

- IAWC was charged \$443,234 by the AWWSC Lab for water quality tests in 2010 using an allocation of costs to regulated operating companies that is largely based upon number of customers, not the level of services provided.

**Exhibit XVII-3  
2010 Lab Tests Performed for IAWC at Commercial Prices**

Test Group	Test Method <sup>17</sup>	Description <sup>18</sup>	Number of 2010 IAWC Test Samples <sup>19</sup>	Unit Test Price <sup>20</sup>	Extended Amount <sup>21</sup>
DBP	502.2	THM	282	[REDACTED]	[REDACTED]
	524.2	VOC			
	6251	HAA			
	300.1	DBP Minerals			
DI METALS	200.7	Chromium	5	[REDACTED]	[REDACTED]
	200.8	DI Metals			
FLUORIDE	300	Fluoride	489	[REDACTED]	[REDACTED]
INDIVIDUAL	5310	TOC	76	[REDACTED]	[REDACTED]
	2320	Alkalinity			
IOC	200.7	ICP (Metals)	42	[REDACTED]	[REDACTED]
	200.8	ICPMS (Metals)			
	245.2	Mercury	29	[REDACTED]	[REDACTED]
	180.1	Turbidity			
	300	Anions	[REDACTED]	[REDACTED]	[REDACTED]
	314	Perchlorate			
	335.4	Cyanide	[REDACTED]	[REDACTED]	[REDACTED]
	200.7	Metals (single)			
	200.8	Metals (single)	[REDACTED]	[REDACTED]	[REDACTED]
LEAD & COPPER	200.8	Lead & Copper	235	[REDACTED]	[REDACTED]
NITRATE & NITRITE	300	Nitrate/ Nitrite	125	[REDACTED]	[REDACTED]
SOC	525.2	Semivolatiles	196	[REDACTED]	[REDACTED]
	505	PCB			
	531.1	Carbamates			
	515.5	Herbicide			
	548.1	Endothall			
	549.2	Diquat			
	504.1	EDB			
	547	Glyphosate			
	521	521 UCMR			
	525	525 UCMR			
	527	527 UCMR			
529	529 UCMR				
535	535 UCMR				
SUVA	5310	TOC Total Organic Carbon	63	[REDACTED]	[REDACTED]
	5910	UV			
Taste and Odor	6040	Taste & Odor	193	[REDACTED]	[REDACTED]
TOC	5310	Total Organic Carbon	231	[REDACTED]	[REDACTED]
VOC	524.2	Volatiles	260	[REDACTED]	[REDACTED]
<b>Total</b>			<b>3,833</b>		<b>\$249,779</b>

<sup>17</sup> DR 197

<sup>18</sup> DR 197

<sup>19</sup> DR 161 and 328

<sup>20</sup> DR 197

<sup>21</sup> NorthStar analysis of provided lab data

- IAWC’s own calculation of testing charges using the Lab’s commercial price sheet is shown in **Exhibit XVII-4**. IAWC’s own calculations show that IAWC should have been charged no more than \$260,764.<sup>22</sup>

**Exhibit XVII-4**  
**IAWC Calculations of 2010 Lab Tests Performed for IAWC at Commercial Prices**

IAWC Tests	Description	IL Samples	Unit Price	Total Price
1623	LT2 (Cryptosporidium)			
180.1R2.0	Turbidity	322		
200.7R4.4	ICP (Metals)	88		
200.8R5.4	ICPMS (Metals), Pb/Cu	341		
200.8R5.4HG	Mercury			
245.2	Mercury	29		
300.0R2.1	Anion (NO3- Nitrate)	125		
300.0R2.1A	Anion (Fluoride)	530		
300.1R1.0	DBP Minerals (Chlorite, Bromide)	1		
314.0R1.0	Perchlorate	4		
335.4R1.0	Cyanide	35		
350.1R2.0MOD	Ammonia			
502.2R2.1	THM (Trihalomethanes)	282		
504.1R1.1	EDB	70		
505R2.1	PCB	68		
515.3R1.0	Herbicide	77		
521R1.0	521 UCMR	30		
524.2R4.1	VOC (Volatiles)	269		
525.2R2.0	525 (Semivolatiles)	209		
525.2R2.0SIM	525 (Semivolatiles)			
527R1.0	527 UCMR	44		
529R1.0	529 UCMR	39		
531.1R3.1	Carbamates	69		
535R1.1	535 UCMR	12		
547	Glyphosate	54		
548.1R1.0	Endothall	69		
549.2R1.0	Diquat	70		
SM2120B	Color			
SM2320B	Alkalinity	76		
SM2330B	Calcium Carbonate Saturation			
SM2510B	Conductivity			
SM2540C	TDS Total Dissolved Solids			
SM2540E	TVS Total Volatile Solids			
SM4500-H+B	pH			
SM5310C	TOC Total Organic Carbon	323		
SM5910B	UV (SUVA)	63		
SM6040DMOD	T & O (Taste and Odor)	193		
SM6251BMOD-19th	HAA (Haloacetic Acids)	294		
SM7500RnB	Radon			
<b>Total</b>		<b>3,786</b>		<b>\$260,764</b>

<sup>22</sup> DR 392 Attachment 1

## XVIII. SUPPLY CHAIN

This chapter covers the procurement sourcing function performed by AWWSC supply chain department and its charges to IAWC. In 2010, IAWC paid \$398,610 for supply chain services.

### A. BACKGROUND

Supply chain conducts strategic sourcing on behalf of AWK operating companies including IAWC. Through strategic sourcing and combining the requirements of the operating companies, supply chain can procure goods and materials, such as chemicals, pipe, meters, hydrants and other items directly from manufacturers, eliminating the markup from distributors and maintaining a direct vendor management relationship with the manufacturer. For goods and materials that cannot be procured nationally, supply chain works with regional suppliers to obtain pricing on items such as copper tubing and certain other items to be purchased regionally. Supply chain also provides the sourcing of local contractors who perform duties such as, street paving, residual removal/disposal and distribution system routine replacement and repair. In principle, consolidating the purchasing needs of all operating companies, including IAWC, improves the benefits from economies of scale that would not otherwise be obtained.<sup>1</sup>

In 2010, supply chain and other AWWSC functions managed 808 vendor agreements covering approximately \$965 million of material and services spent.<sup>2</sup> IAWC utilized slightly less than half of these agreements (396) that amounted to \$93,606,961 in 2010.<sup>3</sup>

Supply chain is primarily located in Mt. Laurel, New Jersey and has two resources dedicated to the Western Division in St. Louis. Supply chain reported to the VP of operations services in 2010. In 2011, supply chain was reorganized under the President and COO, regulated operations.<sup>4</sup> Supply chain allocated the equivalent of 3.3 FTEs to IAWC in 2010.<sup>5</sup> An organization chart for the department is shown in **Exhibit XVIII-1**.

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<sup>1</sup> DR 1, testimony of J. Young Docket 09-0319.

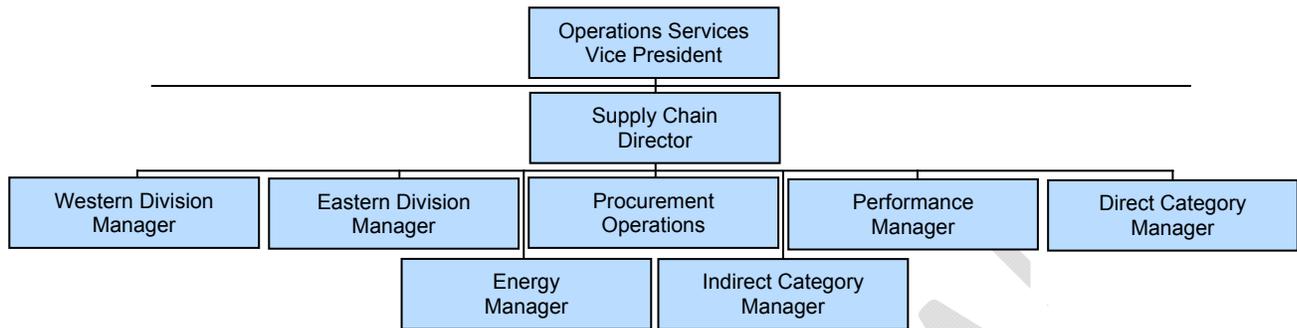
<sup>2</sup> DR 232 and 229.

<sup>3</sup> DR 233

<sup>4</sup> DR 2 and 241

<sup>5</sup> DR 202

**Exhibit XVIII-1  
2010 AWWSC Supply Chain Organization**



Organizational roles and responsibilities for supply chain as organized in 2010 include the following:<sup>6</sup>

- Western Division - Sources Western Divisional and local categories of materials and services. Examples include: paving, network repair, landscaping, maintenance services and janitorial. Similar supply chain organizational units are responsible for Eastern Division, New Jersey and Pennsylvania.
- Procurement Operations – responsible for vendor address book setup, processing purchase orders (PO), validating supplier financial information, and validating supplier legal and accreditation status.
- Performance Management – establishes and tracks supply chain group performance metrics against targets and goals. In addition, this group manages the supply chain budget; spend reporting and other *ad hoc* reporting needs.
- Direct Materials and Services – sources national categories that directly impact water production and distribution, such as chemicals, pipe, meters, pumps, hydrants and valves.
- Energy Management – sources energy supply (electricity, natural gas, oil, bulk fuel, and alternative energy sources) and works with local operating companies and third-party electric providers to reduce energy cost and price volatility.
- Indirect Materials and Services – sources national categories and supplier relationships that indirectly impact water production and distribution, such as ITS hardware and software, office equipment, office supplies, telecommunications, uniforms, managed healthcare, and legal/consulting services.

The AWWSC supply chain function performs only a limited number of activities normally associated with an industrial supply chain function, specifically those activities focusing on vendor sources for materials. IAWC performs the balance of the normal supply chain activities, including requisitioning, purchasing, materials handling, inventory and logistics.

Sourcing activities performed by supply chain are highlighted below.<sup>7</sup>

<sup>6</sup> DR 201

- Completes an internal needs analysis by working with the operating companies to determine both the specifications of materials needed and the estimated volume or quantity of the needed materials.
- Completes an external market analysis on suppliers in the competitive marketplace and an economic view and forecast of the current market.
- Works with a materials management committee with representatives from the regulated utility operating companies to review the above market forecast and recommends a strategy for sourcing the material requirements.
- When RFP's are distributed to the pre-qualified selected suppliers and returned, they are evaluated and an initial recommendation is made to the materials management committee for approval.
- The committee approves the selection of suppliers, conducts further negotiations with selected suppliers and executes a final agreement and contract.
- Once the contract is executed, preferred suppliers are referred to the regulated utility operating companies and pricing lists posted to the AWK Intranet for all requisitioners to use when placing POs for materials.

Supply chain activities performed directly by IAWC include the following:

- POs are completed by the IAWC operations personnel and approved based on delegation of authority levels in the business.
- All approved POs are then routed to the procurement department for verification of pricing against the preferred supplier listing on the intranet and the PO is e-faxed to the supplier.
- When the supplier sends a PO acknowledgment, it is received in procurement and matched to the PO.
- Material is physically received by IAWC storeroom personnel and verified against the packing slip. The dated material is received and noted on the packing slip. The person receiving the material signs the packing slip and enters the quantity into the accounting system. The receipt entry creates a document number that is noted on the packing slip. There is a monthly audit of this process, each stocking location provides packing slips that are verified for accuracy, and the documents are kept on file.
- Material distribution is done through a material request form depending on the application. A requisition is filled out noting the account, project or work order number, required quantity, part number, description and signed by the requisitioner. A supervisor also signs each requisition. The requisition is reviewed and passed to the storeroom clerk to relieve the inventory of stock or to transfer the material to another stocking location. There is a monthly audit of this process. Each stocking facility provides material requisitions that are verified for accuracy, and the documents are kept on file.
- Materials are stored at IAWC warehouses maintained by IAWC personnel.

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<sup>7</sup> DR 73

Total procurement levels for 2010 showing AWWSC and IAWC are shown in **Exhibit XVIII-2**.<sup>8</sup>

**Exhibit XVIII-2  
2010 Procurement Activity Levels**

Sourcing Team	AWWSC	IAWC
Direct Categories	\$216,515,914	\$22,965,266
Energy	111,805,451	9,163,563
Fleet	45,046,358	4,396,545
Indirect Categories	441,687,765	29,075,861
Performance <sup>9</sup>	446,883,442	39,853,843
Eastern Division	135,177,256	0
New Jersey Division	111,168,563	0
Pennsylvania Division	120,913,855	0
Western Division	143,389,451	54,086,288
<b>Total</b>	<b>\$1,772,588,054</b>	<b>\$159,541,365</b>

AWWSC charges to IAWC for the supply chain function in 2010 are summarized below.<sup>10</sup>

**Exhibit XVIII-3  
Summary of 2010 Supply Chain Charges to IAWC**

Business Unit	IAWC	AWWSC	Percent
032010 CORP-Supply Chain-Sourcing	\$316,007	\$3,538,278	8.9%
033010 WE-Supply Chain	\$1,663	\$232,124	7.2%
033510 CE-Supply Chain	\$80,382	\$294,454	27.3%
035010 SE-Supply Chain	\$ 557	\$201,845	0.3%
<b>Total</b>	<b>\$398,610</b>	<b>\$4,266,701</b>	<b>9.3%</b>

**B. TASKS PERFORMED**

To complete the work in this area, NorthStar performed the following tasks:

1. Determined the cost of services obtained from AWWSC during 2010 for supply chain to provide procurement sourcing activities to IAWC.
2. Reviewed existing policies and procedures for allocating supply chain costs.

<sup>8</sup> DR 201

<sup>9</sup> The performance management team manages spend data for some non-sourceable categories such as taxes, licenses, and purchased water.

<sup>10</sup> DR 55, confidential

3. Determined the charges directed to IAWC by AWWSC on a business unit and sub-function basis, for direct charges, allocated charges and overhead costs.
4. Reviewed documentation for functions charged and allocated to IAWC.
5. Reviewed the relevant portions of the IAWC testimony, exhibits, and supporting documentation from Docket 09-0319 specific to supply chain.
6. Identified services and evidence of controls over AWWSC costs.
7. Determined whether reports and documentation included in the testimony provide reasonable support for the costs charged to IAWC for the AWWSC services.
8. Evaluated the functions performed by AWWSC supply chain for outsourcing research.
9. Reviewed data responses to identify metrics, deliverables, and service parameters relative to the services or sub-services provided by affiliates.
10. Requested and reviewed data on volume and level of services provided to obtain estimates of the volume and level of services used by IAWC.
11. Researched industry standards and benchmarks for level of services and cost.
12. Contacted potential competitive service providers to obtain pricing for specific groups of sub-services.
13. Obtained other estimates for the cost of the various groups of sub-services from industry associations, aggregated industry data, salary studies, competitive research from other states or industries, and other sources.
14. Compared the competitive cost of services to the AWWSC costs.
15. Developed conclusions regarding the reasonableness of prices and value of the services provided by AWWSC, given the competitive pricing and all externalities and unique factors.
16. Prepared a task report.

## C. RESULTS

1. **In 2010, AWWSC charged IAWC \$2,220 for employee expenses and overhead when there was no labor charged and no benefits to IAWC from the charges.**
  - In 2010, IAWC received \$557 in charges from the SE-supply chain business unit. Business unit 035010 SE-supply chains charged no labor, either directly or by formula, indicating services believed to be beneficial to IAWC.

- Overhead charges made up \$524 of the total charges and resulted from the allocation of benefit and general overheads by overhead location. AWWSC allocates overheads by accumulating monthly labor charges by overhead location to capture the percentage of labor charged to each company from that location. The percentage is then used to allocate benefit and general overheads to all business units in the particular overhead location. In this instance, even though SE-supply chain did not bill Illinois any labor charges, IAWC was allocated a portion of overhead charges for the labor billed by the entire Southeast Region overhead location. The remaining \$34 for employee awards was billed using the general formula 100001 which distributed the charges to all regulated companies.<sup>11</sup>
  - IAWC received \$1,663 in charges from the WE-supply chain business unit for tuition aid, benefit overhead, general overhead, employee expense, and cell phone in 2010 when there was no labor charged. Business unit 033010 WE-supply chain charged no labor, either directly or by formula, to indicate that services were provided to IAWC. AWWSC allocates overheads by accumulating monthly labor charges by overhead location to capture the percentage of labor charged to each company from that location. The percentage is then used to allocate benefit and general overheads to all business units in the particular overhead location. In this instance, even though WE-supply chain did not bill Illinois any labor charges, IAWC was charged a portion of overhead charges for the labor billed by the entire Western Region overhead location.
  - AWWSC stated that charges for tuition aid, employee expense and cell phone benefitted all the companies serviced by WE-supply chain indirectly, and therefore were distributed among those companies. In instances where the charges cannot be directly assigned to benefit one company, they are distributed among all companies serviced by that business unit.<sup>12</sup>
- 2. Non-regulated AWK entities (IAWC affiliates) are subsidized by the regulated utilities when they utilize AWWSC national contract agreements and pricing but are not charged for supply chain services.**
- Supply chain sources numerous material and services categories based on the direction, requirements and decisions of the regulated AWK entities. National agreements are drafted to be inclusive of “American Water and its Affiliates”.
  - AWWSC stated that this is done for the practical purpose of not having to alter a number of agreements in the event of “organizational changes.” This practice also allows for additional dollars to be spent with the suppliers, which increases leverage during any price negotiations and thereby benefits the regulated entities.<sup>13</sup>
  - It is not clear if any “organizational changes” would affect procurement agreements.

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<sup>11</sup> DR 167

<sup>12</sup> DR 168

<sup>13</sup> DR 238

- If there is value derived from the utilization of national agreements as well as increased negotiating leverage, then procurement for non-regulated affiliates is subsidized by the AWK regulated utilities including IAWC.
- AWWSC stated that if a specific sourcing activity is conducted for a non-regulated entity they are direct charged for that specific event. However, supply chain performs an analysis to support their allocation of time between operating companies' material and services procurement that assumes 100 percent of resources charged to regulated utilities, and none to non-regulated entities.<sup>14</sup> Therefore, supply chain does not plan on charging non-regulated affiliates.
- From 2009 through June 30, 2011, IAWC spent \$141 million with suppliers for materials and services that are covered by agreements managed by supply chain. (2009 – \$54M, 2010 – \$57M, 2011 YTD – \$30M).<sup>15</sup>
- For 2010, the procurement volume for AWK non-regulated entities was \$12.6 million with 56 supply chain-negotiated vendors.<sup>16</sup> AWWSC's Supply Chain Department and other functions managed 808 agreements in 2010.<sup>17</sup> IAWC utilized 396 agreements that amounted to \$93,606,961 in spend. IAWC does not track spending by contract.<sup>18</sup>

**3. Outsourcing the procurement functions performed by the AWWSC supply chain department would not reduce IAWC's operating costs.**

- Eleven procurement outsource providers were contacted by NorthStar regarding pricing for services equivalent to those of supply chain.
- Most procurement outsourcing providers develop gain-sharing agreements with their clients that are based upon savings derived from spending levels. While the savings potential described by these firms were significant, they were contingent upon actual results. Comparable operating cost data could not be obtained.
- Most providers declined to participate in an outsourcing opportunity the size of IAWC. Those few that were interested were only interested in providing services for "indirect" materials and services. This would not displace the supply chain function as currently provided by AWWSC.
- Procurement outsourcing has the potential to reduce the prices paid for materials and supplies. However, many of those firms contacted believed that it probably wouldn't cut actual procurement operating costs, in part because of the necessity for closely managing the supplier of the outsourcing service. IAWC would also incur

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<sup>14</sup> DR 238 and 236

<sup>15</sup> DR 169

<sup>16</sup> DR 237

<sup>17</sup> DR 232

<sup>18</sup> DR 233

administrative and management control costs to oversee a contracted procurement function.

- On a fee basis, offers ranged from \$350,000 as a qualified threshold, to \$2 million per year. Hourly rates provided were \$175 per hour for procurement professionals.
- In 2010, AWWSC charged IAWC \$398,610. Therefore, it does not appear that competitive outsourcing options along with IAWC oversight would reduce this amount.

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## XIX. OPERATIONAL RISK MANAGEMENT AND PHYSICAL SECURITY

This chapter covers AWWSC's operational risk management (ORM) and physical security functions performed for IAWC. In 2010, IAWC was charged \$463,588 for these functions.<sup>1</sup>

### A. BACKGROUND

ORM performs and administers a variety of activities for the AWK operating companies, including IAWC. These functions include: health and safety, operational and physical security, event management, business continuity and emergency response planning, hazardous materials management, accident investigation and claims management related to workers compensation, general and auto liability. AWWSC believes that through these efforts, IAWC has been able to achieve improvements in terms of reduced injury rates, lost workday cases, and workers compensation claims.<sup>2</sup>

In the area of physical security, AWWSC supports the efforts of operating companies to insure the safety and security of operating company customers and employees.

ORM reports to the AWWSC operations services VP. Resources located in Voorhees, New Jersey, administer physical security. Western Division resources located in St. Louis, Missouri perform the ORM activities for IAWC. The organizational structure of ORM is shown in **Exhibit XIX-1**.<sup>3</sup> Site security monitoring is performed under a contract with ADT Security Services and charges are allocated to IAWC.

**Exhibit XIX-1**  
**AWWSC Operational Risk Management Department Organization**



<sup>1</sup> DR 55, confidential

<sup>2</sup> DR 1, Direct Testimony of J. Young in Docket 09-0319.

<sup>3</sup> DR 2 and 241

AWWSC charges to IAWC for ORM and physical security in 2010 are summarized in Exhibit XIX-2 below. Exhibit XIX-3 shows a breakdown of charges by line item.<sup>4</sup>

**Exhibit XIX-2**  
**Summary of 2010 ORM Charges to IAWC**

Function	Business Unit	IAWC	AWWSC	Percentage
Physical Security	032019 CORP-Operational Risk	\$156,499	\$1,479,415	10.6%
Operational Risk Management	033019 WE-Operational Risk	43,764	271,007	16.1%
	033519 CE-Operational Risk	263,123	1,249,572	21.1%
	035019 SE-Operational Risk	202	41,121	0.5%
<b>Total</b>		<b>\$463,588</b>	<b>\$3,041,115</b>	<b>15.2%</b>

**Exhibit XIX-3**  
**2010 AWWSC Physical Security and ORM Support Charges to IAWC**

	032019 CORP-ORM	033019 WE-ORM	033519 CE-ORM	035019 SE-ORM
<b>Labor Hours Charged by AWWSC to IAWC</b>	<b>2314</b>	<b>540</b>	<b>3575</b>	<b>&lt;1</b>
<b>Grand Total</b>	<b>\$156,499</b>	<b>\$43,764</b>	<b>\$263,123</b>	<b>\$202</b>
501200 Labor	\$79,731	\$33,063	\$129,349	\$23
501210 Labor Non Scheduled Overtime	\$116			
501711 Incentive Plan-Off-Annual	\$10,706	\$6,488	\$15,248	\$39
504100 Group Ins Maintenance	\$19		\$18	
504500 Other Welfare Maintenance	\$34		\$42	
504610 Employee Awards			\$71	
504640 Safety Incentive			\$13	
504660 Tuition Aid	\$1,416			
504670 Training	\$73		\$2,578	
507100 401k	\$1,484	\$405	\$2,697	\$9
508101 Defined Contribution Plan	\$1,759		\$882	
520100 Materials & Supplies Operations			\$70	
534998 Benefit Overhead	\$32,261	\$1,341	\$80,752	\$64
534999 General Overhead	\$5,400	\$64	\$6,478	\$19
535000 Contract Services-Other	\$4,116		\$1,100	
541400 Rents-Equipment			\$179	
550000 Transportation IT-Admin			\$3	
550001 Transportation Lease Cost			\$1,079	
550003 Transportation Lease Maintenance	\$14		\$13	
550005 Mileage Reimbursement Personal Vehicle	\$242			
575000 Miscellaneous	\$14		\$648	
575002 Misc General Office	\$4		\$126	
575240 Co Dues/Membership Deduct			\$78	
575242 Co Dues Deduct AWWA			\$52	
575280 Dues/Membership Deductible	\$1,145		\$198	
575340 Employee Expense	\$5,703	\$1,735	\$11,907	\$0
575342 Employee Exp Conf/Registration	\$646			
575350 Meals Deduct	\$767	\$329	\$2,572	
575351 Meals Non Deduct	\$767	\$329	\$2,572	
575620 Office & Admin Supplies	\$568		\$1,415	
575625 Overnight Shipping	\$926		\$13	
575660 Postage			\$1	
575710 Security Service	\$3,488		\$74	
575715 Software Licenses & Support	\$2,959		\$332	
575740 Telephone	\$660	\$11	-\$40	
575741 Cell Phone	\$1,397		\$2,600	\$48
575742 Data Lines	\$86			
575998 P-Card Undistributed	\$0	\$0	\$3	

<sup>4</sup> DR 55, confidential

## **B. TASKS PERFORMED**

To complete the work in this area, NorthStar performed the following tasks:

1. Determined the IAWC cost of services from AWWSC during 2010 for ORM support activities.
2. Reviewed existing policies and procedures for allocating ORM and physical security costs.
3. Determined the charges directed to IAWC by AWWSC on a business unit and sub-function basis, for direct charges, allocated charges and overhead costs.
4. Reviewed documentation for functions charged and allocated to IAWC.
5. Reviewed the relevant portions of the IAWC's testimony, exhibits and supporting documentation from Docket 09-0319 specific to ORM.
6. Identified services and evidence of controls over costs.
7. Determined whether reports and documentation included in the testimony provide reasonable support for the costs charged to IAWC for ORM services.
8. Evaluated the functions performed by ORM and physical security for outsourcing research.
9. Contacted potential competitive service providers to obtain pricing for specific groups of sub-services.
10. Obtained other estimates for the cost of the various groups of sub-services from industry associations, aggregated industry data, salary studies, competitive research from other states or industries, and other sources.
11. Based on research, interviews and other data, developed estimates of competitive prices for as many groups of sub-services as possible.
12. Compared the competitive cost of services to the AWWSC costs.
13. Developed conclusions regarding the reasonableness of prices and value of the services provided by AWWSC, given the competitive pricing and all externalities and unique factors.
14. Prepared a task report.

## C. RESULTS

**1. The ADT security costs are charged to each operating company based on the number of facilities served by ADT in each state.**

- The security costs paid to ADT and incurred by IAWC represent facility and asset protection for only those facilities that have ADT services. Not all facilities have ADT services.

**2. IAWC was erroneously charged \$43,764 by business unit 033019 WE-operational risk.**

- These hours were charged in error.<sup>5</sup> The individual charging time to Western Division ORM does not provide services or support to IAWC.
- As the labor was charged in error, the related overhead charges and expenses are also included as an erroneous charge.
- When the payroll charge code for the Western Division was established, it was believed that the charge allocation code covered only Arizona, California, Hawaii, and New Mexico (WE), when it actually covered the Western Division. AWWSC stated that this has been corrected going forward.<sup>6</sup>

**3. IAWC was inappropriately charged \$202 for amounts incurred by Eastern Division Operations.**

- The AWWSC Eastern Division Operations does not provide services to IAWC.<sup>7</sup> These charges were primarily for overheads and expenses.

**4. Physical security oversight, governance and administration activity charges from AWWSC would not be reduced if contracted.**

- Functions covered by physical security to be contracted by an unaffiliated provider include a wide range of oversight activities:
  - Vulnerability assessments
  - Security hot-line monitoring/evaluation
  - National security awareness
  - Identification (ID) badge and access controls
  - Incident investigations
  - Training and awareness

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<sup>5</sup> DR 245

<sup>6</sup> DR 245

<sup>7</sup> DR 1 Direct Testimony of J. Young in Docket 09-0319, page 9 at 198.

- AWWSC Physical Security allocated IAWC 2,314 hours (approximately one FTE) at \$57.48 per hour (including labor overheads). Charges were allocated based on customer count to all regulated operating companies.<sup>8</sup>
- Benchmark research for security professionals indicated that compensation ranges from \$27.48 to \$88.37 loaded hourly rates.<sup>9</sup> AWWSC charged rates are very close to the average of this compensation range.

**5. No outsource service providers were willing to submit bids to support IAWC in claims management processing activities currently performed by ORM.**

- In 2010, ORM charged IAWC 3,575 hours for \$263,123 for a number of operations risk management activities, largely claims management and processing. Including operational expenses and general/benefits overheads, these hours were charged at the aggregated rate of \$66.63 per hour including labor and general/benefit overheads.<sup>10</sup>
- Six firms were contacted to obtain outsourcing competitive offers. Some firms indicated that the operation was not large enough to bid. None of the firms identified wished to participate.

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<sup>8</sup> DR 2, 55 confidential, 241 and NorthStar analysis

<sup>9</sup> Benchmark data obtained from US Secret Service, FBI, and commercial employers of security services.

<sup>10</sup> DR 2, 55 confidential, 241 and NorthStar analysis

## XX. LEGAL SERVICES

This chapter addresses the legal services provided to IAWC by AWWSC, including the costs charged by AWWSC to IAWC and the outsourcing options available for this function. In 2010, IAWC paid \$995,851 to AWWSC for legal services.<sup>1</sup>

### A. BACKGROUND

The AWWSC legal department provides legal support for many aspects of operating company functions, including those of IAWC. It provides legal advice regarding litigation, regulatory matters, business development, contract negotiations, financing, interpretation of environmental laws and regulations, and labor, purchasing, and general corporate matters. The function handles some civil litigation cases and manages claims made against the operating companies. It is responsible for corporate governance responsibilities and makes decisions to retain outside counsel when specialized legal counsel is required. The legal department is involved in discussions with developers and in negotiations with governmental bodies regarding franchises, and it assures compliance with all business registration, licensing and corporate reporting requirements.<sup>2</sup>

Attorneys assigned to the Western Division and at corporate level were provided to IAWC for 2010 legal services. All legal functions report to the AWK general counsel, located in New Jersey, as shown in **Exhibit XX-1**. At the corporate level, there are attorneys with a focus on labor and employment law and ethics and compliance, in addition to a general corporate attorney, paralegals and legal secretaries. At the Division level, there are attorneys with expertise in regulatory matters and labor and employment law, an individual (not an attorney) with specialized expertise in real estate matters, a contract analyst and a paralegal, all of whom provide support to Illinois and other Western Division states. In 2010, the attorney providing legal services to IAWC was an AWWSC employee who allocated her time between Illinois and Iowa. In 2011, this individual's replacement was assigned full time to IAWC and is no longer an AWWSC employee.

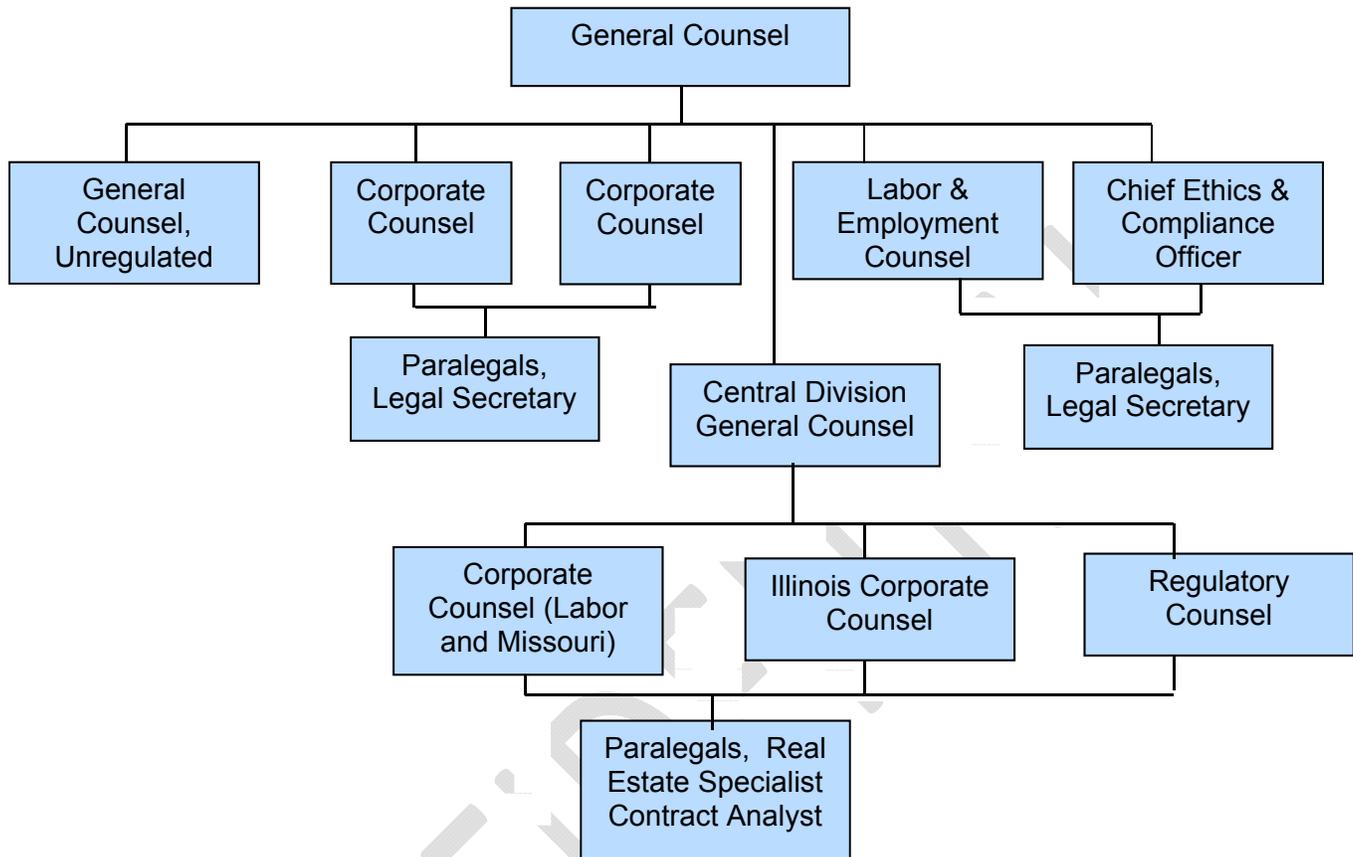
In 2010, IAWC was involved in over 60 legal cases, including various property damage and personal injury cases, and 30 dockets with the ICC. For most of the property damage and personal injury cases, the lead attorney was retained through Travelers Insurance Company, which holds the company's primary insurance policies for these types of cases. Corporate employment counsel handled employment cases together with outside labor attorneys. IAWC in-house counsel, the Western Division regulatory counsel and an outside counsel with specific experience with IAWC regulatory matters handled the regulatory dockets.

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<sup>1</sup> DR 55, confidential

<sup>2</sup> DR 1, testimony of J. Young, Docket 09-0319, pp. 15-16.

**Exhibit XX-1  
 2010 Organization of AWK Legal Function<sup>3</sup>**



Both the AWK legal department and IAWC utilize outside counsel for specific cases or needs. At the corporate level, decisions to utilize outside counsel are made by the AWK general counsel, relying on her general knowledge about leading attorneys in specific fields. Generally, corporate legal tries to avoid major firms because their hourly rates are more. Outside legal counsel is retained by IAWC on advice of the IAWC and Western Division general counsel. Agreements with outside legal firms have been terminated for poor performance, and both the AWK general counsel and the IAWC and Western Divisions counsel indicate they have negotiated and frozen rates of outside counsel. Payments to outside counsel from the corporate legal department and at the division level are allocated based on customer count. Outside firms retained specifically to support IAWC are charged directly to IAWC.

The total cost for legal services charged to IAWC in 2010 is shown in **Exhibit XX-2**. The AWWSC charges included \$52,126 for outside legal counsel allocated to IAWC, so the total cost

<sup>3</sup> DR 2 and 241

for in-house legal services in 2010 paid by IAWC was \$942,725. IAWC paid \$438,049 to its own outside legal counsel, which is not included in the costs shown in **Exhibit XX-2**.<sup>4</sup>

**Exhibit XX-2**  
**2010 Summary Charges to IAWC for Legal Services<sup>5</sup>**

<b>Business Unit</b>	<b>IAWC</b>	<b>AWWSC</b>	<b>Percent</b>
032015 CORP-Legal	\$309,630	\$3,542,621	8.7%
033515 CE-Legal	678,427	2,247,737	30.2%
033015 WE-Legal	6,253	1,177,864	0.5%
035015 SE-Legal	1,147	803,658	0.1%
036515 NE-Legal	395	389,983	0.1%
<b>All Legal</b>	<b>\$995,851</b>	<b>\$8,161,863</b>	<b>12.2%</b>
Outside Legal Counsel charges included above	52,126		
<b>Net In-House Legal Charges</b>	<b>\$942,725</b>		

The charges from Western division to IAWC (\$6,253) represent costs charged in error and the overheads associated with them.<sup>6</sup> The small charges from Southeast and Northeast divisions are assumed to be errors in coding and not representative of services provided to IAWC.<sup>7</sup>

## **B. TASKS PERFORMED**

To complete the work in this area, NorthStar performed the following tasks:

1. Determined the cost of services and associated labor hours charged by AWWSC during 2010 for the legal function, and identified charges and cost allocations that did not appear to conform to AWWSC allocation procedures.
2. Reviewed relevant portions of the IAWC's testimony, exhibits and supporting documentation from Docket 09-0319 specific to the legal functions.
3. Reviewed responses to data requests related to the provision of legal services.
4. Conducted interviews with executives and senior management involved in the legal function.
5. Researched the feasibility of outsourcing the legal function.
6. Identified an extensive data base for pricing outside legal services by using invoices from outside legal counsel contracted by AWWSC and IAWC, and selected a sample of invoices representative of AWWSC and IAWC outside legal contracts to use for pricing of legal services from outside service providers.

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<sup>4</sup> DR 118

<sup>5</sup> DR 55 confidential

<sup>6</sup> See DR 297 and 298.

<sup>7</sup> See DR 299

7. Determined the reasonableness of prices and value of the services provided by AWWSC.
8. Prepared a task report.

## C. RESULTS

### 1. AWWSC legal personnel charge their time consist with the nature of their support for IAWC.

- **Exhibit XX-4** illustrates the use of allocation factors by the legal function to charge time to IAWC.<sup>8</sup>
- The corporate legal business unit provides support across all corporate entities, and appropriately charges most of their time to the Tier 1 allocation factor or the general overhead factor that follows other time.
- The Central Division legal business unit supports all the states in their division, and the time for employees in that department is charged to divisional allocation factors.
- The time charged directly to Illinois reflects the one attorney who supported IAWC and Iowa in 2010.
- Errors in time coding were assumed for the hours charged to IAWC by the NE Legal group.

**Exhibit XX-4**  
**2010 Legal Service Hours Charged to IAWC by Allocation Factor Used**

Business Unit	Tier 1	Central Division	Direct to IAWC	Other Allocation Factors
032015 CORP-Legal	1,342	58	0	723
033515 CE-Legal	1	3,799	1,882	353
036515 NE-Legal	0	0	0	12
Total Hours	1,343	3,856	1,882	1,086

### 2. Many firms, including utilities, outsource their general counsel and other legal functions.

- Outsourcing of the general counsel is common in small to mid-sized companies, and there are vendors that provide general counsel on a contract basis, with appropriate non-disclosure and confidentiality agreements.<sup>9</sup>

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<sup>8</sup> DR 55 confidential

<sup>9</sup> See for example, <http://www.generalcounsels.com/>, accessed 10/28/11



- The benefits of outsourcing legal services include having access to a pool of lawyers with a range of expertise and strategic insights.
  - Additionally, outsourcing of legal services allows a company to pay only for the level of services desired without committing to a full time staff and associated overhead costs.
  - An outsourced general counsel may not have the comprehensive understanding of the company's operations, risks and strategies that would be developed by maintaining a full-time in-house general counsel.
- 3. The total charges from AWWSC to IAWC in 2010 for legal services were consistent with expected levels based on benchmarking data.**
- A 2006 study by Altman Weil for LexisNexis Martindale Hubble, identified that for companies with revenues less than \$250 million, law department expenses would average 0.96 percent of revenues. For companies between \$250 million and \$1 billion, law department expenses average 0.42 percent of revenues.<sup>10</sup>
  - In 2010, IAWC had legal costs of \$1,433,900 (charges from AWWSC plus direct outside counsel charges), or 0.63 percent of revenues, based on 2010 revenues of \$227 million. This is within the range of 0.42 percent to 0.96 percent that the benchmarking studies identified for similar sized companies.
- 4. The average hourly rates paid by IAWC for legal services from AWWSC were significantly less than would be charged by outsourced legal counsel.**
- In 2010, IAWC obtained 8,170 hours of legal services from the AWWSC legal department at an average hourly rate of \$115.39.
  - As shown in **Exhibit XX-5**, hourly rates for outside legal counsel range from \$120 to \$925 per hour, depending on level of experience.

**Exhibit XX-5**  
**Hourly Rates for Outsourced Legal Services<sup>11</sup>**

Rate Classification	AWWSC Outside Counsel	IAWC Outside Counsel	Hourly Weighted Rate*
General Counsel/Partner	\$301 - \$625	\$239-\$925	\$415
Senior Attorney	\$325 - \$495	None	\$346
Staff Attorney	\$170 - \$680	\$200 - \$680	\$329
Paralegal	\$120 - \$315	\$130 - \$185	\$219

\* Weighted based on the actual hours bill by each attorney at their specific rate.

<sup>10</sup> [http://www.altmanweil.com/dir\\_docs/resource/74ecde8f-666f-4f6d-a820-554c1791728c\\_document.pdf](http://www.altmanweil.com/dir_docs/resource/74ecde8f-666f-4f6d-a820-554c1791728c_document.pdf), accessed 10/28/2011

<sup>11</sup> NorthStar analysis based on DR 118

5. If IAWC were to outsource its legal services, the outsource service provider would have to be more than twice as efficient as AWWSC in-house counsel for IAWC to reduce its legal services costs.

- **Exhibit XX-6** shows the calculation of the estimate cost to outsource the legal services obtained from AWWSC, using the hours of each level of experience billed to IAWC in 2010.
- For outsourcing of legal services to reduce the costs to IAWC, the outsource service provider would have to be able to provide the support to IAWC in 3,074 hours, a 55 percent efficiency improvement.<sup>12</sup>

**Exhibit XX-7**  
**Calculation of Estimated Cost of Outsource Legal Services**

Rate Classification	Hours provided by AWWSC	Average Hourly Rate	Estimated Cost
General Counsel/Partner	182	\$415	\$75,530
Senior Attorney	828	\$346	286,711
Staff Attorney	4,074	\$329	1,340,346
Paralegal	1,637	\$219	358,503
<b>TOTAL</b>	<b>6,721</b>	<b>\$307</b>	<b>\$2,061,090</b>
AWWSC Charges to IAWC			942,725
<b>Additional Cost to IAWC</b>			<b>\$1,118,365</b>

<sup>12</sup> \$942,725 at an average rate of \$307 per hour is 3,074 hours, or 45 percent of 6,721 hours allocated by AWWSC.

## XXI. REGULATORY SERVICES

This chapter addresses the regulatory services provided to IAWC by AWWSC, including the costs charged by AWWSC to IAWC and the outsourcing options available for this function. In 2010, IAWC was charged \$74,891 by AWWSC for this function.<sup>1</sup>

### A. BACKGROUND

The AWWSC regulatory services function provides the operating companies with expertise and support as needed with respect to regulatory issues and policies. The function also provides support for litigation involving rates cases and other regulatory proceedings or investigations.<sup>2</sup> In 2010, the regulatory programs business unit reported to the AWK CEO and was comprised of the VP for regulatory programs and one analyst, both located in New Jersey. In addition to this unit, several other groups from throughout the AWWSC organization provided regulatory services to IAWC, as shown in **Exhibit XXI-1**.

The regulatory programs business unit, identified with the box labeled "A" in **Exhibit XXI-1**, provides broad legal and regulatory perspective to all regulated companies. Issues where AWWSC seeks to maintain consistent treatment across operating companies and regulatory bodies include:<sup>3</sup>

- Corporate governance
- Compliance with USEPA quality standards
- Compliance with SEC-related requirements
- Affiliate relationships
- Regulatory and public policy issues

In 2011, this unit was reorganized to report to the President of regulated operations rather than the CEO.

The SSC rates department, indicated by the box labeled "B" in **Exhibit XXI-1**, provides support to all operating companies in the preparation of rate cases and other regulatory filings. This involves preparation of historical financial and projected future costs and capital spending for inclusion in rate case schedules, as well as handling responses to data requests involving accounting and financial data. AWWSC believes consolidating this work in a centralized location with staff that performs these analyses regularly is more efficient than using state-based finance staff that needs to refresh skills on an irregular basis when a rate case for that particular state is filed.<sup>4</sup> Because providing these services requires detailed understanding of the financial books and records and the accounting software, this portion of the regulatory function cannot be

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<sup>1</sup> DR 55 confidential

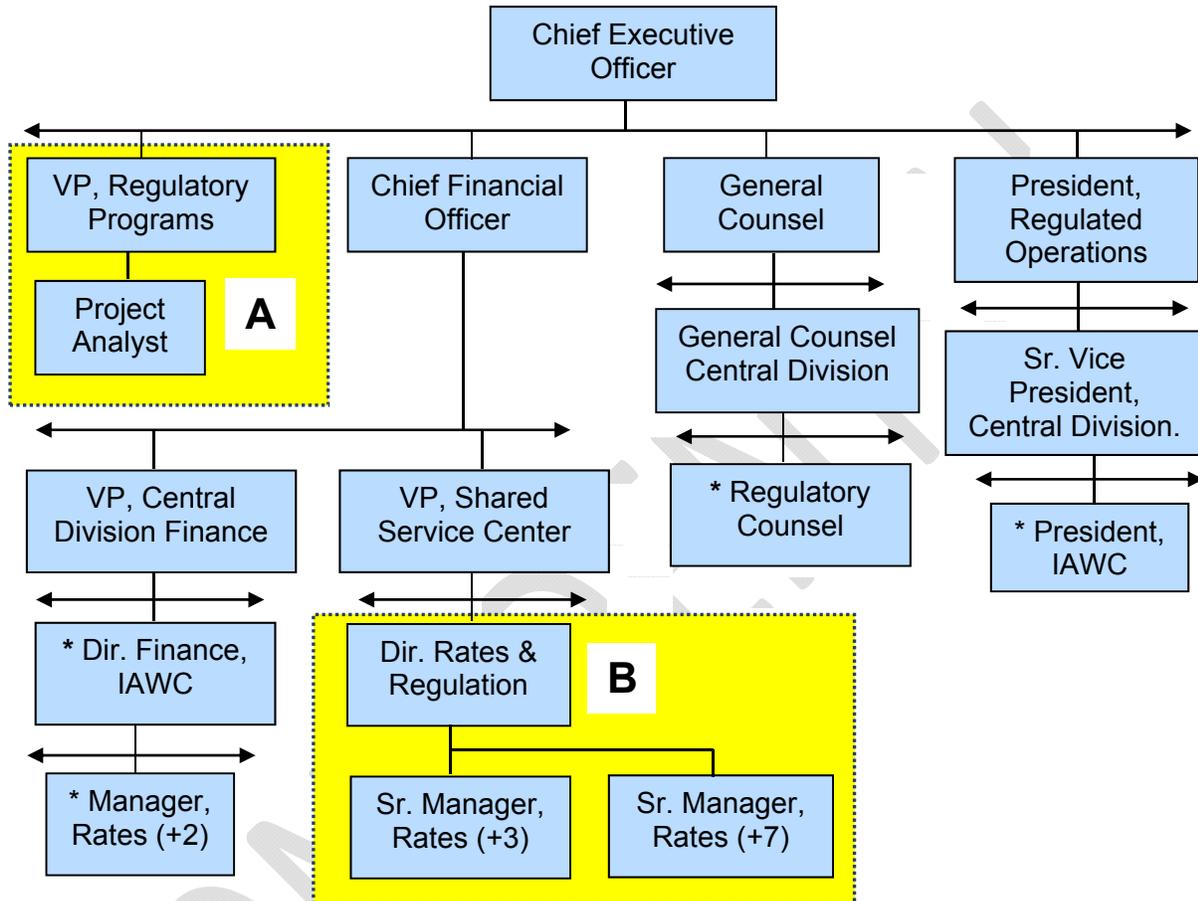
<sup>2</sup> DR 1, Testimony of J. Young, Docket 09-0319, p. 26.

<sup>3</sup> DR 122

<sup>4</sup> IS 63 and DR 122

reasonably outsourced separate from the basic accounting functions. Therefore, the costs and outsourcing options for this business unit were addressed in the accounting analysis in Chapter VI.

**Exhibit XXI-1**  
**2010 Organization of Groups Providing Regulatory Services<sup>5</sup>**



The remainder of the regulatory services were provided by individuals and groups located in various business units at the Central (now Western) Division and IAWC level within the AWK organization. Because the staff that provides this regulatory support is part of other business units, it is not possible to segregate the costs associated with the regulatory aspects of their work from their other job duties. Thus their costs are not included in this analysis.

The IAWC President, the IAWC Finance Director and Rates Manager and the Central Division Regulatory Counsel (all indicated with "\*" on **Exhibit XXI-1**) are members of the IAWC management team, which has overall responsibility for the strategy, timing, content, and execution of IAWC rate cases and other regulatory interactions.<sup>6</sup> IAWC retains outside consultants to address specific issues related to IAWC rates cases, including, for example, a

<sup>5</sup> DR 2 and 241

<sup>6</sup> DR 122, IS 3, 25, 26

depreciation study.<sup>7</sup> The IAWC management team consults with the VP regulatory programs, and coordinates certain aspects of the case to maintain corporate consistency.

As indicated in **Exhibit XXI-2**, charges to IAWC in 2010 for the regulatory programs business unit totaled \$74,891. Of these charges, \$24,724 was for IAWC's portion of retainer fees paid to two consultants that monitor national regulatory developments and provide advice on responding to regulatory challenges facing the water utility industry, such as replacement of aging infrastructure.<sup>8</sup> Removing the outside contractor charges, the average cost of services provided by the regulatory programs group was \$133.78 per hour.<sup>9</sup>

**Exhibit XXI-2**  
**Summary of Regulatory Services Charges to IAWC<sup>10</sup>**

<b>Business Unit</b>	<b>IAWC</b>	<b>AWWSC</b>	<b>Percent</b>	<b>Hours</b>
032069 CORP Regulatory UFS	\$74,891	\$798,055	9.4%	375
Contract Services-Other	-24,724	-266,711	9.3%	n/a
<b>Net In-house Regulatory Charges</b>	<b>\$50,167</b>	<b>\$531,344</b>	<b>9.4%</b>	<b>375</b>

## **B. TASKS PERFORMED**

To complete the work in this area, NorthStar performed the following asks:

1. Determined the cost of services and associated labor hours charged by AWWSC during 2010 for regulatory service functions, and identified charges and cost allocations that did not appear to conform to AWWSC allocation procedures.
2. Reviewed relevant portions of the IAWC's testimony, exhibits and supporting documentation from Docket 09-0319 specific to regulatory service functions.
3. Reviewed responses to data requests related to the provision of regulatory services.
4. Conducted interviews of the executives and managers relating to regulatory services.
5. Developed a "scope of services" provided to IAWC by AWWSC that could reasonably be provided by competitive providers.
6. Researched feasibility of outsourcing the regulatory service functions and contacted possible competitive service providers to obtain pricing for the services.
7. Assessed the reasonableness of prices and services provided by AAWWSC, based on the information provided by IAWC and the responses to outsourcing inquiries.

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<sup>7</sup> IS 3 and DR 123

<sup>8</sup> DR 304

<sup>9</sup> Calculated as \$50,167 divided by 375 hours.

<sup>10</sup> DR 55 confidential

8. Prepared a task report.

## C. RESULTS

### 1. Regulatory consulting services are widely available from national firms, as well as through independent consultants working alone or in small practices.

- The benefits of outsourcing regulatory support services include having access to a pool of consultants with a range of expertise and strategic insights.
- Additionally, outsourcing of regulatory consulting services allows a company to pay only for the level of services desired without committing to a full-time staff and associated overhead costs.

### 2. The total charges paid to AWWSC by IAWC for regulatory services are significantly less than the costs IAWC would incur to obtain these services from an independent outside provider.

- Prices for regulatory services were obtained from two possible competitive outsourcing providers using the following scope of services:
  - Monitor regulatory issues and developments at the national level and across the country that could impact IAWC
  - Develop regulatory strategies to protect IAWC assets and Illinois ratepayers
  - In collaboration with IAWC management team, develop rate case strategies, including timing, content, requested cost, and regulatory treatments
  - Assist with rate case preparation and execution.
- **Exhibit XXI-3** compares the cost estimates obtained from the outside service providers and from contracts with two consulting firms currently used by AWWSC with the current charges to IAWC for regulatory services. Obtaining regulatory services independently from AWWSC would cost IAWC between \$45,109 and \$165,109 more than the company is charged by AWWSC.

**Exhibit XXI-3**  
**Rates of Competitive Regulatory Service Providers<sup>11</sup>**

Service Provider	Annual Costs	Additional Cost to IAWC
Charges to IAWC from AWWSC		\$74,891
Vendor A -- Retainer Service	\$120,000 - \$180,000	\$45,109 to \$105,109
Vendor B	\$240,000	\$165,109
Vendor C (AWWSC incumbent provider)	\$144,000	\$69,109
Vendor D (AWWSC incumbent provider)	\$180,000	\$105,109

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<sup>11</sup> NorthStar research, DR 304

## XXII. BUSINESS DEVELOPMENT

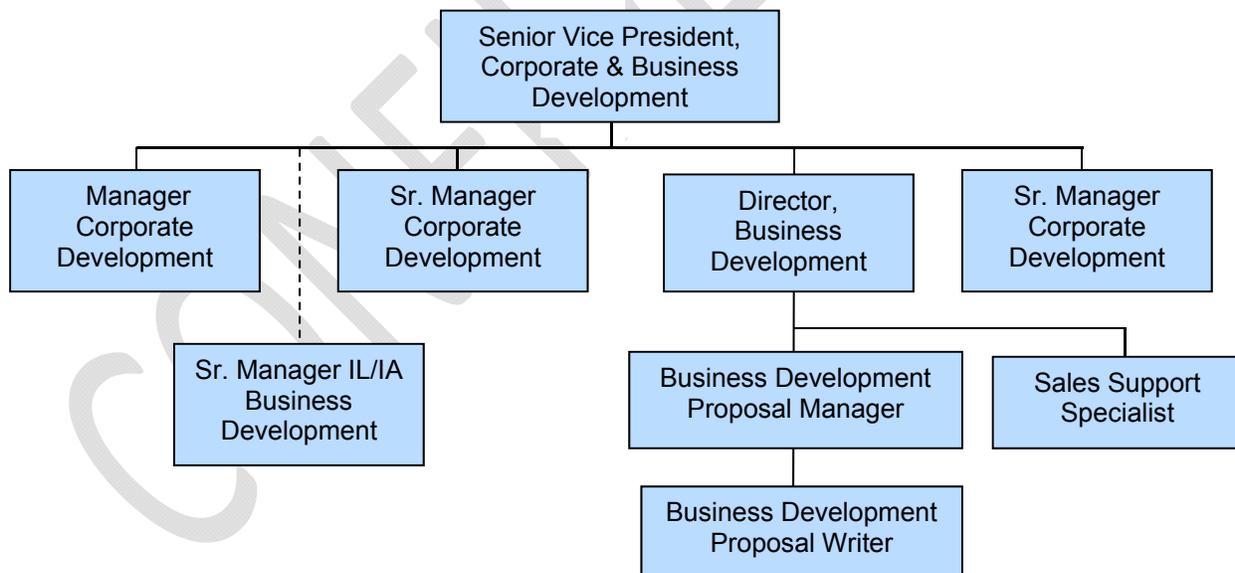
This chapter addresses the business development (BD) functions provided to IAWC by AWWSC, including the costs charged and the outsourcing options available for these functions. In 2010, IAWC was charged \$331,530 for BD services by AWWSC.<sup>1</sup>

### A. BACKGROUND

The BD function within AWWSC coordinates BD resources, activities and reporting for the operating companies, including acquisition support and training.<sup>2</sup> The bulk of the work provided by this group relates to acquisition of other water and wastewater utility operations – both investor-owned and municipal operations. Some activity is directed to customers looking for bulk water contracts.

In 2010, the corporate BD function was comprised of a Senior Vice President (SVP), seven professionals and an executive assistant, as shown in **Exhibit XXII-1**. In 2011, the group was reorganized to include the corporate strategic planning and environmental research functions, and staffing for BD was reduced to five professionals.<sup>3</sup>

**Exhibit XXII-1**  
**2010 Corporate Business Development Organization<sup>4</sup>**



<sup>1</sup> DR 55, confidential

<sup>2</sup> DR 1, Testimony of J. Young, Docket 09-0319, p. 26.

<sup>3</sup> DR 2, IR 60

<sup>4</sup> DR 2 and 241

In addition to the corporate BD function, IAWC receives BD services from a Senior Manager for BD who is shared between Illinois and Iowa, and is therefore an employee of AWWSC. This individual manually allocates 80 percent of his time to Illinois and 20 percent to Iowa. He has dual lines of reporting to the Presidents of IAWC and the Iowa utility, and a "dotted line" reporting relationship to the SVP corporate strategy and BD.

The BD Sr. Manager is responsible for identifying and pursuing water and wastewater acquisition targets within both states, both for outright acquisition and for bulk water sales. If an entity is interested in service contracts, they are referred to non-regulated marketing individuals. According to the BD Sr. Manager, it is generally known before meeting with a potential target that they are a "target" for acquisition by IAWC or bulk water sales from IAWC. If during discussions, it develops that an entity is more interested in service contract options, the lead is transferred to the non-regulated representative. Occasionally, the BD Sr. Manager will join with the non-regulated representative for a first meeting.

When a potential target expresses interest in further discussions, the BD Sr. Manager will utilize in-house (Illinois) resources to conduct engineering and feasibility analysis. On occasion, IAWC will retain outside engineering firms to conduct specific analyses in support of a potential acquisition. Outside services were used on two occasions in 2009 and 2010. Over the past two years, IAWC BD has looked at more than 30 potential targets and has closed on one bulk sale contract and one acquisition of 63 customers.<sup>5</sup>

AWWSC personnel provide analytic support for the IAWC BD efforts, including prequalifying possible acquisition targets and assistance with analyzing the financial aspects (rate impacts, likely new capital investment, and purchase price) of any possible deals. For very large acquisitions (more than 50,000 customers), AWWSC personnel would take the lead on analysis and negotiations.

The AWWSC BD function coordinates AWK's attendance at national conferences and holds corporate-wide training and planning programs. In 2010, the BD Sr. Manager attended the National League of Cities' Congress as part of AWK's efforts to reach out to municipal officials to market its services.<sup>6</sup> In 2011, the AWWSC BD group held four company-wide BD training and planning sessions; no such meetings were held in 2010.<sup>7</sup>

The total cost for BD services charged to IAWC in 2010 is shown in **Exhibit XXII-2**. Charges from the Western Division finance business unit are included in the Exhibit because they were related to work performed by one individual in support of an IAWC BD project.<sup>8</sup> The small charges from the Southeast and Western Division BD business units are presumed to be errors in coding, not actually charges for services provided to IAWC.<sup>9</sup>

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<sup>5</sup> IS 37

<sup>6</sup> DR 267

<sup>7</sup> Ibid.

<sup>8</sup> DR 307

<sup>9</sup> See, for example, DR 297 and DR 308. Due to the small dollars involved, NorthStar did not pursue these costs with IAWC.

**Exhibit XXII-2  
Summary of 2010 Business Development Charges to IAWC<sup>10</sup>**

<b>Business Unit</b>	<b>IAWC</b>	<b>AWWSC</b>	<b>Percent</b>	<b>Hours</b>
032020 CORP-Corporate Business Development	\$155,835	\$2,711,754	5.7%	879
033520 CE-Business Development	123,083	526,820	23.4%	1,844
035020 SE-Business Development	963	728,086	0.1%	0
033020 WE-Business Development	-38	20,126	-0.2%	0
033007 WE-Finance	25,076	n/a	n/a	145
<b>Total Business Development booked costs</b>	<b>\$304,919</b>	<b>\$3,986,785</b>	<b>7.6%</b>	<b>2,868</b>
Reversal of Credits included in CE-Business Development Charges above	26,611	n/a	n/a	0
<b>Adjusted Business Development Charges</b>	<b>\$331,530</b>	<b>3,986,785</b>	<b>8.3%</b>	<b>2,868</b>

IAWC received credits – essentially non-utility revenues – totaling \$26,611, related to: an interconnection project; reversal of an end of year accounting transaction; and, a refund from the sale of a vehicle.<sup>11</sup> Since these credits reduced the charges to IAWC for BD services in 2010, they need to be reversed (added back) to determine the true cost of BD charges to IAWC. Using the adjusted total charges to IAWC for BD services, the average rate for the BD services was \$115.60 per hour.<sup>12</sup>

AWK BD personnel allocate their time 50/50 between regulated and non-regulated businesses, and the regulated portion is allocated to the states based on customer count. While it appears this is the process used for labor hours, the same process does not appear to be followed for non-labor expenses. The percentage of AWK’s BD charges directed to IAWC is greater than the 4.2 percent to be expected from a 50/50 regulated/non-regulated split.

**B. TASKS PERFORMED**

To complete the work in this area, NorthStar performed the following tasks:

1. Determined the cost of services and associated labor hours charged by AWWSC during 2010 for the BD function, and identified charges and cost allocations that did not appear to conform to AWWSC allocation procedures.
2. Reviewed relevant portions of the IAWC’s testimony, exhibits and supporting documentation from Docket 09-0319 specific to the BD function.
3. Reviewed responses to data requests related to the provision of BD services.

<sup>10</sup> DR 55 confidential

<sup>11</sup> DR 300

<sup>12</sup> Calculated as \$331,530 from Exhibit XXII-2 divided by 2,868 hours.

4. Conducted interviews with personnel involved in BD services.
5. Developed a "scope of services," representing the BD services provided to IAWC by AWWSC that could reasonably be provided by competitive providers.
6. Researched feasibility of outsourcing corporate finance functions and contacted possible competitive service providers to obtain pricing for the BD services currently obtained from AWWSC.
7. Based on the information provided by IAWC and the responses to outsourcing inquiries, developed conclusions regarding the reasonableness of prices and value of the services provided by AWWSC.
8. Prepared a task report.

## C. RESULTS

### **1. In 2010, IAWC was overcharged \$5,476 by AWWSC for software used by BD personnel.**

- The charges for BD services include \$7,576 in allocated software costs for the Salesforce™ software package used by all AWWSC BD personnel to track leads.
- The cost per license (including support) for the Salesforce™ software is \$1,500 per year.<sup>13</sup> AWWSC allocates the cost of the 50 licenses on the basis of customer count (Tier 2). IAWC was charged the equivalent of five licenses.
- AWWSC supports using customer allocation rather than direct assignment by stating that other BD staff support IAWC's BD efforts, so there is no one-to-one relationship between licenses and states.<sup>14</sup>
- In 2010, IAWC received the equivalent of 1.4 FTE in BD support (2,868 hours). Based on these hours, IAWC should have only been charged \$2,100 (1.4 times \$1,500 per license) for the use of the Salesforce™ licenses, a reduction of \$5,476.

### **2. Outsourcing of BD support activities is fairly common across a range of industries, including utilities.**

- Services offered by independent BD providers include, identifying and researching acquisition targets, performing initial due diligence research, and prioritizing acquisition targets based criteria that typically include future growth potential. These providers also develop financial models to evaluate the feasibility of the acquisition, and can provide specialized expertise for detailed due diligence analysis, public interface, and contract negotiations.

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<sup>13</sup> DR 268 and 409

<sup>14</sup> DR 409

- Firms that provide BD services are able to maintain within their staff the expertise and tools that enable them to perform the research and analysis of potential targets efficiently, and they understand how to approach targets and close deals.

### **3. Pricing for outside BD services depends on the desired intensity of pursuit.**

- Three firms were contacted to provide prices for BD services to IAWC. The scope of services requested were as follow:
  - On-going services: identifying prospects, prioritizing prospects based on criteria (e.g., proximity, age and known condition of system, financial situation, management status, regulatory compliance issues), monitoring for leads and changes in situation, making initial contacts with prospects, preparing materials for meeting with prospects, and preparing initial feasibility analyses.
  - Live prospect pursuit: coordinating due diligence work, preparing financial models and running scenarios, preparing documentation for presentation to Board, and assisting with negotiations.
- One BD provider suggested they could do general monitoring and reporting for a monthly retainer in the range of \$5,000 to \$10,000 per month. Detailed research, modeling and support on specific targets would be on an hourly basis at rates of \$150 to \$200 per hour.
- Another BD provider provides business development services exclusively on an hourly fee basis, ranging from \$175 to \$275 per hour. Research, monitoring and general analysis is at the low end of the range, while client representation and specific analyses is at the upper end of the range. This firm provided a case study where they were able to identify, develop and pursue seven prospects, and close four deals within one year at a cost of \$250,000. The next year the client took BD in-house, only closed one deal and spent \$750,000.
- The third vendor declined to provide a pricing estimate.

### **4. In 2010, IAWC paid between \$81,410 and \$271,410 more for BD services from AWWSC than if it had obtained those services from an independent BD provider**

- **Exhibit XXII-3** summarizes the cost comparison between AWWSC charges and the estimated cost to provide BD services on an outsourced basis.
- In addition, outsourcing of BD services would provide IAWC with access to a greater range of professional BD personnel, tools, models and expertise in identifying, pursuing, analyzing and successfully closing acquisition deals.

**Exhibit XXII-3**  
**BD Cost Comparison<sup>15</sup>**

	<b>Vendor A</b>	<b>Vendor B</b>
AWWSC Charges from Exhibit XXII-2	\$331,530	\$331,530
Vendor Estimate	\$60,000 to \$120,000	\$250,000
<b>Difference</b>	<b>\$271,410 to \$211,410</b>	<b>\$81,410</b>

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<sup>15</sup> NorthStar analyses

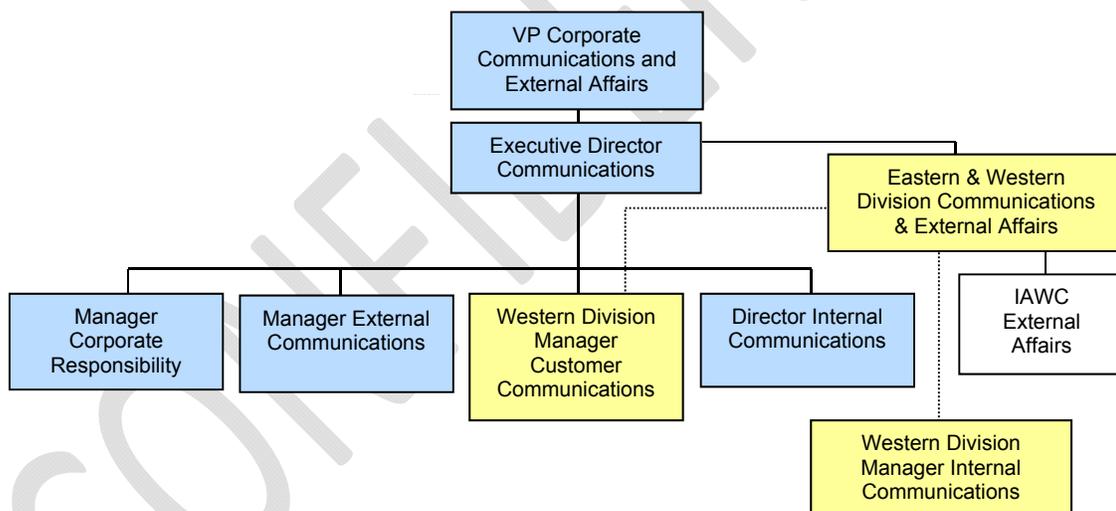
## XXIII. COMMUNICATIONS AND EXTERNAL AFFAIRS

This chapter addresses the costs charged to IAWC by AWWSC for communication and external affairs (communications). In 2010, AWWSC charged IAWC \$764,615 for communications services.<sup>1</sup>

### A. BACKGROUND

IAWC's communications needs are met through products and services provided by a combination of AWWSC corporate, the Western Division and IAWC. The AWWSC communications function provides comprehensive coordination and support for the broad spectrum of communications needs of the operating companies, including IAWC, in the areas of marketing, government and external affairs, internal and external communications, and corporate responsibility. **Exhibit XXIII-1** shows the communications organization. A brief description of each function is provided following the exhibit.

**Exhibit XXIII-1**  
**Communications and External Affairs Organization**



Note: AWWSC organizations are shown in blue, division level in yellow, and IAWC in white.

- AWWSC responsibility supports IAWC's two employee-giving programs – United Way and Water for People.
- External communications assists with the preparation of media strategies, talking points and press releases, event and issues management, and advertising, including, the development of the message, graphic layout, and ad placement.

<sup>1</sup> DR 55 confidential

- Customer communications prepares the monthly bill inserts, door hangers, informational ads, letters, and other information provided to customers.
- Internal communications assists with the development of content for the quarterly printed employee newsletter (*Splash*), the weekly *Splash Points* newsletter that is used in weekly employee-supervisor meeting held throughout IAWC, company announcements, letters from the President, and other employee news.

AWWSC attempts to reduce cost through product standardization and economies of scale. Templates for the various work products are created at the corporate level and customized for each utility. Fully dedicated resources are assigned at the utility level where work volumes justify the assignment of resources.<sup>2</sup>

The Central/Western Division provides management and guidance to IAWC on a day-to-day basis. Two IAWC external affairs managers provide a number of coordination services with principal responsibility for:

- Community Events - the coordination, materials, and staffing of events. In 2010, IAWC was involved in approximately 600 events.
- Press Related Activities – Illinois-related press releases, media inquiries and media events. In 2010, there were over 100 press releases and over 300 media inquiries.
- Internal Communications – Coordination between IAWC and corporate staff for employee information. This includes information from *Splash Points* and *Splash* newsletters.

As shown in **Exhibit XXIII-2**, AWWSC charged IAWC \$764,615 for communications services in 2010, which represented 8.7 percent of AWWSC total cost for this function. Approximately 62 percent of the cost is incurred at the corporate level while only 52 percent of the hours and labor dollars are incurred at the corporate level.<sup>3</sup> This is the result of sharing of costs associated with charitable contributions and community relations.

**Exhibit XXIII-2**  
**2010 AWWSC Communications Costs<sup>4</sup>**

Business Unit	IAWC Allocated Cost	Total AWWSC Expense	Percent
032022 CORP-Government Affairs	\$46,414	\$557,840	8.3%
032025 CORP-External Affairs	110,279	1,315,762	8.4%
032068 CORP-Marketing	135,655	1,541,079	8.8%
032085 CORP-External Communications	84,231	1,006,461	8.4%
032086 CORP-Internal Communications	37,582	458,642	8.2%
032087 CORP-Corp Social Responsibility	57,104	689,843	8.3%

<sup>2</sup> IS 48

<sup>3</sup> DR 55, confidential

<sup>4</sup> DR 55, confidential

Business Unit	IAWC Allocated Cost	Total AWWSC Expense	Percent
033025 WE-External Affairs	3,873	761,657	0.5%
033525 CE-External Affairs	285,937	1,551,616	18.4%
035025 SE-External Affairs	3,183	585,294	0.5%
036525 NE-External Affairs	357	358,774	0.1%
<b>Total</b>	<b>\$764,615</b>	<b>\$8,826,966</b>	<b>8.7%</b>

In addition to the AWWSC charges, IAWC incurred \$793,605 in direct communications costs, for a total communications cost of \$1.56 million. **Exhibit XXIII-3** provides a breakdown of the AWWSC and IAWC costs by category.

**Exhibit XXIII-3  
IAWC and AWWSC Communications and External Affairs Costs<sup>5</sup>  
2010 Actual Dollars**

Cost Component	IAWC Direct	AWWSC Allocated	Total IAWC Costs
Labor Related Costs <sup>6</sup>	\$205,788	\$566,459	\$772,247
Expenses <sup>7</sup>	8,380	59,020	67,400
Advertising	69,293	24,140	93,433
Bill Inserts	137,488		137,488
Brochures and Handouts	7,126	4,512	11,638
Charitable Contributions	22,714	10,941	33,655
Community Relations	300,986	13,507	314,493
Contract Services	41,830	86,036	127,866
<b>Total</b>	<b>\$ 793,605<sup>8</sup></b>	<b>\$764,615</b>	<b>\$1,558,220</b>

**B. TASKS PERFORMED**

To complete the work in this area, NorthStar performed the following tasks:

1. Determined the cost of communications services obtained from AWWSC in 2010.
2. Reviewed existing policies and procedures for allocating communications costs.
3. Reviewed documentation for functions charged and allocated to IAWC.
4. Reviewed the relevant portions of IAWC's testimony, exhibits and supporting documentation from Docket 09-0319.
5. Requested and reviewed data on the types and level of services provided by AWWSC.

<sup>5</sup> DRs 12 and 55 Attachment 7, confidential

<sup>6</sup> Includes all forms of compensation, benefits, payroll taxes, and identified overheads.

<sup>7</sup> Includes travel, meals, supplies, mileage, rents etc.

<sup>8</sup> Excludes general and benefit overheads.

6. Contacted potential competitive service providers to obtain pricing for specific groups of services.
7. Compared the competitive cost of services to the AWWSC costs.
8. Developed conclusions regarding the reasonableness of costs charged by AWWSC.
9. Prepared a task report.

## C. RESULTS

### 1. IAWC could save about \$29,000 by outsourcing the government affairs function through participation in an industry association.

- An independent utility of IAWC's size would not typically have a dedicated government affairs function. Instead it would use the services of an organization such as the AWWA to promote its government agenda.
- IAWC was charged \$46,414 in costs for government affairs in 2010.
- The cost of membership in AWWA is \$17,525, a difference of \$28,889.

### 2. The products and services provided by communications are readily available in the open market and can be competitively bid.

- Dozens of communications and public relations firms are located in the Chicago and Saint Louis metropolitan areas. Many of these firms have utility clients.
- While some firms provide specialized services, many of these firms are full service and provide:
  - Promotional advertising
  - Press relations
  - Employee communications
  - Customer communications
  - Public relations
- AWWSC's communications services were grouped into four categories for competitive bidding. **Exhibit XXIII-4** provides a mapping of the AWWSC business units to each category.

**Exhibit XXIII-4**  
**Outsourced Products and Services**

Products and Services	Business Unit
<b>Press and Community Relations</b>	
Press Releases	032025 Corp-External Affairs
Media Event	033025 WE-External Affairs
Media Inquiries	033525 CE-External Affairs
Community Events	035025 SE-External Affairs
	036525 NE-External Affairs

Products and Services	Business Unit
<b>Promotional Advertising</b> Includes advertisement message, graphic layout and placement.	032068 Corp-Marketing
<b>Customer Communications</b> Bill Inserts, Letters, Call Center Messaging, Field Employee Messaging. Internet, Door Hangars	032085 Corp-External Communications
<b>Employee Communications</b> Splash Points, Newsletters, Letters, Posters, Intranet	032086 Corp-Internal Communications
Not considered for outsourcing	032087 Corp-Corp Social Responsibility

**3. Although communications services can be outsourced, it was difficult to obtain comparable pricing, as there is not a clear distinction between the services provided by AWWSC and those provided directly by IAWC.**

- IAWC and the Central/Western Division work as a team, providing products and services for Illinois. The Central/Western Division serves as supervision and management for IAWC External Relations Managers.
- IAWC and AWWSC develop press releases, media inquiries and other communications materials. Illinois-related materials are developed at IAWC and reviewed and approved by AWWSC while corporate or national related materials are developed by AWWSC.

**4. Based on the pricing information obtained by NorthStar, outsourcing the AWWSC internal and external communications function is not likely to lower costs.**

- **Exhibit XXIII-5** provides AWWSC's costs for each of the categories considered for outsourcing. In 2010, costs for those categories total \$621,313.

**Exhibit XXIII-5  
AWWSC Cost by Competitive Product and Service<sup>9</sup>**

Business Unit	IAWC Cost
Press and Community Relations	\$ 279,954
Promotional Advertising	85,225
Customer Communications	160,176
Employee Communications	95,957
<b>Total</b>	<b>\$ 621,313</b>

- In order to put costs on a comparable basis, NorthStar made the following adjustments to AWWSC's charges:
  - Removal of costs associated with government affairs and corporate social responsibility totaling \$103,518.
  - Removal of costs that would have been incurred regardless of whether the activity was outsourced or not.

<sup>9</sup> DR 55, confidential and NorthStar analyses

- Advertising - \$8,998 (publication costs)
  - Brochures and Handouts - \$4,251
  - Charitable Contributions - \$2,299
  - Community Relations - \$1,413
  - Trade Shows - \$14,907
  - Cost of one AWWSC employee (Business Unit 032068 – Corp Marketing) associated with trade shows - \$7,916
- Business Unit 033525 – CE External Affairs (Press and Community Relations) was reduced \$118,382. Two employees in this business unit were identified as having responsibilities that were more beneficial to customer and employee communications.<sup>10</sup> Correspondingly, Business Units 032085 – Corp External Communications (Customer Communications) and 032086 – Corp Internal Communications (Employee Communications) were each increased \$59,191.
- Business Unit 032068 – Corp Marketing was reduced \$18,347. Two employees in this business unit were identified as having responsibilities that were more beneficial to customer communications. Correspondingly, Business Unit 032085 – Corp External Communications (Customer Communications) was increased \$18,347.<sup>11</sup>
- Four public relations firms were contacted and three submitted prices. The scope of work is shown in **Exhibit XXIII-6**.

**Exhibit XXIII-6**  
**Scope of Work Prepared for Competitive Consideration**

Service	Quantity	Notes
<b>Press and Community Relations</b>		
Press Releases	100 per year	
Media Events	10 per year	
Media Inquiries	300 per year	
Community Events	Hourly Rates	
<b>Promotional Advertising</b>		
Advertisements	20 advertisements per year	In actuality, AWWSC places over 200 advertisements annually on behalf of IAWC; however, many of the ads are based on standard templates. AWWSC costs include determination of where ads are required. Vendor proposals do not include any management of the process.
<b>Customer Communications</b>		
Bill Inserts	9 per year	Proposals from vendors provide the cost of preparing the messages that are communicated. They do not determine what messages are necessary, who needs to hear them, and when they need to be communicated. The management of this process is a large component to providing this service.
Letters	3 or 4 annually	
Call Center Messaging	Daily as needed	
Field Employee Messaging	Daily as needed	
Internet Messaging and Information	Daily as needed	
Door Hangars	4 per year	
<b>Employee Communications</b>		
Splash Points	Weekly	Proposals from vendors provide the cost of preparing the messages that are communicated. They do not determine what messages are necessary, who needs to hear them, and when they need to be communicated. The management of this process is a large component to
Newsletters	Quarterly	
Letters	Quarterly	
Intranet Messaging and Information	Daily as needed	

<sup>10</sup> DR 55, confidential; IS 48; NorthStar Analysis - calculation was based on proportional share of hours to compensation and overhead costs

<sup>11</sup> DR 55, confidential; IS 48; NorthStar Analysis - calculation was based on proportional share of hours to compensation and overhead costs

Service	Quantity	Notes
Posters	Quarterly	providing this service.
<b>Professional Rate Schedule</b>	Hourly	

- Vendor prices ranged from \$317,000 to \$579,000, but did not include all of the services provided by AWWSC. Some costs were provided as fixed prices and others as hourly rates without the expected number of hours specified.

**Exhibit VII-7  
Cost Comparison (Dollars)**

Service [Note 3]	AWWSC	Vendor A	Vendor B	Vendor C
<b>Press and Community Relations</b>	<b>\$279,954</b>	<b>\$ 140,000</b>	<b>\$ 300,000</b>	<b>N/A</b>
Press Releases		60,000	150,000	Retainer
Media Events		20,000	50,000	Retainer
Media Inquiries		60,000	100,000	Retainer
Community Events		Note 2	25,000 for 5 events	Note 2
<b>Promotional Advertising</b>	<b>85,225</b>	<b>100,000</b>	<b>50,000</b>	<b>60,000</b>
<b>Customer Communications</b>	<b>160,176</b>	<b>59,000</b>	<b>65,000</b>	<b>27,100</b>
Bill Inserts		40,000	18,000	11,600
Letters		7,000	8,000	3,500
Call Center Messaging		Note 1	Complimentary	Retainer
Field Employee Messaging		Note 1	Complimentary	Retainer
Internet Messaging and Information		Note 1	35,000	Retainer
Door Hangars		12,000	4,000	12,000
<b>Employee Communications</b>	<b>95,957</b>	<b>255,000</b>	<b>70,000</b>	<b>38,000</b>
Splash Points		104,000	15,000	Retainer
Newsletters		120,000	12,000	22,500
Letters		6,000	Complimentary	3,500
Intranet Messaging and Information		Note 1	35,000	Retainer
Posters		25,000	8,000	12,000
<b>Annual Retainer</b>				<b>192,000</b>
<b>Total</b>	<b>\$ 621,313</b>	<b>\$ 579,000</b>	<b>\$ 510,000</b>	<b>\$ 317,100</b>
<b>Professional Rate Schedule (Dollars per hour)</b>				
Level 1 – Partner or Executive VP		\$400-\$465	\$250-\$275	\$325
Level 2 – Manager		350	187.50-225	250
Level 3 – Account staff		175	100-175	50 to 200
Intern			50-75	

Note 1: Services to be performed at hourly rate of \$175.

Note 2: Services to be provided at hourly rates specified in the hourly rate schedule.

Note 3: Proposals are based on a very limited understanding of the client and its particular requirements. An actual contract with any of the vendors would have to be more specific and negotiated.

- There are some essential services provided by AWWSC that are not included in the vendor proposals but are necessary to IAWC.
  - Budget preparation, monitoring and control
  - Strategic planning, functional goals and objectives
  - Crisis management
  - Contract development and administration (vendor's contract)

- AWWSC costs include all associated expenses. None of the proposals include expenses such as communications, travel, supplies and materials.
- Event management (press and community events) costs were not included in most of the vendor prices. In 2010, IAWC was involved in about 600 events. Inclusion of costs for event management will significantly reduce the difference between AWWSC and the vendors. Average vendor rates for junior staff levels are in excess \$100 per hour.
- Vendor A's price was \$40,000 less than AWWSC but did not include price estimates for a variety of services including event management. These services would be provided at standard hourly rates based on the level of effort required. A modest effort in these areas would elevate Vendor A's costs above AWWSC's cost.
- The least expensive vendor, Vendor C, was \$305,000 below AWWSC's cost. Vendor C provided hourly rates for event management, but not estimated hours.
- Vendor B's cost estimate was \$105,000 lower than AWWSC's cost; however, their pricing only included \$25,000 for five events.

## XXIV. PROPERTY AND CORPORATE ADMINISTRATION

This chapter addresses the costs charged to IAWC by AWWSC for property and corporate administration and appropriateness of including IAWC in the allocation of these charges by AWWSC. In 2010 IAWC was charged a total of \$1.15 million by AWWSC for these services.<sup>1</sup>

### A. BACKGROUND

The two functional groups addressed in this chapter are the corporate non-departmental cost business unit (corporate administration) and the property business units.

The corporate administration business unit is used to distribute costs that are not directly assignable to a specific business unit. Costs such as employee vacancy adjustments, monthly changes in investment values, and other global AWWSC costs not easily attributable to a specific business unit would be charged to this business unit.<sup>2</sup>

In 2010, IAWC was charged \$66,091, representing 10.7 percent of the \$615,969 that was charged to all operating companies by this business unit.<sup>3</sup>

The property function reports to the President and COO for regulated operations as shown in **Exhibit XXIV-1**. The individuals assigned to these business units provide mailroom, clerical, and facilities management support for the AWWSC facilities located in Woodcrest and Voorhees, New Jersey.

The AWWSC facility located in Voorhees houses a range of AWK corporate functions, including:

- Chief Executive Officer
- Corporate Finance
- External Affairs
- Human Resources
- Investor Relations
- Legal
- Operation Services
- Regulated Operations

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<sup>1</sup> DR 55 confidential

<sup>2</sup> DR 383. The original categorization of corporate administration costs provided by IAWC in DR 55 included the CORP-AWE Pass Thru business unit. Response to DR 383 indicated the charges from this business unit were related to engineering support provided to IAWC, so this business unit is addressed in Chapter XIV with the rest of the engineering function.

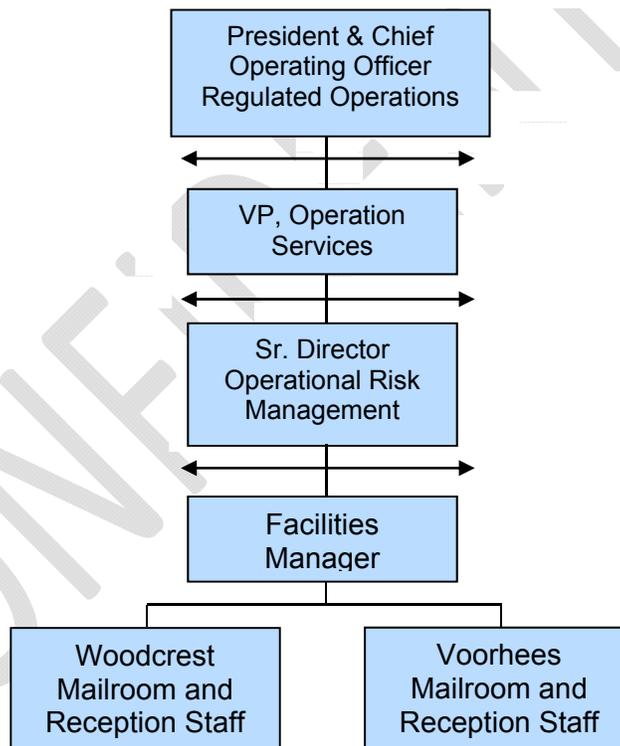
<sup>3</sup> DR 55 confidential

The Voorhees building also serves as the offices of NJAW. The costs of the Voorhees building are allocated between NJAW and AWWSC based on the square footage occupied by each, with the AWWSC costs then allocated to the operating companies based on the labor billed by the AWWSC employees located in that facility.<sup>4</sup>

The Woodcrest facility houses the SSC, which provides back office accounting services to all operating companies, internal audit, and some human resource and corporate finance services.

The property function also includes operating costs related to two other AWWSC New Jersey facilities. The 1000 Voorhees Building houses the Center for Information Technology Excellence (CITE), where ITS and BT staff are located. The 3906 Church Road facility houses the supply chain and corporate engineering staff.<sup>5</sup>

**Exhibit XXIV-1**  
**2010 Organization of the AWWSC Property Function<sup>6</sup>**



The costs charged to IAWC for the property function are shown in **Exhibit XXIV-2**.

<sup>4</sup> DR 410

<sup>5</sup> DR 384

<sup>6</sup> DR 2 and 241

**Exhibit XXIV-2  
Corporate Administration and Property Costs Charged to IAWC, 2010<sup>7</sup>**

Function	Business Unit	IAWC	AWWSC	Percent	Hours
Property	032042 CORP 1000 Voorhees Bldg	\$72,632	\$919,693	7.9%	0
	032046 CORP-3906 Church Road	116,561	1,345,783	8.7%	0
	032062 CORP-Building Services	633,686	6,952,614	9.1%	871
	032063 CORP-Building Services Woodcrest	265,808	3,304,924	8.0%	1,029
	<b>Sub-Total</b>	<b>\$1,088,687</b>	<b>\$12,540,066</b>	<b>8.7%</b>	<b>1,900</b>
Corporate Administration	032098 CORP-Non-Departmental Costs	\$66,091	\$615,969	10.7%	4
<b>TOTAL Corporate Administration and Property</b>		<b>\$1,154,778</b>	<b>\$13,156,035</b>	<b>8.7%</b>	<b>1,904</b>

**B. TASKS PERFORMED**

To complete the work in this area, NorthStar performed the following tasks:

1. Determined the cost of services and associated labor hours charged by AWWSC during 2010 for these two functions, and identified charges and cost allocations that did not appear to conform to AWWSC allocation procedures.
2. Reviewed responses to data requests regarding these business units, functions and costs, and the benefits provided to IAWC from these units.
3. Based on the information provided by IAWC and the results of the outsourcing analysis of the other functional areas, determined the reasonableness of prices and value of the services provided by AWWSC through these functional units.
4. Prepared a task report.

**C. RESULTS**

1. **IAWC received \$13,734 more in corporate administration charges than would be expected from the use of nominal AWK allocation procedures.**
  - The costs allocated through the AWK administration "Non-Departmental Costs" Business Unit are principally related to corporate level activities of a non-specific nature.
  - These types of costs occur through the normal operation of a corporation and cannot be segregated to a particular operating company for possible outsourcing.
  - IAWC received 10.7 percent of these charges; a higher percentage than would occur from an allocation of charges on a Tier 1 (8.5 percent).

<sup>7</sup> DR 55 confidential

- If the charges had been allocated using Tier 1, IAWC would have received charges of \$52,357, \$13,734 less than IAWC was charged.
2. **The property function is integrally linked to corporate facilities providing services to IAWC and cannot be outsourced separately from the functions housed in each of the facilities.**
- **Exhibit XXIV-3** lists the functions housed in the facilities supported by the property group, and the chapters in this report where these functional services are addressed.

**Exhibit XXIV-3  
Functional Activities Housed in Corporate Facilities<sup>8</sup>**

<b>Business Unit</b>	<b>Building</b>	<b>Functions</b>
032042 CORP 1000 Voorhees Bldg	1000 Voorhees Rd.	ITS Business Transformation
032046 CORP-3906 Church Road	3906 Church Road	Supply Chain Corporate Engineering
032062 CORP-Building Services	Main Voorhees Building	AWK personnel Corporate Finance Investor Relations External Relations Human Relations Operations Services NJAW management
032063 CORP-Building Services Woodcrest	Woodcrest Rd	SSC Internal Audit Human Relations

3. **The costs charged to IAWC for the Woodcrest, 1000 Voorhees Road and 3906 Church Road facilities appropriately remain with IAWC, and their allocation is consistent with the services housed there.**
- As listed in **Exhibit XXIV-3**, the functions housed in these facilities support principally regulated operations.<sup>9</sup> It was therefore expected that the property costs associated with these facilities should be allocated consistent with Tier 2 allocation factors.
  - IAWC was charged 8.0 percent of the Woodcrest costs, 7.9 percent of 1000 Voorhees Road costs, and 8.7 percent of the 3906 Church Road costs. All of these are less than the standard Tier 2 allocation of 9.3 percent. Allowing for some costs to be charged at a Tier 1 level (e.g., for IA or HR) or directly to operating companies, these charges are allocated appropriately,

<sup>8</sup> DR 384

<sup>9</sup> The IA and HR functions support both regulated and non-regulated entities

- None of the functions housed at these facilities were found to be viable candidates for outsourcing. Therefore the property function costs associated with these facilities would appropriately remain with IAWC.
- 4. The costs charged to IAWC for the main Voorhees facility appropriately remain with IAWC, but IAWC was allocated a larger percent of the costs than is appropriate given the functions housed in that facility.**
- Most of the functions located at the Voorhees facility (see **Exhibit XXIV-3**) were not viable candidates for outsourcing. Therefore, the property costs associated with these functional activities should be allocated to IAWC.
  - This facility houses the AWK corporate employees (the CEO and CFO) and related support functions, none of which are charged to any operating entity. It would therefore be expected that a noticeable percentage of the costs associated with this facility would be charged directly to shareholders.
  - A rental agreement between NJAW and AWWSC provides for the allocation of costs associated with this facility based on the relative square footage occupied by each of NJAW and AWWSC.<sup>10</sup>
  - The remainder of the employees located at this facility provide services to both regulated and non-regulated entities. The time and costs for these functions are principally allocated with a Tier 1 factor, so the facility costs should be comparably allocated.
  - Since a portion of the costs associated with this facility should be charged to AWK and NJAW based on the square footage occupied by each of those entities, the costs charged to IAWC should be noticeably less than would be charged if the standard customer-based allocation factor (8.5 percent) was applied.<sup>11</sup> However, IAWC was charged 9.1 percent of the costs associated with this facility. It is not mathematically possible for AWK and NJAW to be directly charged for their (square footage) percentage of this facility costs, have the remainder of the costs allocated using Tier 1 factors, and have IAWC be charged more than its Tier 1 allocation.<sup>12</sup>

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<sup>10</sup> DR 410

<sup>11</sup> In the IAWC draft report fact verification review, IAWC stated that AWK was charged based on a square foot allocation. Also, the charges to NJAW from this business unit do not appear to be consistent with the number of NJAW functions housed in the facility. IAWC did not address the appropriateness of charges allocated to IAWC vis-à-vis its affiliates.

<sup>12</sup> For example, if AWK and NJAW together occupy 25 percent of the square footage of the facility, a Tier 1 allocation of the remaining 75 percent of the costs would result in IAWC being charged 6.4 percent of the total costs, not the 9.1 percent the company was charged in 2010.