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Missouri Public Service Commission

Exhibit No.: 17
Issues: *Payroll; Payroll-Related Benefits; Rents, Leases and Software Licenses; Rate Case Expense; PSC Assessment; Governmental Affairs/Lobbying*
Witness: *Jeremy K. Hagemeyer*
Sponsoring Party: *MoPSC Staff*
Type of Exhibit: *Direct Testimony*
Case Nos.: *WR-2003-0500 and WC-2004-0168*
Date Testimony Prepared: *October 3, 2003*

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

DIRECT TESTIMONY

OF

JEREMY K. HAGEMEYER

MISSOURI-AMERICAN WATER COMPANY

CASE NOS. WR-2003-0500 AND WC-2004-0168

Jefferson City, Missouri
October 2003

Exhibit No. 17
Case No(s). WR-2003-0500
Date 12/16/03 Rptr SLM

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of the General Rate Increase for Water and Sewer Service Provided by Missouri-American Water Company.	)))	Case No. WR-2003-0500

Staff of the Missouri Public Service Commission,	)	
	)	Case No. WC-2004-0168
Complainant,	)	
	)	
v.	)	
	)	
Missouri-American Water Company,	)	
	)	
Respondent.	)	

AFFIDAVIT OF JEREMY K. HAGEMEYER

STATE OF MISSOURI	)	
	)	ss.
COUNTY OF COLE	)	

Jeremy K. Hagemeyer, being of lawful age, on his oath states: that he has participated in the preparation of the foregoing Direct Testimony in question and answer form, consisting of 11 pages to be presented in the above case; that the answers in the foregoing Direct Testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.

Jeremy K. Hagemeyer

Subscribed and sworn to before me this 2nd day of October 2003.

D SUZIE MANKIN
Notary Public - Notary Seal
STATE OF MISSOURI
COLE COUNTY
MY COMMISSION EXP. JUNE 21,2004

D Suzie Mankin

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DIRECT TESTIMONY

OF

JEREMY K. HAGEMEYER

MISSOURI-AMERICAN WATER COMPANY

CASE NOS. WR-2003-0500

AND WC-2004-0168

Q. Please state your name and business address.

A. Jeremy K. Hagemeyer, 1845 Borman Ct. Suite 101, St. Louis, MO 63146.

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

A. I am employed by the Missouri Public Service Commission (MPSC or Commission) as a Utility Regulatory Auditor.

Q. Please describe your educational background?

A. I graduated from Southwest Missouri State University, receiving a Bachelor of Science in Accounting in May of 2001.

Q. Please describe your duties while employed by the Commission?

A. I have assisted with audits and examinations of the books and records of public utility companies operating within the state of Missouri.

Q. Have you previously filed testimony before this Commission?

A. Yes. I filed direct testimony in the Laclede Gas Case No. GR-2002-356. I addressed the issues of Plant, Depreciation Reserve, Depreciation Expense, Other Rate Base Items, Dues and Donations, and Miscellaneous Expense. I have also participated in informal rate cases for KMB and Gladlo Water and Sewer Companies.

Q. Did you make an examination and analysis of the books and records of Missouri-American Water Company (MAWC or Company) in regards to matters raised in this case?

A. Yes, in conjunction with other members of the Commission's Staff (Staff). I reviewed Staff data request responses, the general ledger, labor contracts, copies of floor plans, past commission rulings, prior case files, and various lease and service contracts.

Q. What matters will you address in your testimony?

A. I will address payroll, payroll-related benefits other than pensions, and other post employment benefits (OPEBs), incentive compensation, rents, leases, lobbying, PSC Assessment and rate case expense.

Q. What knowledge, skill, experience, training or education do you have in these matters?

A. In addition to the documents I reviewed, I have relied on the accounting training I have received during college. I have attended several training classes in utility regulation. I also have engaged in discussions with and received guidance and in-house training from my supervisors with regard to these issues in general and guidance from my supervisors that relates to this Company. I have reviewed testimony from previous Company rate cases and rate cases of other water/sewer companies on the issues I will be addressing.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to explain and sponsor the following Accounting adjustments:

Payroll	S-9.1, S-10.1, S-11.1, S-12.1, S-13.1, S-14.1
Payroll Taxes	S-17.1
401k	S-14.5
Employee Investment Plan (EIP)	S-14.6
Group Health Insurance	S-14.7
PSC Assessment	S-17.3
Rate Case Expense	S-14.8
Professional Services	S-14.23
Building Leases	S-9.3, S-12.3, S-14.9
Equipment Leases	S-10.2, S-11.6, S-12.8, S-14.22
Software Licenses	S-14.21
Lobbying	S-9.2, S-11.3, S-14.4, S-17.2

PAYROLL

Q. Please explain adjustments S-9.1, S-10.1, S-11.1, S-12.1, S-13.1 and S-14.1.

A. These adjustments represent the Staff's annualization of payroll expense.

Q. What are the different components that the Staff considered in calculating the annualized level of payroll?

A. The Staff's payroll annualization took into consideration the following components:

- Regular payroll for all full-time union, non-union hourly, salaried and management personnel;
- Overtime pay for those eligible employees;
- Operation and maintenance (O&M) expense factor used to determine the level of payroll chargeable to expense; and

- Utilization factors for the each of the districts in order to eliminate unpaid absences from Staff's payroll calculations.

Q. Please describe how the Staff calculated the annualized level of payroll.

A. The Company provided the employee roster including wage rates as of December 31, 2002 and updated the information as of June 30, 2003. The roster indicated to which operating district employees were assigned, annual salary or hourly wage rates, and the operations and maintenance expense percentage of each employee's salary. The annualized level of payroll was calculated by applying the appropriate wage rate for each individual employed as of June 30, 2003 to an annual level of regular hours. After eliminating unpaid absences, overtime wages were added to the regular payroll. The annual payroll for each employee chargeable to expense was based on the operations and maintenance (O&M) ratio of the job code. The O&M payroll expense was further allocated between water and sewer operations for the Parkville district, the only sewer operations of MAWC.

Q. How did the Staff determine the amount of annualized O&M payroll to allocate to sewer operations?

A. Staff calculated a ratio of sewer operations based on the number of sewer customers to total customers in the Parkville district. All payroll expenses relating to the Parkville district were divided between water and sewer operations using this ratio.

Q. Please explain how the O&M ratios were calculated.

A. The O&M ratios were developed based on the distribution of total wages to O&M expense for the past three years. O&M refers to the portion charged to expense as opposed to construction. Ratios were developed for each job code. A three-year period was chosen because the Company only had payroll distributions by district for the last three immediate calendar years.

Q. Please explain what a "utilization factor" is and how it was used in determining annualized payroll.

A. A utilization factor is a number derived from dividing the sum of regular paid hours and paid absence hours by the sum of all non-overtime hours, which includes both paid and non-paid hours. The resulting percentage is an expression of those hours that were paid and, when applied to the annual salaries, excludes the non-paid hours from consideration in the calculation of payroll expense.

Q. How did Staff calculate overtime?

A. Staff used an average of the most recent three calendar years of overtime hours. These hours were then priced-out using current wage rates.

PAYROLL TAXES

Q. How did the Staff calculate payroll taxes?

A. The Staff determined payroll taxes based on its calculation of the annualized payroll levels and the current tax rates and taxable bases. The adjustments to payroll taxes appear in Accounting adjustment S-17.1.

401(K) PLAN

Q. Please explain adjustment S-14.5.

A. Adjustment S-14.5 annualizes the Company's 401(k) retirement plan expense. The Company matches 50% of all employee contributions, up to a maximum of 5% of an employee's annual wages.

Q. How was annualized 401(k) expense calculated?

A. Staff determined the amount of the Company's 401(k) contribution by multiplying employee contributions equal to or below 5% of the individual's annualized salary by 50%. If the employee contributed more to their 401(k) than 5%, Staff multiplied only the first 5% of the contribution by 50% to determine the company match. This annualized Company 401(k) plan matching contribution was multiplied by the annualized O&M payroll percentage.

EMPLOYEE INVESTMENT PLAN (EIP)

Q. Please explain adjustment S-14.6.

A. Adjustment S-14.6 annualizes EIP expense based on the Staff's calculations of annualized payroll and the current plan terms. The EIP is a replacement for the Employee Stock Ownership Plan (ESOP) that ended January 10, 2003. Under the ESOP the Company purchased stock in MAWC's parent company, American Water Works Company, Inc. (AWW), for each eligible employee at one-half percent of the employee's annual wages, excluding overtime and incentive pay. The Company matched 100% of the employee's contribution, up to a maximum of 2% of the employee's base salary. Under the new EIP, contribution rates for the company have remained the same. The only difference is that the employee is offered the same investment options as are available in the 401(k) rather than investing in AWW stock.

GROUP HEALTH INSURANCE

Q. Please explain adjustment S-14.7.

A. This adjustment reflects the Staff's annualization of group insurance expense. The Company has changed the group health insurance provider for the St. Louis County district employees. These employees were provided health insurance by the Great West Insurance Company. The Company is now using Blue Cross/Blue Shield of New Jersey for the St. Louis district, the same provider as used for the rest of the AWW operating companies. The annualized level of Group Health Insurance is based on the current monthly rates multiplied by 12.

INCENTIVE COMPENSATION

Q. Please describe the incentive plans offered by MAWC.

A. There are two AWW incentive pay plans in which select MAWC employees participate. One plan is referred to as the Annual Incentive Plan (AIP) and the other plan is referred to as the Long-Term Incentive Plan (LTIP).

Participants in the AIP are officers and managers who are recommended to the Compensation and Management Development Committee of AWW by the President and Chief Executive Officer. The amount of any award depends on the midpoint of the market-based salary for the position of the participant and the achievement of performance goals. The AIP awards are based 50% on customer service and 50% on financial performance. The customer service goal is based on customer perceptions of the Company. The financial performance goal is based on net operating profit after tax subtracting a rate for invested capital. The individual will receive a standard award based on 85% of the achievement midpoint, unless the President of MAWC feels that an adjustment is warranted by the individual's performance. Before any award can be disbursed to a qualifying employee, a threshold must be met. The plan requires a threshold of $1.90 diluted earnings per share for the year.

Participation in the LTIP is limited to level one and two executives and related to the net income of the parent company subject to stock price valuations. A target award is determined, based on a percentage of the midpoint of the market-based salary for the position. This target is then divided by the value of AWW's stock price average of the last 10 trading days of the previous year and the first 10 trading days of the current year. This number represents the target number of performance share units (PSUs). During the term of the plan the number of performance share units earned are based on meeting and/or surpassing an AWW net income goal. Every percentage point of achievement above the target net income corresponds to an increase of 10 percentage points of the PSUs. Conversely, every percentage point of achievement below the target net income results in a 10 percentage point decrease of the PSUs earned. The percentage of PSUs earned is then multiplied by the target number of PSUs.

Q. Were there any test year payments for either incentive plan?

A. No. The Company accrued payments for the AIP during the test year, but that accrual was later reversed. The Company accrued for the LTIP, but no payments were made during the test year.

Q. Will you be sponsoring an adjustment to include any amount for either the AIP or LTIP?

A. No. The payout of the AIP was contingent upon the level of diluted earnings per share (EPS) of the corporate parent, AWW. Before any AIP amount could be paid, diluted EPS had to be at least $1.90 for 2002. This threshold was not met. An eligible employee of MAWC could have had a perfect customer service score, but still not receive any annual incentive compensation based solely on the diluted EPS of the parent company of MAWC. As a result, the payment of the awards from one year to the next is speculative and therefore unrepresentative of an on-going expense.

The LTIP is driven by goals over which employees of MAWC have little control, namely the net operating profit of the parent company, AWW. The financial goals of the LTIP are dependant on all of AWW's regulated and non-regulated companies. Employees of MAWC have no influence over the earnings of these other companies. For these reasons, the Staff opposes any inclusion of expenses relating to either the AIP or the LTIP in on-going rates.

MPSC ASSESSMENT

Q. Please explain adjustment S-17.3.

A. Adjustment S-17.3 reflects the difference between the Company's test year expense and the most current cost for the Missouri Public Service Commission's assessment.

RATE CASE EXPENSE

Q. Please explain adjustment S-14.8.

A. Adjustment S-14.8 reflects the difference between the Company's test year expense and the Staff's annualized level of rate case expense. At this point, Staff is proposing that the annual rate case expense be equal to the actual rate case expenses incurred in the WR-2000-844 St. Louis County Water rate case, normalized over a period of three years. Staff believes this is the most representative amount of annualized rate case expense, based on the information available to date. Discussions between Staff and Company revealed that the actual expenses incurred in the last MAWC rate case, Case No. WR-2000-281, were clearly not representative of the expected "normal" cost of a rate case. Staff recognizes that the actual amount of expenses associated with this rate case could be less or greater than this annualized level. Therefore, the Staff will reexamine this issue during the true-up audit.

PROFESSIONAL SERVICES

Q. Please explain adjustment S-14.23.

A. Adjustment S-14.23 removes those professional services that are nonrecurring. In response to Staff Data Request No. 362, the Company provided a list of professional services utilized by the Company during the test year. Also contained on the list was a notation by the Company if those charges were nonrecurring.

RENTS AND LEASES

Q. Please explain adjustments S-9.3, S-12.3, S-14.9, S-10.2, S-11.6, S-12.8, S-14.22 and S-14.21.

A. These adjustments annualize the expense for building rentals in St. Louis, Joplin, St. Joseph and Jefferson City, equipment leases and software license expense. The level of expenses reflected in Staff's adjustments reflect only those leases and licenses that Staff has been able to verify. Information regarding leases and licenses that is outstanding may impact the annualized expense level. This item will be reexamined during the True-up audit.

LOBBYING

Q. Please explain adjustments S-9.2, S-11.3, S-14.4 and S-17.2.

A. These adjustments remove half of the annualized expenses related to the Governmental Affairs Department of MAWC. Staff proposes these adjustments in order to eliminate lobbying expenses from the MAWC payroll expense. Staff used the job description of the Director of the Governmental Affairs Department as the basis for eliminating 50% of these expenses. Five of the nine job responsibilities listed for this position are directly related to lobbying.

Q. Should the ratepayer bear the cost of lobbying activities?

A. No. In several past cases presented to the Commission, the Commission has historically disallowed the costs associated with lobbying. Specifically in case 18,180 <u>In the matter of Missouri Public Service Company, Kansas City, Missouri,</u> 20 Mo.P.S.C. (N.S.) 68, 105 (1975) and Case No. ER-83-49, <u>In the matter of Kansas City Power & Light Company</u>, 26 Mo.P.S.C. (N.S.) 104, 116 (1983), the Commission has stated the beneficiaries of lobbying activities are usually the stockholders of the company involved in lobbying. The Commission has also stated that the stockholders of a company involved in lobbying should be the ones to assume responsibility for these expenses unless the company offers substantial evidence for their inclusion in rates. Also, it is very difficult, if not impossible, to say for certain how effective a lobbyist's actions may be, and thus the expenses related to lobbying cannot absolutely be shown to provide any benefit.

Q. Does this conclude your testimony?

A. Yes, it does.