

Exhibit No.:

Issue: Payroll, Payroll Taxes,
Administrative & General
Salaries Transferred,
Employee Benefits,
Pensions

Witness: Arlene S. Pfleeeger

Sponsoring Party: MoPSC Staff

Case No.: WR-91-361

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

ST. LOUIS COUNTY WATER COMPANY

CASE NO. WR-91-361

DIRECT TESTIMONY

OF

ARLENE S. PFLEEGER

FILED
OCT 4 - 1991
PUBLIC SERVICE COMMISSION

Jefferson City, Missouri
October, 1991

1 DIRECT TESTIMONY

2 OF

3 ARLENE S. PFLEEGER

4 ST. LOUIS COUNTY WATER COMPANY

5 CASE NO. WR-91-361

6 Q. Please state your name and business address.

7 A. Arlene S. Pfleegeer, Suite 330, 906 Olive Street, St.
8 Louis, Missouri 63101.

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

10 A. I am a Regulatory Auditor for the Missouri Public
11 Service Commission (Commission).

12 Q. Please describe your educational background.

13 A. I graduated from the University of Missouri at St.
14 Louis in August, 1978, at which time I received a Bachelor of Science
15 Degree in Business Administration, with a major in Accounting.

16 Q. What has been the nature of your duties while in the
17 employ of this Commission?

18 A. I have, under the direction of the Manager of
19 Accounting, conducted and assisted with audits and examinations of
20 the books and records of public utilities operating within the state
21 of Missouri. The audits I have previously participated in are listed
22 on Schedule 1, attached to this direct testimony.

23 Q. Have you made an examination of the books and records
24 of St. Louis County Water Company (SLCWC or Company) with regard to
25 Case No. WR-91-361?

1 A. Yes, I have, with the assistance of other members of
2 the Commission Staff (Staff).

3 Q. Please describe your areas of responsibility in this
4 case.

5 A. My principal areas of responsibility are as follows:
6 payroll and related payroll taxes; administrative and general (A&G)
7 salaries transferred (capitalized); life, health, accident and dental
8 insurance; and pensions.

9 Q. Which Accounting Schedules and Accounting adjustments
10 are you sponsoring?

11 A. I am sponsoring Accounting Schedule 10, Income
12 Statement, and Accounting Schedule 11, Adjustments to the Income
13 Statement. I am also sponsoring the first adjustments in each of the
14 income statement functional expense categories S-10 through S-16,
15 inclusive, relating to payroll. Additionally, I am sponsoring
16 adjustment S-16.B which relates to capitalized payroll. I am also
17 sponsoring adjustments S-16.J, S-16.K, S-16.N, S-16.O, S-16.T and
18 S-16.U relating to employee benefits and pensions; and adjustments
19 S-18.A, S-18.B, S-18.C, S-18.D and S-18.E relating to payroll taxes.

20 Q. Please describe Accounting Schedules 10 and 11.

21 A. Accounting Schedule 10 is the Staff's Income Statement
22 for the twelve months ending May 31, 1991, updated through August 31,
23 1991. Accounting Schedule 11 is the Staff's Adjustments to the
24 Income Statement.

25 Q. Please explain the adjustments relating to payroll.
26
27
28

1 A. Adjustments S-10.A through S-16.A, inclusive, represent
2 the Staff's payroll annualization adjustments to the following income
3 statement classifications: source of supply, power & pumping, water
4 treatment, transmission and distribution, customer accounts, sales
5 promotion and A&G.

6 Q. Please explain the Staff's payroll annualization.

7 A. The Staff's calculation of annualized payroll is based
8 on the Company's payroll at May 31, 1991. The Company has three
9 payroll groups: clerical union, physical union, and non-union. The
10 Staff annualized each individual payroll group based on employee
11 levels and hourly wage rates at May 31, 1991, adjusted for certain
12 payroll changes through December 1, 1991, which are discussed later
13 in my direct testimony. The Staff's adjustment to payroll expense is
14 derived by subtracting the per book test year payroll level for
15 operations and maintenance (O&M) expense for the test year from
16 Staff's annualized O&M payroll.

17 Q. What are O&M expenses?

18 A. O&M expenses are those operational and maintenance
19 expenses included in the income statement which represent expenses
20 which are non-construction related. The O&M ratio is the percentage
21 of payroll costs that are charged to expense as incurred, rather than
22 capitalized to construction or charged to non-regulated operations.

23 Q. How was the test year level of payroll expense
24 applicable to O&M expense derived?

25 A. The test year level was extracted from the final
26 distribution of the total labor dollars for the twelve months ending
27
28

1 May, 1991. This final distribution was derived by redistributing the
2 labor charges booked in clearing accounts back to test year payroll.
3 The redistribution of those labor clearings is based upon ratios
4 developed by performing an analysis of indirect labor charges during
5 the test year.

6 Q. Is the O&M percentage developed through the clearing
7 account analysis the same percentage used by the Staff to determine
8 the normalized level of O&M payroll?

9 A. No, it is not. A discussion of the development of this
10 factor follows my discussion of the development of the payroll
11 annualization.

12 Q. Please continue with the discussion of your payroll
13 annualization. Did the Staff update its payroll annualization beyond
14 May 31, 1991?

15 A. The Staff annualized clerical union and physical union
16 employees at wage rates in effect at September 8, 1991, and included
17 increases to become effective November 1, 1991. Regular non-union
18 and physical non-union employees were annualized at wage rates in
19 effect and adjusted for increases projected to take place on December
20 1, 1991.

21 Q. Why has the Staff included projected wage increases?

22 A. We have included those wage increases we believe to be
23 known and measurable changes. The union increases reflect the most
24 recent labor negotiations of the Company, which resulted in a three
25 year contract signed in 1989 specifying the annual amount of
26 increase. The non-union increases are a result of a resolution by
27
28

1 the Board of Directors of the Company. The Staff believes it is
2 appropriate to include both increases as they will have occurred by
3 the start of the hearings in this case. The inclusion of these
4 adjustments in the Staff's revenue requirement is contingent upon a
5 true-up audit, so these cost increases can be properly synchronized
6 with revenue and rate base changes past the Staff's test year update
7 period. Please refer to the direct testimony of Staff witness
8 Stephen M. Rackers for a further discussion of the Staff's test
9 year/true-up position.

10 Q. Has the Company supplied the Staff with documentation
11 supporting the known and measurable payroll changes?

12 A. Yes, they have. The company supplied letters of
13 intention to hire and acknowledgements by prospective employees of
14 their acceptance of offers of employment. We have reviewed the
15 resolution of the Board of Directors relating to the December 1, 1991
16 increases for non-union employees, and a list, documented by
17 individual employee, which aggregates the overall increase of 5.4%.
18 The Company has also drafted a letter to be mailed to each non-union
19 employee notifying them of their prospective increase effective
20 December 1, 1991. Copies of the letters will be made available to
21 the Staff for review after the Staff's direct filing date, but prior
22 to the prehearing conference. Letters will be mailed to employees
23 after they have been informed of the increases by their supervisors.
24 We were additionally supplied a list of employees and rates in effect
25 for all increases mentioned earlier in my direct testimony.

1 Q. Have you included any payroll increases for budgeted
2 employees?

3 A. No, we have not. We have included only documented new
4 hires and terminations either effective or scheduled to become
5 effective by the date of the prehearing conference. We have also
6 agreed to include any additional documented employee changes at the
7 time of the prehearing conference.

8 Q. Please describe the wage increases that took place
9 during the test year.

10 A. The Staff's payroll annualization reflects non-union
11 increases given on December 1, 1990, including step increases for
12 secretaries, drafting technicians, dispatchers and lab technicians.
13 The annualization also incorporated the April 1, 1991 increase for
14 officers, and step increases for other employees effective in June,
15 1991. We have also included union increases for both clerical and
16 physical union employees which became effective November 1, 1990.

17 Q. Please define "step increases."

18 A. Step increases are those wage increases which represent
19 movement within a job position or job level, as opposed to increases
20 associated with promotions.

21 Q. Has the Staff made any adjustment to test year
22 overtime?

23 A. No, we have not. The Staff has reviewed overtime
24 levels for the last three years, and believes that the overtime
25 experienced during the test year is representative of the ongoing
26 future level of overtime by the Company.

Direct Testimony of
Arlene S. Pfleege

1 Q. Please define "separation pay" and indicate if the
2 Staff has made any adjustment for this item.

3 A. Separation pay represents the amount of accrued
4 vacation accumulated by an employee which is paid to that employee
5 upon termination, resignation or retirement. We have used actual
6 test year amounts of separation pay as representative of ongoing
7 operations.

8 Q. Please define "shift differentials" and indicate if the
9 Staff has made any adjustment for this category of payroll.

10 A. Shift differentials are increases to levels of
11 compensation for certain work categories, such as evening shift
12 differential, Sunday premium differential, holiday premium
13 differential at time and one half, etc. The Staff annualized shift
14 differentials utilizing test year actual data.

15 Q. Did the Staff include an amount for temporary employees
16 in its annualization?

17 A. Yes. The Staff used the test year level of temporary
18 employee payroll expense.

19 Q. Have any adjustments been made to overtime, separation,
20 shift differential or temporary salary dollars for consideration of
21 union or non-union increases effective in November and December 1991?

22 A. Yes. All categories of payroll were adjusted for the
23 3% union increase and the 5.4% non-union increase, effective on those
24 dates, respectively.

25 Q. Have you included any other adjustments to payroll?
26
27
28

1 A. Yes. The Staff has applied a non-utilization factor to
2 the payroll expense for each employee, which represents the payroll
3 expense during the year that will be attributable to absences for
4 which each employee will not be paid. The Staff reviewed data for
5 the last three year period. After review of this data, the Staff
6 used the test year level of non-paid absences in calculating the
7 annualized level of payroll expense. A non-paid absence utilization
8 factor was developed for each budget group, and applied on an
9 individual employee basis to determine the appropriate number of
10 hours to be deducted from 2088 hours (the level of hours the Staff
11 considers to be the normal in a year), before multiplying by the
12 appropriate payroll rate. The same procedure utilized by the Staff
13 in its payroll annualization regarding non-paid absences is used by
14 the Company in its budgeting procedure to determine estimated
15 non-paid absences.

16 Q. What is adjustment S-16.B?

17 A. This adjustment reflects the restoration of payroll to
18 a normalized level. Test year A&G payroll reflects the application
19 of the O&M percentage developed by the Staff in Case No. WR-89-246.
20 It was necessary to restore A&G payroll to a total basis before
21 applying the new O&M percentage which was developed in the present
22 case. This percentage was developed by the Company based on a new
23 analysis of A&G payroll which was ordered by the Commission in Case
24 No. WR-89-246.
25
26
27
28

1 Q. Does the Staff agree with the result obtained from the
2 methodology employed by the Company in developing the new O&M labor
3 ratio per the Commission Order in the last rate case?

4 A. Yes, we do. However, there have been significant
5 changes relating to the development of the new O&M labor ratio
6 utilized by the Company which resulted from the order in Case No.
7 WR-89-246. A synopsis of the events leading to these changes
8 follows.

9 In the last rate case, No. WR-89-246, the Company and Staff
10 disagreed on the level of capitalization appropriate for of the
11 salaries of the Company's officers and managers. The Company
12 proposed a capitalization level of approximately 28% and Staff
13 proposed a level of approximately 32%. The Staff's capitalization
14 percentage issue resulted from an examination of the Company records
15 in Case No. WR-88-5, which indicated that the Company did not
16 capitalize construction-related A&G expense for any of its officers'
17 salaries, with the exception of the Vice President of Operations and
18 the Vice President of Engineering. Additionally, only a small
19 portion of managers' salaries were capitalized as being
20 construction-related. Because all officers performed functions
21 which directly or indirectly benefited construction-related
22 activities, the Staff believed the Company should capitalize a
23 portion of all officers' salaries. The Staff also believed a greater
24 portion of the Company's managers' salaries should be capitalized.
25 The Company's O&M ratio in the last case was based on a labor
26
27
28

1 distribution which understated the appropriate charges to
2 construction and overstated charges to O&M expense.

3 Q. How did Staff develop the O&M labor ratio utilized in
4 the last case?

5 A. The Staff performed an analysis of all payroll charges
6 for the twelve months of the test year used in Case No. WR-89-246,
7 utilizing a SLCWC payroll distribution based on budget groups. For
8 the total payroll dollars, both direct and indirect, the Staff
9 initially deducted officers' and first line managers' salaries from
10 each budget group. The Staff then determined the amount of payroll
11 distributed to construction for the employees supervised by the
12 officers and managers. This allocation percentage was then used to
13 distribute the salaries of the officers and managers for each budget
14 group. This procedure was followed for the operational, production,
15 distribution and engineering budget groups. After developing a
16 composite factor for these groups, the Staff applied this factor to
17 the administrative budget group, less customer accounts salaries.
18 This factor was then added to the previously developed composite
19 factor and the revised composite factor was then applied to the
20 remaining budget group, the executives. Upon completion of this
21 analysis, the Staff had derived a new O&M percentage. This
22 percentage was then used to determine the Staff's adjustments for
23 payroll, benefits and payroll taxes.

24 In the Report and Order for Case No. WR-89-246, the
25 Commission found the Staff's ratio reasonable based upon the
26 construction activity level of the Company and inclusion of all
27
28

1 officers and managers. The order referenced the National Association
2 of Regulatory Utility Commissioners' document entitled
3 "Interpretations of Uniform Systems of Accounts for Electric, Gas
4 and Water Utilities", which states:

5 that the determination of payroll charges included in
6 construction overhead shall be based on time cards, and
7 where time cards are not practical, "special studies" shall
be made periodically of the time supervisory employees
devote to construction costs.

8 This interpretation states:

9 where daily time reports are not in effect, periodic
10 studies should be performed at least once a year, and more
frequently if construction fluctuates considerably.

11 The Commission found this interpretation to be reasonable. The
12 Commission also directed the Company to develop a comprehensive and
13 annual study by which it could account for the actual time spent on
14 construction related matters by officers and managers.

15 Q. Has the Company developed a study which reflects actual
16 time spent on construction-related matters by officers and managers?

17 A. Yes, they have.

18 Q. Has the Staff reviewed this study?

19 A. Yes. The Staff has reviewed this study, and believes
20 it represents a reasonable method for determining the time spent on
21 construction-related activities by the officers and managers of
22 SLCWC. We additionally believe that it is a vehicle that can be
23 utilized by the Company on an annual basis to determine labor levels
24 related to construction. Now that the basic comprehensive format of
25 the study has been developed, it can be utilized from year to year.

1 The Staff will continue to review and evaluate the results of this
2 process in the future.

3 Q. How does the Company's study differ from the analysis
4 performed by the Staff in the last case?

5 A. The Company's study utilizes the Staff's methodology
6 from the prior case, but refines it by incorporating survey results
7 for individuals who do not fill out time cards. The basic philosophy
8 behind the study remains the same.

9 Q. What is this philosophy?

10 A. This philosophy is that any company, such as SLCWC,
11 that has a large, ongoing construction program necessitating frequent
12 rate increases, must recognize that a portion of the salaries of the
13 employees making decisions about this ongoing construction should be
14 capitalized. This study establishes policies and procedures that
15 account for those construction-related A&G salaries and expenses that
16 cannot be charged to a specific construction project, and assigns
17 those amounts ratably among the various construction projects.

18 A. Do construction activities continue to be an
19 important part of SLCWC's operations?

20 A. Yes. Construction is a significant part of this
21 Company's activities, and requires planning, controlling, monitoring
22 and record keeping, along with other management activities. Some of
23 this activity (e. g., planning) may be directly identifiable with
24 specific projects, while other activities (e. g., record keeping) are
25 impractical to identify with specific projects. The fact that it is
26 impractical to assign a given dollar spent to a specific construction
27
28

1 project does not imply that the dollar was not spent in support of
2 construction. For SLCWC, construction expenditures represented over
3 33.112% of the total funds required for current operating expenses in
4 the Staff's test year.

5 Q. How did the Staff annualize pension expenses as
6 reflected in adjustments S-16.J and S-16.N?

7 A. The Staff annualized pension expense by utilizing the
8 minimum contribution for the "plan year" as determined from the SLCWC
9 Actuarial Report dated December 1, 1990, for its pension plan. This
10 report is for the plan year ending November 30, 1991. After
11 determining the appropriate amount of the contribution applicable to
12 the test year, the Staff deducted credits pertaining to prior years.

13 In May, 1989, the Continental Water Company (CWC) Pension
14 Plan was merged into the plan for SLCWC. The Staff has deducted the
15 amount identified as year end cost for the CWC Group. We have
16 additionally deducted the amount identified as year end cost for
17 Water Utility Service Company (WUSCO). WUSCO is addressed in the
18 direct testimony of Staff witness Rackers.

19 Q. How is the contribution determined for the plan year?

20 A. The amount that is to be assigned to the plan year is
21 determined by comparing the current year's employee compensation to
22 the present value of all of the future compensation used in
23 projecting the ultimate pension liabilities. This produces a
24 "normal cost", the value of benefits assigned to 1991. This amount
25 is then increased to reflect the anticipated expenses to be paid out
26 of the fund and the value of disability benefits expected to be
27
28

1 disbursed in 1991. These factors increase the normal cost.
2 Interest is added to this cost to produce the final amount, which is
3 the contribution for the plan year.

4 Q. Have you included any expenses in the case relating to
5 test year supplemental pension plan expense?.

6 A. Yes, we have. The Commission determined in its Report
7 and Order in Case No. WR-89-246 that the payments to vested
8 individuals under the supplemental plan should be recovered in
9 Company's cost of service. Adjustment S-16.U reflects the allowance
10 of the payments actually incurred during the test year.

11 Q. Please discuss employee benefits.

12 A. Adjustment S-16.K annualizes life, health, accident and
13 dental insurance expenses, utilizing employee levels at October 15,
14 1991, and premium rates in effect for the period January 1, 1991 to
15 January 1, 1992. Adjustment S-16.O represents the impact on this
16 annualization of applying the Staff's O&M factor used in this case.

17 Q. Has the Staff included any payroll related adjustments
18 related to CWC?

19 A. Yes, we have. Adjustment S-16.T allocates expenses
20 related to one employee on the payroll of both CWC and SLCWC.

21 Q. How was the allocation determined?

22 A. The Staff developed a ratio of CWC payroll to SLCWC
23 payroll from information contained in the response to Staff Data
24 Request No. 131, and used this ratio for all the associated expenses.

25 Q. Did the Staff make an adjustment to annualize payroll
26 taxes?

1 A. Yes. Adjustment S-18.A annualizes FICA (Social
2 Security) taxes at the revised 1991 FICA rate of 6.2% on a maximum
3 base salary of \$53,400 per employee, and medicare taxes at the rate
4 of 1.45% on a maximum base salary of \$125,000 per employee. FICA and
5 medicare taxes are computed on the level of the Staff's annualized
6 payroll expense.

7 Adjustment S-18.C annualizes federal unemployment taxes at
8 the 1991 rate of .8% on a maximum base salary of \$7,000. This
9 Adjustment also annualizes state unemployment tax at the 1991 rate of
10 .3% on a maximum base salary of \$7,000.

11 Adjustments S-18.B and S-18.D represent the effect on
12 these annualizations of applying the Staff's O&M factor.

13 Q. Please discuss Adjustment S-18.E.

14 A. This adjustment normalizes payroll taxes to give effect
15 to savings in FICA taxes due to the Section 125 Plan.

16 Q. What is the Section 125 Plan?

17 A. On December 7, 1989, the Board of Directors of SLCWC
18 approved implementation of what is known as a Section 125 Plan.
19 Subject to the requirements of the Internal Revenue Code (I.R.C.
20 Section 89), the creation of the Section 125 Plan by the Company
21 generally enabled employees to reduce their taxable compensation by
22 the amount of their share of the Company's health insurance premium.
23 The Section 125 Plan effectively changes what had been an after-tax
24 expense into a pre-tax expense. It benefits the Company by reducing
25 employee compensation subject to payroll taxes (primarily FICA).

26 Q. How was this adjustment calculated?

1 A. In the response to Staff Data Request No. 119, the
2 Company provided the total test year savings in FICA due to Section
3 125. Since some items were not in effect for the full twelve months
4 of the test year, the Staff normalized and used this number as a
5 base. The Staff's adjustment reflects annualized FICA savings, which
6 in effect reduce the annualized level of FICA taxes. If a reduction
7 was not made for the Section 125 Plan, the annualized level of FICA
8 taxes would be too high.

9 Q. Does this conclude your direct testimony?

10 A. Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the matter of St. Louis County Water)
Company for authority to file tariffs to)
increase rates for water service provided) Case No. WR-91-361
to customers in the Missouri service area)
of the Company.)

AFFIDAVIT OF ARLENE S. PFLEEGER

STATE OF MISSOURI)
) ss
COUNTY OF COLE)

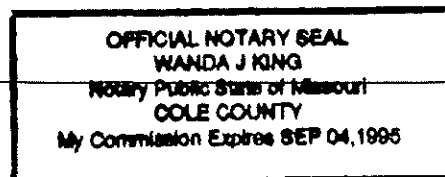
Arlene S. Pfleegeer, of lawful age, on her oath states: that she has participated in the preparation of the foregoing direct testimony in question and answer form, consisting of ___ pages to be presented in the above case; that the answers in the foregoing direct testimony were given by her; that she has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of her knowledge and belief.

Arlene S. Pfleegeer
Arlene S. Pfleegeer

Subscribed and sworn to before me this 3rd day of October, 1991.

Wanda J. King
Notary Public

My Commission expires 9/4/95



RATE CASE PROCEEDINGS

ARLENE PFLEEGER

<u>Company</u>	<u>Case Number</u>
Arkansas-Missouri Power Company	ER-79-48
Radio Communications Company	TR-79-86
Fidelity Telephone Company	18310
Southwestern Bell Telephone Company	TR-79-213
Southwestern Bell Telephone Company	TR-80-256
Union Electric Company	ER-80-17
Union Electric Company	ER-81-180
Union Electric Company	ER-82-52
Union Electric Company	EO-82-86
Union Electric Company	ER-83-163
Union Electric Company	ER-84-168
Union Electric Company	EO-85-17
Union Electric Company - Steam	HR-80-193
Union Electric Company	EM-91-29
Laclede Gas Company	GR-80-210
Laclede Gas Company	GR-81-245
Laclede Gas Company	GR-82-200
Laclede Gas Company	1987 Investigation
	of Earnings
Laclede Gas Company	GR-90-120
Citizens Electric Corporation	ER-81-79
O'Fallon Gas Company	GR-81-51
Capital City Water Company	WR-82-117
St. Louis County Water Company	WR-82-249
St. Louis County Water Company	WR-83-264
St. Louis County Water Company	WR-85-243
St. Louis County Water Company	WR-87-2
St. Louis County Water Company	WR-88-5
St. Louis County Water Company	WR-89-246
St. Joseph Water Company	WR-83-108
Joplin Water Works	WR-83-132
Osage Natural Gas Company	GR-85-183
Arkansas Power & Light Company	ER-85-20
Continental Telephone Company	TR-86-55
Webster County Telephone Company	TR-86-63
Missouri Cities Water Company	WR-86-111
Missouri Cities Water Company	SR-86-112
Cedar Hill Utility	Informal Rate
	Case - 1987
St. Louis County Water Company	WR-88-5
Cat Pak Waterworks	Informal Rate
	Case - 1988
Contel, CSM & Webster Telephone Companies	TR-89-106

RATE CASE PROCEEDINGS

ARLENE PFLEEGER

<u>Company</u>	<u>Case Number</u>
Citizens Electric Corporation	Informal Examination of Legal & Consulting Exp.
Fidelity Telephone Company	Investigation of Earnings - 1989
Bourbeuse Telephone Company	Investigation of Earnings - 1989
Contel	Investigation of Earnings - 1990
SK&M Water Company	Informal Rate Case - 1990
Argyle Estates Water Company	Informal Rate Case - 1990
Missouri-American Water Company	WR-91-211

