BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF DELAWARE

IN THE MATTER OF THE APPLICATION OF ARTESIAN WATER COMPANY, INC. FOR AUTHORITY TO INCREASE RATES AND CHARGES FOR WATER SERVICE (FILED April 11, 2014)	))))))	PSC DOCKET NO. 14-132

DIRECT TESTIMONY OF

RON TEIXEIRA

ON BEHALF OF

THE COMMISSION STAFF

September 24, 2014

Statement of Qualifications

Q: State your name and the name and address of your employer.

A: Ron Teixeira. I am employed by the Delaware Public Service Commission (Commission). My work address is 861 Silver Lake Boulevard, Suite 100, Dover, Delaware, 19904.

Q: What is your position with the Public Service Commission?

A: I am a Public Utilities Analyst with the Commission. I have been employed with the Commission since December 2013.

Q: As an analyst with the Commission, what is the general nature of your duties?

A: My duties include the review of filings by regulated utilities that propose increases in rates and charges; planning and executing the annual compliance and financial reviews for various utilities; analysis of utilities requesting the issuance of debt securities; planning and participating in the audit of regulated companies; conducting reviews of source documents at utility offices, and evaluating the financial, managerial, and technical conditions of utilities.

Q: What is your professional experience and education?

A: I have a B.A. (1997) from the University of Maryland at College Park, an M.B.A (2010) and M.A. in Economics (2012) from the University of Delaware. I have provided regulatory and financial analysis on Federal Communications Commission telecommunications filings for the National Governor's Association, and represented telecommunication and Internet companies on regulatory matters. My education and professional experience have provided me the opportunity to become familiar with and to analyze various components of utility rate structures.

Q: For whom are you testifying in this proceeding?

A: I am testifying on behalf of the Commission Staff.

Q: What is the purpose of your testimony?

A. I am presenting the Commission Staff's ("Staff") review and evaluation of Artesian' s ("Company") total payroll costs.

<u>**Salaries and Wage Expense**</u>

Q: How did the company determine its salary and wage request in this case?

A: The Company has projected the payroll expense to increase by $1,118,030 (DLV-3C-S) through the test period, the 12-months ending September 30, 2014. This results in a projected test period direct payroll expense of $13,837,657 and a total projected payroll cost of $19,465,802, which includes pro forma O&M payroll, pension, payroll taxes, workers comp and benefits cost.

The Company calculates its test period payroll expense by annualizing six months of salary and wage expenses ending December 31, 2013, and projecting a 3% wage increase in base salaries. While the Company projects to add a number of "operational positions" through the end of the test period (Valcarenghi's Direct Testimony, pg. 26-line 3), it is unclear how many new positions will be added during the test period. In fact, the Company has reduced its workforce by 4 positions since the last rate filing (Valcarnegi's Direct Testimony, pg. 26-line 7).

Q: Do you use the same annualized test period method as the Company to calculate the allowed payroll expense?

A: No. Based on the "known and measurable" principle, I started my calculations and adjustments using the actual wage expenses incurred during the test year ending December 31, 2013. These expenses reflect a reported workforce of 222 full-time employees as of December 31, 2013 (Valcarnegi's Direct Testimony, pg. 26-line 1).

Q: Are you recommending any adjustments to the Company's direct payroll expenses?

A: Yes. I recommend that the Commission allow direct payroll expenses of \$12,362,945. This reflects a negative \$1,474,712 adjustment to the Company's requested projected test period payroll expense of \$13,837,657. (See, Schedule RT1-Payroll Expense).

Q: What is the basis for your recommended direct payroll expense adjustment?

A: My recommendation is based on two changes and adjustments to the Company's salary and wage claim. First, I recommend decreasing the 3.8% wage and salary increase granted to employees during the test year to the water utility industry's 2013 average wage increase of 2.3%. Second, I recommend taking out the "Holiday Bonus" expense from the test year, or decreasing the payroll expense by \$160,080. Thus, as reflected on my Schedule RT2, I recommend a test year payroll expense level that reflects my two adjustments to calculate the allowed direct payroll expense for the Company in this case.

Q: Please explain Staff's adjustment to the 3.84% wage increase granted during the test year?

A: According to the Company's response to data request DPA-RR-60, employees were given a 3.84% wage and salary increase during the test year. This wage increase is well above water utility industry's average wage increase for 2013. According to the American Water Works Association's (AWWA) 2013 Water Utility Compensation Study (Schedule RT3), large utilities' salaries increased an average of 2.3% during 2013. Based on that fact, the Company's 3.8% increase seems excessive and 1.54% above the industry norm. Given that the Company has not provided sufficient evidence to support a wage increase above the industry average, I recommend a reduction of \$195,882 to the Company's test year payroll expense, or a 1.54% decrease (Schedule RT2).

This will decrease the Company's 2013 wage increase to 2.3% and make it more in-line with the industry's 2013 average.

Q: Do you recommend any other compensation adjustments to the test year?

A: Yes. I recommend removing the $160,800 "Holiday Bonus" from the test year payroll expense. The data request DPA-RR-102b-0004 (Schedule RT3) contains a memo written by Dian Taylor to the Company's Board of Directors requesting a Holiday Bonus. Ms. Taylor justifies the bonus request as a reward for employee efforts "to take measures to control costs." In the same memo, Ms. Taylor refers to a chart that lists the recent history of holiday bonuses and the Company's earnings per share (EPS) for that particular year. (See, Schedule RT4). Based on the statements and the chart contained in this memo, it appears the 2013 Holiday Bonus is an incentive based compensation program, rewarding employees for implementing cost control measures and achieving a certain level of earnings per share.

The Commission has excluded such incentive programs costs from customer rates in past decisions, in part, for concerns that utility employees will solely focus on profitability of the Company and not on the services it provides its ratepayers. Incentivizing compensation awards established largely on earnings criteria can in extreme cases promote cost cutting measures at the expense of providing safe and reliable utility service. Accordingly, I recommend decreasing payroll expenses by $160,800 for the test year. This would result in a test year O&M payroll expense that includes base pay and overtime of $12,360,401.

Q: Do you agree with the Company's request for a 3% projected wage increase for the test period?

A: No. The Company has not provided sufficient evidence to support the wage increase, and the amount requested falls outside of the industry norm. Therefore, I recommend the Company's wage increase request not be included in the allowed direct payroll expense.

Q: Please provide a summary of your allowed direct payroll expense for the case?

A: I recommend the Company be allowed a payroll expense of $12,362,945 in this case, a reduction of $1,474,712 to the Company's requested test period payroll expense of $13,837,657 (Schedule RT1-Payroll Expense).

My payroll expense adjustment includes three recommended changes to the Company's requested test period expense. First, I do not use the Company's annualized test period wage expense method. Instead, I use direct payroll expense that is actually incurred and can be measured during the Company's test year as the starting point for my adjustments and recommendations.

Second, I decrease the Company's 3.84% test year wage increase to a 2.3% wage increase, reflecting the water industry's average wage increase in 2013. I made this adjustment by removing 1.54% from the Company's test year expense, or decreasing payroll expense by $195,882.

Third, I remove the incentive based "2013 Holiday Bonus" from the test year payroll expense by making a $160,800 downward adjustment. Such incentive based bonuses have not been allowed by the Commission in previous rate cases.

Using the test period as the starting point for the allowed payroll expense, coupled with the two payroll expense adjustments, results in a test year payroll expense reduction of $356,682, resulting in a recommended payroll expense of $12,362,945, rather than the Company's test period request of $13,837,657. These calculations are presented in Schedule RT1- Payroll Expense and in the table below.

Company's Test Year	Staff Adjustment of Test Year 3.8% to 2.3% (Removal of 1.54%)	Removal of the "Holiday Bonus" from Test Year	Total Adjustment to the Test Year Payroll Expense	Staff's Allowed Payroll Expense for the Rate Case
$12,719,627	-$195,882	$-160,800	-$356,682	$12,362,945

Payroll Tax Expense

Q: What adjustments have you made to the Company's payroll tax expense claim?

A: Based on my payroll expense adjustments that can be viewed in Schedule RT1-Payroll Expense, it is necessary to make a corresponding adjustment to Company's identified payroll tax claims made in its test period. Based on my adjustments and using a payroll tax rate of 7.8%, I recommend a payroll tax expense of $ $964,310 or a reduction of $424,791 to the Company's projected test period claim of $1,088,681. As stated previously, the difference between my recommended payroll tax expense and the Company's is that I used the test year payroll expense to calculate tax expenses, instead of using an annualized projected test period payroll expense. My payroll tax expense calculations are included in RT1-Payroll Taxes and in the table below.

Company's Test Period Payroll Expense Claim	Company's Payroll Tax Expense Claim	Staff's Allowed Payroll Expense	Staff's Payroll Taxes Expense Calculation (Based on 5.37% Effective Rate)	Staff's Adjustment to the Company's Payroll Taxes Expense Claim
$13,837,657	$1,088,681	$12,362,945	$663,890	-$424,791

Pension Expense

Q: Do you oppose the Company's increase in pension costs?

A: No. According to David Valcarenghi's Direct Testimony, the Company experienced an increase in the annual pension expense relating to the Company's Defined Contribution 401(k) plan. Based on DLV-3C-S, the Company increased its pension expense from 5.8% in the test year, to 6.7% in the test period. Based on the evidence the Company has provided in this case, I support the Company's rate of increase for the test period pension expense.

Even though I have accepted the Company's pension expense percentage increase, an adjustment to the Company's projected pension costs must be reflected due to the adjustments I made to payroll expense. Using 6.7

%, and my recommended payroll expense of $12,362,945, results in a pension expense of $823,835, or a reduction of $98,271 to the Company's $922,106 pension expense claim. The calculations for the adjustments can be seen on schedule RT1-Pensions and in the table below.

Company's Test Period Payroll Expense Claim	Company's Pension Expense Claim	Staff's Allowed Payroll Expense	Staff's Pension Expense Calculation Based on Company's 6.7% rate	Staff's Adjustment to the Company's Pension Expense
$13,837,657	$922,106	$12,362,945	$823,835	-$98,271

Employee Benefits

Q: Do you have any adjustments to the Company's increase in employee benefits?

A: No. The Company provided sufficient evidence in their response to data request DPA-RR-77 to justify the increase in employee benefits effective August 1, 2014. Based on the evidence it provided, I adopt the employee benefits expense included in the Company's test period, or $3,490,074. This represents an increase in expense of $548,614 from the test year to the test period. Schedule RT2 shows how I incorporated the employee benefits expense in my total payroll cost recommendation.

Worker's Compensation

Q: Do you suggest changes to the Company's workers compensation costs?

A: Yes. I adjusted the workers compensation expense simply to account for my adjustment to payroll expenses. Based on the workers compensation rate of 1.18% used by the Company, I calculated the workers compensation expense to total $116,309. This is a reduction of $13,565 to the Company's projected test period request of $127,283. This calculation is shown in Schedule RT1-Workers Comp. Insurance and in the table below.

Company's Test Period Payroll Expense Claim	Company's Workers Comp. Insurance Claim	Staff's Allowed Payroll Expense	Staff's Workers Comp. Insurance Calculation Based on Company's 1.18% Rate	Staff's Adjustment to the Company's Workers Comp. Insurance Claim
$13,837,657	$127,283	$12,362,945	$113,718	-$13,565

Q: Please provide your recommendation for the total payroll cost allowed in this case?

A: Staff's recommended total payroll cost allowed in this rate case is $17,754,882. This represents a reduction of $1,710,920 to the Company's total payroll cost request for the test period of $19,465,802. My recommend adjustment is based on calculations provided in Schedule RT2 and in the table below.

Company's Test Period Payroll Cost Claim	Staffs Adjustments to Payroll Costs (excluding Employee Benefits)	Staff Adopts the Company's Payroll Employee Benefits Cost	Staff's Total Adjustment to Company's Payroll Cost	Staff's Recommended Allowed Total Payroll Cost for the Rate Case
$19,465,802	-$14,264,808	-$3,490,074	-$1,710,920	$17,754,882

Q: Does that conclude your testimony?

A: Yes.

Schedule RT1
Total Payroll Staff
Adjustments

Payroll Expense

1	Company's rate case expense claimed	13,837,657
2	Adjustment to claimed expense	12,362,945
4	Rate case expense adjustment	(1,474,712)
5	State income taxes @ 8.7%	128,300
6	Federal income taxes @ 34%	457,780
7	Total income taxes	586,080
8	Net income adjustment	888,632

Pensions

1	Company's rate case expense claimed	922,106
2	Adjustment to claimed expense	823,835
4	Rate case expense adjustment	(98,271)
5	State income taxes @ 8.7%	8,550
6	Federal income taxes @ 34%	30,505
7	Total income taxes	39,055
8	Net income adjustment	59,216

Payroll Taxes

1	Company's rate case expense claimed	1,088,681
2	Adjustment to claimed expense	964,310
4	Rate case expense adjustment	(124,371)
5	State income taxes @ 8.7%	10,820
6	Federal income taxes @ 34%	38,607
7	Total income taxes	49,427
8	Net income adjustment	74,944

Workers Comp. Insurance

1	Company's rate case expense claimed	127,283
2	Adjustment to claimed expense	113,718
4	Rate case expense adjustment	(13,565)
5	State income taxes @ 8.7%	1,180
6	Federal income taxes @ 34%	4,211
7	Total income taxes	5,391
8	Net income adjustment	8,174

Staff Adjustments to Total Payroll Cost

1	Company's rate case expense claimed	19,465,802
2	Adjustment to payroll cost (paryoll expense, taxes, benefits and workers comp)	14,264,808
3	Adopt Company's Employee Benefits	3,490,074
5	Total Staff Adjustment to Total Payroll Cost (includes all payroll costs)	17,754,882
6	Rate case expense adjustment	(1,710,920)
7	State income taxes @ 8.7%	148,850
8	Federal income taxes @ 34%	531,104
9	Total income taxes	679,954
10	Net income adjustment	1,030,966

Schedule RT2
Staff Adjustments to the Company's Test Period Payroll Cost

	Direct Payroll	Pensions	Payroll Taxes	Employee Benefits	Workers' Comp.	Total Payroll Cost
Company's Test Period	$13,837,657	$922,106	$1,088,681	$3,490,074	$127,283	$19,465,802
Staff's Adjustment	-$1,474,712	-$98,271 (used Company's 6.7% rate)	-$124,371	-------	-$13,565	-$1,710,920
Staff's Recommendation	**$12,362,945**	**$823,835**	**$964,310**	**$3,490,074**	**$113,718**	**$17,754,882**

SCHEDULE RT3

American Water Works Association

6666 West Quincy Avenue
Denver, CO 80235-3098
T 303.794.7711
www.awwa.org

2013 WATER UTILITY COMPENSATION SURVEY EXECUTIVE SUMMARY

The American Water Works Association (AWWA) and Verisight, Inc., are pleased to present this Executive Summary of the 18th annual Water Utility Compensation Survey. Data for this survey were collected as of March 1, 2013.

INTRODUCTION

This Water Utility Compensation Survey continues to provide the most extensive study of salaries, salary ranges, and compensation practices in the water utility industry. This year, 509 organizations participated, supplying data for more than 14,000 employees. Based on member feedback, there are two versions of the survey report which more accurately reflect competitive labor markets. The two versions are based on size of utility defined by population served as follows:

- Large Utility Report – Population served above 100,000
- Small/Medium Utility Report – Population served below 100,000

Forty-eight jobs are included in the survey. Job descriptions can be found in the full report. Salary data are summarized for the following categories:

- All Participants
- Water Only Participants
- Water and Wastewater Participants

Within these major categories, the data are further broken down by specific demographic parameters supplied by the participants.

OBSERVATIONS

As suspected, there were significant differences between large and small/medium-sized utilities. A comparison of salary data between the two groups indicates that larger utilities, on average, pay more for all jobs included in the survey. Differences range from 10 percent higher for Entry Level Water Plant Operators, Associate Programmer/Analysts and Water Resource Planning Managers to large utilities paying 30 percent-plus more for Conservation Managers, Top Administrative Executives, and Top Executives.

The full survey also provides salary comparisons by job. The analysis is based on common companies that matched jobs in multiple years. From every indication, salary movement overall has increased since 2012. From 2011 to 2012, large utility salaries moved 0.4 percent on average, while small/medium-sized utilities moved 1.9 percent on an annualized basis. From 2012 to 2013, large utility salaries moved 2.3 percent and salaries at small/medium-sized utilities moved 2.7 percent. Regardless of utility size, it's clear that salaries continue to increase.

SURVEY HIGHLIGHTS

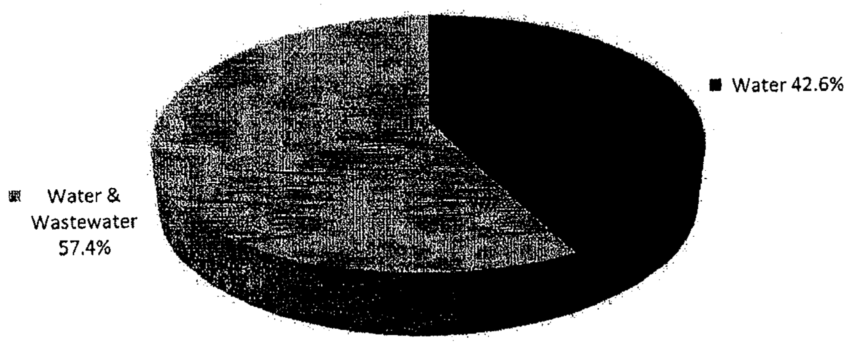
PARTICIPATION

The participation demographics below are based on 391 participants that reported serving a population of less than 100,000, and 118 participants that reported serving a population of more than 100,000. Survey participants were asked to classify their organizations by the following breakouts:

- Type of Utility
- Type of Ownership
- Size (Population Served)
- Total Employment

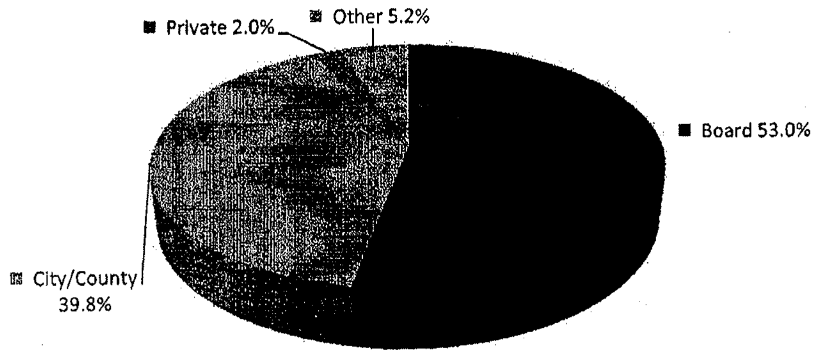
Type of Utility: Small/Medium

The distribution between Water Only (42.6 percent) and Water and Wastewater organizations (57.4 percent) continues to be weighted toward the combined organizations.



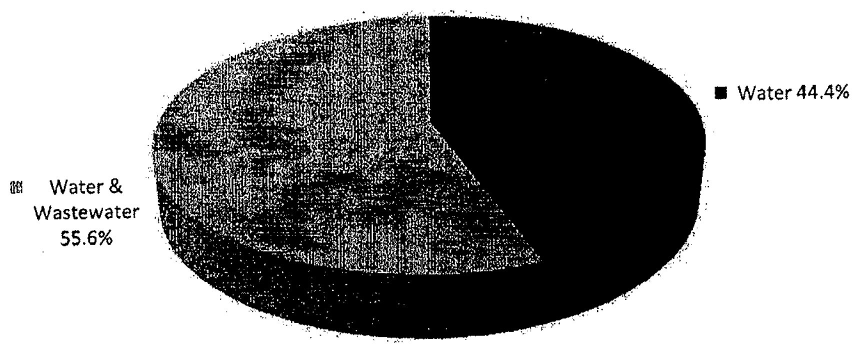
Type of Ownership: Small/Medium

Of the organizations that responded to this question, 205 reported that they are Board operated and another 154 indicated they are operated by a City or County. Only eight organizations that responded to the survey are privately owned and operated. An additional 20 participants classified themselves as "Other." Notable responses under Other included being Investor owned, Local Government owned, Municipality owned, or Political Subdivision, Special District and Township operated utilities.



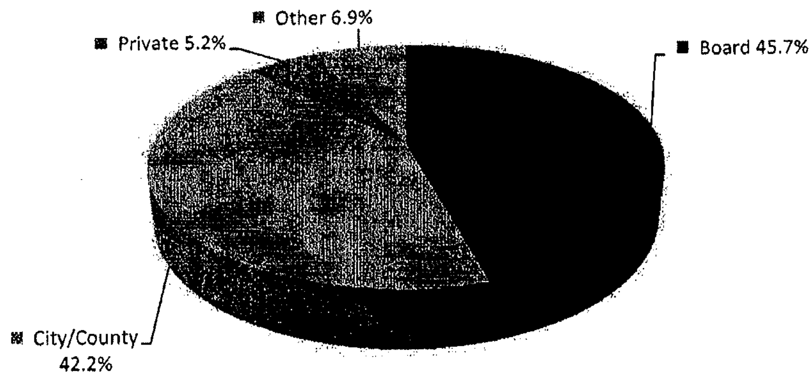
Type of Utility: Large

For large utilities, the distribution between Water Only (44.4 percent) and Water and Wastewater organizations (55.6 percent) also continues to be weighted toward the combined organizations.



Type of Ownership: Large

Of the organizations that responded to this question, 53 reported that they are Board operated. Nearly as many (49) reported that they are operated by a City/County. Only six organizations are privately owned and operated. An additional eight participants classified themselves as "Other." Notable responses under Other included being Board and City operated, Municipality owned, Political Subdivision, State Authority and Special District utilities.



Participating Utility Demographics

This year, 509 large and small/medium-sized organizations participated in this survey; a list of participating organizations can be found in the full survey. Not all participants provided demographic information. Of the 391 participants serving a population of less than 100,000, 11 percent represent California–Nevada, 7 percent are located in the Pacific Northwest, and another 6 percent are located in Kentucky–Tennessee and Texas. Remaining participants are spread throughout the United States. More thorough participant demographic data can be found in the full survey.

Salary Increase Practices for 2013

Of the total participants including small/medium-sized utilities and large utilities, 489 organizations provided data pertaining to the administration of salary and merit increases in 2013. Based on the table below, 20 percent of organizations administered merit increases at higher levels and 15 percent of organizations administered merit increases at reduced levels in 2013. Of the respondents, 21 percent reported they did not anticipate merit increases or planned to freeze salaries in 2013. No organizations reduced base pay in 2013 and 4 percent of organizations planned to defer or postpone merit increases.

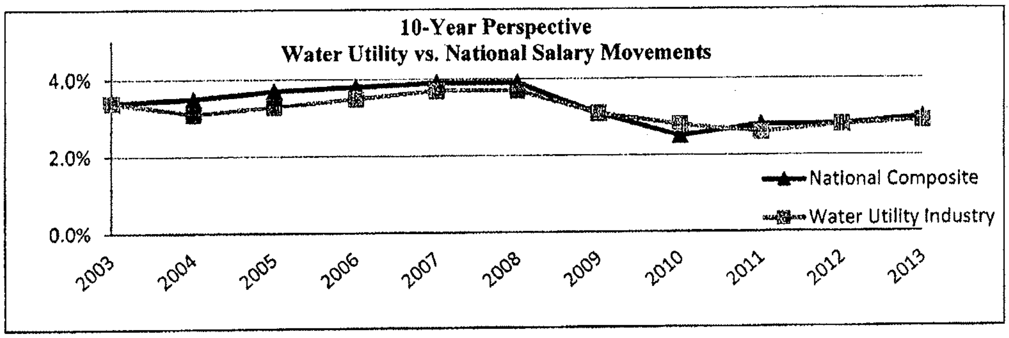
Salary Increases

Average actual 2013 increases reported are higher than the 2013 projected increases for all occupational groups. For comparison purposes, projected 2013 increases are based on responses from the 2012 AWWA Compensation Survey. Overall, actual 2013 increases were higher than anticipated in mid-2012. Salary increase projections for 2014 average 2.3 percent for Staff and Supervisor positions and 2.2 percent for all other employee groups when salary freezes (i.e., zero percent increases) are included. More thorough salary increase data can be found in the full survey.

Salary Movement and the Economy

To explore the relationship between how annual salary increases at water utilities move in comparison with other industries, a 10-year perspective is provided in the chart below.

National salary increases reflect data as reported in the 2012–2013 WorldatWork Salary Budget Survey. Water utility salary increases up to 2013 are represented by an average of management, supervisory, and staff-level positions from the *AWWA Water Utility Compensation Survey* report. Actual 2013 movements are based on average salary increases collected in this survey. As the chart illustrates, water utility industry salary increase budgets closely track all industries for 2013. Salary increases hovered around the 2.9 percent mark for water utilities in 2013 and 3.0 percent for the National Composite.



Changes to Overall Staffing Levels

Of the 339 organizations that responded to this question, 27 percent (90) increased staffing levels in the past 12 months. Nearly 20 percent (67) also hired additional contract/seasonal or temporary labor. Sixteen percent implemented reduction-in-force and 9 percent outsourced work previously done internally. The "Other" responses primarily include staff reduction through attrition, department restructuring or early retirement offering. More thorough staffing level data can be found in the full survey.

Cost Control Initiatives

Similar to 2012, healthcare plan changes and training or continuing education continue to be on top of the list of cost control initiatives for 2013. This year, 487 participants provided data on cost control initiatives they have implemented or plan to implement in a variety of areas. The chart below provides the percentage distribution of those participants that report planned, changed or considering changes to each cost control initiative. A significant number of respondents (52 percent) indicated they are implementing, planning to implement, or considering changes to their healthcare plans that include copayments, deductibles, eligibility, and employee premium cost-sharing. More thorough cost-control initiative data can be found in the full survey.

More information on all the topics addressed in this Executive Summary can be obtained by purchasing the complete 2013 Water Utility Compensation Survey, available at www.awwa.org or (800)926-7337.

THANK YOU FOR YOUR PARTICIPATION IN THE
2013 AWWA WATER UTILITY COMPENSATION SURVEY!

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Accounting Entries | Payment Misc Wrk | Deposit Control

Unit: 20000 Deposit ID: 55064 Payment: 200402 Seq: 1

Amount: 29,107.00 USD

Complete Entry Event:

Budget Status:

Distribution Lines

ChartFields | Currency Details | Budget | Journal Reference Information

	Distribution Sequence	*GL Unit	Speed Type	Line Amount	Currency	Bud Ref	Fund	Dept	Oper Unit	Approp	*Account	Program	Sch Code	PC Bus Unit	Prc
1	1	STATE	Speed Type	-19,107.00	USD	2015	100	200402		70710	43311				
2	2	STATE	Speed Type	-10,000.00	USD	2015	100	200402		70710	43733				

Total

Lines: 2 Total Debits: 0.00 Currency: USD Total Credits: 29,107.00 Currency: USD Net: -29,107.00

Save | Return to Search | Notify | Refresh

Accounting Entries | Payment Misc Wrk | Deposit Control

SCHEDULE RT 4

To: **Board of Directors**

From: **Dian Taylor**

Date: **October 14, 2013**

Re: **Holiday Bonus**

Recommendation:

Based on the efforts of all employees to continue to provide superior customer service and to take measures to control costs, I recommend a holiday bonus of $800, before tax deductions, for all full-time employees with at least 6 months of service to be paid at the December 6, 2013 Service Awards Luncheon, with a $400 bonus paid to all full-time employees with 3 to 6 months of service. Part-time employees would receive a holiday bonus equal to one-half each respective amount based upon their period of service. The 2013 budget includes $191,200 for the Holiday bonus, based upon a bonus of $800 per full-time employee as was provided in 2011, which is the amount recommended for 2013.

Recent History of Holiday Bonus Payments and EPS:

Year	Bonus	EPS
2012	$1,000	$1.13
2011	$ 800	$0.83
2010	$1,350	$1.00
2009	$1,600 (1)	$0.97
2008	$1,150	$0.86
2007	$1,150	$0.90
2006	$ 800	$0.97 (which includes $0.14 gain on sale of land)
2005	$ 800	$0.81
2004	$ 650	$0.72
2003	$ 500	$0.64

Part-time employees were paid one-half of the listed amounts in each year. In 2012, those with 3 to 6 months of service were also paid one-half the listed amount.

(1) Note that no merit increases were provided to employees in 2009 and a higher than usual Holiday Bonus was therefore granted.