BEFORE THE
STATE OF NEW JERSEY
BOARD OF PUBLIC UTILITIES

IN THE MATTER OF THE PETITION OF
NEW JERSEY-AMERICAN WATER COMPANY, INC.
FOR APPROVAL OF INCREASED TARIFF RATES AND
CHARGES FOR WATER AND WASTEWATER SERVICE,
CHANGE IN DEPRECIATION RATES,
AND OTHER TARIFF MODIFICATIONS

BPU Docket No. WR2401____

Direct Testimony of

Michael B. McKeever

January 19, 2024

Exhibit P-7

NEW JERSEY-AMERICAN WATER COMPANY, INC.

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NEW JERSEY-AMERICAN WATER COMPANY, INC.

INTRODUCTION

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

A. My name is Michael B. McKeever. My business address is 1 Water Street, Camden, New Jersey 08102.

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

A. I am employed by American Water Works Service Company, Inc. ("Service Company") as the Senior Director of Rates and Regulatory for New Jersey-American Water Company, Inc. ("New Jersey-American Water," or the "Company"), Virginia-American Water Company ("Virginia-American Water"), and Maryland-American Water Company ("Maryland-American Water"). Service Company is a wholly owned subsidiary of American Water Works Company, Inc. ("American Water") that provides support services to New Jersey-American Water and its affiliates.

3. Q. What are your responsibilities in this position?

A. I am responsible for the management and execution of the rates and regulatory activities for New Jersey-American Water, Virginia-American Water, and Maryland-American Water, with a primary focus on strategic planning in the regulatory environment. My chief responsibilities include the preparation of written testimony, exhibits, and workpapers in support of rate applications and other regulatory filings, as well as data requests for the aforementioned companies. As Senior Director of Rates and Regulatory, I am also a member of New Jersey-American Water's senior management team, where I participate in the decision-making process for all functional areas of the Company.

4. Q. Please describe your educational background and business experience.

A. I hold a Bachelor of Science degree in Accountancy from Villanova University, and I am a Certified Public Accountant licensed in the state of New Jersey. I have been employed by American Water since 2006, beginning in the Accounting department, holding various positions of increasing responsibility, the last being Senior Manager of Accounting for American Water's regulated subsidiaries. From 2016 to 2019, I held the position of Senior Manager of External Financial Reporting, responsible for American Water's Securities and Exchange Commission filings and, from 2019 to 2023, I was the Chief Financial Officer for American Water's Eastern Division, which includes New Jersey-American Water, Virginia-American Water, and Maryland-American Water. Prior to joining American Water, I worked in the public accounting field for Arthur Andersen, LLP, in their Audit Assurance group, and as the Assistant Controller of a privately held, pharmaceutical marketing research company.

5. Q. Have you previously testified in regulatory proceedings?

A. Yes. I have submitted testimony on behalf of Virginia-American Water Company before the Virginia State Corporation Commission.

6. Q. What is the purpose of your Direct Testimony in this proceeding?

A. The primary purpose of my Direct Testimony is to support the Company's proposed expense levels and post-test year adjustments for several categories of expense. My testimony supports operations and maintenance ("O&M") expense, including production costs, compensation and compensation-related expenses, Service Company expenses, and various other operating expenses. I also address the Company's proposed expense levels and post-test year adjustments for property taxes, payroll taxes, revenue-based taxes, and federal income taxes. Finally, my testimony supports the Company's request for regulatory accounting treatment for the deferral of pension and other post-employment benefit expenses, and production costs.

7. Q. Do you sponsor any schedules in your Direct Testimony?

A. Yes. I sponsor the schedules listed below, which are included in Exhibit P-2 and were prepared by me or under my supervision and direction.

- Schedule 6: Statement of Operation and Maintenance Expense
- Schedule 7: Uncollectible Expense
- Schedule 10: Summary of Taxes Other than Income
- Schedule 11: Gross Receipts and Franchise Tax
- Schedule 12: Utility Assessments
- Schedule 13: Water Monitoring Tax
- Schedule 14: Federal Income Tax Calculation
- Schedule 18: Schedule of Payments to Affiliated Companies

8. Q. What test year period is the Company using in this proceeding?

A. For this proceeding, the Company employed a test year comprised of the twelve months ending June 30, 2024 ("test year"). As discussed in the Direct Testimony of Company witness Hawn, the test year includes five months of actual data (July 1, 2023 through November 30, 2023), and seven months of projected data (December 1, 2023 through June 30, 2024). Projected data will be replaced with actual data as this proceeding progresses, ultimately resulting in a test year containing twelve months of actual data, which will be included in the Company's 12&0 update.

9. Q. What is the Company's proposed post-test year period for expense adjustments?

A. Consistent with standards previously adopted by the New Jersey Board of Public Utilities ("BPU" or the "Board") regarding post-test year adjustments[1], and discussed in the Direct Testimony of Company witness Hawn, the Company is proposing certain known and measurable expense adjustments through March 31, 2025, nine months following the end of the Test Year ("post-test year").

10. Q. What methodology did the Company use in calculating its test year and post-test year expense levels in this proceeding?

A. For certain expenses, the Company used actual expenses incurred during the twelve months ended June 30, 2023 ("base year"), and made specific adjustments for known and measurable changes in operating conditions and/or applied an inflation factor based on the Consumer Price Index ("CPI") for Northeast Urban Consumers

[1] *In re Elizabethtown Water Company Rate Case*, BPU Docket No. WR8504330, Order dated May 23, 1985.

("CPI-U"), as provided by the United States ("U.S.") Bureau of Labor Statistics.[2] Given that certain expenses vary on an annual basis, the Company also utilized a three-year historical average to reflect a normalized level of expense for the test year and post-test year. In calculating the three-year historical average, the Company used actual expenses incurred during the twelve months ended June 30, 2021, June 30, 2022, and June 30, 2023 ("three-year historical average"). All adjustments are detailed in the Exhibit P-2 schedules noted above and are discussed in my testimony below.

OPERATION AND MAINTENANCE EXPENSE

11. Q. Please provide a brief overview of the Company's O&M expense levels.

The Company is seeking recovery of approximately $263.7 million of O&M expense (net of purchased water expense and purchased wastewater expense) in this proceeding, representing annualized expense levels through the post-test year. As discussed in the Direct Testimony of Company witness Hawn, the Company has been successful in controlling O&M expense over the past decade and is continuing to do so. O&M expense per customer (net of purchased water expense and purchased wastewater expense) has increased moderately from $298 in 2014, to $358 as proposed in this proceeding. This represents an average annual increase of 1.9% over the past ten years, comparing favorably to inflation, which has increased 3.0% over

[2] The U.S. Bureau of Labor Statistics' Consumer Price Indices ("CPI") are measures of inflation in the U.S. economy. Where applicable, the Company used the CPI that measures price changes in all goods and services for Northeast urban consumers, Series ID: CUUR0100SA0 ("CPI-U"), unless otherwise noted.
See http://data.bls.gov/timeseries/CUUR0100SA0?data_tool=XGtable

the same period as measured by the CPI-U. To put this in perspective, if the Company's O&M expense increased at the rate of the CPI-U, O&M expense per customer would have risen from $298 in 2014, to $401 on a post-test year basis. Using the post-test year customer count included in this proceeding, annual O&M expense would have been over $31 million more than the amount the Company is proposing in this proceeding. The Company's ability to manage its O&M expense has benefited customers for a decade now, and its ongoing efforts to mitigate increases in O&M expense will continue to benefit the Company's customers into the future.

A. Production Costs

12. Q. Please explain which O&M expenses are considered production costs.

A. Production costs are expenses incurred to provide water and wastewater services to the Company's customers and vary depending on the volume of water provided and wastewater processed. These expenses include purchased water, power, chemicals, and waste disposal. The Company's production costs are reflected in Exhibit P-2, Schedule 6, lines 2 – 5.

13. Q. Please explain the impact of system delivery on production costs.

A. System delivery is the amount of treated water that the Company's treatment facilities produce. Water sales as well as other factors impact the amount of water that is delivered and therefore, the amount of water that needs to be purchased or produced by the treatment facilities, directly impacting the expenses associated with treating and distributing that water. As discussed in the testimonies of Company witnesses

Rea and Brooks, the Company has proposed post-test year revenue adjustments related to declining usage, weather normalization, and customer growth, and has calculated associated post-test year system delivery. The Company used this same level of post-test year system delivery in its production cost calculations for the post-test year. Thus, if post-test year system delivery is adjusted, either up or down, during this proceeding, post-test year production costs will be adjusted accordingly.

B. Purchased Water

14. Q. Please describe purchased water expense and the adjustments made to determine post-test year expense.

A. Purchased water expense is comprised of two components: (a) water purchased from third-party utilities, and (b) water diversion fees. In this proceeding, as well as in prior rate cases, and consistent with the BPU's Order[3], the Company has removed third-party purchased water costs from base rates, as these costs are recovered through the Purchased Water Adjustment Clause ("PWAC"). Post-test year expense reflected in Exhibit P-2, Schedule 6, line 2, represents the Company's water diversion fees, which are levied by the State of New Jersey for the processing, monitoring, administration, and enforcement of the water supply allocation program, and by the Delaware River Basin Authority for water withdrawal. Post-test year expense for water diversion fees was calculated using a three-year historical average of actual expenses. Supporting workpapers are provided in Exhibit P-2, Schedule 6-2.

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[3] *In re the Joint Petition of New Jersey American Water Company, Inc., Elizabethtown Water Company, and the Mount Holly Water Company for Approval of Increased Tariff Rates and Charges for Water and Sewer Services and other Tariff Revisions*, BPU Docket No. WR06030257, Order dated April 2, 2007.

C. Power

15. Q. Please describe power expense and the adjustments made to determine post-test year expense.

A. Power expense includes electricity, natural gas, and diesel costs, purchased for the treatment, pumping, and delivery of water, and the collection and treatment of wastewater. The Company has contracted with Constellation Energy Corporation for its electricity supply and Direct Energy Business, LLC for its natural gas supply, with transmission provided by each facility's local distribution company.

To determine post-test year power expense, the Company normalized actual expenses incurred during the base year and adjusted for changes in contract pricing and tariff rates charged by the Company's suppliers and distributers.[4] Additionally, an adjustment was made to reflect the index pricing effective in November 2023, which was favorable to the index pricing experienced during the base year, resulting in a reduction from the base year level of power expense of approximately $1.2 million. Finally, an adjustment for system delivery was made, dividing normalized post-test year power expense by base year system delivery to calculate a rate per 1,000 gallons of system delivery, which was then applied to post-test year system delivery. Post-

[4] The Company made the following tariff rate adjustments in the calculation of post-test year power expense: (a) Atlantic City Electric Company's rate increase from BPU Docket No. ER23020091, Order dated November 17, 2023; and (b) Jersey Central Power & Light's projected rate increase from BPU Docket ER2300144. At the time the Company filed this rate case, Jersey Central Power & Light Company's rate case (BPU Docket ER2300144) was pending, and the outcome was not known. The Company used a projected rate increase in the calculation of post-test year power expense, which will be updated to reflect the final approved rate increase when an Order is issued. The Company also notes that Public Service Electric and Gas Company ("PSE&G") filed for a rate increase on December 29, 2023, which has not yet been incorporated into the Company's post-test year power expense. The Company will incorporate any PSE&G rate change into its 9&3 and 12&0 updates.

test year power expense and adjustments are reflected in Exhibit P-2, Schedule 6, line 3, and supporting workpapers are provided in Exhibit P-2, Schedule 6-3.

D. Chemical

16. Q. Please describe chemical expense and the adjustments made to determine post-test year expense.

A. The Company uses chemicals for both water and wastewater treatment to bring chemical and biological contaminants within the levels prescribed by the U.S. Environmental Protection Agency, in accordance with the Safe Drinking Water Act and the Clean Water Act. Chemicals are also utilized to remove turbidity (cloudiness) of the water and to address any remaining taste or odor issues, and for wastewater treatment. Water conditions can vary seasonally or due to other external factors, which impact chemical usage and expense levels. In order to obtain the best available pricing, the Company participates in American Water's enterprise-wide competitive bidding process and enters into unit-price contracts with successful bidders for the chemicals needed at its water and wastewater treatment facilities.

To determine post-test year chemical expense, the Company began with the three-year historical average of actual usage for each chemical, and adjusted when applicable, for: (a) the addition or elimination of chemicals; (b) known changes in current or future usage; and (c) changes in usage trends brought upon by adjustments in water quality regulations, including new and revised limits for raw and finished water, and emerging compounds (further discussion included in the Direct Testimony of Company witness Shields). For chemical pricing, the Company began with the preliminary bids received from its suppliers for 2024 pricing. Due to current volatility in the market for chemicals, many vendors have deviated from annual contracts and have moved to quarterly or semi-annual contracts. 2024 pricing levels were then adjusted by chemical family, based on input from our suppliers and market indexes to determine post-test year pricing. Post-test year prices were then applied to the adjusted usage levels discussed above. Finally, an adjustment for system delivery was made by dividing normalized post-test year chemical expense by a three-year historical average of system delivery to calculate a rate per 1,000 gallons of system delivery, which was then applied to post-test year system delivery.

If the Company enters into new chemical contracts with material pricing changes during the course of this proceeding, adjustments will be made to reflect the latest pricing and included in the Company's 9&3 and 12&0 updates. Post-test year chemical expense and adjustments are reflected in Exhibit P-2, Schedule 6, line 4, and supporting workpapers are provided in Exhibit P-2, Schedule 6-4.

E. <u>Waste Disposal</u>

17. Q. Please describe waste disposal expense and the adjustments made to determine post-test year expense.

A. The Company incurs waste disposal costs as a result of the need to properly process and dispose of sludge, residuals, and other by-products resulting from the water and wastewater treatment process.

Waste disposal expense incurred in the water treatment process will vary depending on the treatment facility and the method used to process and dispose of the waste generated. Expenses include: (a) costs to de-water, press, and haul sludge for disposal; (b) fees for discharging residuals directly into local municipality's sewer systems; and (c) costs for sludge lagoon cleanings, which occur periodically and depend on residual build-up and the size of the lagoon. In certain locations, residuals are de-watered and pressed, but instead of being hauled to a landfill for disposal, they are combined with subsoil in a 50/50 ratio by a vendor and sold as residential topsoil (known as "beneficial reuse"). This environmentally friendly process provides an alternative for the Company to dispose of residuals and reduces costs for customers.

Waste disposal expense incurred in the wastewater treatment process consists primarily of hauling and disposal costs, as well as fees paid to municipalities and authorities for the treatment of wastewater from the Company's collection-only systems. In this proceeding, as well as in prior rate cases, the Company has removed fees paid to municipalities and authorities for the treatment of wastewater from base rates, as these costs are recovered through the Purchased Wastewater Treatment Adjustment Clause ("PSTAC").

To determine post-test year waste disposal expense, the Company used actual expenses incurred during the base year and adjusted for known changes in pricing, volumes of waste to be processed and disposed, and changes in disposal methodology or operation. An adjustment for system delivery was made by dividing normalized post-test year waste disposal expense incurred in the water treatment process by base year system delivery to calculate a rate per 1,000 gallons of system delivery, which was then applied to post-test year system delivery. Post-test year waste disposal expense and adjustments are reflected in Exhibit P-2, Schedule 6, line 5, and supporting workpapers are provided in Exhibit P-2, Schedule 6-5.

F. Compensation and Compensation-Related

18. Q. Please describe the Company's compensation and compensation-related expenses and the overall approach used in calculating these expenses.

A. The Company's compensation and compensation-related expenses pertain to employees who support New Jersey-American Water exclusively. There are three classifications of New Jersey-American Water employees: (a) union hourly employees; (b) non-union hourly employees; and (c) exempt employees. Union and non-union hourly employees receive base pay and overtime pay, and in some cases, other compensation such as shift premiums and meals, and are eligible for performance pay. Exempt employees receive base pay and are eligible for performance pay.

A critical factor in calculating compensation and compensation-related expenses is employee count, which is based on the total number of full-time and part-time employees, translated into a number that equates to full-time equivalent ("FTE") employees. Depending on the type of job, certain positions are counted as a partial FTE employee, specifically part-time positions. The Company's post-test year compensation and compensation-related expenses were calculated on a position-by-position basis, based on 903.2 FTE employees. This figure excludes 18 FTE employees, which were included in the post-test year expenses for proposed acquisitions as reflected in Exhibit P-2, Schedule 6, lines 20, and discussed in further detail in my testimony below. Please see the Direct Testimony of Company witness Shroba for further discussion of the Company's staffing levels.

A portion of the Company's compensation and compensation-related expenses are capitalized and added to the cost of utility plant. Individual capitalization rates for each category of compensation and compensation-related expenses were calculated, comparing actual dollars charged to capital versus expense during the three-year historical average period. These capitalization percentages were then applied to the individual categories of compensation and compensation-related expenses to determine the portion of these expenses that are capitalized. The capitalization rates used in this proceeding are included in Table 1 below:

Table 1: Capitalization Rates

Expense Category	Workpaper Reference	3-Yr Average Capital Ratio
Salaries & Wages	Schedule 6-6	45.94%
Pension	Schedule 6-7	44.51%
Group Insurance	Schedule 6-8	44.77%
Other Post-Retirement Employee Benefits	Schedule 6-8	47.51%
401k	Schedule 6-9	44.44%
Defined Contribution Plan	Schedule 6-9	41.92%
Retiree Medical	Schedule 6-9	37.37%
Transportation	Schedule 6-12	47.91%
Workers Compensation	Schedule 6-16	47.72%

The compensation and compensation-related expenses discussed in my testimony include:

A. Salaries and Wages
   a. Base Pay
   b. Overtime
   c. Shift Premiums and Meals
   d. Performance Pay
B. Pensions
C. Group Insurance and Other Post-Employment Benefits
D. Other Benefits, including:
   a. 401k
   b. Defined Contribution Plan
   c. Retiree Medical
   d. Employee Stock Purchase Plan
   e. Miscellaneous

Post-test year compensation and compensation-related expenses and adjustments are reflected in Exhibit P-2, Schedule 6, lines 6 to 9, and supporting workpapers are provided in Exhibit P-2, Schedule 6-6 through Schedule 6-9.

G. Salaries and Wages

19. Q. Please describe the various components of salaries and wages expense and the adjustments made to determine post-test year expense.

A. Salaries and Wages expense is composed of four components: (a) base pay; (b) overtime; (c) shift premiums and meal compensation required by union contract; and (d) performance pay for eligible employees. Each component is discussed in further detail below.

Base Pay – To determine post-test year base pay expense for non-union hourly and exempt employees, the Company began with actual wage rates effective at the end of the base year and adjusted these rates using a three-year average (2022-2024) of base pay increases to determine post-test year wage rates. These post-test year wage rates were then applied to regular labor hours (2,088 for non-union hourly employees and 2,080 for exempt employees) to calculate post-test year base pay expense. For union employees, the Company began with actual wage rates from current collective bargaining agreements ("CBAs") that will be in effect at the end of the post-test year period to determine post-test year wage rates. For those CBAs that expire prior to the end of the post-test year period, the Company used the actual CBA wage rates effective at the end of the base year and adjusted these rates using a three-year average (2022-2024) of base pay increases to determine post-test year wage rates. These post-test year wage rates were then applied to 2,088 regular labor hours to calculate post-test year base pay expense.

Overtime – To determine post-test year overtime expense, the Company used a base year overtime rate, calculated by dividing base year overtime expense by base year overtime hours. This rate was then adjusted by the average union wage increase included in the current CBAs that will be in effect at the end of the of the post-test year period to determine a post-test year overtime rate, which was then applied to the three-year historical average of actual overtime hours to calculate post-test year overtime expense.

Shift Premiums and Meals – Certain CBAs provide wage premiums for employees working on uncommon shifts or when employees obtain certain licenses or complete certain training. Employees are also compensated for meals during extended shifts and, therefore, meal compensation is included in salaries and wages expense. To determine post-test year shift premiums and meals expense, the Company used a three-year historical average of actual expense incurred for each expense type.

Performance Pay – Performance pay includes annual and long-term performance compensation for eligible employees. Post-test year performance pay expense was calculated on a position-by-position basis, based on each position's target percent, or percentage of base pay that is provided if program goals are achieved under both the Annual Performance Plan ("APP") and Long-Term Performance Plan ("LTPP"). Target percents were multiplied by each eligible employee's post-test year base pay to calculate post-test year performance pay expense for both APP and LTPP. The testimonies of Company witnesses Shroba and Mustich support the Company's performance pay program and demonstrate why it is just and reasonable for the Board to recognize the related expenses of this program in base rates.

20. Q. Are the levels of compensation paid by the Company "just and reasonable?"

A. Yes, they are. As Company witness Mustich demonstrates in his Direct Testimony, the Company's total compensation levels, which include performance pay, fall within a range of reasonableness around the median of total compensation paid by other utilities, both nationally and regionally. Given that total compensation is in line with market compensation, it is, by definition, reasonable. Furthermore, as Company witness Mustich observes, if performance pay were not paid, base pay levels would have to be increased or the Company's compensation would fall below the market levels, which would harm New Jersey-American Water's ability to attract and retain skilled workers.

21. Q. In the past, the Board has rejected programs where there has been a "financial trigger" before performance pay is paid as being not "known and measurable." Is the Company's performance pay known and measurable?

A. Yes, it is. It is my understanding that in the past, the Board has said that a financial trigger for performance pay programs that have such a gatekeeper device can be an element rendering them to be not known and measurable. For example, in Jersey Central Power & Light Company's 2012 rate case, the Board found that the incentive compensation program was not known and measurable because it was dependent on FirstEnergy Corporation's achievement of financial thresholds.[5] The American Water performance pay program, which governs New Jersey-American Water's performance pay payments, no longer has such a mechanism. Therefore, this element in finding the program not to be known and measurable no longer exists. Furthermore, the fact remains that New Jersey-American Water's employees have

[5] *In re The Matter of The Verified Petition of Jersey Central Power & Light Company For Review and Approval Of Increases In and Other Adjustments To Its Rates and Charges For Electric Service, and For Approval Of Other Proposed Tariff Revisions In Connection Therewith; And For Approval Of An Accelerated Reliability Enhancement Program ("2012 Base Rate Filing"),* BPU Docket No. ER12111052, Order dated March 26, 2015, page 24.

been paid performance pay in every year in which the Company has requested recognition of this expense in base rates.

H. Pension

22. Q. Please describe pension expense and the adjustments made to determine post-test year expense.

A. Certain Company employees, upon retirement, are eligible for pension benefits under a defined benefit plan. Generally, union employees hired prior to January 1, 2001, and non-union employees hired prior to January 1, 2006, are eligible for pension benefits. The Company records pension expense in accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Codification Topic 715 or "ASC 715". To determine post-test year pension expense, the Company began with a report furnished by its third-party actuary, WTW, which provided the Company's 2023 pension costs determined in accordance with ASC 715. From that report, the Company identified the service and non-service cost components of its pension cost. The service cost component was reduced by a capitalization rate of 44.51% (see Table 1 above) to determine the portion of the Company's total pension costs that are recorded as post-test year expense. During the first quarter of 2024, the Company expects to receive projected 2024 pension costs from WTW, which will be incorporated into the Company's 9&3 and 12&0 updates. Post-test year pension expense and adjustments are reflected in Exhibit P-2, Schedule 6, line 7, and supporting workpapers are provided in Exhibit P-2, Schedule 6-7.

Please refer to the "Proposed Regulatory Accounting Deferral Treatment" section in my testimony below for discussion regarding the Company's proposal to continue regulatory accounting deferral treatment for pension expense.

I. Group Insurance and Other Post-Employment Benefits

23. Q. What expenses are included under the Group Insurance heading in Exhibit 2, Schedule 6, line 8?

A. Group insurance and other post-employment benefits ("OPEB") expenses are included under the Group Insurance heading on Exhibit P-2, Schedule 6, line 8, and supporting workpapers are provided in Exhibit P-2, Schedule 6-8.

24. Q. Please describe group insurance expense and the adjustments made to determine post-test year expense.

A. Group insurance includes several types of insurance coverages that the Company provides to its employees. These coverages can be grouped into two primary categories: (a) basic life, short- and long-term disability, and accidental death and disability ("AD&D"); and (b) medical, dental, and vision. Both categories are discussed in further detail below.

<u>Basic Life, Short- and Long-Term Disability and AD&D</u> – To determine post-test year expense for these coverages, the Company began with the 2024 insurance premium rates for each position under the applicable plans for union and non-union employees. These rates were then applied, on a position-by-position basis, to each

employee's post-test year base pay to calculate a level of expense using the 2024 premium rates.

Medical, Dental and Vision – This category of insurance coverage includes a Company expense that is net of employee contributions. The Company's expense and employee contributions vary by plan type (e.g. family, employee, or employee plus spouse) and were calculated on a position-by-position basis, taking into account actual employee plan selections and, similar to above, using the 2024 premium rates.

For both categories of insurance coverage discussed above, once a level of expense was calculated using the 2024 premium rates, a three-year average (2022-2024) of the Company's group insurance cost increases was applied, followed by a capitalization rate of 44.77% (see Table 1 above) to determine the portion of the Company's total group insurance costs that are recorded as post-test year expense.

25. Q. Please describe OPEB expense and the adjustments made to determine post-test year expense.

A. Certain New Jersey-American Water employees are eligible for OPEB benefits upon their retirement, depending on their start date with the Company. Generally, this includes non-union employees hired prior to January 1, 2002, and union employees hired prior to January 1, 2006. OPEB expense is based on the accrual cost recognized under ASC 715, which was provided by the Company's third-party actuary, WTW, for 2023. The Company determined post-test year OPEB expense following the same methodology used to determine post-test year pension expense (described above in my testimony), with the exception of the capitalization rate. The service cost component was reduced by a capitalization rate of 47.51% (see Table 1 above) to determine the portion of the Company's total OPEB costs that are recorded as post-test year expense. During the first quarter of 2024, the Company expects to receive projected 2024 OPEB costs from WTW, which will be incorporated into the Company's 9&3 and 12&0 updates.

Please refer to the "Proposed Regulatory Accounting Deferral Treatment" section in my testimony below for discussion regarding the Company's proposal to continue regulatory accounting deferral treatment for OPEB expense.

J. Other Benefits

26. Q. Please describe the various components of "other benefits" expense and the adjustments made to determine post-test year expense.

A. "Other benefits" expense includes the following savings programs: (a) 401k; (b) Defined Contribution Plan ("DCP"); (c) retiree medical; and (d) Employee Stock Purchase Plan ("ESPP"). Each program is discussed in further detail below.

401k – The Company incurs 401k expense when it matches employee contributions to 401k retirement accounts. The Company's matching amounts are determined by the employee's benefit group or hire date. For union employees hired prior to January 1, 2001, and non-union employees hired prior to January 1, 2006, the Company matches 50% of the first 5% of the employee's contributions (for a maximum of 2.5%). For Local 423 union employees hired prior to April 1, 2006, the Company matches sixty cents on the dollar of the first 6% of the employee's contributions. For the remaining employees, the Company matches 100% of the first 3% of the employee's contributions, and 50% of the next 2% of the employee's contributions (for a maximum of 4%). Post-test year 401k expense was determined on a position-by-position basis, multiplying the employee's post-test year base pay by the level of Company match associated the employee's current 401k contribution election, and then applying a 44.44% capitalization rate (see Table 1 above) to determine the portion of the Company's total 401k costs that are recorded as post-test year expense.

DCP – DCP is a retirement savings program for employees that are not eligible for the Company's defined benefit pension plan. Under the DCP, the Company contributes an amount equal to 5.25% of the employee's base pay into a retirement account. Post-test year DCP expense was determined on a position-by-position basis, multiplying the employee's post-test year base pay by 5.25%, and then applying a 41.92% capitalization rate (see Table 1 above) to determine the portion of the Company's total DCP costs that are recorded as post-test year expense.

Retiree Medical – Union employees who are not eligible for the OPEB plan are entitled to Company-sponsored retiree medical benefits. The Company has established a trust (referred to as the Voluntary Employee Benefits Association, or VEBA) to fund this benefit in the amount of $600 per year, per eligible employee. Post-test year retiree medical expense was determined by multiplying the number of VEBA-eligible employees by $600, and then applying a 37.37% capitalization rate (see Table 1 above) to determine the portion of the Company's total retiree medical costs that are recorded as post-test year expense.

ESPP – ESPP expense is incurred by the Company to fund the 15% discount on purchases of American Water stock by employees who are enrolled in the plan. Post-test year ESPP expense was determined, for those employees enrolled in the plan, on a position-by-position basis, multiplying the employee's post-test year base pay by the percentage of base pay the employee has selected to devote to purchasing American Water stock. This amount was then multiplied by the 15% Company-funded discount.

K. Service Company

27. Q. What services does New Jersey-American Water receive from the Service Company?

A. The services provided by the Service Company include customer service, water quality testing, environmental compliance, human resources, communications, information technology and cyber security, finance, accounting, payroll, tax, legal, engineering, accounts payable, supply chain, and risk management (collectively, the "Support Services"). As part of its customer service function, the Service Company handles customer calls, billing, and collection activities for New Jersey-American Water, as well as customer inquiries and correspondence, and the processing of service order requests. In addition, the Service Company provides field resource coordination for tracking and dispatching service orders for New Jersey-American Water's field representatives and distribution crews, and operates the Central

Laboratory located in Belleville, Illinois, which employs chemists, laboratory technicians, analysts, and support employees to perform water quality testing, analysis and research. The Central Laboratory is certified by the United States Environmental Protection Agency.

28. Q. How do the New Jersey-American Water customers benefit from obtaining the services described above from the Service Company?

A. The Service Company provides New Jersey-American Water access to highly trained professionals who possess expertise in various specialized areas, whose background, experience, and training are focused on water and wastewater utility operations, and who work exclusively for American Water's subsidiaries. Furthermore, the size of the Service Company and the scope of its operations have enabled it to assemble a uniquely qualified group of professionals who, through the Service Company, have a platform for sharing their extensive knowledge, expertise, and experience across the American Water system to the benefit of all of American Water's state-regulated utilities and their customers. New Jersey-American Water benefits from getting these services and tapping into the expertise of the Service Company personnel at cost. The Company also benefits from the size and breadth of American Water, which affords New Jersey-American Water increased purchasing power that it could not obtain on its own and provides access to discounts on equipment and supplies needed for utility operations, including, for example, pipe, fittings, and water treatment chemicals as further discussed by Company witness Shroba. In this way, New Jersey-

American Water achieves costs savings that it could not obtain if it were a stand-alone water company.

29. Q. How does the Service Company charge New Jersey-American Water for its services?

A. The Service Company provides its services to New Jersey-American Water at cost and issues monthly invoices. Support services are charged to the Company in two ways: (a) directly to the Company at 100% of the cost; or 2) a percentage allocation based on factors such as a per customer count across the American Water regulated subsidiaries. If the Service Company can identify costs that relate exclusively to New Jersey-American Water, 100% of those costs are charged directly to the Company. Costs the Service Company incurs in rendering services in common to a group of regulated subsidiaries, and not exclusive to New Jersey-American Water, are charged to each service recipient in the relevant group based on an allocation factor. Company witness Baryenbruch provides analyses and discusses the reasonableness of the Service Company costs charged to New Jersey-American Water as part of his Direct Testimony.

30. Q. Please explain the adjustments made to determine post-test year Support Services expense.

A. Support Services expense is primarily composed of compensation and compensation-related expenses for employees of the Service Company. To determine post-test year expense, the Company used the actual compensation and compensation-related expense incurred during the base year for employees of the Service Company, adjusted to annualize base pay increases effective in March 2023 (3.3% for non-union Service Company employees and 2.75% for union employees of the Service Company). This normalized level of expense was further adjusted to annualize base pay increases effective in January 2024 and January 2025, which include: (a) 3.2% for non-union Service Company employees, based on a three-year average (2021-2023) of base pay increases; and (b) 2.75% for union Service Company employees, based on the annual base pay increases in the current CBAs that will be in effect at the end of the of the post-test year period.

Additionally, in determining post-test year expense, adjustments were made to eliminate severance expense, to normalize pension and OPEB expense, and to adjust APP and LTPP expense based on the latest compensation information. Costs pertaining to charitable contributions, community relations, penalties, and injuries and damages were also removed. Finally, adjustments were made for depreciation expense, interest expense associated with capital leases, operating expense for office space, the removal of a one-time sales tax refund, and the removal of costs related to the Customer Service Centers in Alton, Illinois and Pensacola, Florida. Post-test year Support Services expense and adjustments are reflected in Exhibit P-2, Schedule 6, line 10, and supporting workpapers are provided in Exhibit P-2, Schedule 6-10.

L. Rent

31. Q. Please describe rental expense and the adjustments made to determine post-test year expense.

A. Rental expense incurred by the Company is primarily related to property and equipment leases. To determine post-test year rental expense, the Company used actual expenses incurred during the base year and adjusted for new and terminated leases and known changes to existing lease contracts. Post-test year rental expense and adjustments are reflected in Exhibit P-2, Schedule 6, line 11, and supporting workpapers are provided in Exhibit P-2, Schedule 6-11.

M. Transportation

32. Q. Please describe transportation expense and the adjustments made to determine post-test year expense.

A. Transportation expense includes the costs associated with operating the Company's vehicle fleet. These expenses can be grouped into three categories: (a) fleet management costs, including titling, registration, and fleet administration service fees; (b) maintenance and repairs; and (c) fuel.

To determine post-test year expense for fleet management costs, the Company used actual expenses incurred during the base year and adjusted for employee reimbursement for use of personal vehicles for Company business. To determine post-test year expense for maintenance and repairs, the Company used a three-year historical average of actual expenses and adjusted the expenses for the twelve months ended June 30, 2021 and June 30, 2022, by an inflation factor[6], to align expenses in these periods with those in the base year. To determine post-test year fuel expense, the Company used actual expenses incurred during the base year and adjusted for a decrease in the price of gasoline as compared to the prices seen during the base year, based upon historical statistics published by the U.S. Energy Information Administration ("EIA")[7], an agency within the U.S. Department of Energy. In this calculation, the Company used the EIA's East Coast (PADD 1) Weekly East Coast All Grades All Formulations Retail Gasoline Prices, comparing the base year 52-week average price per gallon to the price per gallon on November 27, 2023, resulting in a decrease of $0.351 per gallon, or (9.69%). Finally, a capitalization rate of 47.91% (see Table 1 above) was applied to each category of transportation costs to determine the portion that is recorded as post-test year expense. Post-test year transportation expense and adjustments are reflected in Exhibit P-2, Schedule 6, line 12, and supporting workpapers are provided in Exhibit P-2, Schedule 6-12.

N. Uncollectibles

33. Q. Please describe uncollectible expense and the adjustments made to determine post-test year expense.

A. Uncollectible expense is calculated by comparing net write-offs for customer non-payment as a percentage of billed water and wastewater revenues. To determine post-

[6] The Company used the CPI-U inflation factor which measures price changes in all goods and services for Northeast urban consumers (Series ID: CUUR0100SA0).
See http://data.bls.gov/timeseries/CUUR0100SA0?data_tool=XGtable

[7] See http://www.eia.doe.gov/oil_gas/petroleum/data_publications/wrgp/mogas_history.html.

test year uncollectible expense, the Company used the three-year historical average net write-offs and billed revenues to calculate an average uncollectible percentage of 0.41%. This uncollectible percentage was then applied to post-test year water and wastewater revenues to arrive at post-test year uncollectible expense, which is reflected, along with adjustments, in Exhibit P-2, Schedule 6, line 13, and supporting workpapers are provided in Exhibit P-2, Schedule 7.

O. Customer Accounting

34. Q. Please describe customer accounting expense and the adjustments made to determine post-test year expense.

A. Customer accounting expense can be grouped into the following categories: (a) costs to generate customer bills ("bill forms expense"); (b) postage expense; (c) other customer accounting costs such as shipping and delivery services, lock box and bank fees for payment collections, and third-party collection agency fees.

To determine post-test year bill forms expense, the Company began with the actual expense incurred during the base year and divided this amount by the number of customer bills mailed during the base year to calculate a cost per bill. The Company then calculated the number of post-test year customer bills by taking the number of bills mailed during the base year and adding the post-test year customer growth. Finally, the number of post-test year customer bills was multiplied by the cost per bill to arrive at post-test year bills forms expense.

To determine post-test year postage expense, the Company used the same number of post-test year customer bills discussed above and sorted this figure by category of mail delivery (for the customer bill). Postage rates effective July 9, 2023, were then applied to the number of customer bills in each category of mail delivery to arrive at post-test year postage expense.

To determine post-test year expense for "other customer accounting costs", the Company used the actual expenses incurred during the base year and applied an inflation factor[8] to capture cost increases anticipated for these types of expenses through the end of the post-test year period, based on recent pricing history reflected by the CPI-U index.

35. Q. What is the Company proposing in this proceeding related to electronic payment fees?

A. The Company is proposing to include, as a base operating expense, electronic payment fees assessed by third-party vendors for customer payments processed via credit card or electronic check. These fees are currently paid directly by the customer, on top of their bill. The Company is proposing to pay the fee for those customers who choose to make payment using one of these methods, which would then be recovered through base rates.

[8] The Company used the CPI-U inflation factor which measures price changes for postage and delivery services in U.S. cities (Series ID: CUUR0000SEEC, CUUS0000SEEC).
See https://data.bls.gov/timeseries/CUUR0000SEEC,CUUS0000SEEC?data_tool=XGtable

36. Q. Why is the Company proposing to include electronic payment fees as an expense in this proceeding?

A. The Company's goal is to provide customers with the most convenient alternatives to pay their bill. Customers are accustomed to paying many of their bills electronically, including with a credit card or electronic check. Charging an additional fee on top of the customer bill adds friction to the process of paying a bill. Eliminating the direct payment of this fee is expected to help more customers pay their bill on time, avoid late fees and potential disconnections, and improve collections. It also encourages paperless billing and the use of online payment platforms, "green alternatives" to submitting payments by mail. According to a National Association of State Utility Consumer Advocates resolution (Resolution 2102-07), "state public utility commissions are urged to survey the utilities within their jurisdictions to determine the options that are available to consumers for paying utility bills without incurring additional charges."

37. Q. Please explain the calculation of post-test year electronic payment fees.

A. Currently, customers making payment using a credit card or electronic check pay a fee of $1.95 per transaction. To determine post-test year electronic payment fees, the Company began with the number of base year transactions where customers made payment via credit card (529,152) and via electronic check (796,087) and multiplied these amounts by the applicable electronic payment fee per transaction of $1.50 or $1.95 depending on the credit card and $0.45 for electronic check. Post-test year electronic payment fees are included as part of post-test year customer accounting expense, which is reflected, along with adjustments, in Exhibit P-2, Schedule 6, line 14, and supporting workpapers are provided in Exhibit P-2, Schedule 6-14.

P. Regulatory

38. Q. Please describe regulatory expense and the adjustments made to determine post-test year expense.

A. Regulatory expense includes: (a) costs associated with the preparation and litigation of this proceeding; and (b) amortization expense related to the remaining, unamortized balances of regulatory expense from prior proceedings.

Costs associated with the preparation and litigation of this proceeding include fees for outside legal counsel and consultants, direct support received from the Service Company, and other miscellaneous expenses for customer communications, mailings, printing, legal notices, and administrative fees. Per Board precedent, 50% of these costs will be amortized to expense over a 24-month period. An annualized amount of amortization expense was included in post-test year regulatory expense for this proceeding.

There are two prior proceedings with remaining, unamortized balances of regulatory expense. One is the Company's most recent BPU management audit[9], which is being amortized over a 120-month period. The other relates to a prior rate case with a matter currently under appeal with the Board, which is being amortized over a 24-

[9] *Audit of the Affiliated Transactions between New Jersey American Water Company, and American Water Works Company, Inc. and its Affiliates including a review of Operational and Financial Performance of New Jersey American Water Company and a Comprehensive Management Audit of New Jersey American Water Company Pursuant to N.J.A.C. 14:3-12.1-14:3-12.4*, BPU Docket No. WA18080849.

month period. Annualized amounts of amortization expense were included in post-test year regulatory expense for both of these proceedings, which is reflected, along with adjustments, in Exhibit P-2, Schedule 6, line 15, and supporting workpapers are provided in Exhibit P-2, Schedule 6-15.

Q. Insurance Other Than Group

39. Q. Please describe insurance other than group ("IOTG") expense and the adjustments made to determine post-test year expense.

A. The Company incurs costs related to several types of insurance coverages including general liability, auto liability, workers' compensation, property, and excess liability, as well as coverages for directors and officers liability, cyber liability, environmental impairment, unmanned aerial vehicles (drone program), employment practices, fiduciary, lawyers, crime, and travel. The Company's general liability, auto liability, and workers' compensation premiums are based on a combination of loss experience (50%) and exposure (50%). Exposure is based on estimated annual revenues and payroll, as well as the number of vehicles for auto liability. Consistent with the underwriting practices in the commercial insurance market, loss experience is based on a five-year historical average, which is used to smooth out losses to the extent the Company suffers an anomalous year of claims experience. Property insurance premiums are based on the total insured value of the Company's assets.

The majority of the Company's IOTG policies renew annually in January. To determine post-test year IOTG expense, the Company annualized premiums based on the terms of the most recent policies, and then adjusted by applying specific policy escalation factors for each policy group at their corresponding renewal dates. Finally, a capitalization rate of 47.72% (see Table 1 above) was applied to workers' compensation costs to determine the portion to be recorded as post-test year expense. For those IOTG policies that are scheduled to renew in 2024, the Company will incorporate the updated policy premiums in their 9&3 and 12&0 updates. Post-test year IOTG expense and adjustments are reflected in Exhibit P-2, Schedule 6, line 16, and supporting workpapers are provided in Exhibit P-2, Schedule 6-16.

R. Engineered Coating of Steel Structures

40. Q. Please describe engineered coating of steel structures and the adjustments made to determine post-test year expense.

A. As discussed in the Direct Testimony of Company witness Shields, the Company invests each year in its water storage tank reinvestment program ("WSTR"), also referred to as engineered coating of steel structures. Water storage tanks are critical assets, allowing for potable water to be stored in the Company's distribution systems for fire protection, flow equalization, pressure management, and emergency storage, as well as management of peak demands. As Company witness Shields explains, detailed tank inspections and subsequent reports and recommendations determine tank rehabilitation needs and priorities. The Company's post-test year expense is based on seven-year tank rehabilitation plan at a total cost of approximately $64.8 million, or approximately $9.3 million per year. Post-test year expense and adjustments are reflected in Exhibit P-2, Schedule 6, line 17, and supporting workpapers are provided in Exhibit P-2, Schedule 6-17.

S. Property Sales

41. Q. Has the Company included any gains from the sale of properties that will be shared with the customers in this proceeding?

A. Yes. The Company sold a parcel of land in the Borough of Runnemede during the first quarter of 2023. The transaction resulted in a gain of $39,000, which will be shared 50%/50% between customers and the Company. The amount of $19,500, or 50% of the recognized gain, will be amortized over a 24-month period. Post-test year property sales and adjustments are reflected in Exhibit P-2, Schedule 6, line 18, and supporting workpapers are provided in Exhibit P-2, Schedule 6-18.

T. Other Operating

42. Q. Please discuss "other operating expenses" and the adjustments made to determine post-test year expense.

A. "Other operating expenses" is composed of all other O&M expenses not otherwise adjusted through specific adjustments discussed in my testimony above. These expenses include maintenance, contracted services, telecommunications, building maintenance, office supplies, employee-related travel, and miscellaneous. To determine post-test year expense, the Company used a three-year historical average of actual expenses and adjusted the expenses for the twelve months ended June 30, 2021 and June 30, 2022, by an inflation factor[10], to align the expenses in these periods with those in the base year. The Company also excluded advertising, charitable contributions, community relations, and lobbying from post-test year "other operating expenses", which is reflected, along with adjustments, in Exhibit P-2, Schedule 6, line 19, and supporting workpapers are provided in Exhibit P-2, Schedule 6-19.

U. Acquisition

43. Q. Did the Company make any post-test year expense adjustments for acquisitions of new water and wastewater systems in this proceeding?

A. Yes. As discussed in the Direct Testimony of Company witness Hawn, included in this proceeding are the following acquisitions: (a) Borough of Bound Brook's wastewater system (closed on August 22, 2022); (b) Egg Harbor City's water and wastewater systems (closed on June 1, 2023); (c) Borough of Somerville's wastewater system (closed on October 3, 2023); (d) Salem City's water and wastewater systems (expected to close prior to the conclusion of this proceeding); and (e) Borough of Manville's wastewater system (expected close prior to the conclusion of this proceeding). Accordingly, since the water and wastewater systems discussed above will be included in New Jersey-American Water's future operations, the Company added the post-test year expenses needed to operate these systems in

[10] The Company used the CPI-U inflation factor which measures price changes in all goods and services for Northeast urban consumers (Series ID: CUUR0100SA0).
See http://data.bls.gov/timeseries/CUUR0100SA0?data_tool=XGtable.

this proceeding, which are reflected, in total, in Exhibit P-2, Schedule 6, line 20, and supporting workpapers are provided in Exhibit P-2, Schedule 6-20.

The Company used an expense per acquired customer methodology to determine post-test year expense for the majority of operating expenses. Calculated individually, by operating expense type, the Company began with the post-test year expense determined for the base operations of the Company (excluding the acquisitions noted above) and divided this amount by the number of New Jersey-American Water customers (excluding the customers added from the acquisitions noted above) to calculate an expense per customer. This expense per customer was then multiplied by the known or projected customer counts for each of the acquisitions noted above, to calculate post-test year expense of each type of operating expense. For the 18 FTE employees added from these acquisitions (and noted in my testimony above), the Company calculated post-test year salaries and wages, group insurance, and "other benefits" following the same methodology as discussed in my testimony above. Post-test year payroll tax expense was calculated following the same methodology as discussed in my testimony below.

TAXES OTHER THAN INCOME

A. Property

44. Q. Please describe property taxes and the adjustments made to determine post-test year expense.

A. Property taxes are levied by the individual jurisdictions in which the Company operates and are calculated by applying applicable tax rates to the assessed value of the Company's eligible property. Property taxes are assessed on an annual basis and paid quarterly.

To determine post-test year property tax expense, the Company began with actual expense incurred during the base year and added annualized property taxes associated with any property addition made after the close of the test year period or is projected to occur before the end of the post-test year period. This included the Company's new Southwest Operations facility located in the Borough of Lawnside, which was completed in September 2023. The Company then calculated a post-test year property tax rate increase using a three-year historical average of the expense increases experienced. This post-test year property tax rate increase was then applied to base year expense to arrive at post-test year property tax expense, which is reflected, along with adjustments, in Exhibit P-2, Schedule 10, line 3, and supporting workpapers are provided in Exhibit P-2, Schedule 10-3.

B. Payroll

45. Q. Please describe payroll taxes and the adjustments made to determine post-test year expense.

A. Payroll tax expense is composed of the federal and state taxes the Company pays based on its employees' salaries and wages. There are two types of taxes are required to be paid in accordance with the Federal Insurance Contributions Act, Old Age Survivors & Disability Insurance ("OASDI," or more commonly "FICA") and Hospital Insurance (or more commonly "FICA Medicare"). The Company is also required to pay Federal Unemployment Tax ("FUTA") and State Unemployment Tax ("SUTA").

Post-test year payroll tax expense was calculated on a position-by-position basis, using the current applicable tax rates and post-test year salaries and wages expense (all components), as discussed in my testimony above. In addition, the Company calculated a post-test year FICA wage limit by applying a three-year historical average of the wage limit increases experienced to the actual 2024 FICA wage limit. Finally, a capitalization rate of 45.94% (the capitalization rate for salaries and wages expense; see Table 1 above) was applied to determine the portion of the Company's total payroll taxes that is recorded as post-test year expense, which is reflected, along with adjustments, in Exhibit P-2, Schedule 10, line 4, and supporting workpapers are provided in Exhibit P-2, Schedule 10-4.

C. Revenue-Based

46. Q. Please describe the various types of revenue-based taxes and the adjustments made to determine post-test year expense.

A. Revenue-based taxes paid by the Company include: (a) Gross Receipts and Franchise Excise Taxes ("GRAFT"); (b) BPU and Division of Rate Counsel ("DRC") utility assessments; (c) water monitoring tax; and (d) other miscellaneous taxes. Post-test year revenue-based tax expense and adjustments are reflected in Exhibit P-2, Schedule 10, lines 5-8.

To determine post-test year tax expense for GRAFT and BPU/DRC utility assessments, the Company applied the gross receipts and franchise tax rates (approximately 14%) and the BPU/GRC utility assessment rates to post-test year gross revenues (see Exhibit P-2, Schedules 11 and 12 for these calculation). Post-test year water monitoring tax expense was determined by taking the total post-test year gallons of water metered, less the gallons sold to resale customers, and applied a $0.01 tax rate per thousand gallons (see Exhibit P-2, Schedule 13 for this calculation).

FEDERAL INCOME TAXES

47. Q. Please describe federal income taxes and the adjustments made to determine post-test year expense.

A. Federal income tax expense is composed of a current component and a deferred component. The Company's post-test year current federal income tax expense was calculated by taking post-test year operating revenues less post-test year tax deductions. Tax deductions include permanent, non-deductible items and temporary differences for book and tax depreciation differences, tax repairs, and other plant related adjustments. The Company's post-test year deferred federal income tax expense was calculated by multiplying the temporary tax deductions discussed above by the federal statutory tax rate of 21%. Deferred federal income tax expense was also adjusted for the following amortizations: (a) excess deferred tax liabilities under the Reverse South Georgia method; (b) excess deferred taxes associated with the Tax Cuts and Jobs Act ("TCJA"); (c) deferred taxes associated with investment tax credits; and (d) excess flow through of federal income tax regulatory assets. Post-test year federal income tax expense and adjustments are reflected in Exhibit P-2, Schedule 14.

PROPOSED REGULATORY ACCOUNTING DEFERRAL TREATMENT

48. Q. For what expenses is the Company requesting regulatory accounting deferral treatment?

A. The Company is requesting to continue regulatory accounting deferral treatment for pension and OPEB expense, consistent with the treatment authorized for these expenses in the Company's last rate case (Docket No. WR22010019). The Company is also requesting regulatory accounting deferral treatment for production costs, excluding purchased water expense and purchased wastewater expense. The sensitivity of these expenses to changes in asset returns, market fluctuations, inflation, and other factors outside of the Company's control creates the potential for large variability in the future. This proposed treatment ensures that the Company and its customers remain protected from large variations in expense levels.

49. Q. What specifically does the Company request as "regulatory accounting deferral treatment"?

A. The Company requests that, through the conclusion of its next rate case, it be permitted to record any amounts above or below the level of expense authorized in base rates in this proceeding, into a regulatory asset or regulatory liability account. Upon the effective date of new rates in this proceeding, the Company will compare the actual expense incurred to the expense authorized in base rates. The difference between the two would be deferred to a regulatory asset or regulatory liability account.

D. Pension and Other Post-Employment Benefits

50. Q. Please describe the Company's request for the continuation of regulatory accounting deferral treatment of pension and OPEB expense.

A. The Company was authorized regulatory accounting deferral treatment for pension and OPEB expense in its last rate case. In this proceeding, the Company is requesting to continue regulatory accounting deferral treatment for these expenses until its next rate case, at which time the Company will address the recovery of these regulatory account balances and any request to continue regulatory accounting deferral treatment beyond its next rate case.

51. Q. Has the Company included in the rates proposed in this proceeding, recovery of the pension and OPEB expenses deferred since the Company's last rate case?

A. Yes, the revenue requirement in this proceeding includes post-test year expense related to the amortization of the pension and OPEB regulatory asset balances that have accumulated since regulatory accounting deferral treatment was authorized in the Company's last rate case. The Company has proposed a 24-month amortization period for these regulatory asset balances, as reflected in Exhibit P-2, Schedule 8-5. If, in this proceeding, the Company is granted authority to continue regulatory accounting deferral treatment for pension and OPEB expense until the conclusion of its next rate case, the Company will remove the post-test year amortization expense from its revenue requirement in this proceeding. However, in the event the continuation of regulatory accounting deferral treatment is not authorized, the Company must be able to recover the deferred balances through the date of new rates in this proceeding, as proposed in Exhibit P-2, Schedule 8-5.

52. Q. Why is the Company requesting the continuation of regulatory accounting deferral treatment for pension and OPEB expense?

A. The level of fluctuation and volatility in pension and OPEB expense can change drastically from year to year based on market conditions, investment returns, and other factors outside of the Company's control. Variations between the returns that are projected on the investments made to fund current and future retirement costs, and the returns actually achieved on those investments, coupled with variations between assumed discount rates and actual discount rates during the period for which costs are being projected, all could have material, economic impacts on the level of expense experienced.

53. Q. Please summarize how the Company's request for continuation of regulatory accounting deferral treatment for pension and OPEB expense would work.

A. The Company would continue to maintain two separate regulatory accounts, one for pension expense and one for OPEB expense. The Company requests the Board authorize in base rates, the post-test year expense proposed for pension and OPEB, as supported in my testimony above. The Company will compare the actual expenses incurred to the expenses authorized in base rates in this proceeding. The difference between the two would be deferred to a regulatory asset or regulatory liability account. As the Company is currently deferring based on the authorized amounts in its last rate case, beginning on the effective date of new rates in this proceeding, the authorized level will be adjusted to the amount approved in this proceeding. This treatment will continue until the Company's next rate case, at which time, the Company will address the recovery of these regulatory account balances and any request to continue regulatory accounting deferral treatment beyond its next rate case.

E. Production Costs

54. Q. Please define what production costs are included in the Company's request for regulatory accounting deferral treatment.

A. The Company is requesting regulatory accounting deferral treatment for chemicals, fuel and power, and waste disposal, excluding purchased wastewater expense, which is recovered through the PSTAC. Purchased water has also been excluded from this request because the Company recovers this expense through the PWAC.

55. Q. Why is the Company requesting regulatory accounting deferral treatment for production costs?

A. Production costs are among the Company's most critical expenses because they are crucial in providing safe and reliable water and wastewater service to customers. Due to strict compliance requirements, production costs are not discretionary expenses the Company can choose to incur or not incur. Nor are they purely variable in nature, in that they do not fluctuate solely based on changes in overall production volumes. For example, the chemicals market has been extremely volatile compared to historical levels, driven by many factors such as the COVID-19 pandemic, global pressures brought upon by the conflict in Ukraine, inflationary growth in commodity prices, escalation in energy prices, and overall supply and demand pressure within a consolidating chemicals market. The Company takes rigorous steps to ensure that it obtains the best pricing possible when it purchases chemicals; however, the factors mentioned above leave these expenses outside of the control of the Company and, in many cases, outside of the control of the Company's suppliers. Likewise, the energy markets in general are all higher than they have been in many years. Market conditions impacting production costs represent an extraordinary combination of circumstances that are expected to continue to produce significant price volatility over the next several years. A regulatory accounting deferral for production costs ensures that the Company and its customers remain protected from large variations in expense levels.

56. Q. Please summarize how the Company's request for regulatory accounting deferral treatment for production costs would work.

A. The regulatory accounting deferral treatment for production costs would work in a similar manner to that approved by the Board for pension and OPEB expense in the Company's prior rate case (and described above). The Company requests the Board authorize in base rates, the post-test year expense proposed for chemicals, fuel and power, and waste disposal (excluding purchased wastewater expense), as supported in my testimony above. The Company will compare the actual expenses incurred to the expenses authorized in base rates in this proceeding. The difference between the two would be deferred to either a regulatory asset or a regulatory liability account. This treatment would begin on the effective date of new rates in this proceeding and would continue until the Company's next rate case, at which time, the Company will address the recovery of these regulatory account balances and any request to continue regulatory accounting deferral treatment beyond its next rate case.

57. Q. Would the regulatory accounting deferral treatment sought by the Company provide a disincentive to management to control production costs?

A. No. The Company will continue to actively find ways to mitigate its exposure to volatility in these expenses, as the Company is committed to providing safe and reliable water service to its customers at affordable rates. This request does not change that; it simply ensures that customers only pay for the production costs incurred, nothing more and nothing less, while allowing the Company to collect the proper revenues to cover those production costs incurred which the Company cannot avoid. This does not grant the Company a "free pass" to mismanage production costs. When returning in its next rate case, the Company will need to show the results of the production cost regulatory accounts and seek recovery in future rates. Those regulatory account balances would be subject to Board scrutiny to determine their reasonableness.

58. Q. Is the Company proposing to recover carrying costs on deferred balances?

A. No. The Company is only proposing to defer any difference between the base level of expense established in this rate case and the actual level of expense incurred.

CONCLUSION

59. Q. Does this conclude your Direct Testimony?

A. Yes, it does.