December 11, 2003

VIA EMAIL ONLY

RE: I/M/O the Petition of the Mount Holly Water Company for an Increase in Rates for Water Service and Other Tariff Modifications
BPU Docket No. WR03070509
OAL Docket No. PUCRL 07280-2003N

TO SERVICE LIST MEMBERS:

Enclosed please find electronic copies of the direct testimonies of the Division of the Ratepayer Advocate's witnesses, Robert J. Henkes, James A. Rothschild, Barbara R. Alexander, Howard J. Woods, and Brian Kalcic, in connection with the above referenced matter.

Should you require anything further, please do not hesitate to contact our office.

Very truly yours,
SEEMA M. SINGH, ESQ.
RATEPAYER ADVOCATE

By: ______________________________
Robert J. Brabston, Esq.
Deputy Ratepayer Advocate

RJB/slc

BEFORE THE STATE OF NEW JERSEY
BOARD OF PUBLIC UTILITIES
OFFICE OF ADMINISTRATIVE LAW

IN THE MATTER OF THE PETITION	**)**	
OF THE MOUNT HOLLY WATER	**)**	**BPU Docket No. WR03070509**
COMPANY FOR APPROVAL OF AN	**)**	**OAL Docket No. PUCRL 07280-2003N**
INCREASE IN RATES FOR WATER	**)**	
SERVICE AND OTHER TARIFF	**)**	
MODIFICATIONS	**)**	

DIRECT TESTIMONY AND EXHIBITS OF ROBERT J. HENKES
ON BEHALF OF THE
NEW JERSEY DIVISION OF THE RATEPAYER ADVOCATE

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MOUNT HOLLY WATER COMPANY
BPU Docket No. WR03070509
Direct Testimony of Robert J. Henkes

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I. STATEMENT OF QUALIFICATIONS

Q. WOULD YOU STATE YOUR NAME AND ADDRESS?

A. My name is Robert J. Henkes and my business address is 7 Sunset Road, Old Greenwich, Connecticut 06870.

Q. WHAT IS YOUR PRESENT OCCUPATION?

A. I am Principal and founder of Henkes Consulting, a financial consulting firm that specializes in utility regulation.

Q. WHAT IS YOUR REGULATORY EXPERIENCE?

A. I have prepared and presented numerous testimonies in rate proceedings involving electric, gas, telephone, water and wastewater companies in jurisdictions nationwide including Arkansas, Delaware, District of Columbia, Georgia, Kentucky, Maryland, New Jersey, New Mexico, Pennsylvania, Vermont, the U.S. Virgin Islands and before the Federal Energy Regulatory Commission. A complete listing of jurisdictions and rate proceedings in which I have been involved is provided in Appendix I attached to this testimony.

Q. WHAT OTHER PROFESSIONAL EXPERIENCE HAVE YOU HAD?

A. Prior to founding Henkes Consulting in 1999, I was a Principal of The Georgetown Consulting Group, Inc. for over 20 years. At Georgetown Consulting I performed the same type of consulting services as I am currently rendering through Henkes Consulting. Prior to my association with Georgetown Consulting, I was employed by the American Can Company as Manager of Financial Controls. Before joining the American Can Company, I was employed by the management consulting division of Touche Ross & Company (now Deloitte & Touche) for over six years. At Touche Ross, my experience, in addition to regulatory work, included numerous projects in a wide variety of industries and financial disciplines such as cash flow projections, bonding feasibility, capital and profit forecasting, and the design and implementation of accounting and budgetary reporting and control systems.

Q. WHAT IS YOUR EDUCATIONAL BACKGROUND?

A. I hold a Bachelor degree in Management Science received from the Netherlands School of Business, The Netherlands in 1966; a Bachelor of Arts degree received from the University of Puget Sound, Tacoma, Washington in 1971; and an MBA degree in Finance received from Michigan State University, East Lansing, Michigan in 1973. I have also completed the CPA program of the New York University Graduate School of Business.

II. SCOPE AND PURPOSE OF TESTIMONY

Q. WHAT IS THE SCOPE AND PURPOSE OF THIS TESTIMONY?

A. I was engaged by the New Jersey Division of the Ratepayer Advocate ("Ratepayer Advocate") to conduct a review and analysis and present testimony in the matter of the petition of Mount Holly Water Company ("MHWC" or the "Company") for an increase in rates for water service.

The purpose of this testimony is to present to the New Jersey Board of Public Utilities ("BPU" or "the Board") the appropriate rate base, pro forma test period operating income and overall revenue requirement for the Company in this proceeding.

In the determination of the Company's appropriate revenue requirement, I have relied on and incorporated the recommendations of Ratepayer Advocate witness James Rothschild concerning the appropriate capital structure, capital cost rates and overall rate of return.

In developing this testimony, I have reviewed and analyzed the Company's July 10, 2003 filing; supporting testimonies, exhibits and workpapers; the Company's responses to initial and follow-up data requests by the Ratepayer Advocate and BPU Staff; and other relevant financial documents and data. In addition, I attended an informal discovery conference in Newark, New Jersey on November 3, 2003. Information obtained in this conference has been incorporated in this testimony.

III. SUMMARY OF FINDINGS AND CONCLUSIONS

Q. PLEASE SUMMARIZE YOUR FINDINGS AND CONCLUSIONS IN THIS CASE.

A. I have reached the following findings and conclusions in this docket:

1. The appropriate pro forma rate base amounts to $33.521 million which is $12.877 million lower than the Company's proposed pro forma rate base of $46.398 million. Schedule RJH-1, line 1 and Schedule RJH-3.
2. The appropriate pro forma operating income amounts to $1.839 million, which is $331,000 higher than the Company's proposed pro forma operating income of $1.508 million. Schedule RJH-1, line 4 and Schedule RJH-8.
3. The appropriate overall rate of return for the Company, as recommended by Ratepayer Advocate witness James Rothschild, is 4.42%, incorporating a recommended return on equity of 9.60%. This compares to MHWC's proposed overall rate of return of 5.58%, including a requested return on equity rate of 11.25%. Schedule RJH-1, line 2 and Schedule RJH-2
4. The appropriate Revenue Conversion Factor to be used for ratemaking purposes in this case is 1.7850. Schedule RJH-1, line 6 and footnote (2).
5. The recommended ratemaking components outlined above indicate the need for a rate decrease of $635,000. This recommended rate decrease is $2.564 million lower than the Company's proposed rate increase of $1.929 million. Schedule RJH-1, lines 5-7.

IV. REVENUE REQUIREMENT ISSUES

A. TEST YEAR AND PRO FORMA YEAR

Q. PLEASE DESCRIBE THE TEST YEAR AND PRO FORMA YEAR USED BY MHWC TO SUPPORT ITS REQUESTED RATE INCREASE IN THIS PROCEEDING.

A. The Company's proposed Test Year in this case is calendar year 2002, including 12 months of actual data. The Company then adjusted its Test Year results for rate base, revenue, expense and tax changes projected to occur in calendar year 2003 and, with regard to plant in service, for projected plant balances as of June 30, 2004, the assumed rate effective date of this case. In an effort to be consistent with this Pro Forma Year approach, the Company annualized its revenues based on projected billing determinants as of December 31, 2003, reflected depreciation expenses based on the projected June 30, 2004 depreciable plant balances, and reflected adjusted annualized O&M expenses and taxes based on expense and tax projections for the Pro Forma Year ending December 31, 2003 and into calendar year 2004.

Q. DO YOU BELIEVE THAT THIS PROPOSED TEST YEAR AND PRO FORMA YEAR RATE MAKING APPROACH IS REASONABLE FOR PURPOSES OF DETERMINING MHWC'S REVENUE REQUIREMENT IN THIS CASE?

A. Not entirely. While I agree with the use of the proposed 2002 Test Year as the starting point and the use of calendar year 2003 as the Pro Forma Year, I do not agree with the

Company's proposal to use projected plant in service balances and annualized depreciation expenses as of June 30, 2004. I will discuss my disagreement on this point in more detail later in this testimony. At the time of this writing, actual results for the first 10 months of the Pro Forma Year ended December 31, 2003 have been available for review and analysis and have been relied on in the preparation of this testimony, and by the time of the scheduled hearings in this case, actual data for the full Pro Forma Year are expected to be available.

In summary, for the foregoing reasons, I believe that it is reasonable and appropriate to use a Test Year of 2002 and Pro Forma Year of 2003 for purposes of determining MHWC's revenue requirement in this proceeding. However, the Company's proposal to reflect projected post-Pro Forma Year plant in service balances as of June 30, 2004, together with the associated annualized depreciation expenses, should be rejected by Your Honor and the Board.

B. RATE BASE

Q. PLEASE SUMMARIZE THE COMPANY'S PROPOSED PRO FORMA RATE BASE, THE METHOD EMPLOYED BY THE COMPANY TO DETERMINE ITS PRO FORMA RATE BASE, AND THE RECOMMENDED RATE BASE ADJUSTMENTS.

A. The Company's proposed pro forma rate base of $46.398 million is summarized by specific rate base component in the first column on Schedule RJH-3. All of the Company's proposed pro forma rate base balances except those for utility plant in service, prepayments, materials & supplies, and cash working capital represent fully projected balances as of December 31, 2003, the end of the Pro Forma Year in this case. The proposed utility plant in service balance is stated as of June 30, 2004, the presumed rate effective date of this case. The proposed rate base balances for prepayments and materials & supplies represent the 13-month average balances for the Test Year ended December 31, 2002 and the claimed cash working capital requirement has been determined through a detailed lead/lag study approach.

I have used December 31, 2003 – the end of the Pro Forma Year in this case – as the cut-off point for the rate base balances to be used for rate making purposes in this case. At this time, I have preliminarily reflected actual account balances as of October 31, 2003 (the latest date for which actual data was available at the time of this writing) for plant in service, accumulated deferred income taxes, customer deposits, customer advances and contributions in aid of construction. These October 31, 2003 rate base balances must be updated for actual balances as of December 31, 2003 once this information has become available. The recommended prepayment and materials & supplies balances represent the average balances for the most recent actual 12-month period ended October 31, 2003. All of the remaining recommended rate base components are currently based on projected balances as of December 31, 2003, but must be updated for actual balances as of December 31, 2003. Depending on the availability of actual data, I intend to provide such updated actual 12/31/03 rate base balances during or after the scheduled hearings in this case.

I have also removed certain of MHWC's proposed rate base components and included additional rate base components which the Company has failed to reflect.

As shown in the second and third columns on Schedule RJH-3, the previously described recommended rate base approach has resulted in a number of rate base adjustments with the effect of reducing the Company's proposed rate base by a total amount of $12.877 million. Each of these recommended rate base adjustments will be discussed in detail below.

- **Utility Plant In Service**

Q. PLEASE DESCRIBE THE DERIVATION OF THE COMPANY'S PROPOSED PRO FORMA TEST PERIOD PLANT IN SERVICE BALANCE.

A. The Company has proposed a pro forma plant in service balance of $67.229 million for ratemaking purposes in this case. This pro forma plant balance represents the projected plant in service balance as of the end of the Pro Forma Year, 12/31/03, plus projected plant in service additions from 1/1/04 – 6/30/04. This is the only rate base component for which the Company has reflected post-Pro Forma Year projected balances through 6/30/04.

The Company used the actual 12/31/02 plant in service balance of $54.309 million as the starting point of its proposed pro forma plant in service balance. As shown on Exhibits P-2, Schedule 28, page 2 and PT-4A, Schedule 1, the Company then proposes to add projected 2003 and 2004 plant in service additions totaling approximately $12.9 million, resulting in a projected 6/30/04 plant in service balance of $67.229 million. As shown in the plant in service filing workpaper, of the total projected plant in service additions of $12.9 million, an amount of $9.2 million represents projected post-Pro Forma Year 2004 plant additions

Q. WHAT IS THE MOST RECENT ACTUAL PLANT IN SERVICE BALANCE AVAILABLE AT THIS TIME?

A. This is the plant in service balance as of October 31, 2003. As shown in the updated response to RAR-A-1, the actual plant in service balance as of October 31, 2003 amounts to $54.801 million. This represents an actual plant in service growth for the first 10 months of 2003 of approximately $492,000.

Q. DO YOU AGREE WITH THE COMPANY'S PROPOSAL TO REFLECT PROJECTED POST-PRO FORMA YEAR PLANT IN SERVICE ADDITIONS FROM 1/1/04 TO 6/30/04?

A. No, I do not. The Company's proposed post-Pro Forma Year approach violates the integrity of the test year and the matching principle. For example, while the Company essentially proposes to include in rate base its proposed plant in service balance as of June 2004, it did not propose the same for other rate base components such as the offsetting depreciation reserve and accumulated deferred income tax ("ADIT") balances. Specifically, rather than bringing its entire embedded depreciation reserve included in rate base forward to June 30, 2004, the Company reflected the December 31, 2003 embedded depreciation reserve, adjusted only for 6 months' worth of depreciation on the 2004 post-

Pro Forma Year plant additions. Similarly, the Company only reflected the projected 12/31/03 embedded ADIT balance rather than moving this embedded ADIT balance forward to 6/30/04. The Company's failure to do so represents a serious mismatch in these three major rate base components.

Another mismatch that is inherent in the Company's proposed post-Pro Forma Year ratemaking approach is the fact that it has reflected plant additions from January 2004 to June 2004, but has failed to reflect corresponding utility plant retirements during the same period.

Finally, while the Company proposes rate base inclusion and annualized depreciation expenses for plant additions extending to June 30, 2004, it has not proposed to reflect offsetting revenue growth from projected customer growth through June 30, 2004.

It should also be noted that the actual balances for the Company's proposed 6/30/04 plant in service account will not be available and cannot be verified for accuracy by the time the record in this proceeding closes, or at the time that Your Honor and the Board will decide this case.

In summary, for all of the foregoing reasons, I recommend that Your Honor and the Board reject the Company's proposal to give rate recognition to projected plant in service additions in the post-Pro Forma Year period 1/1/04 – 6/30/04. Instead, I recommend that rates be set in this case based on the actual plant in service balance at 12/31/03, the end of the Pro Forma Year.

Q. DO YOU ACCEPT, AT THIS TIME, THE COMPANY'S PROPOSED PLANT IN SERVICE BALANCE PROJECTED FOR DECEMBER 31, 2003?

A. No. As shown on the plant in service filing workpaper, the Company has projected total plant in service additions of $3.716 million from 12/31/02 to 12/31/03. Given that the actual plant in service additions for the first 10 months of 2003 only amounted to $.492 million, I cannot accept at this time the Company's projection that it will add $3.224 million of plant in service during the remaining 2 months of 2003.

Q. WHAT IS YOUR RECOMMENDED POSITION REGARDING THIS ISSUE AT THIS TIME?

A. For the foregoing reasons, I have at this time reflected the Company most recent available actual plant in service balance, that being the balance of $54.801 million as of October 31, 2003. However, I recommend that this plant balance be replaced by the actual plant in service balance as of December 31, 2003 once this information has become available.

- <u>Acquisition Adjustment</u>

Q. PLEASE EXPLAIN THE COMPANY'S PROPOSAL WITH REGARD TO THE ACQUISITION ADJUSTMENT ASSOCIATED WITH MHWC'S ACQUISITION OF HOMESTEAD.

A. In June 1999, the Company acquired the Homestead Water Utility water system at a purchase price that was approximately $516,000 in excess of Homestead's net book value. While the Board approved this acquisition for book purposes, it never made a specific ruling as to the ratemaking treatment of the $516,000 acquisition adjustment associated with this acquisition.

In this case, the Company is proposing an annual acquisition adjustment amortization of $51,589 based the 10-year amortization of the acquisition adjustment balance. The Company also proposes a rate base inclusion of the unamortized acquisition adjustment starting balance (see Schedule RJH-3, line 2), net of associated accumulated amortizations included in the amortization reserve (Schedule RJH-3, line 5).

Q. DO YOU AGREE WITH THE COMPANY'S PROPOSAL REGARDING THIS ACQUISITION ADJUSTMENT IN THIS CASE?

A. No, I do not. The Board's current ratemaking policy is that acquisition adjustments can only be given rate recognition[1] if it has been demonstrated that the acquisition results in clearly identified and direct benefits to both the ratepayers of the acquiring utility and the acquired utility. This case represents the first time that the Company is requesting rate recognition for this acquisition adjustment. Other than a generalized two-sentence statement contained in the response to RAR-A-8D, the Company has not provided any detailed evidence regarding the financial and non-financial benefits accruing to the MHWC

[1] This does not necessarily mean full rate recognition. For example, in the last NJAWC rate case, BPU Docket No. WR98010015, the Board only granted rate recognition for 50% of the Howell acquisition adjustment. *I/M/O the Petition of New Jersey-American Water Company for an Increase in Rates for Water and Sewer Service and Other Tariff Modifications*, BPU Docket No. WR98010015, Order Adopting in Part and Rejecting in Part Initial Decision at 20-21 (April 6, 1999).

and (former) Homestead customers from the acquisition. I do not agree with the Company's implied position that the Board's approval of this acquisition for book purposes automatically allows rate recovery for the acquisition adjustment in this case.

Based on the foregoing information, I recommend that all aspects of the Homestead acquisition adjustments be removed for ratemaking purposes from this case. Accordingly, I have removed the Company's proposed Homestead acquisition adjustment amortization expenses of approximately $52,000 and the unamortized Homestead acquisition adjustment rate base balance of approximately $527,000, offset by the associated amortization reserve balance of $245,000 My recommended adjustments are shown on Sch. RJH-3, lines 2 and 5, and Schedule RJH-8, line 12.

Q. DO YOU HAVE ANY ADDITIONAL COMMENTS REGARDING THIS ISSUE?

A. Yes. One of the Board's policy guidelines established in NJAWC's Docket WR98010015 regarding the rate treatment for acquisition adjustments concerns the amortization period to be used for acquisition adjustments:

> To further minimize the effect on rates, the Board ORDERS the use of a 40 year amortization period for each acquisition adjustment…[2]

To the extent Your Honor and the Board were to allow rate treatment for this Homestead acquisition adjustment, the amortization period should change from 10 years to 40 years on a going forward basis and the annual amortization expense to be reflected in this case should be changed accordingly.

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[2] *Id*. at 17.

- **Depreciation Reserve**

Q. HOW DID THE COMPANY DERIVE ITS PROPOSED PRO FORMA DEPRECIATION RESERVE BALANCE AS OF DECEMBER 31, 2003 IN THIS CASE?

A. As shown on filing Exhibit P-2, Schedule 28, page 3, the Company used a rather convoluted methodology to project its proposed pro forma depreciation reserve balance as of December 31, 2003. Specifically, the Company started out with the actual reserve balance at 12/31/2002. It then added 12 months worth of annualized depreciation expenses based on the depreciable plant in service balance at 12/31/2002. Next, it added one-half of the difference between (1) its proposed pro forma annualized depreciation expense based on the projected depreciable plant in service balance as of 6/30/04 and (2) the annualized depreciation expenses based on the depreciable plant in service balance at 12/31/2002.

Q. DID YOU DETERMINE THE RECOMMENDED PRO FORMA DEPRECIATION RESERVE BALANCE AS OF DECEMBER 31, 2003 IN A SIMILAR MANNER?

A. No. I recommend a much more straight-forward method to determine the appropriate pro forma annualized depreciation reserve balance as of December 31, 2003, a method that has been accepted by the Board in prior New Jersey rate proceedings and that has been used on a consistent basis for rate making purposes by the Delaware Public Service Commission. This method is shown on Schedule RJH-5. As the starting point it takes the actual depreciation reserve balance as of 12/31/02, the beginning of the Pro Forma Year. To this actual starting point balance is then added the annualized depreciation expenses recommended for rate making purposes in this case. As shown on line 3 of Schedule RJH-5, this results in a recommended pro forma depreciation reserve balance of $8.980 million. As shown on Schedule RJH-3, line 4, this recommended reserve balance is $129,000 lower than the Company's proposed pro forma reserve balance of $9.109 million.

- <u>Materials & Supplies and Prepayments</u>

Q. PLEASE EXPLAIN THE RECOMMENDED ADJUSTMENT TO THE COMPANY'S PROPOSED MATERIALS & SUPPLIES AND PREPAYMENT BALANCES, AS SHOWN ON SCHEDULE RJH-3, LINES 7 AND 8.

A. The Company's proposed prepayment and materials & supplies balances represent the 13-month average balances for the Test Year 2002. The recommended prepayment and materials & supplies balances represent the average balances for the 12-month period ended October 31, 2003. These recommended balances must eventually be replaced by the average balances for the Pro Forma Year 2003.

- <u>Cash Working Capital</u>

Q. WHAT IS THE COMPANY'S PROPOSED POSITION WITH REGARD TO CASH WORKING CAPITAL IN THIS CASE?

A. The Company has proposed a cash working capital ("CWC") claim of $42,000. The only reference to this CWC claim in this case is contained in two sentences on page 31 of Mr.

Prettyman's testimony:

> Cash working capital reflects the utilization of leads and lags applied to various operating expenses at supported rates. This method is consistent with that used in the Company's prior rate proceedings.

The calculations underlying the Company's proposed CWC claim of $42,000 are presented in summary format on P-2, Schedule 28, page 6.

Q. IS THE COMPANY'S CWC CLAIM SUPPORTED BY A CURRENT LEAD/LAG STUDY?

A. No. In RAR-A-11, the Company was asked to provide (1) a copy of the detailed lead/lag study, including supporting calculations for the revenue collection lag and all expense/tax payment lags summarized on P-2, Schedule 28, page 6, and (2) an explanation of the time period used to determine the lead/lag days shown on P-2, Schedule 28, page 6. In response, the Company could not produce the requested lead/lag study and confirmed that "it is unclear at this time when the actual lead/lag study was performed…."

Q. WHAT IS YOUR RECOMMENDATION BASED ON THIS INFORMATION?

A. There is no detailed lead/lag study with calculations and assumptions in support of the claimed revenue collection and expense/tax payment lags. We do not know what time period was used to measure and calculate the leads and lags reflected on P-2, Schedule 28, page 6 and it may well be that these leads and lags are outdated at this time. In short, the Company is claiming a CWC requirement in this case that is completely unsupported. For these reasons, I recommend that the Company's CWC claim of $42,000 be rejected. Instead, I recommend that Your Honor and the Board reflect a CWC requirement of $0 for ratemaking purposes in this case. My recommendation is shown on Schedule RJH-3, line 9.

- **Deferred Income Taxes, Customer Advances and CIAC**

Q. PLEASE EXPLAIN THE ADJUSTMENTS TO THE COMPANY'S PROPOSED DEFERRED INCOME TAXES, CUSTOMER ADVANCES AND CONTRIBUTION IN AID OF CONSTRUCTION ("CIAC") BALANCES, AS YOU SHOW ON SCHEDULE 3, LINES 11, 12, AND 13.

A. The Company's proposed rate base balances for these accounts are projected balances as of 12/31/03, the end of the Pro Forma Year. Consistent with my approach regarding plant in service, I have reflected the balances for these accounts as of October 31, 2003, the most recent actual balances available at this time. These balances must eventually be updated for actual balances as of 12/31/03 once this information has become available.

- **Consolidated Income Taxes**

Q. DOES THE BOARD HAVE A RATE MAKING POLICY WITH REGARD TO THE RATE MAKING TREATMENT OF TAX BENEFITS TO BE ASSIGNED TO REGULATED UTILITIES UNDER ITS JURISDICTION AS A RESULT OF THESE UTILITIES' FILING OF CONSOLIDATED INCOME TAX RETURNS?

A. Yes. The Board has an established policy requiring that any tax savings allocable to a utility as a result of the filing of consolidated income tax returns be reflected as a rate base deduction in the utility's base rate filings. The BPU first established this policy in its Decision and Order ("D&O") in the Atlantic City Electric Company rate proceeding, BPU Docket No. ER90091090J, dated September 30, 1992. In this D&O, the Board also ruled that the calculation starting point for the consolidated income tax related rate base deduction must be July 1, 1990:

> ...it is our judgment that the appropriate consolidated tax adjustment in this proceeding is to reflect as a rate base deduction the total of the 1991 consolidated tax savings benefits, and one-half of the tax benefits realized from AEI's 1990 consolidated tax filing...
> ...This finding reflects a balancing of the interests to reflect the unique period of uncertainty during the period 1987-1991. We hereby reaffirm and emphasize that the Board's policy is to reflect an equitable and appropriate sharing of consolidated tax benefits for ratepayers in future rate proceedings.…[3]

The Board reaffirmed its consolidated income tax policy in its D&O in the 1991 Jersey Central Power and Light Company ("JCP&L") base rate proceeding, BPU Docket No. ER91121820J, dated February 25, 1993. On pages 7 and 8 of its D&O in that docket the BPU stated:

> The Board believes that it is appropriate to reflect a consolidated tax savings adjustment where, as here, there has been a tax savings as a result of the filing of a consolidated tax return. Income from utility operations provide the ability to produce tax savings for the entire GPU system because utility income is offset by the annual losses of the other subsidiaries. Therefore, the ratepayers who produce the income that provides the tax benefits should share in those benefits. The Appellate Division has repeatedly affirmed the Board's policy of requiring utility rates to reflect consolidated tax savings and the IRS has acknowledged that consolidated tax adjustments can be made and there are no regulations which prohibit such an adjustment.
>
> The issue, in this case, is not whether such an adjustment should be made, but, rather, what methodology should be used to make such an

[3] *I/M/O the Petition of Atlantic City Electric Company for Approval of Amendments to its Tariff to Provide for and Increase in Rates and Charges for Electric Service, Phase II*, BPU Docket No. ER90091090J, Order Adopting in Part and Modifying in Part the Initial Decision at 8 (October 20, 1992).

> adjustment. In this area, the courts have held that the Board has the power and discretion to choose any approach which rationally determines a subsidiary utility's effective tax rate. Toms River Water Company v. New Jersey Public Utilities Commissioners, 158 NJ Super 57 (1978). Based on our review of the record in this case, the Board REJECTS the ALJ's recommendation to accept the income tax expense adjustment proposed by Petitioner and, instead, ADOPTS the position of Staff that the rate base adjustment is a more appropriate methodology for the reflection of consolidated tax savings. The rate base approach properly compensates ratepayers for the time value of money that is essentially lent cost-free to the holding companies in the form of tax advantages used currently and is consistent with our recent Atlantic Electric decision (Docket No. ER90091090J). Moreover, in order to maintain consistency with the methodology applied in the Atlantic decision, we modify the Staff calculation and find that a rate base adjustment which reflects consolidated tax savings from 1990 forward, including one-half of the 1990 savings, is appropriate in this case.[4]

Q. DOES MHWC FILE A CONSOLIDATED INCOME TAX RETURN?

A. Yes. The Company files a consolidated federal income tax return with the parent company, E'town Corporation, and its other subsidiaries.

Q. DID THE COMPANY'S RATE BASE APPROVED BY THE BOARD IN ITS PRIOR RATE CASES REFLECT A RATE BASE DEDUCTION FOR CONSOLIDATED INCOME TAX SAVINGS IN ACCORDANCE WITH BOARD RATE MAKING POLICY AND CALCULATED IN ACCORDANCE WITH A BOARD-APPROVED METHODOLOGY?

A. Yes. In the Company's prior rate case, BPU Docket No. WR99010032, the Board

[4] *I/M/O the Petition of Jersey Central Power & Light Company for Approval of Increased Base Tariff Rates and Charges for Electric Service and Other Tariff Revisions*, BRC Docket No. ER91121820J, Final Decision and Order Accepting in Part and Modifying in Part the Initial Decision at 7-8 (June 15, 1993).

approved a rate base deduction of $45,000 for consolidated income tax benefits. This consolidated income tax rate base deduction, which was proposed and calculated by the Company itself on filing Exhibit P-9-U, Schedule 5, included cumulative consolidated income tax benefits from 1990 through 1998.

Q. HAVE YOU CALCULATED THE APPROPRIATE CONSOLIDATED INCOME TAX RATE BASE DEDUCTION ADJUSTMENT TO BE APPLIED TO MHWC FOR RATE MAKING PURPOSES IN THIS CASE IN ACCORDANCE WITH THE METHODOLOGY PREVIOUSLY ESTABLISHED BY THE BPU?

A. I requested these calculations from the Company in data request RAR-A-14 in this case:

> <u>Request:</u>
> In the prior MHWC rate case, the Company prepared and submitted Exhibit P-9-U, Schedule 5 (Update 4/30/99) showing consolidated income tax information from 1990 through 1998, proposing a total MHWC Consolidated Tax benefit rate base deduction amount of $45,000. Please extend this analysis showing the exact same cumulative MHWC Consolidated Tax benefit rate base deduction amount for the period 1990 through 2002. Provide this in the same format and detail as per Exhibit P-9-U, Schedule 5 (Update 4/30/99) in the prior MHWC rate case.

The Company performed these requested consolidated income tax calculations in its response to RAR-EWC-A-15. As shown in this response, the cumulative consolidated income tax benefit allocated to MHWC from July 1, 1990 through December 31, 2002 amounts to $162,000.

Q. WHAT IS YOUR RECOMMENDATION WITH REGARD TO THIS CONSOLIDATED INCOME TAX ISSUE?

A. As shown on Schedule RJH-3, line 15, I recommend that the Company's rate base in this case be reduced by the cumulative consolidated income tax benefit amount of $162,000. The calculation method for this cumulative consolidated income tax benefit amount and the recommended ratemaking treatment are consistent with previously established Board policy.

- **Insurance Reserve Balances**

Q. WHY DO YOU RECOMMEND A RATE BASE DEDUCTION FOR THE COMPANY'S INSURANCE RESERVES, AS SUMMARIZED ON SCHEDULE RJH-3, LINE 16?

A. As confirmed in the response to RAR-A-15, the Company has been building up an Uninsured Risk reserve fund and a Self-Insurance reserve fund. The most recent available actual Uninsured Risk reserve balance as of 10/31/03 is $35,500. This balance will be at a level of $36,000 as of 12/31/03. The most recent available actual Self-Insurance reserve balance as of 10/31/03 is $53,610. This balance is expected to be $55,260 at the end of the Pro Forma Year, 12/31/03.[5]

These reserve funds were built up by accruing uninsured risk expenses of $3,000 per year since 1993 and self-insurance expenses at varying annual levels. These insurance expense accruals have always been, and still are, treated as above-the-line expenses for ratemaking purposes. For example, in the current case, the Company has again included an uninsured

[5] All of the foregoing balances are shown in the response to RAR-A-65.

risk premium expense amount of $3,000 and a self-insurance expense accrual amount of $9,900 in its Pro Forma Year operating expenses.[6]

These insurance reserve funds represent cost-free, non-investor supplied capital paid for by the ratepayers through prior and current rate inclusions of the uninsured risk and self-insurance reserve accruals. These accrued reserve funds are available to MHWC on a continuous basis for general working capital purposes. Similar to customer deposits and customer advances, a representative level of this balance must therefore be treated as a rate base deduction. Schedule RJH-6 shows that, net of associated prepaid deferred taxes, the net rate base deduction for the insurance reserve balance at this time amounts to $59,000. This net-of-tax balance should be updated for the actual net-of-tax self-insurance reserve balance as of 12/31/03 once this information has become available.

C. OPERATING INCOME

Q. PLEASE SUMMARIZE THE COMPANY'S PROPOSED PRO FORMA OPERATING INCOME, THE METHOD EMPLOYED BY THE COMPANY TO DETERMINE ITS PRO FORMA OPERATING INCOME, AND THE RECOMMENDED OPERATING INCOME ADJUSTMENTS.

A. The Company has proposed a total pro forma after-tax operating income amount of $1.508 million. In deriving this pro forma income level, the Company projected its pro forma operating revenues based on projected levels of customers as of December 31, 2003 and

[6] See the workpapers for P-2, Schedule 15 – Insurance Expenses.

incorporating numerous assumptions regarding normalized consumption levels for each of the various customer classes. The Company's proposed depreciation expenses were determined by applying its currently approved depreciation rates to its projected depreciable plant level as of June 30, 2004. The proposed pro forma O&M expenses were determined by taking the unadjusted test year O&M expenses from the 2002 Test Year as the starting point and then adjusting these Test Year expense levels for changes during and after the Pro Forma Year 2003 that were deemed to be known and measurable. Generally, the same approach was used by the Company to determine its pro forma revenue taxes and other taxes. The Company's proposed income taxes were determined by taking the proposed net operating income (before income taxes) as the starting point, then deducting pro forma interest expenses through the "interest synchronization" method and applying the statutory FIT rate of 35% .

As shown on Schedule RJH-7, I have recommended a large number of operating income adjustments with the effect of increasing the Company's proposed pro forma after-tax operating income by a total amount of $331,000 to a recommended pro forma operating income level of $1.839 million. Each of these recommended operating income adjustments will be discussed in detail below.

- <u>Other Operating Revenues</u>

Q. PLEASE EXPLAIN THE RECOMMENDED ADJUSTMENT TO THE COMPANY'S PROPOSED OTHER OPERATING REVENUES.

A. The Company has taken the position that the actual Other Operating Revenues of $1,226 booked during the 2002 Base Year should be considered representative of what can be expected during the rate effective period of this case. The various Other Operating Revenues components making up the total revenue amount of $1,226 are shown in the first column of Schedule RJH-8. As shown on this schedule, the Other Operating Revenues for turn-on charges, cross connection, construction and miscellaneous totaled $13,179. However, this was offset by a negative revenue entry of $11,953 related to "PWAC Under-Recovery." Of course, the Company's PWAC expired during its prior rate case in 1999[7] and, therefore, this PWAC under-recovery revenue entry should not have been recorded. This was confirmed by the Company during the discovery conference on November 3, 2003.

In summary, the removal of the PWAC under-recovery entry increases the pro forma Other Operating Revenue level to the recommended revenue level of $13,179.

- **Payroll Expense**

Q. DO YOU RECOMMEND THAT ADJUSTMENTS BE MADE TO THE COMPANY'S PROPOSED PRO FORMA PAYROLL EXPENSES IN THIS CASE?

A. Yes. As summarized on Schedule RJH-10, I recommend that two adjustments be made to the Company's proposed pro forma payroll expenses. First, I recommend a downward adjustment of $95,000 in the Company's pro forma labor costs and, second, I recommend

[7] See response to RAR-A-47.

the removal of $9,000 worth of bonus expenses included in the Company's proposed labor costs. After taking into account the capitalized portions of these two labor cost adjustments, my recommendations reduce the Company's proposed expenses charged to O&M by $93,000.

Q. WHAT IS THE BASIS FOR THE COMPANY'S PROPOSED PRO FORMA LABOR COST IN THIS CASE?

A. As described on page 20 of Mr. Prettyman's testimony and shown in more detail on the workpaper in support of filing Exhibit P-2, Schedule 7, the Company's proposed pro forma labor cost in this case reflects 14 full-time employees and representative cost levels for overtime and summer help. It also includes the annualized impact of 3% wage and salary increases effective 2/1/04, 3/1/04 and 4/1/04. This results in the Company's proposed pro forma labor cost amount of $978,011.

Q. DO YOU BELIEVE THIS PROPOSED PRO FORMA LABOR COST AMOUNT TO BE REASONABLE FOR RATEMAKING PURPOSES IN THIS CASE?

A. No, I do not. As shown in the P-2, Schedule 7 workpaper and in the response to SRR-3, the Company's actual labor costs in the 2002 Base Year amounted to $832,733 and for the most recent available actual 12-month period ended 7/31/03 amounted to $825,256. For the full Pro Forma Year 2003, the Company is projecting total labor costs of $833,000 and for the 12-month period ended 6/30/04 total labor costs of $857,000 are projected. It is true that the projected labor cost amount of $857,000 for the 12-month period ended 6/30/04 only incorporates a portion of the annualized impact of the wage and salary increases as of

2/1/04, 3/1/04 and 4/1/04. However, even if one increases this labor cost amount of $857,000 by the full annual 3% impact of all 2004 wage/salary increases, one would arrive at a pro forma labor cost amount of $857,000 x 1.03, or approximately $883,000. This is still significantly lower than the Company's proposed pro forma labor cost of $978,000.

Based on this information, I believe that the Company's proposed pro forma labor cost of $978,000 is overstated and should be rejected by Your Honor and the Board.

Q. WHAT PRO FORMA LABOR COST AMOUNT DO YOU RECOMMEND FOR RATEMAKING PURPOSES IN THIS CASE?

A. I recommend that a pro forma labor cost amount of $883,000 be used for ratemaking purposes in this case. The derivation of this recommended cost amount was just explained by me.

Q. PLEASE EXPLAIN YOUR RECOMMENDATION TO REMOVE THE BONUS EXPENSES OF APPROXIMATELY $9,000 THAT WERE INCLUDED IN THE COMPANY'S PROPOSED PRO FORMA LABOR COSTS.

A. This $9,000 cost represents lump-sum cash bonuses paid out to each of the Company's employees. I understand that these bonuses are paid out independent of what the performance level of the employee will be for the particular bonus year. In other words, even if an employee does not perform at a satisfactory level, he/she still receives the lump-sum cash bonus. I recommend the removal of these bonus expenses for several reasons. Since these bonuses are paid out no matter the employee performance, I do not see how they would increase employee productivity. The Company also has provided no information as to why these bonuses would benefit the ratepayers. Finally, the rate recognition for such bonus awards is inconsistent with established Board policy.

In summary, I have no objection to these bonus award payments as long as they are treated below-the-line and paid for by the stockholders.

- **Employee Benefit Expenses**

Q. WHY HAVE YOU ADJUSTED THE COMPANY'S PROPOSED EMPLOYEE BENEFIT EXPENSES, AS SHOWN ON SCHEDULE RJH-11?

A. As described on page 20 of Mr. Prettyman's testimony, the Company determined its proposed pro forma medical expenses by considering its 2002 medical expense premiums "plus an estimate of 15% increase for 2003 rates." At this time, the actual 2003 premium rates have become available. As shown in footnote (2) of Schedule RJH-11, I have recalculated the Company's proposed pro forma medical expenses in this case based on the actual 2003 premium information contained in the response to EWC-SRR-20. These recommended updated pro forma medical expenses amount to $120,000, or $28,000 lower than the Company's estimated pro forma medical expenses of $148,000.

The Company determined its proposed pro forma pension and post-retirement benefit expenses in this case based on estimates from its actuary regarding the 2003 costs. The actual actuary-determined pension and post-retirement benefit costs for 2003 have now become available. I have updated the Company's proposed pro forma pension and post-retirement benefit expenses based on the actual 2003 cost information contained in the responses to RAR-A-41 and EWC-RAR-A-47. As shown on Schedule RJH-11, lines 4 and 6, the recommended updated pro forma pension expenses are $25,000 lower and post-retirement benefit expenses are $24,000 higher than the corresponding pro forma expenses proposed by the Company.

In summary, the net impact of the recommended adjustments to the Company's overall employee benefit expenses is an expense decrease of $29,000.

- **Power Expenses**

Q. PLEASE DESCRIBE THE RECOMMENDED ADJUSTMENTS TO THE COMPANY'S PROPOSED PRO FORMA POWER EXPENSES, AS SHOWN ON SCHEDULE RJH-12.

A. The first power expense adjustment, shown on line 3 of Schedule RJH-12, increases the Company's proposed pro forma power expenses by $7,374 based on information contained in the response to RAR-A-44.

The second power expense adjustment, shown on lines 4-6 of Schedule RJH-12, decreases the Company's proposed pro forma power expenses by $10,467 to reflect the recommended 3-year amortization of deferred power cost savings incurred since the last case up until 6/30/04.

In summary, the net effect of these two recommended power expense adjustments is a power expense reduction of $3,093.

Q. COULD YOU ELABORATE ON THE REASONS FOR THIS LATTER POWER EXPENSE ADJUSTMENT?

A. Yes. Paragraph 8 on page 5 of the prior MHWC rate case's Stipulation provides that:

> The operation and maintenance expenses for this case reflect power costs for the Mansfield Plant and power costs for the Green Street and Woodland Plants, reduced by 7% for the Board-ordered rate savings for restructuring of the power industry. <u>If the BPU orders any further rate reductions, costs savings for the reduction in the power rates will be deferred and will be refunded to the customers of Mount Holly as an offset to the revenue requirement from the next rate case</u>. [emphasis supplied]

Since MHWC's last rate case, the BPU ordered total cumulative PSE&G rate reductions of approximately 13%.

In response to RAR-A-44, the Company confirmed that the power cost savings resulting from PSE&G's rate reductions in excess of 7% incurred since the end of the prior rate case through June 30, 2004 amount to $31,401. In accordance with the previously referenced Stipulation provision, this power cost savings amount of $31,401 must be used as an offset to the revenue requirement in the instant case. I recommend that this be accomplished by a 3-year amortization of this total power cost savings amount, consistent with the 3-year amortization period used for rate case expenses in this case. As shown on Schedule 12, lines 4-6, the recommended 3-year amortization produces a power expense credit of $10,467.

- **Purchased Water Expenses**

Q. HAS THE COMPANY RECENTLY ENTERED INTO A PURCHASED WATER CONTRACT WITH NJAWC?

A. Yes. In late 2002, the Company entered into a water sales agreement with NJAWC under which MHWC began purchasing water from NJAWC on January 1, 2003. The agreement has a 10-year minimum term and a minimum daily purchase requirement (DPR) of 50,000 gallons.

Q. WHAT ARE THE REASONS WHY MHWC ENTERED INTO THIS PURCHASED WATER AGREEMENT?

A. The reasons are described on page 11 of Mr. Schaefer's testimony with the following question and answer:

> Q. The MHWC Capital Program identifies a Major Project, Mansfield Expansion. Could you please describe the scope of this project and why it is needed?
>
> A. The first phase of the Mansfield Plant was placed into service in 1999 and designed with infrastructure to facilitate growth and expansion. MHWC has experienced a significant growth rate which is expected to continue for the foreseeable future…. Mt. Holly's total production is approaching its diversion limit and has prompted the need to purchase water from New Jersey-American Water Company until the project is complete. This [Mansfield Expansion] project will increase the Mansfield facility's production capability from 4 MGD to 7 MGD by adding three new production wells and the needed treatment facilities. Utilization of additional capacity beyond 4 MGD is conditional upon receiving additional diversion from the New Jersey Department of Environmental Protection ("NJDEP"). An application for the needed diversion was submitted to NJDEP in July, 2002 and is currently under review. The new facilities will be available for service by June 30, 2004 even if the new diversion is delayed somewhat.

Q. WHAT IS COMPANY'S PROPOSED POSITION IN THIS CASE WITH REGARD TO THE COSTS ASSOCIATED WITH THIS PURCHASED WATER CONTRACT, AS WELL AS THE COSTS ASSOCIATED WITH THE MANSFIELD EXPANSION PROJECT?

A. First, the Company has assumed that the Mansfield Plant Expansion from 4MGD to 7 MGD will be completed and in service by June 30, 2004. As a result, the Company has proposed a post-Pro Forma Year rate base addition of $5.73 million for this Mansfield Expansion plant project, as well as annualized depreciation expenses associated with this plant project. I have estimated that the annual revenue requirement associated with this plant project is in excess of $500,000. At the same time, the Company is also claiming annual purchased water expenses of approximately $63,000 associated with the NJAWC purchased water contract minimum DPR of 50,000 gallons.

Q. DO YOU AGREE WITH THIS PROPOSED POSITION?

A. No. The Company's proposal is internally inconsistent and equivalent to a "have your cake and eat it too" situation. As evident from the above-quoted Schaefer testimony, the need to purchase water from New Jersey-American Water Company would only last until the Mansfield Expansion project is complete. In this case, the Company has assumed that this Expansion project will be complete and in service by June 30, 2004. This would increase the Company's production capacity by <u>3,000,000 gallons a day</u> and would no longer necessitate the 50,000 gallons a day from the NJAWC purchased water contract. Thus, if one were to accept the Company's proposal of including the projected Mansfield

Expansion project in rate base in this case, then there should be no simultaneous rate recognition for the purchased water expenses from the NJAWC contract. Conversely, the only situation in which it would be appropriate to give rate recognition to the annual purchased water expenses from the NJAWC contract is if one does not give rate recognition to the Mansfield Expansion project based on the positions that this project (1) will not be in service by June 30, 2004; and/or (2) is too far removed from the end of the Pro Forma Year; and/or (3) will have final costs that are too speculative to be recognized for ratemaking purposes in this case.

Q. EVEN THOUGH THE NJAWC PURCHASED WATER CONTRACT IS FOR A 10-YEAR TERM, DOES MHWC HAVE THE OPTION OF REDUCING THE MINIMUM DAILY PURCHASE REQUIREMENT OF 50,000 GALLONS A DAY?

A. Yes, I believe so. In its response to RAR-A-50, the Company states that the water purchase contract with NJAWC "allows the minimum DPR requirement [of 50,000 gallons per day] to be increased or decreased every six months to adjust for system demand."

Q. WHAT IS YOUR RECOMMENDATION WITH REGARD TO THIS PURCHASED WATER EXPENSE ISSUE IN THIS CASE?

A. As discussed earlier in this testimony, I recommend that the end of the Pro Forma Year, i.e., 12/31/03, be used as the appropriate cut-off point for plant in service rate base investment. I have assumed that the Company's actual plant in service balance as of 12/31/03 – for which I recommend rate recognition in this case – does not include plant additions associated with the Mansfield Expansion project. For that reason, I have reflected the Company's proposed annual purchased water expense of approximately $63,000 for the NJAWC purchased water contract.

Q. DOES THE COMPANY CURRENTLY HAVE A PURCHASED WATER ADJUSTMENT CLAUSE ("PWAC") IN EFFECT?

A. No. The Company's PWAC expired during its prior 1999 rate case in BPU Docket No. WR99010032.[8] After that case, the Company apparently made a conscious decision not to apply for another PWAC.

Q. DESPITE THE FACT THAT THE COMPANY HAS HAD NO PWAC IN EFFECT SINCE 1999, IS THE COMPANY MAKING A DEFERRED PURCHASED WATER EXPENSE CLAIM IN THIS CASE AS IF A PWAC WERE IN EFFECT?

A. Yes. As discussed on page 22 of Mr. Prettyman's testimony, the Company is deferring the purchased water costs from the NJAWC purchased water contract that it is incurring effective January 1, 2003 until June 30, 2004. The Company is doing so because the rates in effect from January 1, 2003 to June 30, 2004 do not include recovery for these new purchased water costs. The total deferred under-recovered purchased water cost so determined by the Company as of June 30, 2004 amounts to approximately $125,000. As shown on filing Exhibit P-2, Schedule 12, the Company is proposing in this case to amortize this deferred purchased water cost to the ratepayers on a going forward basis over a 3-year period, resulting in an annual deferred purchased water cost amortization of approximately $41,000. In this regard, Mr. Prettyman states on page 22 of his testimony:

[8] As confirmed in the response to RAR-A-47.

> The PWAC adjustment on [P-2] Schedule 12 reflects the cumulative under recovered purchased water costs as of June 30, 2004, the estimated effective date of new rates in this case.

Q. DO YOU AGREE WITH THIS PROPOSED RATEMAKING APPROACH?

A. No. First, I should note that Mr. Prettyman's reference to this deferred purchased water expense adjustment as a "PWAC adjustment" is incorrect and somewhat misleading. As explained earlier, since 1999 the Company chose to eliminate its PWAC mechanism, so no PWAC was, or will be, in effect from January 1, 2003 to June 30, 2004. What the Company is proposing here represents inappropriate single-issue ratemaking applied on a retroactive basis. Rates are set on a forward-looking basis based on the best information available in a rate case and, absent the existence of a reconcilable adjustment clause, are not to be compared and reconciled with actual experience during the rate effective period. Even if this practice for some reason *were* to be allowed, it would be wrong to consider just this one expense item without considering the differences between actual experience and rate allowance for all other expense components as well as for all revenue, rate base, capital structure and capital cost components.

In summary, for the foregoing reasons, I recommend that the Company's proposal to amortize these deferred purchased water expenses in this case be rejected by Your Honor and the Board.

Q. WHAT IS THE IMPACT OF YOUR RECOMMENDATION ON THE

COMPANY'S PROPOSED PRO FORMA YEAR OPERATING EXPENSES?

A. As shown on Schedule RJH-13, my recommendation reduces the Company's proposed Pro Forma Year purchased water expenses by $41,000

- **<u>Tank Painting Expenses</u>**

Q. WHAT IS THE COMPANY'S PROPOSAL IN THIS CASE WITH REGARD TO TANK PAINTING EXPENSES?

A. Based on an assumption that all of its tanks should be painted over a 20-year period, the Company has estimated what it would cost to paint all of its tanks over the next 20 years and then divided this total estimated cost amount by 20 to arrive at its proposed "normalized" annual tank painting amount of approximately $80,000. The Company additionally proposes a balancing account that will defer the difference between the proposed annual recovery amount of $80,000 and the actual annual tank painting expenses. Any tank painting expense deferrals in this balancing account would then be charged or credited to the ratepayers in the Company's next base rate case. In other words, the Company is essentially proposing the establishment of a reconcilable adjustment clause for its tank painting expenses.

Q. WERE THE TANK PAINTING COST ESTIMATES BASED ON ACTUAL TANK PAINTING CONTRACTS OR BIDS FROM OUTSIDE CONTRACTORS?

A. No. The Company did not base its cost estimates on actual painting contracts or competitive tank painting bids from outside tank painting contractors to prepare each of the tank painting expense estimates in the normalized 20-year cycle. As described on page 22 of Mr. Prettyman's testimony, all of the tank painting cost estimates underlying the Company's proposed normalized expense amount of $80,000 were "based upon painting all of the tanks (inside and exterior) times a cost per square foot provided by the tank painting inspector."

Q. IN THE PRIOR CASE, THE COMPANY CLAIMED TANK PAINTING EXPENSES OF $230,000 FOR THE EVERGREEN TANK TO BE INCURRED IN 1999. WHAT WERE THE ACTUAL EVERGREEN TANK PAINTING EXPENSES?

A. As confirmed in the response to RAR-A-73 A, the actual Evergreen tank painting expenses turned out to be approximately $160,000 rather than $230,000.

Q. WHAT IS THE TANK PAINTING STATUS OF THE COMPANY'S SIX TANKS?

A. As shown on the tank painting workpaper in support of P-2, Schedule 13, 4 of the Company's 6 tanks (Marne Highway tank – 1.20 MG; Vincentown tank – 35 MG; Mansfield tank – 1.91 MG; and the Evergreen tank – 1.12 MG) were painted within the last 6 years. Therefore, under the 20-year painting cycle adopted by the Company, these 4 tanks will not be repainted for at least another 14 years and the future cost of painting these tanks, in my opinion, should not have to be considered in this case.

The 2 remaining tanks concern the Company's smallest tanks, the Homestead tank (0.23 MG) and the New Egypt tank (0.10 MG). The Homestead tank was last painted in 1986 and the last painting date of the New Egypt tank is not known. The Company has not provided any evidence in this case indicating any painting plans for these two small tanks. Moreover, there are no current contracts or bids from tank painting contractors concerning the future painting of these two tanks.

Q. DO YOU AGREE WITH THE COMPANY'S PROPOSED NORMALIZED TANK PAINTING EXPENSE LEVEL OF $80,000?

A. I do not agree with the Company's proposed annual normalized tank painting expense level of $80,000 and the associated balancing account rate mechanism and I recommend that the Company's entire tank painting rate treatment approach proposed in this case be rejected by Your Honor and the Board. I believe the Company's proposed normalized annual tank painting expense level is based on unreliable and unproven projections and is unrealistic given the recent historic tank painting experience. In addition, recent history has shown that the Company's tank painting projections turn out to be significantly overstated.

Q. BASED ON THE FOREGOING FINDINGS AND CONCLUSIONS, WHAT PRO FORMA ANNUAL TANK PAINTING EXPENSE LEVEL ARE YOU RECOMMENDING FOR RATEMAKING PURPOSES IN THIS CASE?

A. The evidence provided by the Company in this case regarding tank painting expenses provides very little guidance for an appropriate future tank painting expense rate allowance. Nevertheless, I will recommend an annual tank painting expense level of $50,000. This rate allowance is based on the assumption that the two small Homestead and New Egypt tanks will be painted within the next 5 years.

As shown on Schedule RJH-9, line 7, my recommendation decreases the Company's proposed pro forma tank painting expenses by approximately $29,000.

- **Cost Allocations From EWC**

Q. WHY HAVE YOU ADJUSTED THE COMPANY'S PROPOSED COST ALLOCATIONS FROM EWC, AS SHOWN ON SCHEDULE RJH-14?

A. The recommended $145,000 expense reduction adjustment shown on Schedule RJH-14, line 2 represents the removal of an expense double-count that was included in the Company's proposed pro forma Managerial Cost Allocations from EWC. As confirmed in the response to RAR-A-56 A, the Company agrees that this expense double-count should be removed.

- **Rate Case Expenses**

Q. PLEASE SUMMARIZE THE COMPANY'S PROPOSED RATE CASE EXPENSES TO BE RECOGNIZED FOR RATE MAKING PURPOSES IN THIS CASE.

A. The Company's proposed rate case expenses are detailed in the first column of Schedule RJH-15. The Company has estimated a total expense level of $90,000 for the current case, consisting of $50,000 for outside counsel, $25,000 for its rate of return study and $15,000 for miscellaneous expenses. The Company proposes to allocate 100% of this proposed rate case expense to the ratepayers and amortize this expense over a 3-year period for an annual amortization expense of $30,000.

Q. DO YOU RECOMMEND ADJUSTMENTS TO THE COMPANY'S PROPOSED RATE CASE EXPENSE APPROACH IN THIS CASE?

A. Yes. While the Company has proposed to charge 100% of the rate case expenses in this case to the ratepayers, I have reflected a 50/50 sharing of the rate case expenses between the Company's stockholders and ratepayers. This sharing is based on a long-standing and well-established rate making policy of the Board. This policy was recently confirmed in a Board Order involving Pennsgrove Water Supply Company's rate case in Docket No. WR98030147 where the Board stated on page 12 of this Order:[9]

> Having reviewed the entire record in this matter, the Board ADOPTS the ALJ'S recommendation. In recognition of the argument that stockholders benefit from a rate proceeding, it has been the policy of the Board to utilize 50 - 50 sharing of rate case expenses for larger utilities, including water utilities. In addition, the Board notes that, in this case, since Petitioner's revenues have exceeded one million dollars in each of the last three years (companies with revenues of one million dollars or more are generally classified as Class A water companies), the Board FINDS a 50 - 50 sharing to be appropriate in this matter.[10]

The Company has not provided any evidence in this case for the BPU to deviate from this rate making policy.

Q. WHAT IS THE RECOMMENDED ANNUAL RATE CASE EXPENSE AMORTIZATION THAT SHOULD BE ADOPTED IN THIS PROCEEDING?

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[9] Order Adopting in Part and Rejecting in Part Initial Decision, *I/M/O the Petition of Pennsgrove Water Supply Company for an Increase in Rates for Water Service*, BPU Docket No. WR98030147, OAL Docket No. PUC02655-98, dated June 30, 1999.
[10] *I/M/O the Petition of Pennsgrove Water Supply Company for an Increase in Rates for Water Service*, BPU Docket No. WR98030147, Order Adopting in Part and Rejecting in Part Initial Decision at 12 (June 30, 1999).

A. Schedule RJH-15 shows that, based on the recommended position previously described, the Board should adopt an annual rate case expense amortization level of $15,000. This recommendation decreases the Company's proposed Pro Forma Year operating expenses by $15,000.

- **Research Foundation Expenses**

Q. WHAT IS THE COMPANY'S PROPOSAL WITH REGARD TO EXPENSES CLAIMED IN THIS CASE FOR THE AMERICAN WATER RESOURCE CENTER, ALSO REFERRED TO AS RESEARCH FOUNDATION EXPENSES?

A. The Company's proposal concerning the American Water Research Center is described in detail in the direct testimony of Company witness Clerico. The proposed Center will be an independent non-profit organization with the intent to use the resources of water and wastewater utilities together with academia and other non-governmental non-profit organizations to advance new watershed based solutions, enhance water quality and protect water resources for the future.

It is envisioned that the New Jersey Operation Units of American Water – New Jersey-American Water, Elizabethtown Water and Mount Holly Water (the "NJOUs") – will serve as the catalyst to create the Center by providing the initial start-up, administration and funding and then to welcome other utilities including water purveyors, wastewater providers and emerging storm water managers to join as they create similar funding mechanisms.

In their respective rate cases, the NJOUS are requesting rate recognition of an annual expense of $1 million to operate the Center, plus another $1 million in startup costs to be amortized over 3 years. Thus, the total annual expense amount for which the NJOUs are requesting rate recognition is $1.333 million. This total annual expense amount is then allocated among the three NJOUs based on number of customers. Through this allocation method, MHWC is being allocated $33,895 and is requesting inclusion of this annual expense amount in its Pro Forma Year operating expenses.

Q. WHAT IS THE RATEPAYER ADVOCATE'S POSITION ON THIS MATTER?

A. The Ratepayer Advocate opposes the Company's proposal to charge the cost of this initiative to the ratepayers.[11] The Ratepayer Advocate is of the opinion that if the Company is looking for a "grant" to underwrite the launching and operation of this Center, it should look to its ultimate parent company, RWE, not the captive ratepayer body of the NJOUs. RWE is a worldwide organization with enormous resources. The ratepayers of MHWC are already being burdened with a large rate increase request in this case. In the Ratepayer Advocate's opinion, it would be untimely and inappropriate to request that the ratepayers additionally fund such a discretionary item.

Q. WHAT IS YOUR RECOMMENDATION WITH REGARD TO THIS ISSUE AND HOW WOULD THIS RECOMMENDATION IMPACT THE COMPANY'S

[11] Ratepayer Advocate witness, Howard J. Woods, Jr., P.E., presents testimony concerning the need for this initiative in light of other research efforts already being funded by ratepayers. The Ratepayer Advocate does not oppose the creation of the Center, but believes that the Company's owners should fund the costs of additional

PROPOSED PRO FORMA OPERATING EXPENSES IN THIS CASE?

A. Based on the previously described position of the Ratepayer Advocate on this matter, I recommend that the cost associated with the proposed American Water Research Center be treated below-the-line for ratemaking purposes in this case.

As shown on Schedule RJH-9, line 12, my recommendation decreases the Company's proposed Pro Forma Year operating expenses by approximately $34,000.

- **Other O&M Expenses**

Q. PLEASE EXPLAIN THE RECOMMENDED OTHER O&M EXPENSE ADJUSTMENTS SHOWN ON SCHEDULE RJH-16.

A. The Company's proposed pro forma level of Other O&M expenses of $430,000 is based on the actual Other O&M expenses of $418,000 for the 2002 Test Year, increased by an estimated 3% inflation factor of approximately $12,000.

In this case, the Company has made many pro forma O&M expense adjustments which it believed were known and measurable or which could be approximated with reasonable accuracy. To support these specific pro forma O&M expense increases, the Company supplied workpapers showing all calculations and underlying assumptions. However, to add an estimated general inflation factor to the remaining O&M expenses without any detailed support for the reasonableness or accuracy of the resulting costs increases is

research initiatives.

inappropriate and contrary to established BPU policy.[12] I therefore recommend the removal of the Company's proposed 3% inflation adjustment of $12,000.

I have also removed the lobbying expense portion of the Company's test year NAWC dues, amounting to approximately $2,000, as confirmed by the Company in its response to RAR-A-30.

Finally, I have removed from the test year operating expenses an amount of $50,000 the Company has proposed to include for so-called Thames Overhead charges. The inclusion of these Thames Overhead charges in the 2002 base year is shown in the responses to RAR-A-32 (account 930-517968). I understand that MHWC is no longer charged with this Thames Overhead cost allocation of $50,000. This is also evidenced by the fact that these costs are no longer booked by MHWC in the 2003 Pro Forma Year.

As shown on line 5 of Schedule RJH-16, the combined impact of these Other O&M expense adjustments is a decrease of $64,000 in the Company's proposed pro forma Other O&M expenses.

- **Annualized Depreciation Expense**

Q. PLEASE EXPLAIN THE COMPANY'S PROPOSED AND YOUR

[12] *I/M/O the Petition of New Jersey-American Water Company for an Increase in Rates for Water and Sewer Service and Other Tariff Modifications*, BPU Docket No. WR98010015, Order Adopting in Part and Rejecting in Part Initial Decision at 33 (April 6, 1999).

RECOMMENDED ANNUALIZED DEPRECIATION EXPENSE LEVELS.

A. The Company has proposed a total annualized depreciation expense of $1.275 million. As shown in detail on filing Exhibit P-2, Schedule 21, MHWC generally determined this proposed annualized depreciation expenses by applying its currently authorized depreciation rates to its proposed projected depreciable plant balances as of June 30, 2004. This produced annualized deprecation expenses of $1.430 million. The Company then reduced this annualized depreciation expense by the depreciation associated with plant funded by Customer Advances and Contributions in Aid of Construction. The net result is the Company's proposed pro forma annualized depreciation expense of $1.275 million. This is summarized in the first column on Schedule RJH-18.

Schedule RJH-18 shows that when the Company's proposed annualized gross depreciation expense of $1.430 million is divided into the Company's projected 6/30/04 depreciable plant in service balance, this results in an overall composite depreciation rate of 2.153%. In determining the recommended annualized depreciation expense level, I have applied this same overall composite depreciation rate of 2.153% to the preliminary recommended depreciable plant in service balance of $53.604 million. As shown on Schedule RJH-18, line 5, this produces a preliminary recommended annualized depreciation expense of $1.162 million. I then reduced this annualized depreciation expense by the depreciation expense associated with plant funded by Customer Advances and Contributions in Aid of Construction. This produces the currently recommended annualized net depreciation expense level of $1.009 million. This annualized depreciation expense number must eventually be updated by re-calculating it based on the actual plant in service and actual

Customer Advances and Contributions in Aid of Construction levels as of December 31, 2003.

- **Amortization Expenses**

Q. WHY DID YOU ADJUST THE COMPANY'S AMORTIZATION EXPENSES, AS SHOWN ON SCHEDULE RJH-7, LINE 12?

A. As discussed earlier in this testimony, I have reduced the Company's proposed Pro Forma Year amortization expenses by approximately $52,000 to reflect my recommendation that all aspects of the Homestead Water Acquisition Adjustment, including the Company's proposed 10-year amortization of this acquisition adjustment, be removed for ratemaking purposes from this case.

- **Payroll Taxes**

Q. WHY HAVE YOU ADJUSTED THE COMPANY'S PROPOSED PRO FORMA PAYROLL TAXES, AS SHOWN ON SCHEDULE RJH-7, LINE 14?

A. The recommended payroll tax adjustment is a direct result of the recommended payroll expense adjustment. The calculations underlying this recommended payroll tax adjustment are shown on Schedule RJH-10.

- **Revenue Taxes**

Q. WHY DID YOU ADJUST THE COMPANY'S PROPOSED REVENUE TAXES, AS SHOWN ON SCHEDULE RJH-7, LINE 16?

A. The Company's revenue taxes are a function of its operating revenues. Since I have recommended an operating revenue adjustment, the Company's revenue taxes should similarly be adjusted. As shown in footnote (2) of Schedule RJH-7, the recommended revenue tax adjustment is calculated by applying the combined Gross Receipts and Franchise Tax rate of 13.51% to the total recommended operating revenue adjustment shown on line 8 of Schedule RJH-7.

- **Income Taxes**

Q. HOW DID YOU DERIVE THE RECOMMENDED PRO FORMA INCOME TAXES TO BE USED FOR RATE MAKING PURPOSES IN THIS CASE?

A. As shown on Schedule RJH-18, I have used the exact same methodology and calculation components as those used by the Company to derive the recommended pro forma income taxes. Therefore, there is no income tax issue per se. The only reason why the recommended pro forma income taxes are different from the Company's proposed pro forma income taxes is because of the recommended adjustments made by me in the areas of operating revenues, operating expenses and pro forma interest.

- Synergy Savings

Q. HAS THE COMPANY REFLECTED ANY SYNERGY SAVINGS IN ITS FILING IN THIS CASE?

A. No, it has not. The Synergy Study presented by Company witness Doll only identifies and quantifies merger related synergy savings calculated for NJAWC and EWC, but not for MHWC. Curiously, on page 3, lines 7-8 of his testimony, Company witness Chapman states in this regard that the rate requests of NJAWC, EWC and MHWC (referred to as the New Jersey Operating Utilities, or NJOUs) reflect the synergy savings from the Joint Provisioning and Purchasing as a result of the common ownership by RWE. However, nowhere in MHWC's testimonies and filing schedules is there any mention or reflection of specifically identified synergy savings for MHWC similar to what the NJOU filings show for NJAWC and EWC. In confirmation of this fact, the Company states in its response to RAR-SS-2 that:

> No additional savings resulting from joint provisioning and purchasing have been specifically identified as relating to costs incurred for the Mount Holly Water Company.

Q. DO YOU BELIEVE THAT POTENTIAL SYNERGY SAVINGS EXIST FOR MHWC THAT ARE NOT REFLECTED IN THE COMPANY'S SYNERGY STUDY?

A. Yes. While I don't have enough information available at this time to identify and quantify such potential additional synergy savings for MHWC, I cannot accept the Company's position that no synergy savings exist for MHWC. For example, as implied in RAR-E-46, as a result of the consolidation in Lawrenceville or the implementation of the statewide functional organization, the Mount Holly office may no longer be needed, thereby resulting in potential cost savings. And the responses to RAR-E-48, 60 and 62 indicate that potential additional – but not yet quantifiable – synergies may exist for MHWC in the areas of meter purchasing, the procurement of materials and supplies, and stock maintenance.

Q. DO YOU HAVE RECOMMENDATIONS BASED ON THE FOREGOING OBSERVATIONS?

A. Yes. First, I recommend that Your Honor and the Board order the Company to identify and quantify all known and measurable synergy savings for MHWC in a manner similar to the Synergy Study performed for NJAWC and EWC. All of these known and measurable synergy savings that will become available prior to the close of record in this case should be incorporated for ratemaking purposes in this case. Second, I recommend that Your Honor and the Board order the Company to keep track of, quantify and defer all additional net synergy savings that will not be reflected for ratemaking purposes in this case but will actually be experienced before and after June 30, 2004 until the rate effective date of the Company's next base rate proceeding. The Company should establish a clear accounting and audit trail for such additional net synergy savings, including workpapers showing all assumptions and calculations underlying these deferred synergy savings. These deferred net synergy savings should then be allocated to the ratepayers through an appropriate amortization mechanism in the Company's next base rate proceeding. Due to the extraordinary nature of this merger and potential magnitude of these – as yet unquantified – merger synergy savings, I believe it is appropriate that Your Honor and the Board order this deferral mechanism.

Q. MR. HENKES, DOES THIS CONCLUDE YOUR DIRECT TESTIMONY IN THIS PROCEEDING?

A Yes, it does.

SUPPORTING SCHEDULES

RJH-1 - RJH-18

MOUNT HOLLY WATER COMPANY
SUMMARY OF REVENUE REQUIREMENT POSITIONS
$000's

	MHWC (1)	Adjustments	RPA	
1. Pro Forma Rate Base	$ 46,398	$ (12,877)	$ 33,521	Sch. RJH-3
2. Rate of Return	5.58%		4.42%	Sch. RJH-2
3. Income Requirement	2,589		1,483	
4. Pro Forma Income	1,508	331	1,839	Sch. RJH-7
5. Income Deficiency	1,081		(356)	
6. Revenue Conversion Factor	1.78500		1.78500	(2)
7. Rate Increase/(Decrease)	$ 1,929	$ (2,564)	$ (635)	

(1) P-2, Schedule 4

(2)

Revenues	100.0000	$ (635)
GRFT	(13.6115)	86
Bad Debt	(0.2000)	1
	86.1885	(547)
FIT @ 35%	(30.1660)	191
Income	56.0225	$ (356)
Conversion Factor (100.000 / 56.0225)	1.78500	

MOUNT HOLLY WATER COMPANY
SUMMARY OF RATE OF RETURN POSITION

MHWC PROPOSAL:	Ratios	Cost Rates	Weighted Cost Rates
	(1)	(1)	(1)
Long Term Debt	26.88%	2.75%	0.74%
Short Term Debt	43.87%	3.53%	1.55%
Total Debt	70.75%		2.29%
Common Equity	29.25%	11.25%	3.29%
Total Cost of Capital	100.00%		5.58%

RPA RECOMMENDATION:	Ratios	Cost Rates	Weighted Cost Rates
	(2)	(2)	(2)
Long Term Debt	26.88%	2.75%	0.74%
Short Term Debt	43.87%	2.00%	0.88%
Total Debt	70.75%		1.62%
Common Equity	29.25%	9.60%	2.81%
Total Cost of Capital	100.00%		4.42%

(1) PT-8A, Schedule 1, page 1 with ROE at 11.25%
(2) Testimony of James Rothschild, Schedule JAR-1

MOUNT HOLLY WATER COMPANY
SUMMARY OF RATE BASE POSITIONS
$000's

	MHWC (1)	Adjustments	RPA	
1. Utility Plant in Service	$ 67,229	$ (12,428)	$ 54,801	Sch. RJH-4
2. Acquisition Adjustment	527	(527)	-	Henkes Testimony
3. Gross Utility Plant	67,756	(12,955)	54,801	
4. Depreciation Reserve	(9,109)	129	(8,980)	Sch. RJH-5
5. Amortization Reserve	(245)	245	-	Henkes Testimony
6. Net Utility Plant	58,402	(12,581)	45,821	
7. Materials and Supplies	168	(22)	146	(2)
8. Prepayments	67	(6)	61	(2)
9. Cash Working Capital	42	(42)	-	Henkes Testimony
10. Customer Deposits	(1)	1	-	(3)
11. Deferred Federal Income Taxes	(2,839)	(109)	(2,948)	(3)
12. Customer Advances	(4,877)	74	(4,803)	(3)
13. Contributions in Aid of Constr.	(4,454)	29	(4,425)	(3)
14. Unamortized Pre-71 ITC	(110)		(110)	
15. Consolidated Income Taxes	-	(162)	(162)	(4)
16. Insurance Reserve Balance	-	(59)	(59)	Sch. RJH-6
12. TOTAL NET RATE BASE	$ 46,398	$ (12,877)	$ 33,521	

(1) P-2, Schedule 28, page 1 of 8
(2) 13-month average balance for October 2002 through October 2003. To be updated for actual year 2003 average balance.
(3) Actual balance as of 10/31/03. To be updated for actual balance at 12/31/03
(4) Response to RAR-EWC-A-15

MOUNT HOLLY WATER COMPANY
UTILITY PLANT IN SERVICE
$000's

1. MHWC's Proposed Estimated Plant in Service Balance as of 6/30/04	$	67,229	(1)
2. Actual Plant in Service Balance at 10/31/03		54,801	* (2)
3. Preliminary Plant in Service Adjustment	$	(12,428)	

* To be replaced by the actual plant in service balance as of December 31, 2003 once this actual information has become available.

(1) P-2, Schedule 31, p. 2 of 8
(2) Response to RAR-A-1

MOUNT HOLLY WATER COMPANY
RECOMMENDED DEPRECIATION RESERVE BALANCE
$000s

1. Actual Depreciation Reserve Balance at 12/31/02/02	$	7,971	(1)
2. Recommended Annualized Depreciation Expense Based on 12/31/03 Plant		1,009	Sch. RJH-17
3. Recommended Pro Forma Depreciation Reserve at 12/31/03	$	8,980	

(1) P-2, Schedule 28, p. 1 of 8

MOUNT HOLLY WATER COMPANY
INSURANCE RESERVE RATE BASE DEDUCTION
$000's

1. Self-Insurance Reserve Balance as of 12/31/03	$	55	*	(1)
2. Uninsured Risk Insurance Reserve as of 12/31/03		36	*	(1)
3. Total Insurance Reserves	$	91		
4. Associated Deferred Income Taxes @ 35%		(32)		
5. Net After-Tax Reserve Balance	$	59		

* To be updated for actual reserve balance as of 12/31/03

(1) Per response to RAR-A-65

MUNT HOLLY WATER COMPANY
SUMMARY OF OPERATING INCOME POSITIONS
$000's

	MHWC (1)	Adjustments	RPA	
1. Operating Revenues:				
2. General Metered Service				
a. Mount Holly	$ 5,704		$ 5,704	
b. Plumstead	152		152	
c. Southampton	122		122	
d. Homestead	363		363	
e. Total GMS	6,341		6,341	
5. Public Fire	486		486	
6. Private Fire	106		106	
7. Other Operating Revenues	1	12	13	Sch. RJH-8
8. Total Operating Revenues	6,934	12	6,946	
9. Operating Expenses:				
10. O&M Expenses	2,784	(453)	2,331	Sch. RJH-9
11. Depreciation Expenses	1,275	(266)	1,009	Sch. RJH-17
12. Amortization Expenses	52	(52)	-	Henkes Testimony
13. Total Depr. and Amort. Exp.	1,327	(318)	1,009	
14. Payroll Taxes	79	(7)	72	Sch. RJH-10
15. Property Taxes	48		48	
16. Revenue Taxes	942	2 (2)	944	
17. Other Taxes	15		15	
18. Total Taxes o/t Income Taxes	1,084	(6)	1,078	
19. Total Operating Expenses	5,195	(777)	4,418	
20. Net Revenues Before Income Tax	1,739	789	2,528	
21. Income Taxes	231	458	689	Sch. RJH-18
22. Pro Forma Net Operating Income	$ 1,508	$ 331	$ 1,839	

(1) P-2, Schedules 4, 5 and 6
(2) GRFT rate of 13.51% x total operating revenues adjustment on Sch. RJH-7, L8

MOUNT HOLLY WATER COMPANY
SUMMARY OF OTHER OPERATING REVENUE POSITIONS

Other Operating Revenues:	MHWC (1)	Adjustments	RPA
1. Turn-On Charges	$ 6,641		$ 6,641
2. Cross Connection	450		450
3. PWAC Under-Recovery	(11,953)	11,953	-
4. Construction Water	4,910		4,910
5. Miscellaneous	1,178		1,178
6. Total Other Operating Revenues	$ 1,226	$ 11,953	$ 13,179

(1) P-2, Schedule 5, page 1 and response to RAR-A-58
(2) Responses to RAR-A-1 (updated) and RAR-A-65

MOUNT HOLLY WATER COMPANY
SUMMARY OF PRO FORMA OPERATION AND MAINTENANCE EXPENSE POSITIONS
$000's

	MHWC (1)	Adjustments	RPA	
1. Salaries and Wages	$ 876	$ (93)	$ 783	Sch. RJH-10
2. Employee Benefits	363	(29)	334	Sch. RJH-11
3. Production Power	392	(3)	389	Sch. RJH-12
4. Chemicals	63		63	
5. Residual Disposal	21		21	
6. Purchased Water	104	(41)	63	Sch. RJH-13
7. Tank Painting	79	(29)	50	Henkes Testimony
8. Capit. Overhead & Cost Allocations	165	(145)	20	Sch. RJH-14
9. Insurance	124		124	
10. Vehicle Lease Expenses	89		89	
11. Rate Case Expense	30	(15)	15	Sch. RJH-15
12. Research Foundation	34	(34)	-	Henkes Testimony
13. BPU and RPA Assessments	14		14	
14. Other O&M Expenses	430	(64)	366	Sch. RJH-16
15. Total Pro Forma O&M Expenses	$ 2,784	$ (453)	$ 2,331	

(1) P-2, Schedule 6

MOUNT HOLLY WATER COMPANY
SUMMARY OF PRO FORMA PAYROLL EXPENSE POSITIONS
$000's

	MHWC (1)	Adjustments	RPA	
IMPACT ON O&M EXPENSES:				
1. Total Pro Forma Labor Costs	$ 978	$ (95)	$ 883	(2)
2. Remove Bonus Costs Included in Line 1	-	(9)	(9)	(3)
3. Total Payroll Cost Prior to Capitalization	978	(104)	874	
4. Capitalization Rate	10.43%	10.43%	10.43%	
5. Capitalized Payroll [L4 x L5]	102	(11)	91	
6. Payroll Charged to O&M Exp. [L3 - L5]	$ 876	$ (93)	$ 783	
IMPACT ON PAYROLL TAXES:				
7. Composite Payroll Tax Ratio		8%	(4)	
8. Payroll Tax Impact of Payroll Expense Adjustment on Line 6 [L6 x L7}		$ (7)		

(1) P-2, Schedule 7

(2) Per response to SRR-3:

	Total Payrol Costs		
2002	$ 832,733		
12 months ended 7/31/03 - Act.	825,256		
2003 - Projected	833,000		
12 months ended 6/30/04 - Proj.	857,000	x 1.03 =	$ 882,710

(3) Workpapers supporting P-2, Schedule 7

(4) P-2, Schedules 7 and 23: P/R tax expense of $78,511 divided by payroll expense of $978,011 is 8%

MOUNT HOLLY WATER COMPANY
SUMMARY OF PRO FORMA EMPLOYEE BENEFIT EXPENSE POSITIONS
$000's

	MHWC (1)	Adjustments	RPA	
1. Medical	$ 148	$ (28)	$ 120	(2)
2. Dental	14		14	
3. Life Insurance	4		4	
4. Pensions	99	(25)	74	(3)
5. 401K	30		30	
6. Post-Retirement Benefits	68	24	92	(3)
7. Total Pro Forma Employee Benefit Expenses	$ 363	$ (29)	$ 334	

(1) P-2, Schedule 8

(2) Response to EWC-SRR-20:

- Actual 2003 monthly premium	$ 10,320
	12 x
- Annualized	$ 123,840
- Employee Contributions	(3,456)
- Net Medical Expenses	$ 120,384

(3) Responses to RAR-A-41 and EWC-RAR-A-47

MOUNT HOLLY WATER COMPANY
SUMMARY OF PRO FORMA POWER EXPENSE POSITIONS

	MHWC (1)	Adjustments	RPA	
1. Pro Forma Power Cost per MG	$ 225.79		$ 230.04	(2)
2. Pro Forma MG Production	1,735		1,735	
3. Pro Forma Power Expenses	$ 391,746	$ 7,374	$ 399,119	
4. Deferred Power Cost Savings thru 6/30/04	-		$ 31,401	
5. Amortization Period of Deferred Savings (Yrs)	-		3	
6. Annual Power Cost Savings Amortization	-	$ 10,467	$ 10,467	
7. Net Pro Forma Power Expenses [L3 - L6]	$ 391,746	$ (3,093)	$ 388,652	

(1) P-2, Schedule 9
(2) Response to RAR-A-44

MOUNT HOLLY WATER COMPANY
SUMMARY OF PRO FORMA PURCHASED WATER EXPENSE
$000's

	MHWC (1)	Adjustments	RPA
1. NJAWC Purchased Water Expense	$ 63		$ 63
2. NJAWC Purchased Water Expenses Deferred from 1/1/03 - 6/30/04	125		-
3. Amortization Period (Yrs)	3		-
4. Deferred Purchased Water Amortization	41		-
5. Total Annual Purchased Water Expense [L1+L4]	$ 104	$ (41)	$ 63

(1) P-2, Schedule 12

MOUNT HOLLY WATER COMPANY
SUMMARY OF PRO FORMA CAPITALIZED OVERHEAD AND COST ALLOCATION POSITIONS
$000's

	MHWC (1)	Adjustments	RPA	
1. Pro Forma Capitalized Overhead	$ (355)		$ (355)	
2. Pro Forma Managerial Cost Allocations from EWC	286	(145)	141	(2)
3. Pro Forma CCS Costs Allocated from EWC	234		234	
4. Total Cap. Overhead and Cost Allocations	$ 165	$ (145)	$ 20	

(1) P-2, Schedule 14
(2) Response to RAR-A-56 A

MOUNT HOLLY WATER COMPANY
SUMMARY OF RATE CASE EXPENSE POSITIONS
$000s

	MHWC (1)	Adjustments	RPA
1. Legal Expense	$ 50		$ 50
2. Rate of Return Expense	25		25
3. Miscellaneous Rate Case Expense	15		15
4. Total Rate Case Expenses	90		90
5. Ratepayer/Stockholder Sharing	-		(45)
6. Ratepayer Expense Portion @ 50%	90		45
7. Amortization Period (Yrs)	3		3
8. Total Annualized Expense	$ 30	$ (15)	$ 15

(1) P-2, Schedule 17

MOUNT HOLLY WATER COMPANY
RECOMMENDED OTHER OPERATIONS AND MAINTENANCE EXPENSES
$000s

	MHWC (1)	Adjustments	RPA	
1. Adjusted Base Year Other O&M Expenses	$ 418		$ 418	
2. Estimated Inflation Increaes @ 3% of Line 1	12	(12)	-	
3. Pro Forma Other O&M Expenses	430	(12)	418	
4. Remove NAWC Lobbying Expenses	-	(2)	(2)	(2)
5. Remove "Thames Overhead Charges	-	(50)	(50)	(3)
5. Total Net Other O&M Expenses	$ 430	$ (64)	$ 366	

(1) P-2, Schedule 20
(2) Response to RAR-A-30
(3) Responses to RAR-A-32 and RAR-A-76

MOUNT HOLLY WATER COMPANY
SUMMARY OF ANNUALIZED DEPRECIATION EXPENSE POSITIONS
$000's

	MHWC (1)	Adjustments	RPA	
1. Pro Forma Utility Plant in Service	$ 67,229	$ (12,428)	$ 54,801	Sch. RJH-4
2. Less: Non-Depreciable Plant	(805)		(805)	
3. Pro Forma Depreciable Plant	66,424	(12,428)	53,996	
4. Composite Depreciation Rate	2.153%		2.153%	
5. Gross Depreciation Expense	1,430	(268)	1,162	
6. Less: Depreciation on Plant Funded by Customer Advances and CIAC:				
a. Cust. Adv. and CIAC at 12/31/03	(9,331)		(9,228)	Sch. RJH-3
b. Composite Depreciation Rate	1.66%		1.66%	
c. Depreciation Expense Credit	(155)	2	(153)	(2)
7. Net Depreciation Expense [L5 - L6c]	$ 1,275	$ (266)	$ 1,009	

(1) P-2, Schedule 21

MOUNT HOLLY WATER COMPANY
SUMMARY OF PRO FORMA INCOME TAX POSITIONS
$000's

	MHWC (1)	Adjustments	RPA	
1. Net Revenues Before FIT	$ 1,739		$ 2,528	Sch. RJH-7, L20
2. Less: Pro Forma Interest	(1,062)		(542)	(2)
3. Taxable Income	677	1,309	1,986	
4. FIT Rate	35%		35%	
5. Pro Forma Income Taxes	237	458	695	
6. Deduct: ITC Amortization	(6)		(6)	
7. Adjusted Pro Forma Income Taxes	$ 231	$ 458	$ 689	

(1) P-2, Schedule 27

	MHWC	RPA	
(2) Rate Base	$ 46,398	$ 33,521	Sch. RJH-3
Weighted Cost of Debt	2.29%	1.6166%	Sch. RJH-2
Pro Forma Interest	$ 1,062	$ 542	

APPENDIX I

<u>PRIOR REGULATORY EXPERIENCE OF ROBERT J. HENKES</u>

* = Testimonies prepared and submitted

ARKANSAS

Southwestern Bell Telephone Company Divestiture Base Rate Proceeding*	Docket 83-045-U	09/1983

DELAWARE

Delmarva Power and Light Company Electric Fuel Clause Proceeding	Docket 41-79	04/1980
Delmarva Power and Light Company Electric Fuel Clause Proceeding	Docket 80-39	02/1981
Delmarva Power and Light Company Sale of Power Station Generation	Complaint Docket 279-80	04/1981
Delmarva Power and Light Company Electric Base Rate Proceeding	Docket 81-12	06/1981
Delmarva Power and Light Company Gas Base Rate Proceeding*	Docket 81-13	08/1981
Delmarva Power and Light Company Electric Fuel Clause Proceeding*	Docket 82-45	04/1983
Delmarva Power and Light Company Electric Fuel Clause Proceeding*	Docket 83-26	04/1984
Delmarva Power and Light Company Electric Fuel Clause Proceeding*	Docket 84-30	04/1985
Delmarva Power and Light Company Electric Fuel Clause Proceeding*	Docket 85-26	03/1986
Delmarva Power and Light Company Report of DP&L Operating Earnings*	Docket 86-24	07/1986
Delmarva Power and Light Company Electric Base Rate Proceeding*	Docket 86-24	12/1986 01/1987
Delmarva Power and Light Company Report Re. PROMOD and Its Use in	Docket 85-26	10/1986

Fuel Clause Proceedings*		
Diamond State Telephone Company Base Rate Proceeding*	Docket 86-20	04/1987
Delmarva Power and Light Company Electric Fuel Clause Proceeding*	Docket 87-33	06/1988
Delmarva Power and Light Company Electric Fuel Clause Proceeding*	Docket 90-35F	05/1991
Delmarva Power and Light Company Electric Base Rate Proceeding*	Docket 91-20	10/1991
Delmarva Power and Light Company Gas Base Rate Proceeding*	Docket 91-24	04/1992
Artesian Water Company Water Base Rate Proceeding*	Docket 97-66	07/1997
Artesian Water Company Water Base Rate Proceeding*	Docket 97-340	02/1998
United Water Delaware Water Base Rate Proceeding*	Docket 98-98	08/1998
Delmarva Power and Light Company Revenue Requirement and Stranded Cost Reviews	Not Docketed	12/1998
Artesian Water Company Water Base Rate Proceeding*	Docket 99-197 (Direct Test.)	09/1999
Artesian Water Company Water Base Rate Proceeding*	Docket 99-197 (Supplement. Test)	10/1999
Tidewater Utilities/ Public Water Co. Water Base Rate Proceedings*	Docket No. 99-466	03/2000
Delmarva Power & Light Company Competitive Services Margin Sharing Proceeding*	Docket No. 00-314	03/2001
Artesian Water Company Water Base Rate Proceeding*	Docket No. 00-649	04/2001
Chesapeake Gas Company	Docket No. 01-307	12/2001

Gas Base Rate Proceeding*		
Tidewater Utilities Water Base Rate Proceeding*	Docket No. 02-28	07/2002
Artesian Water Company Water Base Rate Proceeding*	Docket No. 02-109	09/2002
Delmarva Power & Light Company Electric Cost of Service Proceeding	Docket No. 02-231	03/2003
Delmarva Power & Light Company Gas Base Rate Proceeding*	Docket No. 03-127	8/2003

DISTRICT OF COLUMBIA

District of Columbia Natural Gas Co. Gas Base Rate Proceeding*	Formal Case 870	05/1988
District of Columbia Natural Gas Co. Gas Base Rate Proceeding*	Formal Case 890	02/1990
District of Columbia Natural Gas Co. Waiver of Certain GS Provisions	Formal Case 898	08/1990
Chesapeake and Potomac Telephone Co. Base Rate Proceeding*	Formal Case 850	07/1991
Chesapeake and Potomac Telephone Co. Base Rate Proceeding*	Formal Case 926	10/1993
Bell Atlantic - District of Columbia SPF Surcharge Proceeding	Formal Case 926	06/19/94
Bell Atlantic - District of Columbia Price Cap Plan and Earnings Review	Formal Case 814 IV	07/1995

GEORGIA

Southern Bell Telephone Company Base Rate Proceeding	Docket 3465-U	08/1984
Southern Bell Telephone Company Base Rate Proceeding	Docket 3518-U	08/1985

Georgia Power Company Electric Base Rate and Nuclear Power Plant Phase-In Proceeding*	Docket 3673-U	08/1987
Georgia Power Company Electric Base Rate and Nuclear Power Plant Phase-In Proceeding*	Docket 3840-U	08/1989
Southern Bell Telephone Company Base Rate Proceeding	Docket 3905-U	08/1990
Southern Bell Telephone Company Implementation, Administration and Mechanics of Universal Service Fund*	Docket 3921-U	10/1990
Atlanta Gas Light Company Gas Base Rate Proceeding*	Docket 4177-U	08/1992
Southern Bell Telephone Company Report on Cash Working Capital*	Docket 3905-U	03/1993
Atlanta Gas Light Company Gas Base Rate Proceeding*	Docket No. 4451-U	08/1993
Atlanta Gas Light Company Gas Base Rate Proceeding	Docket No. 5116-U	08/1994
Georgia Independent Telephone Companies Earnings Review and Show Cause Proceedings	Various Dockets	1994
Georgia Power Company Earnings Review - Report to GPSC*	Non-Docketed	09/1995
Georgia Alltel Telecommunication Companies Earnings and Rate Reviews	Docket No. 6746-U	07/1996
Frontier Communications of Georgia Earnings and Rate Review	Docket No. 4997-U	07/1996
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Continental Telephone Company of Maine Base Rate Proceeding	Docket 90-040	12/1990
Central Maine Power Company Electric Base Rate Proceeding	Docket 90-076	03/1991
New England Telephone Corporation - Maine Chapter 120 Earnings Review	Docket 94-254	12/1994

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