as of April 30, 2011. This  
21 weighted cost of capital reflects a cost of common equity estimate of 11.50%, which is  
22 supported by the testimony provided by Company witness Pauline Ahern.

1 **Q48. What do the remaining D Schedules reveal concerning the Company's capital**  
2 **structure?**

3 A48. Schedule D-2 shows that no short-term debt is included in the Company's capital  
4 structure as of April 30, 2011.

5 Schedule D-3, line 26, shows that Ohio American's embedded cost of long-term debt is  
6 6.32% as of April 30, 2011.

7 Schedule D-4, line 14, shows that Ohio American's embedded cost of preferred stock is  
8 8.53% as of April 30, 2011.

9 Schedule D-5 lists comparative financial data for the previous ten years (i.e., 2001  
10 through 2010). Data on this schedule pertains to plant, construction work in progress,  
11 capital structure, condensed income statement, cost of capital and fixed charge coverage.

## 12 **VIII. SECTION S SCHEDULES**

13 **Q49. Are you sponsoring schedules from section S of the Standard Filing Requirements?**

14 A49. Yes. Schedules S-1, S-2-1, S-2.2A, S-2.2B and S-2.3 and related workpapers contain  
15 projected financial information for three calendar years beginning with 2011. The  
16 information on these schedules is prepared under the assumption that Ohio American will  
17 continue to file for timely rate relief based on its construction and filing programs,  
18 projected water sales and operating expenses and the embedded cost of Ohio-American's  
19 common equity.

20 Schedule S-1 contains the Company's projected construction budget for the calendar  
21 years 2011, 2012 and 2013. All projects expected to cost more than \$100,000 have been  
22 identified separately. The last column of this schedule shows the projected amount of

1 AFUDC associated with this construction.

2 Schedule S-2.1 shows the projected income statements; rates of return and interest  
3 coverage for the projected calendar years 2011, 2012 and 2013.

4 Schedule S-2.2A is a three-year projection of the year-end rate base for 2011, 2012 and  
5 2013.

6 Schedule S-2.2B is a three-year projection of year-end capital structure for 2011, 2012  
7 and 2013.

8 Schedule S-2.3 is a three-year projection of changes in financial position for 2011, 2012  
9 and 2013.

10 Schedule S-3 is the proposed notice for newspaper publication that gives notice of the  
11 application for rate increase, which rates will be affected, and the proposed new rates.

12 Schedule S-4.1 contains an executive summary of the Company's corporate process  
13 utilized by the board of directors and corporate officers.

14 Schedule S-4.2 contains an executive summary of the Company's management policies,  
15 practices, and organization to meet the corporate goals determined by the board of  
16 directors and corporate officers.

17 **IX. PROCUREMENT OF SUPPORT SERVICES**

18 **FROM THE SERVICE COMPANY**

19 **Q50. What is the purpose of your testimony on Service Company services?**

20 A50. In Ohio American's last rate case, Case No. 09-0391-WS-AIR, there appeared to be some  
21 confusion related to the support services that Ohio American obtains from the Service  
22 Company. Therefore, my testimony is intended to clarify the services that Ohio

American provides for itself and those it obtains from the Service Company.

**Q51. Did the Opinion and Order in the Company's last rate case discuss Service Company Fees?**

A51. Yes. In Ohio American's last rate case, the PUCO's Opinion and Order noted concern with the Company's control of Service Company costs and the Company's cost-related decision-making, and therefore recommended an investigation and audit of Ohio American's management policies and administrative practices for the purposes of the Company's next rate proceeding. (Case No. 09-0391-WS-AIR, Opinion and Order, p. 59 (May 5, 2010).) Specifically, the Opinion and Order stated:

Given the level of average management fee expense increases since 2003 in relation to other regulated utilities' management fee levels and recognizing that Staff did not undertake an investigation of affiliate transactions or analyze in-depth capital project spending for purposes of this rate case, we determine that an audit, conducted by Commission Staff, outside the scope of this pending proceeding and concluded within 12 months should be undertaken with the results of that audit considered in a future rate case proceeding. In making this determination, we find that our Staff has the necessary expertise to investigate and make recommendations to us regarding areas the Company can focus on to control expenditures without engaging the resources of an outside auditor. Ohio American is instructed to cooperate with and provide required information to our Staff in

1 furtherance of this audit.

2 Id. at 61.

3 Although Ohio American employees have worked diligently to provide any and  
4 all pertinent data to Staff to expedite the process, the investigation and audit has not yet  
5 been completed. Accordingly, the results of the investigation and audit cannot be  
6 considered in this case as contemplated in the Opinion and Order in the last case. As  
7 such, I am providing testimony on Service Company fees specifically to aid the PUCO  
8 and its Staff in understanding the process by which Ohio American obtains services from  
9 the Service Company.

10 **Q52. What services are necessary to support Ohio American's operations?**

11 A52. Numerous services are required to operate a water and wastewater utility. To properly  
12 function, Ohio American requires utility-related and customer-oriented services such as  
13 construction, meter reading, field services and facilities maintenance, engineering, billing  
14 and accounting, finance and financial reporting, tax, rates and regulation, customer  
15 service and a call center, water quality testing, information technology, external  
16 communications, human resources, legal, environmental regulation, supply chain, risk  
17 management/insurance procurement and employee safety, among others. Ohio American  
18 must obtain these services, and incur the attendant costs, regardless of the source of the  
19 services. In other words, the cost of these services is unavoidable whether the services  
20 are obtained from the Service Company or from another source.



1 **Q53. In general, how does Ohio American procure the services it needs to support its**  
2 **operations?**

3 A53. Ohio American provides most of the services needed to support its operations through  
4 Ohio American utility employees. However, like any other business, Ohio American also  
5 obtains certain services from outside sources. In deciding whether to meet service needs  
6 with internal or external resources, Ohio American considers cost effectiveness, quality of  
7 service, timeliness of service provision, reliability of service and adequacy of alternate  
8 suppliers. Based on these considerations, Ohio American maintains a staff of full-time  
9 Ohio American employees to provide a number of necessary support services, such as on-  
10 site engineering, water quality, and cross connection monitoring. However, for other  
11 necessary support services, such as legal, accounting, regulatory management and other  
12 services described more fully elsewhere, Ohio American is able to both maintain high  
13 service quality and achieve efficiencies by obtaining those services from outside sources.  
14 The Service Company is one of those sources; other sources include local contractors or  
15 service vendors.

16 **Q54. Please describe the relationship between the Service Company and Ohio American.**

17 A54. The Service Company and Ohio American have a contractual relationship pursuant to  
18 which the Service Company provides to Ohio American certain services necessary to  
19 support Ohio American's operations on an at-cost, non-profit basis from the Service  
20 Company. The terms governing that relationship are set forth in a Services Agreement  
21 executed on January 1, 1989 between the Ohio American Water Company and the  
22 American Water Works Service Company, Inc. A copy of the Services Agreement will

1 be provided to Commission Staff during the initial field audit as Item 27 of the  
2 Supplemental Filing Requirements. Per the Services Agreement, the Service Company  
3 provides Ohio American support services for accounting, administration, communication,  
4 engineering, financial, human resources, information systems, operations, rates and  
5 regulation, risk management, water quality, and other services as may be agreed upon  
6 between Ohio American and the Service Company. The support services provided by the  
7 Service Company are necessary to Ohio American's operations.

8 **Q55. Where is the Service Company located?**

9 A55. The Service Company maintains several offices from which it serves Ohio American and  
10 the American Water operating companies. Its corporate office is located in Voorhees,  
11 New Jersey. This office provides executive management and corporate support services  
12 to Ohio American and the other operating companies. The Service Company maintains  
13 two national customer service centers, one located in Alton, Illinois and one located in  
14 Pensacola, Florida. These centers process customer calls, service orders and other  
15 customer correspondence as well as customer billing, credit and collections matters, on  
16 behalf of Ohio American and the other operating companies. The Service Company also  
17 maintains a National Shared Services Center in Cherry Hill, New Jersey which provides  
18 financial, accounting, treasury, and other support services. Divisional offices provide  
19 those services which are necessary to support the operating companies', including Ohio  
20 American's, operations, but which are best provided on a regional basis given their  
21 location-specific nature. The Divisional Office providing services to Ohio American is  
22 located in Lexington, Kentucky. Divisional services include rates and revenue support

1 services, financial planning and analysis support services, field resource customer  
2 communication services, and engineering services. The Service Company's centralized  
3 Information Technology Services ("ITS") Center is located in Voorhees, New Jersey, and  
4 several data centers are set in other locations. Finally, the Service Company maintains a  
5 centralized water quality testing laboratory in Belleville, Illinois which is available to  
6 service certain of Ohio American's water quality testing needs, and that of the other  
7 American Water operating companies.

8 **Q56. Does the Services Agreement require Ohio American to obtain the services necessary to**  
9 **support its operations from the Service Company?**

10 A56. No. Article 1 of the Services Agreement states that Ohio American may hire its own staff or  
11 engage the services of another outside vendor to provide the necessary support services.

12 **Q57. Does Ohio American ever engage outside vendors other than the Service Company to**  
13 **provide necessary support services?**

14 A57. Yes. Although, in many cases, the Service Company is the most cost-effective and  
15 qualified source for outside services required by Ohio American to support its operations,  
16 sometimes it is unable to provide the specialized services warranted by certain  
17 circumstances. In those circumstances, Ohio American engages the services of an outside  
18 vendor other than the Service Company. For example, it is often appropriate for Ohio  
19 American to engage outside regulatory lawyers, rate of return experts, cost of service  
20 consultants and depreciation study consultants to assist it in preparing and litigating a rate  
21 case given the specialized expertise of such counsel and consultants. Given the time  
22 frame of a typical rate case, the use of outside counsel, for example, is often more

1 efficient. Rate cases require the assistance of a team of lawyers over a set period of time  
2 occurring only once every two to three years. It is often more efficient to use outside  
3 counsel during that period rather than retaining on a permanent basis in-house regulatory  
4 counsel. Ohio American also sometimes hires outside contractors and engineering firms  
5 to assist in various construction projects. Ohio American has also hired a part-time  
6 communications consultant from a private communications firm to assist in company-  
7 related consumer education programs.

8 **Q58. Is there anything unique about the Service Company that makes it better qualified**  
9 **or more cost effective than other vendors?**

10 A58. Yes. As I noted earlier, the Service Company is a purpose driven entity. The Service  
11 Company provides services at its cost, without profit or mark-up. Further, the Service  
12 Company maintains a highly capable staff of officers and employees who are expert in all  
13 aspects of the water utility business. They spend substantially all their time serving  
14 operating water companies and thus are knowledgeable and experienced in the efficient  
15 management, financing, accounting and general operation of water utility business and  
16 water utility assets. Moreover, they have knowledge and experience relating to the  
17 operations and facilities of Ohio American specifically, as well as American Water's  
18 other operating companies. As such, it would be difficult for Ohio American to find local  
19 service providers with the same specialized water industry expertise as that possessed by  
20 the Service Company staff, and thus who can provide the services necessary to support  
21 Ohio American's operations as efficiently.

22 In addition, where outside service providers generally bill their clients for every

1 hour worked, the Service Company's exempt personnel charge a maximum of eight hours  
2 per day to the operating companies they serve, even when they work more hours,  
3 resulting in savings to Ohio American and the other operating companies.

4 **Q59. Are there additional factors that allow the Service Company to provide services more**  
5 **cost-effectively than other vendors?**

6 A59. Yes. The Service Company exists to provide "shared" services necessary to support the  
7 operations of American Water's operating companies, including Ohio American. These  
8 services are provided at cost—i.e., without profit or markup. Thus, only the actual costs  
9 of the services are recovered from Ohio American and its customers. Moreover, use of  
10 the Service Company allows Ohio American to "share" the cost of the functions within  
11 the Service Company that provide those services. This sharing results in economies of  
12 scale and multiple benefits to Ohio American, and, consequently, its customers. For  
13 instance, consolidation of the operating companies' purchasing needs allows the Service  
14 Company to procure goods necessary to all of the operating companies' businesses, such  
15 as insurance, chemicals and piping, on a large scale. This results in increased bargaining  
16 power, and, in turn, procurement of the goods at a cost lower than that at which Ohio  
17 American could procure the goods as a stand-alone entity. Among other examples, the  
18 chemicals used in the water and wastewater treatment process are procured for Ohio  
19 American through a nation-wide negotiated contract by Service Company procurement  
20 personnel, thus giving Ohio American the ability to purchase chemicals at a negotiated  
21 price based on the chemical usage volumes generated to treat water and wastewater for  
22 the 3.2 million customers that represent all of the subsidiaries of American Water, not

1 just the 57,000 water and wastewater customers of Ohio American Water. Use of the  
2 Service Company also provides operating economies of scale in that the workloads of the  
3 American Water operating companies are balanced across more personnel and more  
4 facilities—i.e. one information technology service center handles all of the operating  
5 companies' information technology needs, rather than each procuring such services on an  
6 individual basis. Likewise, as opposed to having a call center in each of the 18 states  
7 served by American Water's subsidiaries, two call centers provide utility customer  
8 support nationally.

9 The Service Company further promotes continuity of service in that the expertise  
10 of Service Company employees in all facets of water utility operations and, specifically,  
11 Ohio American's operations, allows continued, high-quality service to Ohio American,  
12 even when key personnel are absent or resign.

13 **Q60. How does the Service Company determine what cost it will charge for a particular**  
14 **service?**

15 A60. The Service Company charges Ohio American and the other American Water operating  
16 companies for the services it provides those entities only what it costs the Service Company  
17 to offer the services. In other words, the Service Company is not a profit center. If a Service  
18 Company employee is completing work for a specific state, such as Ohio, their time for that  
19 work is direct charged to Ohio American. If that Service Company employee is completing  
20 work that benefits more than one state, their time is charged to an allocation formula that is  
21 calculated annually and is based on customer counts for those states. Other costs such as  
22 supplies, rent, depreciation, etc. are either direct charged if state specific or are allocated

1 through an overhead factor applied employee hours. For instance, I am a Service Company  
2 employee. If I am working on a regulatory issue specific to Ohio American, I direct charge  
3 my time specifically to Ohio American. As Director of Rates for American Water's Eastern  
4 Division, I also direct charge my time to any one of the nine states that make up the Eastern  
5 Division. If I am working on something that affects all states in the Eastern Division, I will  
6 charge my time to a formula that allocates (based on the customer count of the states within  
7 the Eastern Division) that time to all of the states in the Eastern Division. I can also allocate  
8 my time to a formula that gets spread to all states in the American Water system if I am  
9 working on a project that benefits all states. And, unlike a consultant who would charge a  
10 client for each and every hour worked on a project, I only account for eight hours a day, or 40  
11 hours a week, when accounting for my time. Thus, if I work more than 40 hours in a week,  
12 Ohio American benefits.

13 **Q61. Does the Service Company provide services to Ohio American that Ohio American**  
14 **cannot feasibly procure from another source?**

15 A61. Yes, there are several. The Service Company provides Corporate Governance support  
16 services to Ohio American which cannot be procured from non-affiliate vendors due to  
17 need to maintain the confidential nature of certain financial information in accordance  
18 with securities laws. Additionally, the Corporate Governance function by its very nature  
19 must be provided by management personnel who are directly accountable to Ohio  
20 American's shareholders. Accordingly, those management personnel must be employed  
21 by Ohio American or an affiliated entity only.

22 It is also appropriate to use affiliated personnel to perform customer service

1 activities to assure current and proper management control over customer  
2 communications, billing processes, compliance with regulatory requirements and prompt  
3 action in circumstances requiring notice of a “boil order” or service interruption. Also,  
4 due to public health and safety concerns related to water utility operations, as well as the  
5 rigorous requirements related to the training and monitoring of customer service  
6 functions, those services should be provided by affiliated personnel. For this reason,  
7 Ohio American believes it is appropriate to utilize the services of the Service Company’s  
8 Customer Service Center as compared to otherwise outsourcing its customer service  
9 needs.

10 Finally, as I discuss more fully below, the Service Company also provides an  
11 Employee Benefits Service Center, which is operated by the Service Company’s Human  
12 Resources department. Due to the complex and confidential nature of employee benefits,  
13 affiliated personnel must also be employed to provide this necessary service.

14 **Q62. If Ohio American did not obtain the services you just described from the Service**  
15 **Company, how would the Company obtain them?**

16 A62. If Ohio American did not obtain the above services from the Service Company, it would  
17 be required to self-provide those services or obtain them from a third party. That is, Ohio  
18 American would be required to hire, orient, train and, in some cases, relocate the  
19 qualified personnel necessary to carry-out the above-described services on behalf of Ohio  
20 American. As a result, Ohio American would incur the additional costs associated with  
21 the hiring, orienting, training and relocating these employees or contractors.



1 **Q63. How does the Service Company bill Ohio American for the support services it**  
2 **provides?**

3 A63. Per the Services Agreement between the Service Company and Ohio American, the  
4 Service Company provides support services to Ohio American at the Service Company's  
5 cost. The Service Company invoices Ohio American for services provided on a monthly  
6 basis. The monthly bill for those services is broken down into five expense categories:  
7 labor, administrative support services, labor related overhead expenses, office related  
8 overheads, and vouchers/journal entries.

9 Every week, Service Company management and professional employees complete  
10 an electronic time sheet, detailing the time they have worked and the operating company  
11 or operating companies whom their work supported. Where a task benefits one operating  
12 company (e.g., work on a particular rate case), it is noted as a direct charge to that  
13 company. Where a task benefits a group of or all American Water operating companies,  
14 the appropriate allocation formula is so noted. Expenses are similarly treated. At the end  
15 of the month, the total hours worked directly for, or allocated to, Ohio American are  
16 generated, and a cost is determined based on the hourly rate of the management and  
17 professional employees who performed the work.

18 Administrative personnel also complete weekly electronic time sheets, but bill  
19 their time to a "General Admin" code. That time is then allocated to each operating  
20 company in proportion to the total management and professional employee labor costs  
21 assessed the operating company.

22 Labor related overhead expenses, such as employee benefits, payroll taxes,

1 employee medical and disability insurance premiums and pensions, and general building  
2 related overhead expenses, such as office rent, equipment leases, telephones expenses,  
3 electricity charges, office supply costs, property taxes and office maintenance costs, are  
4 also allocated to the operating companies in the same manner as administrative support  
5 services. That is, those overhead expenses related to the Service Company staff and  
6 facilities utilized by a particular operating company are allocated to each operating  
7 company in proportion to the total management and professional employee labor costs  
8 assessed that operating company for the month.

9 Finally, vouchers and journal entries, such as travel expenses, software licenses  
10 and professional dues, are charged directly to the operating company they benefit or are  
11 allocated among multiple operating companies based on which companies benefit from  
12 the expenses.

13 **Q64. How does the Service Company allocate the costs of services which benefit all of its**  
14 **affiliates?**

15 A64. As stated, where possible, Service Company employees identify the specific affiliate or  
16 group of affiliates that directly benefit from the services they provide so that the costs of  
17 those services may be charged directly to that affiliate or group of affiliates. These are  
18 “direct charges.” Once all direct charges have been applied, the Service Company  
19 allocates the costs of services which benefit all of its regulated and non-regulated  
20 affiliates among those affiliates. With respect to its regulated affiliates, the Service  
21 Company allocates the costs of services which are beneficial to all regulated affiliates in  
22 proportion to the customer count of each regulated affiliate per the Services Agreement.

1 In this way, neither small nor large affiliates, and in turn their customers, shoulder more  
2 than their fair share of the costs.

3 **Q65. Does Ohio American review the bills it receives from the Service Company?**

4 A65. Yes. The Service Company billing goes through a multiple review process. First,  
5 Financial Planning and Analysis personnel that support American Water's Eastern  
6 Division states review the Service Company billings for each Eastern Division state to  
7 ensure no overall billing errors are included. From there, Ohio American personnel  
8 review the Service Company billing in more detail and question inappropriate charges  
9 and ensure they are removed from the billing. Finally, David Little, President of Ohio  
10 American, reviews the Service Company billing on a monthly basis and has questioned  
11 specific charges and had them removed from the billing. These detailed reviews ensure  
12 that the Service Company's bills are reasonable and accurate. As mentioned above, if  
13 there is a charge on the bill that seems incorrect or unreasonable, Ohio American will  
14 challenge it. Any mistakes or inaccuracies found in a particular month's bill are credited  
15 to Ohio American in a subsequent billing. In addition, when it appears that a Service  
16 Company employee has billed 100% of his or her time to Ohio American, and Ohio  
17 American personnel are not aware of any services provided by that individual, personnel  
18 from Ohio American will either call or e-mail that employee and ask for an explanation of  
19 the charges to ensure its accuracy or validity. In this way, Ohio American monitors  
20 Service Company invoicing and controls Service Company costs.

1   **Q66. Does Ohio American have in place other measures to monitor and control Service**  
2       **Company costs?**

3   A66. Yes. Ohio American has in place several measures to monitor and control Service  
4       Company costs on an ongoing basis. Cost control begins with appropriate budgeting and  
5       planning. The Service Company and Ohio American develop a proposed annual budget  
6       outlining the services and level of services Ohio American will require in an upcoming  
7       year. That budget details the planned level of each support service to be provided and the  
8       corresponding cost allocated to Ohio American. Ohio American personnel, specifically,  
9       the Senior Finance Manager and the President, review the proposed budget and must  
10      approve it before it can take effect. Finally, the Service Company budget for Ohio  
11      American is approved as a part of the annual Ohio American budget by the Ohio  
12      American Water Board of Directors on an annual basis. The Service Company also  
13      prepares a monthly budget/actual variance report for all of its operations. This report is  
14      submitted to Ohio American Water personnel for review and scrutiny.

15           The Service Company budget receives this type of review from all operating  
16      companies of American Water. The Service Company budget is also approved annually  
17      by the Service Company Board of Directors and the American Water Board of Directors.  
18      Board membership for the Service Company includes State Presidents who serve on the  
19      Service Company Board of Directors on an annual rotational basis. David Little, Ohio  
20      American President, has served on the Service Company Board of Directors in the past  
21      and as such has had additional review and approval capability over the Service Company  
22      budget in that role.

1 In addition, as I have stated above, Ohio American prepares its own budget, which  
2 includes a line item for Service Company fees, and which must be approved by the Ohio  
3 American Board of Directors. It also engages in its own budget variance reporting and  
4 analysis on a monthly basis.

5 Several layers of oversight also ensure Service Company costs are reasonable and  
6 controlled. Divisional American Water executives and directors oversee Ohio  
7 American's finances and spending as well as the Service Company's performance. First,  
8 the Divisional Senior Vice President of American Water's Eastern Division, Nick Rowe,  
9 serves as a director on the Service Company's Board. Mr. Rowe is responsible for the  
10 overall performance of Ohio American and the other operating companies in his Division.  
11 In this respect, he monitors Service Company quality and spending. He also must review  
12 and approve any major project sought to be undertaken by the Service Company before  
13 the same can be charged to Ohio American. Those projects ultimately must be accounted  
14 for in the Service Company's annual budget and approved by its Board. Next, the  
15 Divisional Vice President and Treasurer, Deborah Degillio, is responsible for the  
16 financial reporting, performance and internal controls of Ohio American and the other  
17 operating companies in the Eastern Division. These individuals also sit on Ohio  
18 American's Board of Directors, thus providing an additional layer of oversight. Financial  
19 analysts on Ms. Degillio's Eastern Division Finance team monitor Service Company  
20 performance and reporting and contest bills whenever they believe Service Company  
21 quality and/or service are not appropriate. Finally, Ohio American's Senior Finance  
22 Manager, Charles Dean Van Horne, as well as Ohio American's President, David Little,

1 review Service Company billings on a monthly basis for a final “on the ground” review of  
2 the charges included in the billings.

3 **X. DESCRIPTION OF SERVICE COMPANY SERVICES**

4 **Q67. What specific services does the Service Company provide to Ohio American?**

5 A67. Within the Service Company are a number of departments, or “functions,” which provide  
6 services necessary to support Ohio American’s operations. The functions primarily  
7 serving Ohio American are the (1) Customer Service Center; (2) Central Water Testing  
8 Laboratory; (3) Information Technology Services Center; and (4) Shared Services Center.

9 Additional Service Company functions which provide necessary support services to Ohio  
10 American are Communications and External Affairs, Corporate Finance, Human  
11 Resources, Legal, Rates and Regulations, and Operations Services Department.

12 **A. CUSTOMER CALL CENTER**

13 **Q68. Please describe the Service Company’s Call Center and the necessary support**  
14 **services it provides to Ohio American.**

15 A68. The Service Company’s CSC provides Ohio American with necessary customer service  
16 and call handling services. That is, the CSC receives, manages and processes inbound  
17 customer calls and other correspondence, including that received by mail, facsimile and e-  
18 mail, responds to customer inquiries and creates service orders as necessary. The CSC  
19 effectively addresses call volume peaks by handling a traditional daily call distribution  
20 over the entire day with the latest staffing and scheduling programs. This enhances  
21 customer convenience and improves service levels by spreading peak volumes. The CSC  
22 also invests in leading-edge training facilities and techniques, which leads to improved

1 first call effectiveness and increased customer satisfaction. It provides economies of  
2 scale in the use of technologies needed to meet increasing customer expectations, ongoing  
3 comparison with established measures of service excellence, and a focus on improving  
4 Ohio American's customers' experience in contacting their utility service provider.

5 In addition, the Service Company's CSC also provides the following necessary  
6 customer service related support services: (1) *Billing* - calculating bills, processing  
7 adjustments, and resolving billing issues; (2) *Collections* - managing collection of unpaid  
8 bills, issuing notices regarding overdue amounts, handling outbound calls to customers  
9 regarding overdue amounts, issuing shut-off orders, resolving collections disputes and  
10 handling the processing of bankruptcy notices; (3) *Education and Development* - training  
11 new customer service employees and providing ongoing training to current employees;  
12 (4) *Quality control* - monitoring the quality of customer calls handled, service orders  
13 created and billing and collections and reporting to CSC leadership on the same for the  
14 purpose employee coaching and development; (5) *Additional support* - providing  
15 necessary finance, work force management, human resources, information technology and  
16 administrative support, including cost control, recruitment, staffing, scheduling, overtime  
17 needs, administrative functions and system/desktop support.

18 **Q69. How does the CSC provide customer service specifically to Ohio American customers?**

19 A69. The CSC and Ohio American work together to provide high-quality support to Ohio  
20 customers. The CSC operates a telephone system to route and deliver calls from those  
21 customers to call handling agents, or Customer Service Representatives ("CSRs"). CSRs  
22 greet Ohio American customers making inbound calls, answer their questions, handle

1 their requests, process service orders and other customer correspondence and handle  
2 account billing and collection. The CSC answers Ohio American's customers' calls 24  
3 hours per day, 7 days per week, 365 days per year. As such, it is one of the main  
4 customer-facing aspects of Ohio American, along with Ohio American field service  
5 operations which are responsible for reading meters and providing other required field  
6 service to customers. Last year, CSRs responded to 114,871 inquiries and concerns from  
7 Ohio American customers. Since Ohio American Water was brought to the CSC in 2003,  
8 an average of 128,678 calls have been received by the CSC every year.

9 **Q70. Does the CSC assess the quality of interactions with Ohio American's customers?**

10 A70. Yes. The CSC has a quality monitoring program to ensure that Ohio American's  
11 customers' concerns are addressed and resolved in a courteous and efficient manner. In  
12 response to customer survey results, the CSC has developed critical metrics for CSR  
13 performance, including active listening, effective issue diagnosis and an emphasis on first  
14 call resolutions. In addition, the PUCO Staff has in the past and is presently able to at any  
15 time request access to random calls made to the CSC by Ohio American customers to  
16 verify first hand that the CSC is providing efficient, professional, and courteous service to  
17 Ohio American customers when they call with inquiries or questions about their bill or  
18 their service.

19 **Q71. Does the CSC employ other means to assess CSR performance?**

20 A71. Yes. The CSC monitors and tracks internal metrics to assess the overall performance and  
21 effectiveness of its CSRs, including level of service, call abandonment rate, average  
22 speed of answer and incidence of first call resolutions.



1 **Q72. What are the costs of the services provided to Ohio American by the Service**  
2 **Company's Customer Service Center?**

3 A72. The cost of the services provided to Ohio American by the Service Company's Customer  
4 Service Center that are included in this rate filing are \$794,758.

5 **Q73. What would be required to replicate the support services provided Ohio American**  
6 **by the CSC?**

7 A73. As discussed above, the customer account support services provided by the CSC are  
8 necessary to Ohio American's operations and must be provided by an affiliated entity.  
9 Thus, if Ohio American could not obtain those services from the CSC, it would be  
10 required to provide those services itself. To replicate the services provided by the CSC,  
11 Ohio American first would need to secure the facilities, equipment and technology  
12 necessary to establish a call center. Ohio American would also need to hire, orient, train  
13 and potentially relocate personnel to staff the call center, as well as provide those  
14 personnel the benefits received by other Ohio American employees.

15 **B. INFORMATION TECHNOLOGY SERVICES**

16 **Q74. Please describe the Service Company's Information Technology Services function and**  
17 **the necessary support services it provides to Ohio American.**

18 A74. The Service Company's Information Technology Services ("ITS") function is comprised  
19 of five departments: (1) Enterprise Architecture; (2) Infrastructure and Operations; (3)  
20 Business Application Development; (4) Client Services and Security; and (5) the Project  
21 Management Office (the "PMO"). I will address each department in turn.

22 ***Enterprise Architecture.*** The American Water ITS Enterprise Architecture (ITS

1 EA) team is responsible for providing technology direction and developing the  
2 information technology strategy and roadmap. The ITS EA group provides  
3 strategies, policies, standards and recommendations in order to establish the  
4 overall information technology direction of the company. The benefits of  
5 providing a standard technology direction include ensuring that solutions provide  
6 value to the business, are cost effective to implement, and are built according to  
7 industry adopted best practices. By having a long range technology plan,  
8 American Water can leverage technology and costs across different business  
9 groups and solutions.

10 The Enterprise Architecture team not only focuses on providing long term  
11 technology direction, but also works as a key contributor to the designs for  
12 projects. The architects work in partnership with the business and the delivery  
13 team to create a design that balances long term direction with the need to  
14 implement a cost effective solution. On an as needed basis, ITS EA subject matter  
15 experts provide technical support during any major incidents or outages.

16  
17 ***Infrastructure and Operations.*** The Infrastructure & Operations team is  
18 responsible for the operations, support, and maintenance of the data center, batch  
19 processing functions, and voice and data communications infrastructure. This  
20 includes responsibility for all the servers in the data center, back-up and recovery  
21 processes, data storage voice and network performance and American Water's bill  
22 print and distribution operations.

1                   The Infrastructure and Operations organization consists of three units: the  
2                   server management team, network communications team, and the computer  
3                   operations team. The server management team provides the services necessary to  
4                   install, maintain, and administer American Water's data and Customer Service  
5                   Center servers and data storage hardware, and e-mail communications. The  
6                   responsibilities of the network communication team include data and voice  
7                   network communication equipment and circuit installations, monitoring and  
8                   maintenance. The computer operations team performs the customer and financial  
9                   system operational tasks, such as posting of the bill batches and customer  
10                  payments, and coordinates and supervises the third party vendor that provides  
11                  customer correspondence printing and mailing services.

12  
13                  ***Business Application Development.*** The Business Application Development  
14                  team focuses on design, development and delivery of software applications.  
15                  Business Application Development provides second and third level break/fix  
16                  support for all application-related technology solutions including critical business  
17                  applications (e.g. JD Edwards – stores human resources and financial data,  
18                  Enterprise Customer Information System – houses American Water's account,  
19                  customer and contact information, Hyperion – handles financial reporting,  
20                  planning and financial management, Identity and Access Management System  
21                  (IAM) – improves and automates the processes of granting and removing user  
22                  access to information technology applications and technical resources). The team

1 also addresses on-going enhancement requests and maintenance, such as upgrades  
2 to these critical business applications.

3  
4 ***Client Services and Security.*** The Client Services and Security Operations  
5 organization provides many levels of end user support. These functions include  
6 end user desktop support, help desk support, user access provisioning, incident  
7 and problem management, change control management, desktop and software  
8 patching, antivirus, laptop encryption, cyber-security monitoring, vulnerability  
9 management, and security testing. Benefits provided by Client Services and  
10 Security Operations include:

- 11 • Improved customer service to fellow employees by focusing courtesy,  
12 timeliness, technical knowledge, and professionalism
- 13 • Reduced the risk of lost data and exposure for American Water mobile  
14 computers by introducing full drive encryption for computer hard drives,  
15 upgrading the antivirus environment with antivirus and antispyware and  
16 restructuring the patch management process to more effectively apply security  
17 patches to IT systems
- 18 • Improved operating effectiveness and efficiency with the introduction of a  
19 centralized procurement model for IT equipment for customers

20  
21 ***Project Management Office.*** The PMO manages all projects within the ITS  
22 function. This team is responsible for managing projects using a standard

1 methodology that enables consistent and repeatable process that are applied to all  
2 projects allowing for consistent scope, budget and schedule management as well  
3 as quality delivery.

4 **Q75. How do Ohio American customers benefit from these services?**

5 A75. Use of the above support services provided by the Service Company's ITS function  
6 reduces the per-customer cost incurred by Ohio American for necessary information  
7 technology services as compared to Ohio American itself providing such services. Use of  
8 ITS takes advantage of economies of scale and scope as well as any applicable volume  
9 discounts, and it spreads information technology costs over the large customer base of  
10 American Water's combined operating companies. For example, the Service Company's  
11 ITS function is able to obtain software licenses at a lower per-customer cost based on the  
12 volume of licenses purchased. Similarly, it is able to leverage the server infrastructure by  
13 purchasing fewer, larger servers to house the necessary software applications, instead of  
14 requiring multiple, smaller servers at Ohio American and the other operating companies.  
15 All of those servers have to be monitored, patched and maintained. By utilizing the  
16 support services provided by the Service Company's ITS function, fewer total servers can  
17 be maintained by fewer employees. Moreover, software applications can be developed  
18 and maintained centrally, instead of at Ohio American and every other individual  
19 operating company. The alternate approach would require that any application changes be  
20 made multiple times, and would expend more resources and cause more idle time because  
21 of the number of skill-sets required and the lower volume of work in each line of those  
22 skill-sets for a single operating company.

1 Another benefit provided to Ohio American by its use of the Service Company's  
2 ITS function is that function's ability to efficiently employ the specialized skills of  
3 multiple personnel. For example, the operation and maintenance of a single software  
4 application requires multiple employees with specialized skill sets because all of the  
5 requisite skills seldom are possessed by a single employee. Utilizing ITS allows Ohio  
6 American access to a team of skilled technicians that Ohio American could not cost-  
7 effectively procure on a stand-alone basis. The work required to maintain server  
8 infrastructure is the same regardless of the number of end users, whether it is 10 or  
9 10,000, because the application residing on the server has the same functions.  
10 Additionally, application developers typically specialize in a specific set of languages.  
11 Due to the specialized nature of each technician's skills, Ohio American as a stand-alone  
12 entity could not employ the services of the required technical staff as efficiently.

13 **Q76. Does Ohio American employ any in-house IT personnel?**

14 A76. No.

15 **Q77. What are the costs of the services provided by the Service Company's IT Services**  
16 **Department?**

17 A77. The cost of the services provided to Ohio American by the Service Company's IT  
18 Services Department that are included in this rate filing are \$1,112,083.

19 **Q78. What could be required to replicate the support services provided Ohio American**  
20 **by the ITS?**

21 A78. The Service Company provides all IT services required by Ohio American. If the  
22 Company was unable to procure those services from the Service Company, it would lack

any of the information technology services imperative to its operations. Ohio American would therefore have replicate all of the above-discussed IT services it obtains from the Service Company by itself providing those services or by procuring them from outside vendors on a stand-alone basis. To self-provide the services, Ohio American would need to secure the technology and equipment necessary to support its operations as well as hire, orient, train and potentially relocate the personnel knowledgeable about that technology and equipment, and particularly experienced and/or certified in the specific software applications necessary to Ohio American's operations. Additionally, Ohio American would be required to provide those personnel the benefits received by other Ohio American employees.

**C. SHARED SERVICE CENTER**

**Q79. Please describe the Service Company's Share Service Center and the necessary support services it provides to Ohio American.**

**A79.** The Service Company's Shared Service Center ("SSC") provides various accounting and financial activities to Ohio American and the other American operating companies, including general accounting, financial reporting, payroll processing and reporting, oversight of accounts payable and purchasing card transactions, invoice payments, processing of capital expenditures and fixed asset processing, receipt and distribution of cash (cash management), tax-related services, and providing support for the rates and regulation functions of Ohio American and the other operating companies.

Operation of the SSC allows Ohio American and the other operating companies to realize economies of scale that could not be obtained otherwise. In addition, the use of

1 specialized software technology at the SSC, such as for asset capitalization and  
2 maintenance, sales and use tax management, treasury workstation, automated cash  
3 handling, bank lockbox management and invoice scanning and documentation software,  
4 provide benefits to each operating company, including Ohio American. The cost to  
5 purchase, implement and train users of these technologies would be higher for Ohio  
6 American to do on a stand-alone basis. Centralizing the knowledge-base necessary to  
7 utilize these technologies allows Ohio American to realize additional economies of scale.

8 **Q80. Does Ohio American employ an in-house internal auditing, accounting or tax**  
9 **personnel?**

10 A80. No.

11 **Q81. What are the reasonable costs of the services provided by the Service Company's**  
12 **Shared Services Department during the test year?**

13 A81. The test year cost of the services provided to Ohio American by the Service Company's  
14 Shared Services Department that are included in this rate filing are \$387,075.

15 **Q82. What could be required to replicate the support services provided to Ohio American**  
16 **by the Shared Services Department?**

17 A82. As stated, because the services which Ohio American obtains from the Shared Services  
18 Center are necessary to Ohio American's operations, Ohio American would be required  
19 to replicate those services, either by self-providing those services or by outsourcing them  
20 to another vendor.



1 **D. CENTRAL LABORATORY SERVICES/WATER QUALITY TESTING**

2 **Q83. What are the water quality testing needs of Ohio American?**

3 A83. Due to the fact that Ohio American supplies a service to its customers that is related to  
4 their health and hygiene, the water quality is subject to many regulations for testing and  
5 certification by the Ohio EPA and others to ensure it meets all quality standards. Ohio  
6 American has two main types of water testing requirements: immediate onsite testing and  
7 other testing that is not required on an immediate basis but is more thorough and requires  
8 specialized equipment, laboratory and lab analyst certification in order to complete. Ohio  
9 American handles the immediate on-site testing requirements with Ohio American  
10 employees at its water treatment plant sites. Due to the additional expense of equipment,  
11 lab certification and lab analyst certification, Ohio American testing that must be sent off  
12 site to a facility with the necessary equipment is sent to the Service Company's Central  
13 Laboratory Center located in Belleville, Illinois.

14 **Q84. Please describe the Service Company's Central Laboratory Center and the necessary**  
15 **water quality testing services it provides to Ohio American.**

16 A84. The Service Company operates a Central Laboratory Center and, as stated above, the lab  
17 is located in Belleville, Illinois. This Laboratory provides a key service to American  
18 Water's mission to provide high quality water service to all of the customers and  
19 communities it ultimately services, including Ohio American's customers. The  
20 Laboratory has 32 employees dedicated to performing water quality testing for Ohio  
21 American and all of American Water's operating companies. It is certified by the Ohio  
22 Environmental Protection Agency ("Ohio EPA") as well as other state water quality

1 certification programs in states where American's operating companies provide service.  
2 These certifications are completed in accordance with the requirements set forth by the  
3 National Environmental Laboratory Accreditation Conference. The Laboratory provides  
4 timely, accurate and cost-effective water chemistry analytical services to assure regulatory  
5 compliance, support treatment process control and optimization, maintain and improve  
6 distribution system water quality, and address customer inquiries related to water quality.

7 In 2010, over 60,000 water quality tests were conducted for American Water and over  
8 2,000 were analyzed on Ohio American's behalf, covering more than 100 regulated  
9 analytes under the Safe Drinking Water Act (and approximately 200 analytes in total). As  
10 a dedicated facility, the Laboratory consolidates all analytical testing and archived data in  
11 a single location and is able to offer a higher level of service at a lower cost when  
12 compared to the alternative of commercial laboratories, both on a per test basis and on an  
13 hourly basis. The higher service levels include sample kit scheduling, shipping and  
14 management, filing of analytical reports to meet regulatory compliance requirements,  
15 comparison of test results to regulatory limits and action levels with immediate issuance  
16 of alerts as needed, and the handling of rush or special requests. The Laboratory works  
17 closely with the U.S. EPA and other laboratories to maintain an expert position on  
18 challenging and new analytical methods and upcoming regulations. In 2008, it became  
19 one of only 14 laboratories in the county to achieve certification for the testing methods  
20 related to Phase 2 of the U.S. EPA Unregulated Contaminant Monitoring Rule  
21 ("UCMR2"). Through these efforts, the Laboratory is able to provide expert guidance to  
22 Ohio American field personnel for complex water chemistry conditions and analytical

requirements for current and new regulations.

**Q85. What are the reasonable costs of the services provided by the Service Company's Central Laboratory Center?**

A85. The test year cost of the services provided to Ohio American by the Service Company's Central Laboratory Center that are included in this rate filing are \$84,589.

**Q86. What could be required to replicate the support services provided Ohio American by the Central Laboratory Center?**

A86. Ohio American cannot operate without the requisite water quality testing provided by the Belleville Lab. Accordingly, if Ohio American were unable to obtain the services of the Belleville Lab, it would be required to obtain those services on the open market.

Alternatively, Ohio American could replicate the Lab's service by securing laboratory facilities and equipment, and hiring, orienting, training and, if necessary, relocating analysts to staff the lab and perform the necessary testing.

**E. ADDITIONAL BUSINESS SUPPORT SERVICES**

**1. COMMUNICATIONS AND EXTERNAL AFFAIRS**

**Q87. Please describe the Service Company's Communications and External Affairs function and the services it provides to Ohio American.**

A87. The Service Company's Communications and External Affairs ("Communications") function provides comprehensive coordination and support for the broad spectrum of communications needs of Ohio American and American Water's other operating companies. Ohio American's customers and employees, as well as government officials, require various types of information. The Communications function is structured to

1 provide standardized information resources at an efficient cost, and it works with Ohio  
2 American personnel to ensure the accuracy of all information provided. For example, the  
3 Communications function works with Ohio American to prepare information on the  
4 Company's website regarding rates, service application requirements, bill payment  
5 information, customers' rights per Ohio law, and other information useful to current and  
6 prospective customers.

7 **Q88. What would result from Ohio American being unable to procure the necessary**  
8 **communications and external affairs support services from the Service Company?**

9 A88. Ultimately, Ohio American could be in violation of the rules and regulations established  
10 and enforced by the PUCO that require proper notification and communication of rates,  
11 tariffs, customer rights, and annual consumer confidence reports to the customers of Ohio  
12 American Water.

## 13 **2. CORPORATE FINANCE**

14 **Q89. Please describe the Service Company's Corporate Finance function and the services**  
15 **it provides to Ohio American.**

16 A89. The Service Company's Corporate Finance ("Finance") function works with Ohio  
17 American employees to support monthly financial analysis, annual budget preparation  
18 and analysis, compliance reporting, and other financial analyses required by Ohio  
19 American's management. The Finance function is comprised of three sub departments—  
20 Treasury, Controller and Planning and Reporting. The Treasury department administers  
21 the investment by American Water in the common equity of its operating companies and  
22 oversees the borrowing and debt compliance requirements of American Water Capital

1 Corporation ("AWCC") and the operating companies. AWCC is a wholly owned  
2 subsidiary of American that pools the financial needs of American's subsidiaries in order  
3 to secure cost-effective financing for the operating companies. The Controller  
4 department researches and interprets accounting pronouncements of regulatory agencies  
5 such as the Financial Accounting Standards Board and the Internal Revenue Service. It  
6 also implements requisite internal controls to protect the interests of both customers and  
7 investors. The Planning and Reporting department reviews the accounting of Ohio  
8 American and the other operating companies, and coordinates the preparation of budgets  
9 and financial forecasts for those entities. In addition, this department implements  
10 expense controls, performs variance analyses and reviews in detail Service Company  
11 charges Ohio American and the other operating companies.

12 **Q90. What would result from Ohio American being unable to procure the necessary**  
13 **corporate finance support from the Service Company?**

14 A90. If Ohio American was not able to procure these services from the Service Company, these  
15 services would either need to be procured from one or more outside consulting firms that  
16 could provide the services, or Ohio American would have to hire staff that would have  
17 the expertise to complete these tasks internally. Ohio American currently is able to  
18 leverage the Service Company staff to provide these services without having to hire full  
19 time staff capable of providing those services at a higher cost. Further, if Ohio American  
20 did not have access to AWCC, Ohio American could experience higher costs to obtain  
21 debt or other financing.

1           **3.       HUMAN RESOURCES**

2   **Q91.   Please describe the Service Company's Human Resources function and the**  
3       **necessary support services it provides to Ohio American.**

4   A91.   The Service Company's Human Resources ("HR") function is responsible for employees  
5       from the date of employment through termination or retirement. HR is organized into  
6       five areas: Compensation and Benefits, Employee and Labor Relations, HR Systems and  
7       Processes, Business Center and Corporate Staffing, and Organizational and Talent  
8       Development. These functional areas administer compensation and benefits plans,  
9       performance review procedures and forms, HR-related policy and practice administration,  
10      and HR policy analysis and research. Some of the support services provided to Ohio  
11      American include employee benefits, discrimination issues, collective bargaining unit  
12      negotiation strategies and employee issues, including hiring practices, employee  
13      development, training and relocation.

14           Additional necessary support services provided by the Service Company's HR  
15      function to Ohio American include: (1) Benefits and the Benefits Service Center; (2)  
16      Compensation; (3) HR Policy and Practice Administration; and (4) Labor and Labor  
17      Relations. I will address each in turn.

18      ***Benefits and Benefits Service Center.*** Members of the Service Company's HR function  
19      working in the Benefits and Compensation area operate a national Benefits Service  
20      Center ("BSC") for American Water's operating companies. The BSC is staffed with  
21      employees who have the specialized knowledge and skill-set necessary to address  
22      employee and retiree questions and to resolve questions raised daily by active employees

1 and retirees and their dependants concerning the benefits to which they are entitled under  
2 the various benefits plans and programs offered to American Water's employees. The  
3 Service Company employs a bid process to select employee benefits service providers for  
4 its operating companies. Accordingly, multiple providers may be selected to provide  
5 various types of benefits to employees. As a result, it is more efficient for the Service  
6 Company to staff, equip and operate a single source—the BSC—to address questions  
7 regarding benefits. In addition, through the BSC, the operating companies, including  
8 Ohio American, receive a cost advantage resulting from large volume purchasing of  
9 benefits plans covering all of American Water's operating companies. They also receive  
10 reduced costs for administration and vendor selection.

11 ***Compensation.*** The Service Company's HR function designs, implements and manages  
12 employee compensation programs aimed at (a) ensuring cost-effective operations; (b)  
13 providing strong competitive market positioning by conducting extensive research  
14 regarding market-based compensation levels for each position; (c) attracting and retaining  
15 talent; (d) reinforcing a performance-based culture; (e) placing accountability with line  
16 management; and (f) complying with regulatory and statutory requirements.

17 ***HR Policy and Practice Administration.*** The Service Company's HR function also  
18 develops and administers HR-related policies and practices, and it conducts industry-wide  
19 research and analysis regarding HR policies applicable to all levels of management. In  
20 addition, HR prepares reports required by government agencies at both the state and  
21 federal levels.

22 ***Labor and Labor Relations.*** The Service Company's HR function also supports Ohio

American and other operating companies' personnel with respect to labor relations. Specifically, it provides training for field negotiations teams and provides information regarding national labor market trends. It also oversees employee recruiting using a variety of national and regional job boards for Ohio American and all of American Water's operating companies. Using this approach, the Service Company can reduce the cost to Ohio American of access to such services by leveraging the combined size of the operating companies to obtain optimal pricing while at the same time localizing recruiting efforts. As a result, Ohio American incurs a lower cost for employee recruiting than it would if it performed these services internally. The Labor and Labor Relations area of the HR function also oversees and administers the applicant tracking system. In this regard, HR negotiates price advantages for the identification of candidates based on the combined volume of operating company use of the services involved. HR also obtains volume purchase discounts for background check services and the like relating to prospective employees of Ohio American and the other operating companies. Finally, HR provides the training tools and guidance necessary for various employee development initiatives, such as supervisory training and ethics training.

**Q92. What would result from Ohio American being unable to procure the necessary human resources support from the Service Company?**

A92. While Ohio American Water does have one person on its staff that is a full time HR Manager, there are a number of employee relations, labor negotiations, and benefit services that are beyond the scope of the HR Manager's duties and are currently provided by the Service Company Human Resource personnel. The Service Company's HR



1 function and personnel assist in providing services for Ohio American Water's employees  
2 that begin before they are hired and continue beyond their retirement, and in everything in  
3 between. As such, if Ohio American was unable to procure the necessary HR support  
4 services from the Service Company, it would be required to self-provide those services.  
5 Self-provision would require the hiring, orienting, training and, if necessary, relocating of  
6 the personnel qualified to provide HR support to Ohio American, at a cost which would  
7 necessarily be passed on to Ohio ratepayers.

#### 8 **4. LEGAL**

9 **Q93. Please describe the Service Company's Legal function and the necessary support**  
10 **services it provides to Ohio American.**

11 A93. The Service Company's Legal function provides legal support for many aspects of Ohio  
12 American's operations and those of American Water's other operating companies. When  
13 specialized legal counsel is required, members of the Service Company's Legal function  
14 decide whether to retain outside counsel and, if so, select and retain the same. The Legal  
15 function also has corporate governance responsibilities, such as the Corporate Secretary  
16 function for Ohio American and the other American Water operating companies as well  
17 as the preparation of required materials for Ohio American's Board of Directors  
18 meetings. The Legal function also provides legal advice regarding litigation, regulatory  
19 matters, business development, contract negotiation, financing and labor issues, including  
20 collective bargaining agreements and the handling of grievances through arbitration.  
21 Legal counsels Ohio American regarding environmental laws and regulations. Legal also  
22 handles certain civil litigation and handles claims asserted against Ohio American and the

1 other operating companies. In addition, Legal negotiates and reviews property  
2 acquisitions, easements, leases and the disposition of real estate. Legal employees  
3 negotiate with developers regarding the installation of main extensions and draft related  
4 agreements. They conduct negotiations with government entities regarding franchises for  
5 operations within their jurisdictions. Moreover, as a regulated entity, Ohio American  
6 must comply with myriad national, state and local laws, rules and regulations. It is  
7 subject various federal and state administrative agencies' regulations. Legal employees  
8 also assure Ohio American's compliance with all business registration, licensing and  
9 corporate reporting requirements.

10 In sum, the Service Company's Legal function provides Ohio American with  
11 access to legal personnel with specialized knowledge and experience relevant to the areas  
12 of the law that most affect Ohio American's operations, and permit such access on a cost-  
13 effective basis. Accordingly, on account of its use of the Service Company's Legal  
14 function through which it shares the cost of specialized counsel with other American  
15 Water operating companies, Ohio American is able to maintain legal costs below the  
16 amount it would incur to itself retain in-house legal counsel.

17 **Q94. Does Ohio American employ any in-house legal personnel?**

18 A94. No.

## 19 **5. OPERATIONS SERVICES DEPARTMENT**

20 **Q95. Please describe the Service Company's Operations and Services Department**  
21 **function and the necessary support services it provides to Ohio American.**

22 A95. The Service Company's Operations and Services Department function is a multi-

1 disciplined department comprised of technical, operations and business professionals  
2 providing the following areas of support to Ohio American and the other American Water  
3 operating companies: (1) Engineering; (2) Maintenance and SCADA Services; (3)  
4 Innovation and Environmental Stewardship; (4) Supply Chain; (5) Best Operating  
5 Practices; and (6) Operational Risk Management. Each of these departments is  
6 responsible for establishing and implementing functional strategies with supporting  
7 policies, practices and standards. These groups also provide specialized expertise and  
8 resources to Ohio American to address issues or events, and support implementation of  
9 functional strategies on larger or more complex projects. The Operations Services  
10 Department leverages both economies of scale and scope, as well as expertise to provide  
11 highly experienced, specialized resources to Ohio American and the operating companies  
12 in a cost-effective manner. Department personnel also are charged with driving best  
13 practices in the respective areas to produce service level benefits and operational  
14 efficiencies that otherwise would be lost.

## 15 **6. OTHER SERVICES**

16 **Q96. Are there other support services available to Ohio American from the Service**  
17 **Company?**

18 A96. Yes. The Service Company provides other necessary support services to Ohio American  
19 and the other American Water operating companies in addition to the support services I  
20 have already addressed. First, the Service Company's Business Development function  
21 coordinates business development opportunities, activities and reporting, including  
22 acquisition support and training, for Ohio American and the other American Water

operating companies. Its Regulatory Programs function provides expertise related to regulatory issues and policies, as well as litigation support in rate proceedings and other regulatory proceedings and investigations, as well as in civil litigation. Next, the Service Company's Internal Audit function conducts periodic audits of Ohio American's accounts, records, policies and procedures. Its Investor Relations function strategically integrates expertise in finance, communication, marketing and securities law compliance to enable effective communication with the financial community. It submits periodic reports to the SEC on behalf of Ohio American. This provides a direct benefit to Ohio American's customers in that it protects the Company's investors, who are necessary to the health of the Company.

**F. SERVICE COMPANY FEES**

**Q97. What is the test year level of Service Company fees?**

A97. The Company is reflecting a test year level of Service Company fees of \$3,863,805, which is almost \$200,000 less than what the Company requested in Case No. 09-0391-WS-AIR.

**Q98. How was that level of expense determined?**

A98. The \$3,863,805 level of Service Company fees is based on a test year measurement comprised of four months of actual expenses and eight months of projected expenses. That is, that level of expense represents Service Company fees actually incurred from January through April 2011 and Service Company fees projected to be incurred from May through December 2011. The forecasted expenses are based on a detailed operating and capital budget, by account and by Service Company functional group, which the Service

1 Company and Ohio American prepares each year by evaluating its operating needs as well  
2 as the level of costs needed to meet the support service expectations of Ohio American.  
3 This evaluation includes a review of employee levels, employee benefits, contract  
4 services, rents, transportation costs, travel costs, building costs, depreciation, capital  
5 needs and other operating costs. This annual process is critical in determining the  
6 appropriate cost to include in Ohio American's business plan. Ohio American's  
7 requested level of Service Company fees thus is based not only on actual fees incurred,  
8 but also on a detailed budgeting of the projected costs for the Service Company to  
9 provide the services necessary to support Ohio American's operations in the test year.

10 **Q99. If Ohio American is not permitted to recover its total level of projected Service**  
11 **Company fees, what will be the effect on the support services it obtains?**

12 A99. Disallowance of any portion of Ohio American's projected Service Company fees for the  
13 test year does not alleviate the need for Ohio American to obtain the support services  
14 which the Service Company provides and which are imperative to Ohio American's  
15 operations. Ohio American would still be required to obtain the necessary support  
16 services and, in turn, to incur the attendant (and higher) costs from other service  
17 providers.

18 **Q100. Has the level of Service Company fees incurred by Ohio American increased over**  
19 **the past several years?**

20 A100. Not really. In fact, the Service Company fees incurred by Ohio American have remained  
21 relatively flat for the past five years. In 2006, Service Company fees totaled \$3,845,998;  
22 in 2007, they were \$3,915,007; in 2008, they were \$3,965,328; in 2009, they were

1           \$3,970,165; and, in 2010, they were \$3,952,468. Ohio American and the Service

2           Company have both worked hard to control Service Company costs to the Company.

3   **Q101. Is there any overlap between services provided by Ohio American employees and**  
4   **Service Company employees?**

5   A101. No. There is only one entity primarily responsible for each service necessary to support  
6   Ohio American's operations, whether that service is provided by Ohio American's in-  
7   house staff or by Service Company personnel. Responsibilities are clearly defined. There  
8   is no redundancy or overlap in the designations of responsibility for Ohio American's  
9   water utility functions. This is true even where job titles sound similar. For example,  
10   Ohio American employs lab analysts located in Ohio. Ohio American lab analysts  
11   perform testing when results are required immediately, such as hardness, alkalinity, pH,  
12   fluoride, chlorine, magnesium, turbidity, stability, odor, bacteriological, nitrate,  
13   phosphate, temperature, dissolved oxygen, biochemical oxygen demand and total  
14   suspended solids. Other samples, however, require different testing with highly  
15   specialized equipment and must be sent to the Service Company's Belleville Lab, which  
16   has more sophisticated equipment and a higher level of certification that is required for  
17   that testing than Ohio American's local lab. Both labs test water and employ "analysts,"  
18   but they test for different things. The Central Laboratory performs complex analysis  
19   which involves sophisticated instrumentation and personnel. Examples of these  
20   chemistries include volatile (method 524.2) and semivolatile (method 525.2) analyses by  
21   gas chromatography- mass spectrometry, specific organic analyses (methods 531, 547,  
22   and 549) utilizing high performance liquid chromatography and various anion

1 determinations ( ex. nitrates, method 300.0) performed by ion chromatograph. Testing  
2 described above performed locally in Ohio are the basic, general chemistry tests which  
3 require less sophisticated instrumentation and analyst qualifications and experience. In  
4 sum, both types of testing are necessary. However, there is no overlap in the testing they  
5 perform or duplication in the responsibilities of the analysts they employ.

## 6 **XI. AQUA OHIO, INC. ACQUISITION**

### 7 **Q102. Does American Water intend to sell Ohio American?**

8 A102. Yes. On July 11, 2011, American Water announced that it is selling all of the outstanding  
9 capital stock of Ohio American to Aqua Ohio, Inc. Ohio American and Aqua intend to  
10 file a joint application with the Commission requesting approval of this transaction by no  
11 later than December 31, 2011. The companies expect to file the joint application in  
12 August or September.

### 13 **Q103. Does the transaction have any effect on test year revenues or expenses?**

14 A103. No, it does not. The Commission approved a test year consisting of calendar year 2011.  
15 The closing of the proposed transaction will not occur until at least the first week of  
16 January, 2012. Thus, the proposed transaction will not be consummated during the test  
17 year.

### 18 **Q104. Does the proposed transaction require any adjustments to the test year revenue** 19 **requirement?**

20 A104. No, for several reasons. First, the Commission historically has not allowed adjustments  
21 to the test year revenue requirement based on events expected to occur after the test year.  
22 Second, the transaction is subject to regulatory approval. There are no assurances that

1 regulatory approval will be received during the test year, and even if it is, closing of the  
2 transaction will not occur during the test year. Third, the Company does not know, and  
3 cannot know, how Aqua will manage Ohio American's system once it acquires  
4 ownership, let alone quantify how Aqua's ownership and management may affect the  
5 utility's cost structure on a going-forward basis. Ohio American's requested rate increase  
6 is necessary regardless of who owns the stock of the utility, and traditional regulation  
7 requires that the revenue requirement be developed based on test year data.

8 **Q105. Does this conclude your testimony?**

9 A105. Yes.